IF AT FIRST YOU DON'T SUCCEED... RECONCEPTUALISING THE INCOME CONCEPT IN THE TAX ARENA

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[The concept of income is central to the taxation system in Australia. the concept is not defined in the Income Tax Assessment Act 1936 (Cth). Over the years, the courts have developed certain criteria to determine when a receipt can be said to be income on ordinary concepts. The High Court decision in FCT v Myer Emporium Ltd *grappled with these issues and led to a spate of litigation trying to redefine the core principles. This article argues that there is no justification, either in policy or precedent terms, for the concept to have developed in the way that it has. Parliament should intervene and define the concept carefully and objectively identify the way it should integrate with the capital gains provisions.]*

I INTRODUCTION

It is not too difficult to imagine that an income tax law has something to do with the taxation of income. One might also expect, after nearly 80 years of operation of the federal law, that judges, tax practitioners and the Federal Commissioner of Taxation would have a clear and uniform view on what income actually means. Yet as recently as 1987, a joint judgment of the Full High Court saw a number of comments made that have allowed for quite polarised views about the ambit of that concept. The case was *FCT v Myer Emporium Ltd*[1]. Lower court decisions, seeking to apply the comments in *Myer*, display some fundamentally different views as to the ambit of the decision. Both the results and the reasoning of those decisions are difficult to reconcile or integrate into any clear test. The Commissioner spent some years devising a Ruling which outlines his view of the meaning of *Myer*. The profession has taken issue with a number of perceptions in his Ruling.[2] Subsequent High Court decisions have not shown a desire, or any perceived need, to re-examine, refine or analyse the comments in that case.

Against this background, this article seeks to outline and assess the nature of the income concept as it currently stands in Australian tax law. It concentrates on business and commercial transactions, the area of greatest practical conflict and conceptual difficulty. It begins by identifying the traditional judicial view of income. The litigation in Myer is then examined in order to evaluate its effect on those traditional notions of income. Subsequent cases and the Commissioner's

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1 *FCT v Myer Emporium Ltd* (1987) 163 CLR 199 (*Myer*).

2 Taxation Ruling TR 92/3, 'Income Tax: Profits on Isolated Transactions'.

Ruling are then analysed. The ultimate thesis is that tax courts in Australia have developed a concept that has insufficient merit in policy terms and which is extremely difficult to employ in practice. It encourages continual litigation and puts undue strain on administrators, advisers and appellate courts. While the courts have been dynamic in their development of tax doctrine in recent years, and thus further positive modifications to the applicable principles are possible, the common law concept has sufficient flaws to suggest that the legislature should intervene. In particular, there is no coherence between the principles currently applied by the courts in the income context and the policy behind the capital gains provisions introduced in 1985. Parliament should intervene and return the income concept to the prima facie notion of all gains being taxable. Parliament can then, after proper analysis and debate, directly identify those gains that it wishes to exempt from such treatment.

II The Judicial Income Concept

In any first course on taxation law, students are likely to begin with some policy analysis of competing forms of taxation. Where income is sought to be the base for taxation, students might then be directed to some basic economic arguments and, in particular, the definitions of income proposed by leading economists such as Hicks,[3] Haig[4] and Simons.[5] The thrust of the economic view is that income is merely a gain. As such, it is usually easy to calculate arithmetically. The only practical assessment problem with such a definition is to value accurately unrealised gains. That is, gains in value that are not converted into money or money's worth. Under such a definition, other problems familiar to tax lawyers would disappear. The source of the gain would be wholly irrelevant. It would not matter how, why or in what form a gain is made as long as it is truly a gain. On this approach, gifts and lottery winnings would be treated as income alongside traditional categories such as an employee's wages.

While the economic approach was largely accepted by scholars at the time it was first mooted, it received a mixed reception in the courts throughout the world. It had the least influence in the United Kingdom and Australia. Judges were more concerned to follow doctrines of precedent than to apply a policy oriented analysis of this concept. Yet when judges in those jurisdictions were first asked to apply income tax legislation, they found themselves faced with a major problem. Our Act gives no indication of the meaning of income, yet the courts were compelled to interpret the term.

Various approaches to interpretation can be found in the cases. Some followed the long-standing and unassailable proposition of statutory interpretation that a word in a statute is to be taken to have its ordinary meaning, except where the contrary intention can be inferred. At first sight, this ordinary meaning approach

[3] John Hicks, *Value and Capital* (2nd ed, 1946) 172.

[4] R Haig, 'The Concept of Income - Economic and Legal Aspects: The Federal Income Tax' in W Klein (ed), *Policy Analysis of the Federal Income Tax* (1976) 116.

[5] Henry Simons, *Personal Income Taxation* (1938) 50.

appears to have been influential in Australia. Many leading authorities in this country begin their analysis with an approval of the comments of Jordan CJ in *Scott v Commissioner of Taxation*,[6] who said that '"income" is not a term of art'.[7] Decisions are instead to be made 'in accordance with the ordinary concepts and usages of mankind' except where a contrary intention is indicated.[8]

Notwithstanding the widespread approval of these comments, they are largely indeterminate. Income is a word which derives from the world of financial affairs. Thus, it does not have a distinctive ordinary meaning exclusive of the meaning that might be ascribed to it by economists or accountants in that environment. A dictionary definition is never likely to be able to deal with all of the variations of commercial dealings unless it has a simple base such as the economic definition and its central notion of gain. While not referring to this specific problem, Dixon J in *Commissioner of Taxes (SA) v Executor Trustee and Agency Co of SA Ltd*[9] nevertheless provided support for this view when he suggested that the courts have generally been governed 'by the principles recognised or followed in business and commerce', unless there is a specific provision to the contrary.[10] Because there is no real common meaning, Jordan CJ's initial attempt to identify the source of the income concept as it would apply in Australian tax law simply did not generate an objective, predictable and workable test.

Yet, in spite of these problems, decisions were made and categories of taxable and non-taxable receipts were developed over the years. A number of commentators have proceeded to analyse the sources that were most influential in developing the judicial income concept.[11] For the purposes of this article, the most important is trust law which developed the supposedly contrary concept of capital. Other influences were accounting theory and United Kingdom precedents, notwithstanding that the United Kingdom legislation is wholly different in form to the Australian legislation.

As a result of these diverse influences, there developed a number of features that distinguished judicial income from income as it would be defined by economists. The Asprey Committee[12] identified four elements of the judicial notion of income. The first category of judicially defined income comprised receipts from the carrying on of an organised activity directed to the making of gains. The second related to gains which could be described by analogy as the fruit of the tree, where the tree represents a capital asset. This analogy is used to

6 (1935) 35 SR (NSW) 215.
7 Ibid 219.
8 Ibid.
9 (1938) 63 CLR 108 (*Carden's* case).
10 Ibid 152.
11 See, eg, Ross Parsons, *Income Taxation in Australia: Principles of Income, Deductibility and Tax Accounting* (1985); Ross Parsons, 'Income Taxation: An Institution in Decay' (1991) 13 *Sydney Law Review* 435; Yuri Grbich, 'The Duke of Westminster Graven Idol' (1978) 9 *Federal Law Review* 185; Richard Vann, 'Income as a Tax Base' in Richard Krever (ed), *Australian Taxation: Principles and Practice* (1987).
12 Commonwealth, Taxation Review Committee, Full Report (K W Asprey, Chairman) (1975) 59.

try to distinguish income from the supposedly contrary concept of capital. The third category comprises compensation which substitutes for gains that would have been income.[13] Finally, the judicial notion of income will at times include periodical gains as having an inherent income nature, as periodicity was thought to be an important indicator of income.

The most important principle underlying these categories is that income must be both a product of a recognised earning activity and must not be of a capital nature. This is sometimes described as the flow concept. The first requirement excludes gifts and most forms of gambling. The second excludes many gains even in a business or commercial setting.

The income/capital distinction leads to immense problems of factual characterisation. In most cases, where an asset is dealt with in a profitable way, to be income on ordinary concepts, the gain must flow from the asset rather than constitute a gain to the asset's value. In addition, it must be more than a mere conversion or realisation of the asset's value by sale or similar dealing.

Some judges sought to develop methods for distinguishing income from capital. In an American case, *Eisner v Macomber*,[14] Pitney J referred to the views of economists in support of the previously mentioned horticultural analogy that capital is the tree and income the fruit of the tree. Like Jordan CJ, he also said he required 'only a clear definition of the term "income" as used in common speech'.[15] He indicated that he examined dictionaries in common use but found little to add to the definitions adopted in earlier US cases. In that context he said that income may be defined as the gain derived from capital, from labour, or from both combined, but added a proviso that it included profit gained through a sale or conversion of capital assets. The latter proviso is of fundamental importance. Under US law, if a taxpayer buys a building which increases in value, no tax is payable at that stage because it is only an increase in the asset's value. But if the building is sold, the profit would be income under Pitney J's proviso.[16]

The same approach was not taken in English or Australian courts. Remarkably, the passages from *Eisner v Macomber* were cited with approval by Viscount Finlay in *IRC v Blott*,[17] and in many subsequent English and Australian authorities, yet the latter have never gone so far as to establish the proviso as a proposition of law. On the contrary, English and Australian courts have developed an income concept that only taxes the gains on asset sales if the transaction can itself be characterised as an earning activity. Thus our courts must consider what factors are relevant in determining when such an activity exists. This will be satisfied if the transaction is part of the ordinary business activities of the taxpayer. A builder selling a building is a clear example. On the other hand, if

[13] See, eg, *Commissioner of Taxation (NSW) v Meeks* (1915) 19 CLR 568.
[14] 252 US 189 (1920).
[15] Ibid 206-7.
[16] Various capital gains exemptions would now apply but the principle remains intact.
[17] [1921] 2 AC 171, 195.

there was no profitable intent behind a transaction, our courts would often conclude that the gain was a capital gain.

A *Characterisation and the Role of Facts*

This approach raises practical as well as theoretical problems. How do we decide what is an 'ordinary' activity and what purpose lay behind a particular transaction? Will a 'one-off' profitable transaction, where profit was a dominant or at least substantial aim, be treated as sufficiently commercial to give rise to assessable income? Over the years, the courts have grappled with questions such as these.

Because these principles were developed in the guise of mere interpretation of tax legislation where there was no parliamentary guidance, it is not remarkable that the income concept was somewhat difficult to identify in the early days of Australian tax litigation. A more fundamental question, however, is why the true ambit of that concept is still contentious so many years later. An application of the above principles to a simple example shows the difficulties. Let us assume that a taxpayer owns a block of flats and leases the individual flats to separate tenants in return for periodic rental. That rental would constitute income on ordinary concepts as it is a product of the earning activity of leasing property. What will be the tax position, however, if the taxpayer sold the entire block of flats for a significant profit? As indicated, the basic principles of US tax law define this as income. Under Australian law, if the taxpayer's activity could be characterised as dealing in property, then the gain would be a product of that activity and taxed as income accordingly. If, on the other hand, the taxpayer's activity is merely characterised as being a lessor, then the sale of the building would be described by the courts as a mere realisation of a capital asset, which in turn satisfies the traditional notion of a non-taxable capital receipt. The case would be won or lost depending on the way the court describes the taxpayer's activity. Thus characterisation under the above principles is about findings of fact. In turn this raises questions of how much relevance to place on facts such as the taxpayer's past conduct, future intentions and testimony.

While we now have provisions that treat certain types of capital gains as assessable income, characterisation remains vital. Even though many transactions are now caught by capital gains provisions in Part IIIA of the Income Tax Assessment Act 1936 (Cth) (the 'Act'), many assets pre-date those changes and are exempted. Capital gains legislation also provides preferential treatment by excluding the inflation component from most gains, while capital losses have more limited utility. Furthermore, schemes have already been devised to try and subvert the operation of capital gains provisions. Finally, those provisions will generally not have any practical effect on a transaction that is assessable on ordinary principles. For all of these reasons, the distinction between income and capital remains of considerable importance in Australian tax law. It also remains a distinction based on determinations of fact.

B *Commercial or Business Activities and the Income Concept*

The development of an income concept that makes the factual characterisation of the taxpayer's activity the ultimately determining factor, rather than the taxpayer's financial ability to contribute to tax revenue, explains to a large degree why there will always remain great difficulty in predicting accurately the outcome of tax disputes. If the ordinary or anticipated flow from a business or commercial venture gives rise to income on ordinary concepts, this shifts the judicial analysis to a determination of the nature of the business or commercial activity. Judges must consider what features are necessary for an activity to constitute a commercial activity giving rise to assessable income or, at least, what criteria will allow both positive and negative inferences. Features that are held to be relevant in particular cases are then important in delineating inductively the legal principles identifying income. Yet if the relevant features are not easy to identify, then it must be even more difficult to delineate an objective legal principle defining the income concept. If the courts cannot agree on the relevant features, then there is no agreement on the underlying concept.

One difficulty facing anyone attempting a sensible definition of a concept such as income, or in defining what is a commercial or business activity, is the need to devise a definition which can be applied broadly and consistently and which can withstand the inevitable onslaught of tax minimisation endeavours. A significant problem is the undue effect on tax doctrine of what might be described as illogical inverse propositions. The illogical inverse proposition will always be a key tactical tool of the tax avoidance industry. It usually involves finding a case which says a particular set of features implies that there is a commercial activity and then trying to conclude that if a transaction does not have one of the features or even if the transaction can be deliberately constructed not to have some of those features, there is an argument that there is no assessable income.

The dictionary definitions of concepts such as income and business show the dangers associated with this type of reasoning. Either the definitions merely use synonyms, which maintain the lack of clarity, or set up propositions which, if true, could easily lead to tax avoidance if inverse reasoning prevails. For example, one dictionary defines 'business' in part as 'the state of being busily engaged'.[18] If this definition prevailed, it would mean that any business person who devotes little or no time to a very successful activity would thereby avoid tax. This is an example of an illogical inverse. In the revenue area, where many dollars are at stake and there is usually a good cost/benefit justification for challenging most adverse determinations by the Federal Commissioner of Taxation, judges must be particularly careful of guarding against such inversions.

The problem of inversions also shows the problem of devising a test. The inversion is only illogical if the relevant feature is not a necessary criterion of

[18] *New Shorter Oxford English Dictionary* (1993).

income. Yet, if it is not necessary, in what way was it included in past cases and in any statements of principle from those cases?

C *Factors Relevant to Characterisation*

After giving the concept some thought, many judges are seen to acknowledge that there is no formulation that can be developed to accurately assess what is a business or commercial activity. In *FCT v Whitfords Beach Pty Ltd*,[19] Mason J (as he was then) commented that words such as 'business' and synonyms such as 'commercial' and 'trading' have a 'chameleon-like hue' in that their meaning adapts to the context in which they are being used.[20]

In spite of Mason J's caution, a number of factors have been considered relevant over the years although the ultimate question is said to be one of 'fact and degree'.[21] There is no leading case in Australian tax jurisprudence that sets out the relevant factors comprehensively or in a way which has been cited over time. The following list, therefore, is merely a synthesis of a number of decisions, academic commentaries and governmental reports.[22] The propositions go as follows:

1. An asset which is sold and which had no utility other than through trade, is more likely to have been sold for a commercial reason.
2. The shorter the period of ownership of an asset, the more likely it was acquired with intent to be traded.
3. The more regular the transactions and the greater the volume, the more likely the transactions were part of a commercial activity.
4. The more busy one is in connection with the transaction, the more likely the activity is commercial.
5. Certain taxpayers, such as corporations, look more likely to be involved in commercial transactions.
6. If an activity is carried on in a similar way to the way business is normally carried on in that area, it is more likely to be a business activity itself.
7. If the circumstances that motivated the transaction were of a private nature, it is less likely to be seen to be of a business or commercial nature.
8. The final criterion, namely, the presence of a profit intent or purpose in the mind of the taxpayer, is the factor considered most relevant in the *Myer* decision. Acquiring an asset with an intent to resell at a profit makes the ultimate gain more likely to be income.

[19] (1982) 150 CLR 355.
[20] Ibid 378-9.
[21] *Evans v FCT* (1989) 89 ATC 4540, 4554-5 (Hill J).
[22] In particular, see United Kingdom, Royal Commission on the Taxation of Profits and Income (1955) Cmnd 9474; *Ferguson v FCT* (1979) 26 ALR 307; Richard Parsons, *Income Taxation in Australia* (1985).

Profit purpose is the criterion to be discussed in greatest detail in the balance of this article. The ambit of this criterion was never comprehensively explored prior to *Myer* and is considered further in the context of that decision. Leaving that aside for the moment, the other criteria can readily be seen to do no more than give rise to certain rebuttable presumptions. None are necessarily required for an activity to be seen as business-like in character. It is easy to devise factual situations that go against each presumption. Taking the above list in turn, we can easily assert the following contrary propositions. Goods that do not normally have a commercial flavour can easily be traded in a business activity. Some businesses require long periods of ownership of stock intended for trade to take into account fluctuations in value. An isolated highly profitable transaction can still be a business. Some business activities require little, if any, effort. Private motivations can be the reasons why a taxpayer chooses to embark upon a business activity. Companies can be used to gain limited liability for bodies such as social clubs without giving rise to any sensible inference of a commercial activity.

If these were the only criteria identified by the courts, the indeterminate nature of the test is easy to demonstrate. We begin with the word income. The legislature provides no guidance as to its meaning. The judges choose to define it as requiring a product of an earning activity. One form of earning activity is a business or commercial activity. Yet the judges are then unable to identify any one criterion that is necessary before an activity can be described as such. At the same time, they identify a list of factors from which to infer, but not compel, certain conclusions. Because no single one of these factors is necessary, because they can be manipulated, because they will not all point in the one direction and because they themselves contain questions of degree, they provide no basis for inductively refining the income concept in the commercial arena.

This brings us to the last criterion and the High Court decision in *Myer*. The following sections analyse that decision and subsequent decisions, primarily to determine if the reference to purpose and other comments of the court overcome these criticisms.

III MYER EMPORIUM LTD V FCT

Stated in its simplest form, the case dealt with the tax treatment of a lump sum received in return for the assignment of the right to receive interest under a long-term loan. The background facts were somewhat more complex. Myer Emporium, a major retailing conglomerate, had been considering restructuring its entire group of companies. The Board of Directors at Myer Emporium had considered reorganising the group in order to separate the property and retail arms. The initial proposal included a property trust. In July 1980, the Federal Government announced that it would tax public unit trusts at the company rate where established as a result of the reorganisation of a company. Because of this, the Board resolved not to go ahead with the property trust. It subsequently sought advice from a merchant bank. It received a recommendation that Myer

Emporium should remain a group holding company. All real estate should become the property of one subsidiary company. Another company should operate all retail trading outlets and a new finance subsidiary should be incorporated to control the bulk of the group's financial operations.

Myer Emporium sought to diversify extensively at the same time as the reorganisation and needed to find some external finance. Its ability to borrow was limited by a borrowing ratio stipulated in its debenture trust deed. The final arrangement undertaken was as follows. Myer Emporium sold shares it held in property owning subsidiaries to the real estate subsidiary company in return for $80 million. Myer Emporium then lent that $80 million on 6 March 1981 to the finance subsidiary for a period in excess of seven years. The finance subsidiary was obliged to pay interest at the rate of 12½% per annum. Three days later, on 9 March 1981, Myer Emporium entered into a deed of assignment with Citicorp, an independent financier. Under that agreement, Citicorp paid Myer Emporium a lump sum of $45.37 million in return for Myer Emporium assigning to Citicorp all its rights to interest under the loan to the finance subsidiary. The right to the interest over the period of the loan totalled $72.58 million. The figure of $45.37 million was the present value of this stream of interest payments to be made by the subsidiary.

The transaction clearly had commercial features. Myer Emporium received an immediate injection of finance from an independent financier. In return, a subsidiary merely had to make payments of equal present value over a seven year period. The borrowing ratio under Myer Emporium's debenture trust deed was not affected by the transaction. Thus, there was a commercial benefit irrespective of the tax treatment of the transactions.

Where tax was concerned, to be beneficial to the group, the $72.58 million paid by the finance subsidiary would need to be deductible while the $45.37 million would have had to be a non-assessable capital receipt. The report of the merchant bank showed that if the anticipated tax treatment was allowed by the Commissioner, the Myer Group would make a net after tax gain of some $9 million. Citicorp was able to offer such a generous proposal because it had accumulated tax losses against which it could apply the future interest stream. The transaction occurred prior to the operation of the capital gains provisions of the Act. Because the assignment by Myer Emporium was for a period exceeding seven years, Division 6A of the Act, which attacks certain short term alienations, would not adversely affect the assignment.

A number of important factual conclusions were drawn by the courts. Murphy J, the judge at first instance, held that all the matters were in Myer Emporium's contemplation before it entered into the initial loan transaction.[23] The judge held that insofar as purpose was relevant, the various steps were preplanned, the transactions were effected with a view to ensuring the most favourable tax treatment, but the purpose which above all motivated the taxpayer was

[23] *Myer Emporium Ltd v FCT* (1985) 85 ATC 4111 (first instance).

the immediate obtaining of working capital to allow it to diversify its profit-making activities in a way which would not offend its debenture trust deed and would not lead to adverse publicity through the publication of further borrowings in its accounts. In His Honour's opinion, it was clear that Myer Emporium did not enter upon the proposal for the purpose of profit-making but, rather, for the purpose of obtaining working capital; an important conclusion, although one not consistent with the High Court's ultimate handling of the case.

The Commissioner raised a number of arguments in support of his assessment. He argued that the lump sum was in substitution for income and was therefore to be characterised as income. Murphy J rejected this argument. He held that Myer did not assign income, it assigned rights. The right to income was a chose in action but, until the payments fell due, those rights could not be classified as income for taxation purposes. In his view, the right assigned was 'a wasting capital asset which may produce income'.[24] This is an argument which appears from time to time in the taxation arena. From a policy point of view, it is unfortunate as it confuses the nature of particular receipts with the timing issue of when they become assessable. The conceptual issue is whether a receipt must already be derived to have the nature of income.[25] This view was also later rejected by the High Court.

Murphy J then quoted *Commissioner of Taxation (Vic) v Phillips*[26] for the unassailable proposition that it is erroneous to treat a sum of money as income simply because it is measured by the loss of future income. Notwithstanding the comments in the *Phillips'* decision, there have been a number of cases where payments received in 'substitution' for income are somehow found to have an income nature themselves. *Phillips'* case itself saw an employee who received a lump sum in consideration for loss of his employment contract assessed, notwithstanding that the right to future wages could also not have been present income because no work had been done. Murphy J in *Myer* indicated that in all such substitution type cases where the Commissioner had won, two features were in evidence. First, the cases involved the extinction of what would clearly have been an income receipt and secondly, that received in their stead were damages or compensation measured solely by reference to the income loss. His Honour considered that this principle could not apply to the *Myer* case as there were other components in the amount calculated as the present value of the future interest payments to be made by the subsidiary. These included the

[24] Ibid 4115.

[25] Tax practitioners have often been heard to argue in this way, particularly in the hope of avoiding the operation of s 19. That section indicates that income is deemed to be derived by a person notwithstanding that it is not received by him or her but rather dealt with at their direction. The profession has tried to argue that this provision is virtually meaningless because it says 'income' is deemed to be derived in certain circumstances. Yet, if it is not yet derived, and if that precludes it from having the essential nature of income, the suggestion is that no deeming can operate. Such an argument is tenable with respect to s 19 on the grounds of literal interpretation. From a purposive point of view, however, it would make a mockery of the section in most circumstances and ought as a result to be rejected, even under the more restrictive interpretation doctrines.

[26] (1936) 55 CLR 144.

liquidity and stability of the taxpayer and the likely interest rate changes over time. This form of reasoning could be criticised on the basis that *Phillips'* case ought also to stand for the proposition that the fact that a payment is calculated by reference to some non-income element does not automatically render the payment non-taxable.

His Honour then considered that in looking at whether the lump sum was income, each case is found to turn on its own facts, citing *Van den Berghs Ltd v Clarke*.[27] In that case, compensation received for cancellation of a commercial contract was held to be capital because the contract related to the whole structure of the appellant's profit-making apparatus. The magnitude of the sum was also seen as relevant. Murphy J considered that while the latter consideration was not altogether irrelevant, it could hardly be determinative in the instant case. Notwithstanding this, he then proceeded to refer to the fact that this was a one-off transaction as being a relevant one. In his view, 'income ... is normally periodic and recurrent'.[28]

He then found that the money was sought by the taxpayer as working capital and as a result was not of an income character. Such a finding runs the risk of seeking to characterise the amount by looking at its end use. A company that needs extra funding may seek to do so by borrowing or by generating profits. The profits themselves may be of an income nature and yet the end use for those profits is to increase the working capital of the company by way of retained earnings. His Honour then indicated that because the taxpayer chose to create the income stream which it then assigned, the lump sum paid might as a result be argued also to be income. However, he felt the better view was that the capitalisation of the right to interest was itself capital.

Judgment at first instance was given in favour of the taxpayer. The Commissioner appealed. The Full Federal Court dismissed the appeal.[29] Fox J held that an asset was sold which was not part of Myer's stock in trade. The transaction was not in the ordinary course of Myer's dealings and it was not recurrent. His Honour considered the case of *Shepherd v FCT*[30] to be relevant where an assignment of a partial right to royalties was held not to give rise to assessable income. Lockhart J was concerned with the nature of the assignment agreement and in particular whether it was an agreement which operated as a present assignment of a legal chose in action or as an agreement to assign monies as they fell due in the future. In his view, if the latter was the more apt description, it would give the receipts more of an income flavour. This again adopts the logic

27 [1935] AC 431.

28 *Myer Emporium Ltd v FCT* (1985) 85 ATC 4111, 4117. Unfortunately, His Honour did not draw the crucial distinction between *Van den Bergh* and *Myer*. In *Van den Bergh's* case the contract had been used for some time as part of its business structure. In *Myer's* case, the contract of loan was brought into being specifically so it could be assigned.

29 *FCT v Myer Emporium Ltd* (1985) 85 ATC 4601 (Fox, Lockhart and Jenkinson JJ).

30 (1965) 113 CLR 385.

of the High Court in *Shepherd's* case.[31] He held that the agreement operated as a present assignment. He considered that there was no relevant nexus between the ordinary trading activities of the taxpayer and the assignment. When Jenkinson J looked at the transaction, he was even able to utilise the preordained nature of the arrangement as a factor in the taxpayer's favour. Because one interest payment was contemplated, His Honour saw the consideration as going beyond a mere substitution for future income forgone. Unlike the judge at first instance, he considered that Myer's purpose to employ the money as working capital was irrelevant to the determination under s 25. He considered, however, that a capital asset was sold and hence the transaction did not give rise to assessable income. All three judges considered that there was no profit for the purpose of s 26(a).[32] The Commissioner was granted special leave to appeal against this decision.[33] The High Court handed down its decision on 14 May 1987. Mason ACJ, Wilson, Brennan, Deane and Dawson JJ delivered a joint judgment.[34] Argument before the High Court concentrated on s 25 and s 26(a).

The judgment needs to be looked at in some detail as there is no obvious and unambiguous principle that can be discerned, although a number of propositions were presented and others may be inferred. The taxpayer asserted that a gain must be in the ordinary course of business to constitute income. The High Court rejected this contention.

The Court then addressed the relevance of profit-making purpose. Comments at various parts of the judgment raise conflicting notions about the importance of purpose. In speaking of ordinary business receipts, the court said:

> 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.[35]

Speaking more generally, the court said:

> 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 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

[31] This is in spite of the fact that the cases were essentially different: one looking at the tax treatment of the consideration, while the other looked at whether the assignment was effective in law to move assessability of royalties.

[32] While the Federal Court judges all agreed that s 26(a) did not apply because the sum was not a profit, their reasoning was different. Fox J saw the sum as compensation for the loss of the interest. Lockhart J saw the sum as capitalisation of the entitlement to interest. Jenkinson J simply saw the sum as the present value of the future interest and hence no profit at all.

[33] *FCT v Myer Emporium Ltd [No 1]* (1986) 160 CLR 220. The Federal Court had ordered that the Commissioner issue an amended assessment. The Commissioner made application before Dawson J in the High Court to have this order stayed until the hearing and the determination of the appeal to the High Court.

[34] *FCT v Myer Emporium Ltd* (1987) 163 CLR 199 (*Myer*).

[35] Ibid 209.

> 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 or a 'one-off' transaction preclude it from being properly characterised as income (*FCT v Whitfords Beach Pty Ltd* (1982) 39 ALR 521; 150 CLR 355 at 366-7, 376). 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.[36]

The first quote could imply that profit purpose of itself makes ordinary business receipts assessable. The second quote suggests it is only one relevant factor. The third suggests that it is of paramount importance.

The variations between quotes are one problem, but there are also difficulties within each. Where the last is concerned, its meaning depends on what is meant by the phrase 'business operation or commercial transaction'. If the presence of a profit motive by itself makes something into such a transaction, then there was no need to refer to the phrase. If something more is required, the judgment does not explain what that is.

One view is that the High Court is saying that a separate business characterisation is necessary before the presence of profit-making purpose can be presumed to automatically give rise to assessable income. Another view is that the Court was merely using the words business and commercial to distinguish taxpayers who are generally in business from those in a purely private activity. If this view is correct, it will be easily satisfied in most cases.

While the latter interpretation should be preferred on policy grounds, it seems more likely that the former interpretation was intended, given the older cases that were approved of in the judgment. Even here those cases throw up similar ambiguities. The Court referred to the distinction drawn in *Californian Copper Syndicate v Harris*[37] between 'a mere realisation or change of investment' and 'an act done in what is truly the carrying on, or carrying out, of a business'[38] and asserted that:

> The important proposition to be derived from Californian Copper and Ducker 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.[39]

Unfortunately, both this quotation and the original quote from *Californian Copper* again make tautologous references to 'business'.

The next key passage seeks to explain why it is not possible to assert that profit purpose will always be determinative:

[36] Ibid 209-10.
[37] (1904) 5 TC 159.
[38] *Myer* (1987) 163 CLR 199, 210.
[39] Ibid 211, citing *Ducker v Rees Roturbo Development Syndicate* [1928] AC 132.

> 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 is capital.[40]

Importantly, the Court sought to explain the context of these established principles, which in turn reduces their importance. The Court noted that these principles were influenced by the schedular structure of taxation legislation in the United Kingdom. The Court then referred to the English case of *Edwards v Bairstow*[41] which showed that an isolated transaction can give rise to assessable income, notwithstanding the earlier decision in *Jones v Leeming*.[42] Where the *Californian Copper* principle was concerned, emphasis needed to be placed on the adjective 'mere'. If the taxpayer goes further than 'merely realising', assessability becomes more likely. The Court said:

> 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 realised subsequently in order to capture the profit arising from their expected increase in value. [43]

They may also constitute income:

> if the decision to sell is taken by way of implementation of an intention or purpose, existing at the time of acquisition, of profit-making by sale, at least in the context of carrying on a business or carrying out a business operation or commercial transaction. [44]

Once again the concept of business is referred to without further explanation.

The judgment also fails to deal with another vital question, namely, what is the necessary degree of profit purpose where that was not the sole purpose? One guide is the Court's reference to *London Australia Investment Co Ltd v FCT*.[45] In a group of cases, including *London Australia*, insurance or investment companies were held to be assessable on profits from sales of assets such as shares and rental property which were used to generate recurring profit or dividends and rent respectively. This was so even though the pursuit of such profit was not the dominant purpose in acquiring the asset.[46]

[40] *Myer* (1987) 163 CLR 199, 211.
[41] [1956] AC 14.
[42] [1930] AC 415.
[43] *Myer* (1987) 163 CLR 199, 213.
[44] Ibid.
[45] (1977) 138 CLR 106.
[46] See, eg, *Colonial Mutual Life Assurance Society Ltd v FCT* (1946) 73 CLR 604.

The Court then referred to key criteria that have had considerable influence in the formulation of the income concept for Australian tax purposes. These were periodicity, the distinction between capital and income for trust purposes and the analogy of the difference between fruit and tree. After noting that these criteria have been criticised, the Court said:

> For present purposes it is sufficient for us to say, without necessarily agreeing with these criticisms, that, valuable though these considerations may be in categorising receipts as income or capital in conventional situations, their significance is diminished when the receipt in question is generated in the course of carrying on a business, especially if it should transpire that the receipt is generated as a profit component of a profit-making scheme. If the profit be made in the course of carrying on a business that in itself is a fact of telling significance. It does not detract from its significance that the particular transaction is unusual or extraordinary, judged by reference to the transactions in which the taxpayer usually engages, if it be entered into in the course of carrying on the taxpayer's business. And, if it appears that there is a specific profit-making scheme, it is pointless to say that it is unusual or extraordinary in the sense discussed. Of course it may be that a transaction is extraordinary, judged by reference to the course of carrying on the profit-making business, in which event the extraordinary character of the transaction may reveal that any gain resulting from it is capital, not income. [47]

To understand this statement we must determine what is meant by the phrase 'the course of carrying on a business'.. The High Court cannot be saying that any gain which somehow relates to a business is income, otherwise all realisations of assets by businesses would be fully taxable. The phrase presumably relates to the actual business activities. If they give rise to profit, even through an unusual transaction but one which is contemplated in the course of the business, then that is at least 'of telling significance'. Yet the language used still does not say whether it is determinative.

After these general statements, the Court then turned to the facts. The High Court identified Myer Emporium's business as that of retailer and property developer. The transactions in question were seen as being entered into by Myer in the course of its business. While they were novel, they remained within the course of that business, although the High Court did not indicate why it felt this was so. The Court went on to say that the transaction could not be seen as a 'mere' realisation of a capital asset. The two transactions were interdependent and pre-ordained.

The Court then turned to an argument that there was no profit, on the basis that the amount received was merely the present value of the future interest stream. The Court said that if the two transactions were seen as independent, then there would be much force in this argument. To sell an asset for its present value looks much like a mere realisation. But once the two transactions were looked at together, the taxpayer was seen to profit by the sum of the consideration plus the first interest payment. It lent $80 million to a subsidiary and shortly thereafter

[47] *Myer* (1987) 163 CLR 199, 215-6.

received one interest payment and the sum of $45.37 million. It was still entitled to receive repayment of the principal sum of $80 million at the end of the loan period with its subsidiary. Consequently, in absolute dollar terms, it was better off, by the value of the consideration received for the assignment. In accounting terms, it was not really better off as that amount reflects in the main the decrease in present value of the principal sum by reason of the fact that it is only to be repaid after seven years. However, the Court pointed out that this is so wherever money is lent for a term. Australian tax law is based on actual monetary amounts and not on the time value of transactions as would be determined by actuaries and accountants. Whilst this can lead to anomalous situations from a policy perspective, it is absolutely clear that this is the way tax litigation must be addressed. The Act deals with historical cost not economic equivalence.[48]

The Court then talked about the right to the interest. Interestingly, the Court spoke of the way it would be treated for accounting purposes before it addressed the legal analysis of the nature of such a right. The latter was of primary importance in cases such as *Shepherd* which were addressed by the Federal Court. From the accounting point of view, the Court considered that 'the right to interest is not distinguished ... from the interest to which it relates'.[49] Furthermore, the Court considered that 'the right to interest is not a capital asset which is progressively transformed into income as and when the interest is received'.[50] In effect this had been asserted by the judge at first instance.

The Court then drew a distinction between the right to interest and the right to an annuity. Annuities arise purely from contract. On the other hand, the source of interest relates to the principal sum that has been lent. This aspect of the judgment, while technically correct as a matter of law, has given solace to the tax planning profession and encouraged some practitioners to read the *Myer* decision as a narrow precedent relating specifically to assignments of interest. The narrow way of analysing the *Myer* decision is said to be that a sale of a right to future interest income itself gives rise to income on ordinary concepts.

The High Court then cited with approval *Commissioner of Internal Revenue v PG Lake Inc*,[51] an American decision that saw the sale of a right to future income as giving rise to an immediate income receipt. In *PG Lake*, the taxpayer assigned oil payment rights. The US Court of Appeal adopted a substance over form approach and taxed these payments as the present value of income which the recipient would otherwise obtain in the future. The High Court went on to say that it would have also held the amount to be assessable under the second limb of s 26(a) which taxed 'profit making undertakings or schemes', but did not feel it necessary to comment on the relationship between that provision and s 25(1). Section 26(a) has now been replaced by s 25A and will not apply to

48 In so commenting, the High Court used *IRC v Europa Oil (NZ) Ltd [No 2]* (1976) 76 ATC 6001 as authority (a case often cited in favour of tax planning schemes to protect the particular scheme).

49 *Myer* (1987) 163 CLR 199, 217.

50 Ibid.

51 356 US 260 (1958).

property dealings that arose after the commencement of the capital gains provisions.

The shift in *Myer* was significant, although the judgment was unclear. The next stage was to watch how subsequent courts handled the High Court's comments. The following section analyses these cases.

IV JUDICIAL APPLICATION AND REFINEMENT OF MYER

In analysing the more important cases that sought to apply the *Myer* decision, the intention is to show that the pre-*Myer* problems and difficulties have not been overcome by that decision or any subsequent decisions. Most importantly, the cases do not adequately resolve questions about the role of purpose, the degree of purpose required and the relationship to other criteria which the courts have looked at to determine if there is a business activity. The key questions are addressed below in the context of these later cases.

A *Will* Myer *Lead to All Receipts of a Business Being Taxed?*

One of the earliest cases to refer to *Myer* was *FCT v Spedley Securities Ltd.*[52] The taxpayer was a merchant bank. It received compensation when a customer cancelled a proposed loan that the taxpayer was seeking to arrange on a commission basis. *Myer* was only relevant in relation to the Commissioner's attempt to establish the widest possible proposition from it. The judgment indicates that the Commissioner had sought to argue that *Myer* established that if a general business is conducted with a view to profit, then that general profit purpose can be imputed to all gains made by the business. This would determine that they are all income in nature. The Court quite properly rejected this proposition.

B *Is Characterisation Still the Vital Determinant?*

FCT v Moana Sand Pty Ltd[53] showed how the determination of the importance of profit purpose is caught up with the factual characterisation of the taxpayer's activities. The taxpayer bought land intending to mine the excess sand and ultimately sub-divide and sell the land. The decision to go ahead in that manner clearly required both modes of profit generation, although there had been a finding of fact that the dominant purpose was not resale. The land was not in fact sold in this way but was resumed. The Court held that the profits on resumption were assessable income. It was seen as a single transaction which itself had the appropriate profit purpose. The case went on appeal to the Full Federal Court.[54] The Full Federal Court applied the *Myer* reasoning and found for the Commissioner.

[52] (1988) 88 ATC 4126.

[53] (1988) 88 ATC 340.

[54] *Moana Sand Pty Ltd v FCT* (1989) 89 ATC 4897.

C *What Level of Purpose is Required?*

In *Cooling v FCT*,[55] the court expressly asserted that a less than dominant purpose would suffice. The case dealt with the tax treatment of an incentive payment given to a solicitor to induce the legal partnership's service company to take a lease in a new office block. The case went on appeal to the Full Federal Court.[56] All three judges held that the monetary incentive was income on ordinary concepts because a taxpayer which operates from leased premises, and who moves premises, is acting in the course of the business activity when doing so.

Hill J, who delivered the leading judgment, attempted to survey and analyse the authorities in a comprehensive fashion and asserted the following propositions. Whether an amount is income on ordinary concepts depends upon its quality in the hands of the recipient. The motive of the donor will not necessarily be irrelevant but it will not be determinative. The test to be applied is objective rather than subjective. If a taxpayer is carrying on business, the proceeds of that business will be income. To answer the question whether a business is being carried on, a 'wide survey' and 'an exact scrutiny' of a taxpayer's activities may be necessary. Where profit arises from the disposal of property, the test to be applied is that emanating from *Californian Copper*, namely, whether it is merely a realisation or change of investment or, instead, an act done in what is truly the carrying on or carrying out of a business. If the nature of the business 'of necessity' ensures that the funds are invested in assets which are realised from time to time, the proceeds of realisation will be income. It is an act done within the course of business. If it is truly done in the course of carrying on that business, it ought not to matter how frequently the transaction is undertaken, or whether the taxpayer hoped to make more profit from the sale of the investment or from the holding of the investment.

His Honour went on to reiterate the important point made in *Myer* that the latter position cannot be inverted. The fact that a transaction is a normal incident of a business activity and therefore gives rise to receipts having an income character, does not mean that a profit arising from an unusual or extraordinary transaction will not be income. Hill J considered that whether it is or not, depends upon the other principles in *Myer*. The profit 'may' constitute income where the transaction was entered into with the intention or purpose of making a profit. Like the High Court, his comments imply that profit intent alone is not the determining factor.

Hill J referred to 'two strands of thought' in the *Myer* judgment. The narrower one was that a sum received in substitution for a stream of income was assessable as a conversion of future income into present income. Where this occurs, the taxpayer's purpose 'was largely irrelevant'. He saw the wider strand of thought covering cases where a

[55] (1989) 89 ATC 4731.
[56] *FCT v Cooling* (1990) 90 ATC 4472.

> gain was made by the taxpayer in a business operation for the purpose of profit-making and was therefore income on ordinary concepts, notwithstanding that the transaction was extraordinary, judged by reference to the ordinary course of the taxpayer's business.[57]

Hill J found on the facts that the profit was made 'in the course of its business activity'.[58] He also found that incentives such as this were ordinary incidents at the relevant time.

He did not leave it there, however. He also considered whether the facts would allow for the conclusion that the transaction giving rise to the incentive payment could itself be characterised as a profit-making scheme. Certainly profit was not the sole purpose, as the transaction required moving the professional partnership's premises. Ultimately, one would expect that the main consideration would be the need for suitable office space at a fair rent. The most important comment of Hill J in this regard is that the scheme could constitute a profit-making scheme, notwithstanding that profit was not the dominant or sole purpose. He found himself able to support this proposition from the facts in *Myer* itself. There had been a finding of fact at first instance in *Myer* that the main motivating purpose behind the transaction was to obtain working capital. He went on to say 'it should, however, be noted that on the facts of that case the attaining of working capital was possible only if the profit contemplated by the taxpayer was made'.[59] Hill J went on to conclude that the transaction was a commercial transaction forming part of the business activity of the firm and 'a not insignificant purpose' of it was the obtaining of a commercial profit by way of the incentive payment.

He also asserted that *Moana Sand* provided authority for the proposition that 'a scheme may be a profit-making scheme, notwithstanding that neither the sole nor the dominant purpose of entering into it was the making of the profit'.[60] Yet, it is more accurate to say that in *Moana Sand* the Court held that the scheme was a single plan which comprised both the decision to mine and the ultimate decision to sub-divide. If the scheme is identified this broadly, there will be no difficulty in holding that the dominant purpose was to make a profit. Hill J's reading of the case implied that the Court saw the two features as separate schemes which did not occur.

Hill J, as part of the Full Federal Court, had another opportunity to consider *Myer* in *Henry Jones (IXL) Ltd v FCT*.[61] The case concerned a lump sum paid as consideration for an assignment of rights under a royalty agreement. The taxpayer's subsidiaries were involved in the canned fruit industry. The taxpayer owned trade marks associated with the businesses. It negotiated to sell the business when it became unprofitable. A ten year license agreement was entered

57 Ibid 4483.
58 Ibid 4484.
59 Ibid 4482.
60 Ibid 4484.
61 (1991) 91 ATC 4663.

into in December 1981 with an annual royalty of 5% subject to a guaranteed minimum. The taxpayer subsequently assigned the right to the royalties to an independent financier in return for a lump sum. The evidence allowed for the inference that the taxpayer had intended to assign its right under the license agreement before it was entered into. The judge at first instance applied *Myer* in finding for the Commissioner. The Full Federal Court dismissed the taxpayer's appeal. Hill J, in the leading judgment, again referred to the two strands of thought in *Myer*, one relating to property acquired for the purpose of profit-making, the other being that the assignment of a mere right to interest generally led to the consideration being treated as assessable. Hill J referred to the use of the words 'purpose' and 'intention' in *Myer*. He said:

> There may be a fine distinction between purpose and intention, purpose being generally the object which the taxpayer has in view, and intention being the act of determining mentally upon some action or result. A person may acquire property having the intention of re-selling it without, of course, acquiring it for the purpose of profit-making. [62]

His Honour went on to indicate that it was unnecessary to determine if there was a distinction between the two concepts and felt that the High Court had used the terms interchangeably in *Myer*. His Honour then considered the argument that there was no relevant profit-making purpose here, even though the taxpayer knew it was going to assign the rights to the royalties in advance. After looking at some analogies and the nature of profit, his Honour unfortunately provided a brief conclusion that he thought the facts of the present case were distinguishable from *Myer*. Certainly, an important difference is that in *Henry Jones (IXL) Ltd*, the license agreement was intended as the means to cease a legitimate business. The loan agreement in *Myer* on the other hand, seems to have been created as a basis to allow the assignment to occur.

His Honour then considered that the second strand in *Myer* would apply. He went on to conclude that while there was some doubt, he thought *Myer* established that

> except in the case of the assignment of an annuity where the income arises from the very contract assigned, an assignment of income from property without an assignment of the underlying property right will, no matter what its form, bring about the result that the consideration for that assignment will be on revenue account, as being merely a substitution for the future income that is to be derived.[63]

This is so regardless of whether the future income is secured by an agreement which itself is assigned. Heerey J did not see the facts as distinguishable from *Myer*, considering the pre-ordained nature of the transaction to be sufficient. Jenkinson J agreed with the judgment of Hill J.

[62] Ibid 4669-70.
[63] Ibid 4675.

The added issue raised by the assertion of Hill J in *Cooling*, that dominant purpose is unnecessary, is whether that view fails to properly distinguish between two types of circumstances. The first is where there are a number of mutually exclusive purposes. Here, the case will be determined by the question whether there must be a dominant purpose of profit-making, or by deciding on the facts what was the taxpayer's true purpose. The second type of situation is where the various purposes will not be in dispute, but where they support each other, rather than contradict each other. A simple example will suffice. Let us assume that banks are offering interest rates of 10%. Let us further assume that a particular share shows a dividend yield of 5% and a likely capital appreciation of 6%. An investor in that share does not solely intend either the dividend or the capital appreciation. Nor does the investor really have a dominant purpose of one over the other. Unless the investor is confident that both forms of return are likely, there would simply be no reason to invest in the share, rather than put the money in the bank. Thus, there are two distinct purposes but they support each other.

In terms of what motivated the transaction, both can be said to do so if one applied a 'but for' test along the lines of that developed through tort law. This does not mean that this analysis must apply in the tax field. If this were the case, there would again be little potential operation of capital gains legislation in the investment area. But it certainly may do so and may be the logical progression of the analysis in the tax cases discussed above. It also means that the courts may not necessarily direct that there is one particular level of profit purpose that is appropriate in all circumstances. Certainly, Hill J's conclusion is a fair way to interpret the *Myer* case as a precedent but its ease of application is another matter and that is before we come to the real problems from a policy perspective. But given the ambiguities in the language used in the case, it would have been better for the High Court to reconsider its views in the later cases and give an express indication of what it intended.

D *How Specific Must the Relevant Purpose Be?*

This question was considered in *Westfield Ltd v FCT*.[64] The taxpayer was a property developer who acquired an option over land for the purposes of development. The plan fell through, so the taxpayer acquired other options in the area and sold the land at a profit. The Commissioner argued that the land was an asset available to be dealt with in the ordinary course of its business and was dealt with in one of the alternate ways contemplated. As such he considered that it was income on ordinary concepts. Sheppard J at first instance stated that the whole transaction was carried out in the ordinary course of the applicant's business and was part of an overall profit-making venture. The applicant's intentions at the time of acquiring the land were critical and although not envisaging sale as a 'necessary consequence' it was 'certainly a possibility'.

64 (1990) 90 ATC 4801.

The taxpayer successfully appealed to the Full Federal Court.[65] Hill J again delivered the leading judgment and elaborated on his comments in *Cooling*. He suggested that the key comments in *Myer* were made to refute the argument that an extraordinary transaction outside of the scope of the taxpayer's business could not give rise to assessable income. In his view, *Myer* emphasised that such transactions would give rise to assessable income, if the transaction was not only 'commercial', but in addition, where at the time it was entered into, there was the intention or purpose of making a relevant profit. This will be self evident if the transaction is part of the ordinary business of the taxpayer or an ordinary incident of that business activity. On the other hand, where a transaction falls outside the ordinary scope of the business, the purpose of profit-making must exist in respect of the means by which the profit was in fact made. There may be taxable cases such as *Steinberg v FCT*,[66] where a taxpayer acquires property with a profit-making purpose without having resolved the means to generate the profit. A profit-making scheme may lack specificity of detail but, to be taxable, the mode of achieving that profit must still be contemplated as one of the alternatives at the relevant time. He ultimately held that on the facts in *Westfield*, it could not be said that the taxpayer ever had the initial intent of making a profit in the way achieved.

E *When Will an Unusual Transaction Be Part of the Business Activities?*

In some cases the argument will be whether an unusual transaction is still part of the ordinary scope of the particular business. If so, the gains will be income. Yet there is nothing in *Myer* or any subsequent cases that provides a means of determining this question. Instead, it remains a troublesome question of factual characterisation well illustrated by two cases with seemingly similar facts. In *GKN Kwikform Services Pty Ltd v FCT*,[67] the taxpayer ran a business hiring out scaffolding equipment. On the rare occasions when equipment was sold to customers, the Commissioner treated such sales as being on capital account. On the occasions when a significant amount of equipment was not returned by customers, the taxpayer would charge the customer with the current supplier's list price. The Commissioner asserted that either this amount or alternatively any profits generated from such a procedure, was assessable. The taxpayer had instead employed the recoupment provisions of s 59 where it received an amount in excess of the depreciated value of the plant, because it considered the scaffolding to be depreciable plant. This approach would only make assessable the amount already allowed as a deduction under the depreciation provisions. If the Commissioner was right, however, the profits over and above the total depreciation previously allowed would also be assessable.

[65] *Westfield Ltd v FCT* (1991) 21 ATR 1398.
[66] (1975) 134 CLR 640.
[67] (1990) 90 ATC 4823.

Foster J said it was quite clear that no new ground had been broken by *Myer*. If the sale was an integral part of the operation of the business, it would give rise to assessable income. If there was no intention of selling it at a profit at the time of acquiring the equipment, it would be a mere realisation of a capital asset. The Commissioner asserted that it was integral because the liability was contained within the contracts of hire that were the essence of the business. Foster J rejected this view. He distinguished between hiring receipts and compensation payments. On appeal to the Full Court, the case was decided in the Commissioner's favour. The non-return was regular and expected. The taxpayer charged non-returns at profitable rates. Subsequently the Full Federal Court decided the case of *Hyteco Hiring Pty Ltd v FCT*.[68] The taxpayer was in the business of hiring fork lift trucks. When no longer used for hiring, they were sold, at times at a profit. Hill J held that the sales were not in the ordinary course of business. Nor was there an intention to sell at a profit at the time of acquisition. He distinguished *GKN Kwikform*. Here, the profit was not inevitable and arose from the sale of the business apparatus and not from the process of the business.

F *What Refinements, if any, would the High Court make to* Myer*?*

With such disparate results at the Federal Court level, much might have been expected of the High Court once it had an opportunity to comment on these principles. An opportunity arose in *GP International Pipe Coaters Pty Ltd v FCT*.[69] The taxpayer was established in order to coat pipes to be used in a natural gas pipeline. The contract required the taxpayer to build the plant at which this work would be undertaken. The taxpayer was given establishment costs for this purpose and was allowed to retain title to this plant. The establishment fee was treated as assessable income by the Commissioner. The High Court agreed.[70] The Court said:

> 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. [71]

No attempt was made to refine the *Myer* comments. Nevertheless, the reiteration of these traditional principles suggests that the Court was not keen to be seen as making fundamental changes to tax doctrine and implied that no single factor is determinative. One reason why *Myer* might not have been analysed was

68 (1992) 92 ATC 4694.

69 (1990) 90 ATC 4413.

70 Surprisingly, both sides accepted that the expenditure by the taxpayer on constructing the plant was capital in nature and that only depreciation was allowable. This would not be the normal situation for a person in the business of building. The factor that would support the capital argument was the right to keep the building. The taxpayer was not building for others.

71 *GP International Pipe Coaters Pty Ltd v FCT* (1990) 90 ATC 4413, 4420.

because the Court was able to say on the facts that the receipt was in the ordinary course of the taxpayer's business.[72]

Another High Court case that dealt with these principles in a tangential fashion was *Thiel v FCT*.[73] The case concerned the meaning of the words 'enterprise carried on' in a double tax agreement/treaty and whether they covered the acquisition of units in a private unit trust in anticipation of future gains and which led to such gains. The relevant Article in fact refers to an enterprise which carries on 'business', but the case was decided on the other elements of the expression. Of necessity, however, the decision shows that the concept of business is incorporated within the concept of enterprise. This, of itself, invites consideration of the ambit of *Myer*.

Franklin J, at first instance, found that the appellant invested in the units with the clear purpose and intention of selling all of them or the shares which they could be converted into but held that the transaction did not carry any of the hallmarks of carrying on business or a business activity other than the intention to make a profit. He considered that it did not follow as a matter of necessity from *Myer* that profits from an isolated venture in which property was acquired with the purpose of resale at a profit, constitute income according to ordinary concepts even though such transaction has the features of a business operation or commercial transaction.[74]

On appeal to the Full Federal Court, Sheppard J considered that *Myer's* case covered 'a separate and isolated transaction different from the ordinary business activities of the *Myer* company, but nevertheless part of its business'.[75] He had expressed reservations about applying that case to transactions admittedly carried out with the dominant purpose of profit making by sale, but which were not part of any overall business activity carried on by the taxpayer. Lee J stated that trading in property with the intention of making a profit 'may, if the business dealing component is clear' give rise to liability under s 25(1) or s 25A.[76] No indication was given as to the other features that would clearly identify a business dealing.

On appeal, the Full High Court held that the transaction satisfied the expression in the Treaty. Mason CJ, Brennan and Gaudron JJ agreed with Sheppard J, that even a single transaction may constitute an enterprise if 'entered into for business or commercial purposes' but did not indicate what features gave rise to this inference.[77] Wilson J asserted that an enterprise making profits through a

72 As was the position in *FCT v Becker* (1952) 87 CLR 456, 467; *GP International Pipe Coaters Pty Ltd v FCT* (1990) 90 ATC 4413, 4422.
73 *Thiel v FCT* (1990) 171 CLR 338.
74 *Thiel v FCT* (1988) 85 ALR 80.
75 *Thiel v FCT* (1989) 89 ATC 4015, 4039.
76 Ibid 4050.
77 *Thiel v FCT* (1990) 171 CLR 338, 344-5.

permanent establishment may properly be described as carrying on business.[78] Dawson J made the following comments:

> Profit from a single transaction may amount to a business profit rather than something in the nature of a capital gain even if it does not involve the carrying on of a business .... a single transaction may amount to a business dealing so as to characterise the profit derived from it as a business profit.[79]

McHugh J considered that the text of the Treaty required that the profits did not need to come from a business, but must at least be profits from 'an adventure in the nature of trade'.[80] He found on balance that this was so. His reasoning required him to consider the type of factors relevant in determining the presence of income from business. First, the venture, although highly speculative, carried a prospect of large profits. The taxpayer had to raise finance. He acquired more than one interest, held, then exchanged them and gave instructions to sell as soon as they were listed. Over 40 separate sales were made in a short period. The fact that the taxpayer was a businessman was seen as 'a matter of considerable importance' as it coloured the whole venture.[81] This judgment lends support to the view that the determination of the presence of a business activity remains as uncertain as ever, regardless of the Myer authority. It should be noted, however, that these comments were made in the context of interpreting words appearing in the Double Tax Agreement and not common law notions of income. In *Thiel* it was the taxpayer who was arguing that the transaction was an enterprise carried on. If that was the case, the profits would have been taxed in Switzerland and relieved of Australian taxation. One of the main motivating factors behind the High Court's decision in favour of the taxpayer in *Thiel* was that a wider interpretation would reduce the potential for double taxation which it considered was the purpose of the international legislation.

G *What Effect Will* Myer *Have on the Tax Treatment of Traditionally Non-Taxable Gains?*

The approach taken by Hill J to the question of the degree of purpose required has potentially immense ramifications. For example, if a less than dominant purpose can suffice, it is then open to the Commissioner to argue that investors are assessable on the gains from asset sales as well as on the regular returns from their investments. Yet, traditionally, the investment asset is treated as a capital asset by the courts. This of course will now be subject to capital gains tax but the possibility exists to apply s 25. After Hill J in *Cooling* considered that a less than

[78] A similar line of reasoning has been adopted by the High Court in looking at the residence of companies. Although the Act in s 6 requires both central management and control and carrying on business in a particular place, the High Court has said that the place of central management and control automatically constitutes carrying on business: *Koitaki Para Rubber Estates Ltd v FCT* (1940) 64 CLR 15.

[79] *Thiel v FCT* (1990) 171 CLR 338, 351.

[80] Ibid 359.

[81] Ibid 361.

dominant purpose of profitable resale would suffice, the ground was laid for the Commissioner to be more aggressive in his assessment of investors.

These issues had begun to be addressed in a number of older insurance company cases. A number of similar cases were also decided shortly after *Myer* and *Moana Sand* and reiterated the earlier views of the High Court in the pre-*Myer* decisions, namely that if the ordinary business activity is defined widely, then transactions within it will be treated as being on income account. It is common for insurance companies to invest premiums until such time as they are needed to pay out claims or other expenses. If an insurance company invests in shares or rental property, the dividends and rent would be income on ordinary concepts. The issue, however, is whether any profits on sale of the shares or the properties are also assessable under s 25.

This was held to be so in *Colonial Mutual Life Assurance Society Ltd v FCT*[82] and *Australian Catholic Assurance Co Ltd v FCT*,[83] on the basis that such profits were an intended part of the overall business strategy. Initially, this was thought to be a principle limited to certain types of insurance companies and banks. In *London Australia Investment Co Ltd v FCT*,[84] Gibbs J clearly rejected the attempt to confine the analysis to banking and insurance companies. He indicated that the decisions in these cases flowed from the *Californian Copper* test which is applicable to any business.

In spite of these long-standing authorities, which appear to be reinforced by *Myer*, subsequent cases show the continued scope for trying to refine and distinguish precedents, simply because the test in each case depends upon the way the particular business is characterised and upon the purposes found to underlie particular transactions. In *RAC Insurance Pty Ltd v FCT*,[85] Lee J, in the Federal Court, held that gains on the realisation of investments of premium monies were within the taxpayer's business operations and were accordingly assessable. The Full Federal Court dismissed an appeal,[86] and declined to accept the taxpayer's purported distinction that short-term life insurance businesses should be treated differently to those dealing in longer term insurance policies. After a string of insurance company cases asserted that turnover of investments is a normal part of an insurance business, the hint was taken and a separate entity was used in *CMI Services Pty Ltd v FCT*.[87] A subsidiary company set up by an insurance company did nothing other than invest in rental properties. The Court accepted that the investment business was truly independent of the insurance business. However, sale of assets still constituted more than a mere realisation of those investments. An appeal was made to the Full Federal Court.[88] The Full Federal Court affirmed the initial decision.

82 (1946) 73 CLR 604.
83 (1959) 100 CLR 502.
84 (1977) 138 CLR 106.
85 (1989) 89 ATC 4780.
86 *RAC Insurance Pty Ltd v FCT* (1990) 90 ATC 4737.
87 (1989) 89 ATC 4847.
88 *CMI Services Pty Ltd v FCT* (1990) 90 ATC 4428.

Some insurance cases went the other way. In *Equitable Life and General Insurance Co Ltd v FCT*,[89] the taxpayer had formerly conducted a life insurance business. It stopped this business and continued solely with an investment portfolio mainly consisting of shares. Ultimately it sold off all the shares. Wilcox J reiterated the view that periodic contemplated sales of investments are a part of the business of investing. When the taxpayer sold the entire portfolio, however, it was held to be closing down its business and only generating capital gains. On appeal, a majority in the Federal Court held in favour of the taxpayer.[90] The majority in *Equitable Life* distinguished *London Australia* on the basis that the latter case involved a taxpayer whose dominant purpose was receiving dividends but who sold investments to maintain dividend yield. In *Equitable Life*, the main reason for buying the shares was their 'capital gain'.[91]

The mixed results in these cases suggest that *Myer* had little or no effect on a pre-existing judicial trend. The legal principles applicable could also be criticised for being unable to ensure consistent economic treatment of similar individual transactions.

The special problem of investment gains was directly addressed in *Radnor Pty Ltd v FCT*,[92] although the court did not deal with the issue of the degree of purpose required. An investment vehicle was assessed on the profits from the sale of shares in its portfolio. The vehicle was used to provide for a disabled family member. The Court examined the share transactions to see what inferences could be drawn. It found that about 20% of the portfolio was sold in each of seven years. Average profits in each year were $67,000. While this seemed substantial, Davies J noted that if sales which resulted from takeovers were excluded, the percentage disposed of was much lower. This was relevant to an assessment of purpose as such sales are prompted by actions beyond the taxpayer's control. He also noted that the transactions were primarily in 'blue chip' shares, which again supported the view that the business was investing rather than trading.

His Honour said that the question is 'one of fact or of fact and degree'.[93] Factors pointing to assessability were the regularity and frequency, the business-like way the activity was carried on and the fact that the taxpayer was an incorporated company. The contrary conclusion was supported by the principle

[89] (1989) 89 ATC 4972.

[90] *FCT v Equitable Life and General Insurance Co Ltd* (1990) 90 ATC 4438.

[91] Other insurance cases in this period were: *FCT v Employers' Mutual Indemnity Association Ltd* (1991) 91 ATC 4850, where the Full Federal Court rejected an argument that an insurance company's investments were purely an internal investment fund and therefore not part of the ordinary insurance reserves of such a business; *AGC (Investments) Ltd v FCT* (1991) 91 ATC 4180, where Hill J considered the position of a wholly owned subsidiary of an insurance company that invested in shares and fixed interest securities and found as a fact that the taxpayer had the relevant purpose of re-sale at the time of acquisition; *GRE Insurance Ltd v FCT* (1991) 91 ATC 4454, where Heerey J of the Federal Court dismissed appeals against assessments of a holding company which was a general insurer and a subsidiary used to hold the insurer's equity; *Unitraders Investments Pty Ltd v FCT* (1991) 91 ATC 4454.

[92] (1990) 90 ATC 4637.

[93] Ibid 4647.

that the general duties of trustees is to preserve capital and not to speculate. An appeal to the Full Federal Court[94] was dismissed. The Full Court also considered that whether one is carrying on a business is a question of fact and degree and ultimately a question of impression. The trustee argument was relevant but not determinative. The appeal was dismissed because the evidence showed that the shares were not acquired with the purpose of profit-making by sale.

Another traditionally non-taxable area has been gambling winnings, at least when the taxpayer is not in a business of gambling. One of the criticisms of the High Court in *Myer* was its failure to clarify the exact importance of profit intent. Yet the judges' task was made difficult by the presence of clear tax precedents that indicate that profit motive of itself does not guarantee that an activity gives rise to assessable income. The purchase of a lottery ticket would invariably be accompanied by such an intent but is simply not seen as an earning activity under Australian tax jurisprudence. In other jurisdictions, where virtually all realised gains are seen as income on ordinary concepts, lottery winnings are assessed.

Because profit motive of itself does not render a transaction as being of a business or commercial nature, this presumably explains why in a trilogy of post-*Myer* gambling cases, *Myer* received little attention. In *Brajkovich v FCT*,[95] the Full Federal Court merely cited *Myer* as illustrating that an isolated transaction may produce assessable income and also referred to the passage in *Myer* that gave reasons why earlier courts would not accept that profit purpose alone will stamp a transaction as giving rise to assessable income. Similar approaches were taken in *Babka v FCT*[96] and *Evans v FCT*.[97]

V An Evaluation of the Present State of the Law

There are clearly a number of potentially far reaching comments in the *Myer* decision. Equally clearly, those comments have not sufficiently identified the exact importance of profit purpose. Nor have they comprehensively outlined the criteria relevant for determining whether a transaction has a business or commercial flavour. It seems, however, that the Court has emphatically rejected the idea that an isolated transaction thereby has less of a revenue flavour. It also made sufficient comments that acknowledge that profit purpose is the most important criterion, even if not itself determinative. It is this aspect that led many practitioners to assert that the *Myer* decision went too far and fundamentally changed the law. We should begin an evaluation by examining the force of this criticism.

Those who assert that the statements in *Myer* go against long standing judicial authorities may be overlooking the earliest comments of the High Court. They may be concentrating instead on the more pro-taxpayer decisions of the 1960s

[94] *FCT v Radnor Pty Ltd* (1991) 91 ATC 4689.
[95] (1989) 89 ATC 5227.
[96] (1989) 20 ATR 1251.
[97] (1989) 20 ATR 922.

and 1970s. A group of cases from the 1920s and 1930s is illustrative. In *Blockey v FCT*,[98] the Full High Court unanimously held that the gain by two hardware merchants on an isolated purchase of wheat bonds and their disposal over a period was taxable. In *IRC v Livingstone*,[99] a taxpayer was assessed after purchasing, refurbishing and selling a ship. In *Martin v Loury*,[100] acquisition and disposition of waste linen was seen as a trading activity. *Jolly v FCT*[101] saw share dealings treated as a general course of speculation giving rise to assessable income.

These cases involved one-off or short term dealings, yet the courts were still able to find the receipts assessable. Why, then, is *Myer*, a case decided over 50 years later, seen as so far reaching? Here it is necessary to trace a peculiar development in Australian tax law. Presumably, the historical problem was the case of *Jones v Leeming*,[102] a 1930 House of Lords decision. There, an isolated transaction with a profit-making intent was held not to give rise to the receipt of income. Under the English legislation, it was necessary for the activity to be in the nature of trade to be assessable. The finder of fact at first instance had already concluded that the transaction was not in the nature of trade. The House of Lords respected that finding and held that an isolated transaction will either be in the nature of trade or will be a mere acquisition and disposition of property. Given the finding of fact, the House of Lords held that the profit was not assessable.

Amendments to the definition of 'assessable income', which were then repeated as s 26(a) of the Australian legislation, the precursor to s 25A, were clearly enacted as a reaction to this decision.[103] The Treasurer of the day, in introducing the amendment, stated that it was merely a statutory declaration of what has for many years been accepted as settled law in Australia, ie, that the profit derived from any transaction or scheme entered into for the purpose of profit-making is income which is assessable to income tax, notwithstanding that the transaction does not amount to or is not part of a trade or business.[104] Such a statement is itself more far reaching than *Myer* because it makes profit purpose determinative without the need for a business link.

The first limb of s 26(a), which taxed 'profit arising from the sale by the taxpayer of any property acquired by him for the purpose of profit-making by sale', can be directly traced to the perceived need to overcome *Jones v Leeming*. The second limb, which taxed 'profit arising from the carrying on or carrying out of any profit-making undertaking or scheme', can be traced to *Ruhamah Property Co v FCT*[105] and to the question posed by Lord Justice Clarke in

[98] (1923) 31 CLR 503.
[99] (1927) 11 TC 538.
[100] [1927] AC 312.
[101] (1933) 50 CLR 131.
[102] [1930] AC 415.
[103] Income Tax Assessment Act 1930 (Cth).
[104] Commonwealth, *Parliamentary Debates*, 20-21 Geo V, vol 125, 3724-5; vol 126, 4854-6.
[105] *Ruhamah Property Co v FCT* (1928) 41 CLR 148.

Californian Copper where he asked 'is the sum of gain that has been made a mere enhancement of value by realising a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making'.[106] *Ruhamah Property Co Ltd* spoke of 'the question whether the sale was an operation of business in carrying out a scheme of profit-making'.[107]

Here, again, the troublesome and undefined business concept is unfortunately incorporated in the suggested principle. Yet, the second limb of s 26(a) in fact deleted the reference to 'business' which could, in turn, support an argument that Parliament intended to develop a very broad taxing provision, although this is not clear from the Parliamentary Debates. The Debates specifically refer to an intent to confirm the High Court's decision in *Blockey* and prevent it being overturned by *Jones v Leeming*. An analysis of *Blockey*, however, does not resolve the question whether there must be a business activity. In a relatively short series of individual judgments, the five judges all found for the Commissioner. All saw the test as being that emanating from *Californian Copper*, which itself referred to business. Isaacs and Starke JJ considered that some repetition would be necessary to constitute carrying on a business. Yet both thought that the receipts could be 'income from property' if the facts showed that there was no business.[108] In any event, most, if not all, felt that they would be able to somehow tax a one-off transaction which was intended to generate profit by resale.

While there is at least a tenable argument that the widest application was intended, subsequent courts did not interpret the provision in this way. Gibbs CJ in *FCT v Whitfords Beach Pty Ltd*[109] asserted that the Court in *Ruhamah* did not intend to depart from the 'established' law that profits from profit-making schemes were only treated as income 'if the scheme could be described as a business, a trading adventure, or a commercial venture'. Mason J also asserted that it was a long settled principle that the sale of property must be made in an operation of business to give rise to income on ordinary concepts. [110] Neither judge traced the authorities in support of their assertions. The issue is largely circular. Whether their statements are consistent with *Blockey* depends on the criteria they believe are necessary, or at least relevant, to determine when a transaction constitutes a business or commercial venture.

As too often happens when Australian courts cite English authorities, insufficient attention is given to subsequent English decisions. This is an unfortunate, but perhaps understandable, response under the imprimatur of the doctrine of precedent. The first English decision is at best persuasive. If it succeeds in persuading the Australian High Court, however, a subsequent English decision overturning the first remains persuasive, while the Australian High Court

[106] *Californian Copper Syndicate v Harris* (1904) 5 TC 159, 166.
[107] *Ruhamah Property Co v FCT* (1928) 41 CLR 148, 152.
[108] Different tax rates applied depending on whether income was from personal exertion (including business from property) or not.
[109] (1982) 150 CLR 355.
[110] Ibid 372.

decision is binding. The irony of it all was evidenced in the 1956 House of Lords decision in *Edwards v Bairstow*.[111] In similar circumstances to *Jones v Leeming* and again where a finding of fact favourable to the taxpayer had been made at first instance, the House of Lords overturned the decision, holding that there was no other reasonable conclusion than that the profit from the isolated venture was assessable.

The perversity in Australian tax jurisprudence is that s 26(a), the provision incorporated to overcome the potentially adverse effect of *Jones v Leeming*, had an even greater adverse effect itself. The High Court began by pointing out that regardless of the obvious source of the language of the provision, being a statutory provision, it must be applied directly. This then encouraged a significant number of semantic arguments seeking to ensure that transactions were not caught by s 26(a). Even more perversely, this was linked to a perception that seemed to pervade both practitioners and the courts to the effect that if Parliament brought in a specific provision to deal with one-off transactions, a taxpayer who avoided the operation of that provision would not be caught by s 25. Yet the clearly stated policy behind s 26(a) was to bolster that very provision.

Through the 1960s and 70s, taxpayers had some celebrated victories under this form of analysis.[112] It was only after *Whitfords Beach* and *Myer* that the High Court forced the analysis back into the s 25 domain. Whatever the ambit of these decisions, the return to a style of reasoning not found for some 30 years, was itself something which understandably jolted practitioners, even if they were wrong in asserting that this was an unjustified departure from established authority.

This article has argued that many important questions were left unanswered by *Myer* and, further, that all of the pre-existing difficulties in determining the distinctions between income and capital in a business context remain. At one extreme, the Commissioner originally saw *Myer* standing for propositions so far reaching that it would have overturned all pre-existing authorities. When the High Court revisited these issues in *GP International Pipe Coaters* it merely reiterated the long-standing relevant, but non-determinative considerations. At the Federal Court level, different judges saw *Myer* standing for some quite distinct propositions.

Hill J in a group of cases attempted the most detailed analysis and sought to resolve the ambiguities by induction and deduction from the results in *Myer* and *Moana Sand*. He considered that the relevant purpose need not be a dominant or sole purpose. He indicated quite properly that when the Commissioner seeks to assess the sale of an asset, the relevant purpose must be found at the time of acquisition of the asset. He also discussed the murky distinction between concepts such as purpose, intention and motive.

Taken together, the cases show that subsequent courts did not see *Myer* as fundamentally changing the nature of the income concept in Australian tax law.

111 [1956] AC 14.
112 See, eg, *Steinberg v FCT* (1975) 134 CLR 640; *FCT v NF Williams* (1972) 72 ATC 4188.

Instead, the decision was seen as clarifying two separate strands of thought pertaining to particular factual situations. The first strand confirmed that a lump sum received in substitution for a future stream of income would normally be seen as income itself. The second strand, and the more difficult area from *Myer*, required a gain to be made in the context of a business or commercial operation. Where this occurred, *Myer* confirmed that the dominant factor is whether there was a purpose of profit-making existing at the time of the acquisition of the asset or the commencement of the transaction and relating to the means whereby the profit was generated. Where the transaction is part of the ordinary business operation of the taxpayer, that purpose can be presumed. Where it is out of the ordinary, that purpose must be examined specifically.

While these principles appear clearly, *Myer* remains ambiguous if the Court is referring to 'profit-making schemes' without indicating whether the requisite purpose must be a sole purpose, a dominant purpose, a significant purpose or any purpose. In addition, consideration needs to be given to the way that purpose is to be identified. Will the court look only at objective evidence or subjective evidence, or both? To what extent will indirect purposes be relevant? What if anything is the difference between purpose, motive and intent? How will the purpose of a corporation be decided? Will the court look only to the acts of its Board of Directors? Will it look at shareholders, other controlling parties, holding companies, subsidiaries, associates or those with indirect or less obvious control?

Another difficulty thrown up by both *Myer* itself and the subsequent cases is the undue importance given in Australian tax law to non-tax law principles. Whether it is the discussion of annuities in *Myer*, premiums in *Cooling* or trustees in *Radnor*, courts again find themselves making conclusions about individual fact situations based on general principles of non-tax law. While those principles may be relevant factors, they can too easily be elevated to strong presumptions which preclude more rigorous analysis. In *Cooling*, Hill J proceeded to refer to the argument that the amount was analogous to a premium paid to a landlord. A number of cases have led to a perception that a premium on a lease is *prima facie* capital. This arises from a tendency to presume that property law conclusions apply readily in the tax field. Because a premium is consideration for the actual grant of the lease and because a leasehold interest is a property interest, the premium is said to relate to a change in the property interest and consequently be on capital account. Yet, cases such as *Kosciusko Thredbo Pty Ltd v FCT*[113] show clearly that if the receipt of premiums forms part of a taxpayer's business, they will be income on ordinary concepts.

An alternate and better way to analyse such situations is to see a premium, that does no more than accompany the grant of a lease which would be made in any case, as being a profit from the decision to lease. A lessor who wishes to grant a lease in any event and who receives a return by an initial payment of premium

[113] (1984) 84 ATC 4043.

and regular rent, is only embarking upon the transaction because he or she is happy with the total return. That transaction was only entered into because the lessor intended both forms of profit. In a tax context, the premium might only relate to a capital item if on the facts it induces the lessor to do something with the property that truly changes the nature of the property interest. For example, a shopkeeper might be approached by a developer to lease the land. The shopkeeper could argue that he or she does not wish to do so as it would mean ceasing business. The developer might argue that it would pay a premium to compensate the lessor for going out of business and for changing from having a fee simple in the property to a lessor's interest only. But in the normal case where a lessor clearly intends to rent out a property for the highest return possible, the premium should be seen in exactly the same way as was seen in *Kosciusko Thredbo Pty Ltd*, namely, a slight variation of the normal way of carrying on a leasehold business. After all, the mere agreement to lease will itself change the property rights of the lessor.

Similar problems can be seen when Davies J considered the functions of trustees in *Radnor*. He asserted that a trustee may not speculate, citing *Re Whiteley; Whiteley v Learoyd*[114] for the proposition that the duty of a trustee is to take such care as an ordinary prudent person would take if he were minded to make an investment for the benefit of other persons. Yet, in any individual trust situation, this general presumption must be coloured by the actual trust obligations as determined by the settlor. The vast majority of trusts in modern society are business entities set up for commercial and tax reasons, where the motivation of the trustee is no different to the motivation of the people who pay the legal fees to establish the trust in the first place. Where this is so, nineteenth century notions about the purposes of trustees may be less relevant, at least as a means of raising presumptions in revenue litigation.

Perhaps the major difficulty is that *Myer* has neither removed the importance of factual characterisation, nor has it greatly assisted in showing how that characterisation is to be performed. Because the cases still make characterisation of the nature of the business or commercial activity and determination of purpose the central issues, findings of fact dominate the outcome. There is simply no guarantee that two identical economic transactions will be treated similarly for tax purposes as the taxpayers in each case may be described as having different businesses and different purposes. Leaving aside the policy implications, this has significant administrative problems. It encourages litigation and leads to uncertainty. No matter how radical a subsequent court sees the decision in *Myer*, it cannot compel a radical finding of fact. If the finder of fact at first instance does not find the requisite purpose, then that will be the end of the matter.[115]

[114] (1886) 33 Ch D 347, 355.

[115] See, eg, *FCT v Cainero* (1988) 88 ATC 4427, where the Commissioner sought to assess a taxpayer as a result of certain land sales. The Administrative Appeals Tribunal had already said that ss 25 and 26(a) did not apply. The Commissioner appealed. The appeal was unsuccessful, even after the *Myer* decision had been handed down, because the Commissioner had lost on the

The insurance company cases also showed the complications of the characterisation exercise when the identity of the taxpayer can be changed simply by altering a corporate structure. Characterisation may always be complicated when corporations are involved. Subsidiary or holding companies can be used to change the identity of the taxpayer under examination. Subsidiaries can be used to shelter a potentially taxable transaction from a wider business context that would support the Commissioner's contention that the receipt ought to be on income account.

Another difficulty is that the development of an income concept that makes facts of paramount importance and fine distinctions of fact the stuff of most litigation, tends to disenfranchise appellate courts. This is because appeals arise on matters of law not fact. This does not guarantee that findings of fact at first instance will remain inviolate. A number of cases have shown appellate courts effectively overturning finding of facts by finding a sufficient question of law in the primary tribunal's decision. In the main, however, taxation appeals tend to concentrate on the express and even implied statements of law in a lower court's decision. While this is inherent in the appellate process, it is of particular concern if the principles of law are so unclear that they can almost never be stated in any meaningful way. In such an event, it is far more likely that tribunal members and single judges, in attempting to define the undefinable, will make comments which can help support an argument that the judge misunderstood the law.[116]

There are a number of things we can conclude. The trends in *Myer* are both desirable and limited. The desirable feature is that it makes it far less onerous for the Commissioner to show that a particular transaction has a business or commercial flavour. The criteria of periodicity, continuity, scale, etc, that wrongly allowed people to assert that isolated transactions could not be taxed under s 25, have been significantly downgraded. The limitation is that whatever the ultimate meaning of the *Myer* decision, it is clear that the distinction between income and capital in the business context at least, rests as it always has with the way the court describes the taxpayer's business. If the course of the taxpayer's business is wide enough to incorporate the particular unusual transaction and that transaction contemplated profit, it will be assessable. If the asset is not acquired in the course of the business but rather forms part of the business structure itself, the sale will almost certainly be dealt with under the capital gains regime. Every adverse assessment is worth challenging simply because a different view of the ambit of the business and the relevant purposes might be taken by the court.

original finding of fact. The case shows clearly that no matter how radical the principles in *Myer* may be, they cannot compel a radical view of the *facts* in a particular case. The finding of fact simply negated a profit purpose.

116 The paradigm example is probably *Statham v FCT* (1989) 89 ATC 4070.

A Myer Emporium *and the Ruling System*

The Commissioner has also had extreme difficulty in analysing and applying the state of the law. Quite some time was spent trying to develop an income tax ruling which elaborated on the Commissioner's views of these cases. On 3 February 1992, the Commissioner released Exposure Draft Ruling 72 entitled 'Income Tax: Profits on Isolated Transactions'. In due course, this was published in final form as Ruling TR 92/3 (the 'Ruling'). There has been much debate in the profession about the correctness of this Ruling. It is not the purpose of this article to provide a detailed critique of the text or to suggest any improvements. That would miss the point of this article. The suggestion is instead that the state of the law makes it virtually impossible to set out an administratively efficient and policy efficient set of guidelines. The point that needs to be understood from an analysis of the above cases is that whatever the final form of the Ruling, it could never avoid the ambiguities and generalities of the leading authorities.

Only a few specific comments will be made about the Ruling. The text makes clear that there must be both the relevant purpose and a business or commercial context. This again requires attention to be given to all of the pre-*Myer* relevant but non-determinative factors. The Ruling merely lists these again. Where the more contentious issues from *Myer* are concerned, the Ruling accepts the comments in *Cooling* that the purpose need not be a dominant purpose. The Ruling also suggests that purpose is to be determined in an objective manner. The Ruling supports this conclusion by quoting the passage from *Myer* that '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'. 'Circumstances' are presumed to be objective ones. Yet, there is nothing in *Myer* to suggest that witnesses' evidence cannot form part of those circumstances. Furthermore, there is nothing in *Myer* to suggest that the logical inverse of that statement also holds true, namely, that the absence of objective factors precludes a finding of assessability.

The Ruling takes issue with comments of Hill J in *Westfield* where he asserted that *Myer* stands for the view that if the transaction falls outside the ordinary scope of the business, the purpose of profit-making must relate to the very means by which the profit was in fact made. The Ruling suggests that this is *obiter dicta*. Yet, it is an unassailably correct view of *Myer*. What is not able to be shown by *Westfield*, the Ruling or any other case, is how one sensibly and effectively works out the scope of the business in the modern complex commercial world. Policy analysts would also ask why that should ever be a relevant factor.

These comments merely aim to show that the Commissioner cannot clarify matters left uncertain by the courts. The Ruling also shows that lack of clarity in the cases allows the Commissioner to reach contentious conclusions and downgrade propositions that appear unfavourable to him.

B *Is the Distinction Between Income and Capital Inevitable Under the Australian Statute?*

Previous sections have sought to show that an attempt to distinguish between income and capital, when no such distinction can be made on policy grounds, forces the courts to adopt criteria such as purpose and commerciality that are ambiguous and uncertain. This article has also previously sought to distinguish the response of US judges, who took a different approach, even though faced with similar legislative provisions. An examination of the history of income tax legislation in Australia supports an argument that our courts are not precluded from following the United States approach. There is simply nothing in the legislation which demanded the restrictive analysis that eventuated.

Section 14 of the Income Tax Assessment Act 1915 (Cth) included cash prizes in a lottery in a list of income categories.[117] Section 14(a) included 'profits derived from any trade or business'. Business was defined inclusively. Trade was not defined. Section 14(c) contained a s 26(e) type fringe benefits element in the definition. The Income Tax Assessment Act 1922 (Cth) expanded the prizes category to include prizes by way of bonds.[118] The Income Tax Assessment Act 1934 (Cth) added the s 25 general approach and the specific additions of s 26. The Explanatory Memorandum indicated that the s 25 wording came from the definition of assessable income in the 1922 Act. The definition of income from personal exertion also contained the language of s 26(a). This was not commented on in the Explanatory Memorandum. Because some of the elements of s 26 would be income on ordinary concepts, no presumption ought to be raised that it has any fundamentally different conceptual basis to s 25. Section 26 merely attempted to clarify certain ambiguous areas or provide special treatment in certain circumstances. Thus, as outlined above, s 26(a) sought to ensure that *Jones v Leeming* did not apply in Australia. Section 26(d) provided favourable treatment for retirement payments. Section 26(e) ensures that non-cash payments can still be income. Section 26(f) ensures that royalties will be assessable without the separate need to consider whether they are of an income nature.[119] Thus, there is simply nothing within our Act that directs the development of a concept of non-taxable capital gains in the way that this has evolved.

C *Comparative Law Lessons*

Problems of distinguishing between income and capital for tax purposes are not confined to this jurisdiction. Lest it be thought that the principles from *Myer's* case are novel, the report of the United Kingdom Royal Commission on the Income Tax in 1920[120] said:

117 Section 14(h)
118 Section 16(h).
119 The Income Tax Assessment Act 1934 (Cth) s 84 also included premiums in assessable income as well as certain lessee's improvements.
120 United Kingdom, Royal Commission on the Income Tax (1920) Cmnd 615 ('The Colwyn Commission').

> We are of opinion that any profit made on a transaction recognisable as a business transaction, ie a transaction in which the subject matter was acquired with a view to profit-seeking, should be brought within the scope of the Income Tax and should not be treated as an accretion of capital simply because the transaction lies outside the range of the taxpayer's ordinary business or because the opportunities of making such profits are not likely, in the nature of things, to occur regularly or at short intervals.[121]

The 1955 Royal Commission on the Taxation of Profits and Income[122] rejected this as it would apply to most investors who contemplated that their investment assets would one day rise in value. They considered that a test which depends on the motive or view of a person at the date of acquisition is a bad general test. They also considered that such a test gives 'a helping hand to the person who can make a plausible defence of himself in the witness chair'.[123]

The Commission considered the possibility of adopting a length of holding test rather than the existing judicial tests. They rejected such an approach. They considered that a presumptive rule, such as a 12 month rule (as had been the case in Australia in s 26AAA) would raise an undesirable presumption that gains outside that period were not assessable. Certainly, the Australian experience from s 26AAA and s 26(a) prior to *Whitford's Beach* supports such a concern. They were also concerned with hardship cases within the stipulated period. They ultimately concluded that there should be no single fixed rule. It was in that context that the Committee drew together certain 'badges of trade' which are incorporated in the list of criteria of judicial income outlined early on in this article.

The minority of the UK Royal Commission pointed to the incongruity of the UK legislation. By including a general 'sweeping up clause'[124] which taxed 'any annual profit or gain', in an Act which built up the concepts of 'income', 'profit' or 'gain' through specific schedules, and without anywhere defining what is to be swept up, makes little sense. They went on to say:

> The law faces the same dilemma as the medieval Schoolmen who were forced to deny to exotic birds and beasts, captured by travellers in strange lands, the status of birds and beasts, since they relied for their definition on an exhaustive list of birds and beasts reported by tradition to have entered the Ark with Noah.[125]

In the minority view, the flow concept has only 'been abandoned gradually, through the piecemeal adoption of basically inconsistent provisions, and without the consequences of its abandonment ever having been systematically taken into account'.[126] They considered that the proper test ought to be a person's spending

121 Ibid para 91.

122 United Kingdom, Royal Commission on the Taxation of Profits and Income (1955) Cmnd 9474.

123 Ibid para 113.

124 Which was included in Income Tax Act 1952 (UK) Schedule D, Case VI. The current operative legislation in the UK is the Income and Corporations Taxes Act 1988.

125 Royal Commission on the Taxation of Profits and Income, above n 122, 357.

126 Ibid 358.

power during a period. When set alongside this, the principles applied by the Court to determine what receipts constitute income, appear 'irrelevant'. The minority commented that '[i]n fact no concept of income can be really equitable that stops short of the comprehensive definition which embraces all receipts which increase an individual's command over the use of society's scarce resources'.[127] Thus the minority favoured the Haig/Simons definition of income.

These views were in response to the principles adopted in the English cases. As well as the policy concerns, there is certainly no consistency or certainty in English decisions for the same reasons as were evident from the analysis of the Australian cases. In *IRC v Mallaby-Deely*,[128] Sir Wilfred Greene MR considered the distinction between income and capital to be 'sometimes a very fine and rather artificial one' whose operation 'in individual cases may present some appearance of unreality'.[129] In *IRC v British Salmson Aero Engines Ltd*,[130] after commenting about the borderline between capital and income, he said the ultimate question is one of fact and is in fact an accountancy question. In *Harry Ferguson (Motors) Ltd v IRC*,[131] Lord MacDermott CJ said the authorities 'set up no conclusive test of general applicability and it is fruitless to argue from the facts of one instance to the differing facts of another'.[132] Lord Sands in *Burmah Steamship Co Ltd v IRC*[133] said the distinctions 'are somewhat artificial, and some of the decisions may appear to be arbitrary'.[134] In *Barr Crombie and Co Ltd v IRC*,[135] Lord President Normand said that no legal criterion is readily applicable.

Similar questions have troubled the courts in Canada. The Canadian Income Tax Act s 3 used 'any other source' in a wide definition of income as did the United States.[136] Section 248(1) of the Canadian Act defines business as an 'adventure or concern in the nature of trade'. Thus Canada drew inspiration from both British and American law. Abbott J in *Oxford Motors Ltd v Minister of National Revenue*[137] indicated that no one has been able to define income in a way to be of value for tax purposes. In deciding on the meaning of the term 'the Courts are faced with practical considerations which do not concern the pure theorist seeking to arrive at some definition of that term'.[138] Criticisms from a policy perspective were forcefully and influentially raised in that jurisdiction. The Carter Commission[139] considered that taxes should be allocated according to

[127] Ibid 355.
[128] [1938] 4 All ER 818.
[129] Ibid 824.
[130] [1938] 2 KB 482.
[131] (1951) 33 TC 15.
[132] Ibid 42.
[133] (1930) 16 TC 67.
[134] Ibid 73.
[135] (1945) 26 TC 406.
[136] Income Tax Act 1948 (Can); cf 61 Internal Review Code 1986 (US).
[137] (1959) 18 DLR (2d) 712.
[138] Ibid 718.
[139] Canada, Report of the Royal Commission on Taxation (1966) vol 1.

the changes in the economic power of individuals and families. All of the traditional considerations applied to determine whether a receipt is taxable income 'should be ignored either because they are impossible to determine objectively in practice or because they are irrelevant in principle, or both'.[140]

It is therefore possible to conclude that intractable problems have arisen wherever judges have taken a narrow approach to interpreting income. In each case, the question is essentially factual, with purpose being the major item for consideration.

D *Is Purpose a Desirable Criterion?*

The present state of the law, to the extent that it can be determined as a result of all the abovementioned cases, has many unfortunate features. The most obvious is its lack of clarity. This article has already pointed out a number of further decisions which must be made if purpose becomes a key element of a tax principle. The High Court in *Myer* simply failed to address these questions. The language used raised other major issues, primarily the question of what, if any, business features must be present besides profit purpose. When the High Court used the concepts of 'business' or 'commercial' transactions within the *ratio decidendi*, was this merely another tautologous definition of the type that riddles both legislative drafting and judicial reasoning in the tax arena?[141] Or was the High Court's reference to these expressions simply to be read alongside its observation that earlier courts had not gone so far as to say that the mere existence of a profit intent will itself suffice to stamp a receipt with the character of income? This article has already argued that the better way to read the decision in *Myer* is to see the references to 'business' and 'commercial' as additional requirements beyond profit purpose, merely as intended to exclude the relatively insignificant cases where the profit is generated in a private or gambling transaction. Yet it is by no means clear that this is what was intended.

The case also leaves little scope for sensible administrative distinctions between investment and business activities. If profitable intent becomes a key criterion, and one to be determined on objective evidence, what, if anything, stands in the way of the proposition that most reasonable business persons look to total yields on assets and compare market values to income generation powers to determine whether assets should be kept or sold? Unless a court was prepared to say that there must have been a dominant purpose of making the profit by the way it was ultimately generated, then the Commissioner could in theory succeed on such an argument and tax every investor on the sale of investment assets. Yet subsequent cases clearly imply that this would be rejected. A taxpayer could succeed in defending such an assessment if he or she argued successfully that they never contemplated the sale of the investment. For most intelligent people

[140] Ibid vol 1, 10.

[141] See, eg, the definition of income from personal exertion in s 6(1) of the Act and the definition of inventor in s 158B(1) of the Act.

in a modern world, such an assertion is somewhat far fetched. If most investments were assessed in this way, this would virtually disenfranchise much of the capital gains regime.

Such a criterion is inherently difficult for all parties in the decision making process. How is the Commissioner to determine what purposes people had on an historical basis? As a general rule, tax assessments are based on self-assessment with minimal documentation submitted to departmental officers. The Commissioner does not interrogate individuals prior to deciding whether they ought to pay tax or not. It would be highly inefficient for him to have to do so each time a person acquires and disposes of an asset. As a result, the bureaucrat is more likely to rely on the type of secondary indicators outlined at the beginning of this article. The Ruling supports this approach and finds some support from *Myer*. Yet these indicators have been criticised on a number of grounds. First, they cannot be stated to be part of any legal test. They are merely rebuttable presumptions that are also open to abuse. Alternatively, the Commissioner can rely on the policy of self-assessment or on applying the onus on the taxpayer. Yet this policy is only justified where the objective evidence upon which to base liability is in the hands of the taxpayer. The taxpayer ought to be expected to bring forward all the relevant material to ensure that he or she achieves a favourable result. If the law is dependent on objective purposes, however, it is not clear how a taxpayer satisfies the onus. This is a matter that the High Court had to grapple with under s 26(a). The Court came to the only sensible conclusion in holding that the taxpayer's onus is merely to lead evidence that if accepted is sufficient to mount a *prima facie* case in his or her favour.[142] Where the issue in dispute is the historical intent, the taxpayer need do no more than go into a witness box and assert that intent. If they are believed, then they can succeed.

Whilst that conclusion ensures that the taxpayer is not placed in an invidious position, it does not ensure that the system is an efficient and workable one. It still does not indicate how in the majority of situations that are not destined for court, the Commissioner is to make a determination. It also places performance in the witness box on an unduly high plane as a determinative criterion.

More fundamentally, a purpose based test has no justification on policy grounds. There is simply no equitable reason why a person's mental attitude at some historical point of time should be the determining factor in deciding whether gains are taxable or not. While this article implies that even on traditional legal principles, the courts could well tax all investors on the increased value of their investment properties, this is by no means a sensible development, although the *prima facie* policy perspective is that these distinctions are meaningless. The complicating factor is the introduction of a capital gains provision in our legislation. This has shown some legislative policy to provide favourable treatment for certain forms of gains. It is less justifiable for the courts to apply

142 Relying on the decisions in *Pascoe v FCT* (1956) 30 ALJ 402; *Gauci v FCT* (1975) 135 CLR 81; *Macmine Pty Ltd v FCT* (1979) 9 ATR 638.

economic criteria that in many instances override the operation of the capital gains regime and which do so on a different policy basis.

The policy issues behind the favourable treatment of capital gains relate to the extent of time over which gains are made and the need to provide a fair level of tax when the gains are bunched in one year in a progressive tax system where traditionally high levels of inflation are consistently maintained. The common law principles dealing with the distinction between income and capital do not look at timing issues nor do they consider the policy justifications that support the capital gains provisions. They merely look at the relationship of the asset to the total business structure. A taxpayer which buys a property with the intention of developing it, changes its mind a day later and sells the property at a profit, has made a capital gain on ordinary concepts. A taxpayer which buys the identical property, with a view to holding it for 20 years and selling it at a profit, generates an income gain.

While Australia was one of the last countries in the OECD to adopt any form of specific capital gains legislation, all jurisdictions provide some form of preferential tax treatment to such gains. This may either be through lower rates, partial exemption or as in the case of Australia, through an exemption of the inflation component. There are a number of problems with any of these approaches. First, they ensure uncertainty and dead weight costs as a result of the need to maintain some form of definition as to the distinction between income and capital. This is a particular problem in Australia. For understandable revenue reasons, the provisions give priority to the normal assessment provisions of the Act, particularly s 25. That choice is understandable because Parliament obviously did not wish the more lenient capital gains provisions to suddenly apply to transactions which formerly would have been fully taxed under s 25. Unfortunately, this leaves the ambit of the capital gains provisions to be determined by the ambit of those ordinary concepts. This forces the courts to continue with consideration of all of the *Myer* type issues.

This is so, notwithstanding that capital gains provisions appear totally non-purposive. They have neither the implied direct purpose tests of ss 25 and 51, the express purpose test of s 25A or the 'rule of thumb' purpose test, ie the 12 month rule of former s 26AAA. In effect, the 12 month rule as employed under s 26AAA has been adopted as the distinction between fully taxable and favourably taxed gains. Full gains, with the exception of those specifically exempted (such as lottery winnings), or those which on legal analysis do not relate in any way to assets are to be taxed regardless of whether they are income or capital on ordinary concepts. In either event, if the gain is made within a 12 month period, it will be fully taxed. Income gains will be taxed fully whenever they are made. It is only non-income gains which take more than 12 months to realise which have some allowance for inflation.

The justification for this approach is that in a progressive tax system, to tax the gain fully in the year of realisation could lead to a higher amount of tax than appropriate. Conversely, it is arguable that a realisation requirement, which

allows tax to be deferred until a later period than is proper on economic theory, could lead to the contrary result. In any event, a realisation based tax in a progressive tax system is almost never likely to find the 'right' amount of tax to impose. The application of full marginal rates after providing an inflation allowance is a second best formula aimed at giving a reasonably accurate tax assessment. But all these issues are brushed aside because s 25 takes precedence and again forces a *Myer* analysis to limit indirectly the application of capital gains provisions.[143]

The second problem with preferential provisions is that they encourage taxpayers to try and re-organise their transactions so that any gains will be seen as capital gains. Any preference will thus have certain implications for commercial activity.[144] A more serious concern is that preferential treatment for capital gains will bias the decision-making process of investors in favour of such gains. If productive business gives rise to ordinary income but purchases and sales of investment real estate do not, it is easy to see how this can help develop a non-entrepreneurial culture amongst Australian business. On the other hand, if corporate stock is also favourably treated, this may induce an increase in investment activity. When added to the tax-free status of the family home and the tax expenditure in favour of superannuation, the income/capital distinction in Australian tax law helps show a significant investor bias which at the very least raises an onus on those in favour of such a distinction to show the likelihood of economic benefits.

VI CONCLUSION

An income tax law should be concerned with identifying real gains and matching them to the period that is most appropriate. The judicial income concept, which is the centrepiece of our Act and which indirectly limits the capital gains provisions, simply does not do this in any consistent equitable and efficient manner. By requiring attention to be given to purpose and general criteria of business activities, the resolution of many tax questions approaches indeterminacy.

143 Whilst it has never been tested, it is at least arguable that the introduction of capital gains provisions have led to some transactions being treated more generously for tax purposes than they otherwise would have been. A *Myer* type analysis might be able to catch more peripheral transactions than formerly was the case where property is acquired and of which there is a disposal. But taxpayers under capital gains provisions are likely to offer a lower amount of tax to the Commissioner after deducting the inflation allowance. If the Commissioner accepts that, then less tax is payable. Accordingly, if the *Myer* trend develops further in expanding the meaning of income on ordinary concepts, a future government which removed the capital gains tax might add to that trend by ensuring that more cases come before the Court which ask it to analyse that trend and afford it the opportunity to proceed.

144 Some have sought to argue that preferential treatment for capital gains helps to counteract the lock-in effect whereby taxpayers hold on to assets longer than they would otherwise like, simply because of the tax ramifications: see, eg, Martin Feldstein, Joel Slemrod and Shlomo Yitzhaki, 'The Effects of Taxation on the Selling of Corporate Stock and the Realization of Capital Gains' (1980) 94 *Quarterly Journal of Economics* 777. But, see, however, the critique of Michael McIntyre, 'Capital Gains, Lock-In Effects, and Fairness', *Tax Notes*, 28 August 1978, 241.

Whatever the words used, any difference in tax treatment between ordinary business transactions and other transactions must of necessity import a significant degree of inefficiency of resource allocation. The present position, providing, as it does, uncertainty, an unjustified economic bias and the potential for avoidance through the manipulation of subsidiary criteria, is a failure. This is a lesson well worth learning after nearly 80 years of operation of the Act. The ultimate conclusion is that the reform process of 1985 merely built a complex edifice on inadequate foundations.

The solution is straightforward: Parliament should make it clear that income for tax purposes encompasses 'any realised gain from any source whatever', except where specifically exempted by some other provision. Legislators could then turn their attention to those specific areas where exemption or special treatment is sought and consider the policy arguments directly. The onus should be squarely on those advocating special treatment, as experience has shown that limitations on the tax base cause uncertainty, complexity and misallocation of resources. Whilst the last election saw considerable debate about the relative merits of income and consumption taxes, we would do well to remember that comprehensive reform of the income base has yet to occur and remains an important option.