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RECOURSE TO FOREIGN AUTHORITY IN DECIDING AUSTRALIAN TAX CASES

Introduction

1 The subject of my talk this morning grew out of a perception that we increasingly see references to foreign authorities in reasons for judgment of superior appellate courts in deciding tax cases in this country. I thought it would be instructive if we had a look at some of these cases to see if we could discern any points of principle as to when a court is likely to embrace a foreign authority in support of an argument or process of reasoning and when it is likely to decline to do so; and, in some cases, to evaluate whether recourse to the foreign authority is, in all the circumstances, appropriate and, more importantly, helpful.

2 References to foreign authority invariably have one of two sources: The researches and argument of counsel or the court's own researches. Experience suggests that recourse to foreign authority is more likely to occur where there is no Australian authority directly in point but that same experience also teaches us that lack of Australian authority does not necessarily make it more likely that foreign authority will be embraced. Whether it is or not, principally depends on the object intended to be served by recourse to the foreign authority.

3 It is not surprising that both counsel and the courts will each have recourse to foreign authority in the course of their arguments in conducting, and in the course of their processes of reasoning in deciding, tax cases. After all, the vast majority of, if not all, taxes that exist in

this country today, at both state and federal level, have their origins in foreign countries, and overseas experience with these taxes is invariably greater than ours. This is particularly so in the case of new taxes, such as the GST, essentially a value added tax which has existed in the United Kingdom for many years and in Canada and New Zealand well before its introduction in Australia.

Matters of Statutory Construction

4 It is unlikely that a court will be persuaded to embrace some foreign authority in support of a proposition involving a matter of statutory construction where the foreign authority is dealing with a different statutory scheme; the more so where there are also perceived factual differences between those under consideration and those the subject of the foreign authority. A very recent illustration of this is the decision of the High Court in *Avon Products Pty Ltd v Commissioner of Taxation*¹, handed down in June of last year. This was an appeal from a Full Court of the Federal Court (Ryan and Merkel JJ, Conti J dissenting)² concerning the entitlement of the appellant ('Avon') to a credit under Part 4 of the *Sales Tax Assessment Act 1992* (Cth) ('the Act') for sales tax overpaid. It was not in dispute that Avon remitted the sums in question to the respondent ('the Commissioner'), nor indeed that they constituted an overpayment. What was at issue was whether Avon passed on all or part of those amounts so as to entitle it to a credit pursuant to s 51(1) and credit ground CR1 in Table 3 of Schedule 1 to the Act. The Full Court dismissed an appeal by Avon against the decision of Hill J which rejected Avon's claim that the disallowance of its claim to the credit be set aside.

5 In its reasons, the High Court observed that Hill J had correctly identified the question as to whether sales tax had been passed on as a question of fact. The court observed that his Honour held that, although the regular prices were not calculated as a function of cost, the undeniable significance of discounting in Avon's operations (which was done so as to produce an overall margin over cost for each campaign) was such that Avon had failed to prove that its prices were not set with regard to cost. The High Court further observed that the ultimate decision of Hill J was based upon the failure by Avon to satisfy the burden of proof imposed by s 14ZZO of the *Taxation Administration Act 1953* (Cth) ('the Administration Act').

6 The High Court went on to observe that a majority of the Full Court (Ryan and Merkel JJ) accepted the findings of Hill J, including the critical findings on price-setting practice and onus of proof. They observed that the essence of the majority decision was correctly identified in the High Court by the Commissioner as being that, where the facts disclosed that the taxpayer set prices at a level to ensure that they exceed cost (including sales tax), it would be difficult for the taxpayer to satisfy its onus under s 14ZZO of the Administration Act to show that it has borne the tax burden itself. This the High Court concluded Avon had failed to do.

7 Avon’s contention in the High Court was that a tax is only passed on if the price at which the goods are sold is increased by the amount of the tax. The High Court observed that its contention in the Full Court appeared to have been expressed somewhat differently, namely that a tax will have been passed on if the seller made a profit less than (or sustained a loss greater than) had it not been overpaid. The High Court further observed that each proposition actually represents the inverse function of the other. Avon submitted that, since its regular prices remained constant and were fixed by reference to market bench marks without reference to cost and, further, since its discounting policy remained constant (so that no smaller discount would have been made had the true cost position been known), then the above ‘test’ was satisfied. That is, since the buyer was no worse off when the sales tax was overpaid than it would otherwise have been, and the seller was worse off, the tax was absorbed by Avon.

8 In response to this submission, the High Court said:

[25] Avon’s approach suffers from the fallacy that it converts the question posed by the words of credit ground CR1 in Table 3 of Sch 1 to the Act into a hypothetical question, expressed in the nature of a “test”. ... This should not be accepted; the “tests” merely restate the question using words different from the statutory language, and thus distract attention from the real task of the court.

[26] Apart from the fundamental incongruity in approaching a question as to whether sales tax was in fact passed on by reference to a hypothetical question of this kind, Avon’s “test” is unsatisfactory at a more basic level. It assumes that, if a cost is being passed on, removing it from the entire system will have an immediate correlative effect upon price and profit. That assumption is in conflict with the more complex reality of price determination Indeed, the complexity of Avon’s own pricing mechanisms belies that assumption. The Act requires proof of “the extent that

the claimant has not passed [the overpayment] on". This question is not to be answered merely by pointing to price as the sole indicator of passing on.'

9 When the case was in the Full Court, Avon relied on both United States and United Kingdom authorities in support of its contention. As to the United States authorities, the majority said:

'[11] Of the two United States authorities relied on by the appellant, we derive no assistance in resolving the present appeal from Worthington Pump & Machinery Corp v United States (1954) 122 F.Supp. 843. In that case, in the year in which a credit or refund was allowed, the vendor made a loss, albeit a loss greater than the amount of excise tax paid. Another important distinction between that case and the present is that the vendor's prices for its goods remained unchanged after the overpayment of excise tax from what they had been before the overpayment occurred. That permitted the Chief Judge to draw the inference, which he did for the 1948 fiscal year, that the vendor had not intended to pass the overpaid tax on to the purchasers of the unit. The drawing of that inference seems to have been based on an implicit finding that the vendor, Delta, had been aware of the amount by which excise tax had been overpaid but nevertheless made a deliberate choice not to pass on that amount. By contrast, in the present case, it is not possible to identify a fixed price for each item of Avon's goods which prevailed at all relevant times before and after the sales tax changes. Rather, Avon's techniques of adjusting or "tweaking" prices in response to a number of market forces subject only to the requirement that the price for any item not fall below its cost to Avon (including sales tax), meant that no inference could be drawn one way or the other as to whether any overpayment of sales tax occurring from time to time had been "passed on".'

10 A little later, the majority said:

'[17] As with the United States authorities, we derive little or no assistance from the VAT cases decided in the United Kingdom to which we have been referred. That is partly because the Customs and Excise Commissioners bore the onus or proving that the "undue" VAT had been passed on so that the vendor would have been unjustly enriched if it had received a refund of the "undue amount." In the second place, when their Lordships in Customs and Excise Commissioners v National Westminster plc [2003] STC 1072 identified the key question as being "what in the light of all the known facts would have been the financial position of Lombard if the undue tax had not been imposed?" – they were referring to the financial position of the lessee which occupied a situation analogous to that of the purchasers from Avon in the present case. There is no evidence which would permit a finding as to what would have been the position of those purchasers had Avon not paid the excessive or undue amounts of sales tax.'

11 When the case went up to the High Court, the court observed that the proposition for which Avon contended was unsupported by relevant authority. The court observed that the

sole Australian authority relied upon by Avon in support of its contention was a passage from the judgment of Mason CJ in *Commissioner of State Revenue (Vic) v Royal Insurance Australia Ltd*³. That case, the court observed, concerned quite different legislation, and the passage from the judgment of Mason CJ provided no assistance.

12 The court then went on to deal with the foreign authorities relied upon by Avon in the Full Court and before it:

[28] The international authorities relied upon by Avon must be treated with considerable caution. They deal with different statutory regimes. In particular, Pt 4 of the Act provides a code of the applicable law relating to credits of sales tax in Australia. The international authorities tend to muddy the waters rather than to illuminate them. The United Kingdom authorities may be put to one side because the statutory regime in force is quite different from the scheme of the Act.

[29] The United States authority upon which Avon particularly relied was Worthington Pump & Machinery Corp v United States. There, the United States Court of Claims considered a statute which Avon urged was to similar effect to the Act in question here. The court in Worthington Pump said:

[T]he fact that a firm is making a profit or loss does not in itself determine whether or not it has passed on the tax. The only test is whether the seller has made a profit less than or sustained a loss greater than had the tax not been imposed on him.

This “test” was identical to that for which Avon contends. However, even if Avon is correct that the statutory provision was relevantly analogous (which is doubtful), the situation in Worthington Pump is clearly distinguishable, as Ryan and Merkel JJ pointed out in the Full Court. This is because the taxpayer in Worthington Pump made a loss in the year for which the refund was claimed and the Court of Claims inferred an intention not to pass on the overpaid taxes. That is to say, the Court of Claims, contrary to the “test” urged by Avon, looked at factors outside price and profit margin.’

13 At the end of last year, a Full Court of the Federal Court handed down its judgment in *Saga Holidays Limited v Commissioner of Taxation*⁴, dismissing an appeal by the taxpayer from the judgment of Conti J. The appellant (‘Saga’) was a company incorporated in the United Kingdom. It sold holiday package tours of Australia, mostly to United Kingdom residents. It did not sell tours to Australian residents and had neither premises nor employees in Sydney. Saga was, however, registered for the purposes of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (‘the GST Act’). The question in the appeal was whether a packaged holiday tour of Australia, sold by Saga to non-Australian residents was, within the

meaning of s 9-5 of the GST Act, to any extent, a taxable supply. Saga submitted that there was no such taxable supply. In the alternative, and only if its primary submission was not accepted, Saga submitted that only the right to occupy a hotel room falls within the section, not any of the other aspects of the tour and not any of the other facilities supplied by a hotel.

14 Conti J had held that, in assessing the nature of the supply and its connection to Australia in the context of an executory contract, the ‘duration of the process or event which constitutes the taxing event or circumstance said to constitute the supply’ ought not to be considered. Given the wide scope of the statutory notion of supply, his Honour rejected the submission that all that the tourist received from Saga was a chose in action. Rather, Saga supplied a holiday of which an essential part was the right to occupy hotel rooms allocated to the customers. Since the relevant hotels were situated in Australia, the connection to Australia for the purposes of s 9-5(c) of the GST Act was established.

15 The Full Court was unanimous in its dismissal of Saga’s appeal. In the course of her judgment, Stone J, with whom Gyles J agreed, said:

[41] One aspect of Saga’s submission that the contract between Saga and the tourist did not involve the supply of real property was that the accommodation component of the contract was comprised of a number of components in addition to the right to occupy a room. ... It was submitted that “having regard to its essential character” the provision of a room was a subsidiary aspect of what should properly be described as “accommodation services” and not the provision of a contractual right exercisable in relation to land. Counsel for Saga referred the Court to Beynon and Partners v Commissioner of Customs and Excise [2005] 1 WLR 86 at 91, in support of the submission that where a supply is, from an economic point of view, a single service, it is inappropriate to consider individually the constituent elements of that service.

[42] The Commissioner argued that the supply of the accommodation component of the tour was “in substance and reality”, a single supply that included all these components. The services and facilities are adjuncts to the right to use the room and, in general, they are not charged for separately. That being so the accommodation component is properly regarded as a single supply of real property.’

In relation to this submission, her Honour said:

[43] I agree with his Honour, the primary judge, that Beynon, which was concerned with whether, for the purposes of the VAT, a doctor administering a drug to a patient supplied goods, namely drugs (which were zero rated for VAT) or a

medical service (which would be input taxed), with the drugs incidental to the service, is of little assistance on this point. I am conscious of the High Court's comment in Avon Products Pty Limited v Commissioner of Taxation (2006) 227 ALR 398 at [28] about the considerable caution that must be exercised before relying on international authorities that deal with different statutory regimes. The warning is particular apt in the present circumstances since the details of the GST Act are significantly different from those of the equivalent legislation in the UK and other countries. In any event, I do not regard the facts of Beynon as analogous to the present circumstances. Nevertheless, in so far as Lord Hoffman focused on the "social and economic reality" of the transaction I regard his approach as relevant. In my view the accommodation component is a single supply which is properly characterised as a supply of real property.'

16 This extract from her Honour's judgment illustrates the reluctance of appellate courts to embrace foreign authority in determining issues of statutory construction where the foreign authority is concerned with a different statutory regime, particularly where the facts of the foreign authority are not analogous to the facts under consideration, and yet embrace the same foreign authority where the object of the recourse is to support a particular social or economic approach anterior to the process of statutory construction.

17 This exemplifies the point in [2] above that it is the object intended to be served by the recourse that principally determines its embrace or not, as does the next case referred to.

Restitution of Overpayment

18 Where the issue is not whether the overpayment of tax has been 'passed on' as a matter of statutory construction, but whether a claim for restitution can be made for overpayment of tax, which was declared unconstitutional and therefore invalid, notwithstanding that the tax was in fact passed on, the High Court in *Roxborough & Ors v Rothmans of Pall Mall Australia Ltd*⁵ showed no reluctance in relying on foreign authority, in addition to Australian authority, to support its conclusion.

19 The relevant background is summarised in the head note to the ALR report of the case, in the following terms:

Under the Business Franchise Licences (Tobacco) Act 1987 (NSW), a periodic licence fee was imposed on wholesalers and retailers of tobacco products. Any products in respect of which a fee had been paid by a licensed wholesaler were disregarded in the calculation of the licensed retailer's fee.

The appellants were licensed retailers who purchased tobacco from the respondent, a licensed wholesaler. The purchase price comprised, and was expressly apportioned in invoices between (a) the wholesale price of the products sold and (b) amounts in respect of the tobacco licence fee. In effect, the respondent passed its licence fee on to the appellants. The appellants benefited from the respondent's payment of a licence fee in respect of the products, as no fee would be payable in respect of those products by the appellants. Ultimately the fee was borne by consumers in the form of higher retail prices.

The High Court declared the legislation to be constitutionally invalid, as the licence fee was in substance an ad valorem tax on goods levied impermissibly (by virtue of the Constitution s 90) by a state. By that time, the appellants had already paid amounts to the respondent, as part of the purchase price, in anticipation of licence fees for products supplied. The appellants brought an action in the Federal Court of Australia for, inter alia, money had and received by reason of total failure of consideration, seeking repayment of the component of the purchase price that represented the unconstitutional licence fee. Their indebitatus claim was dismissed by the primary judge, and by the Full Court. The appellants appealed.

20

Allowing the appeal, the court (Kirby J dissenting) held:

- (i) The component of the purchase price which represented the tobacco licence fee was separate, distinct and severable from the remainder of the consideration for which the purchase price was paid.*
- (ii) The tobacco licence fee legislation was the basis upon which the appellants paid to the respondent the licence fee component of the purchase price. The unconstitutionality of that legislation resulted in a total failure of that severable part of the consideration.*

All members of the court held:

- (iii) The fact that the appellants passed on the invalid licence fee to consumers in the form of higher retail prices is not by itself a general defence upon which the respondent can rely against a claim in restitution.*

21

In the joint judgment of Gleeson CJ, Gaudron and Hayne JJ, their Honours said:

[18] The case is not unlike that considered by the Court of Appeals of New York in Wayne County Produce Co v Duffy-Mott Co Inc. A war tax of 10% was imposed on cider. A manufacturer sold a quantity of cider by wholesale, at a certain price per gallon, less a stated discount, plus the tax. The total amount was paid to the manufacturer, and the manufacturer remitted the tax to the government. Later, it was ruled that the particular product sold was not taxable, and the manufacturer recovered the tax from the government. The purchaser claimed to recover from the manufacturer that part of the amount paid for the cider which was referable to the

tax. The Court of Appeals upheld the claim. Cardozo CJ, who delivered the reasons of the court, described the issue as being whether the money refunded to the manufacturer by the government was held “to the use of the plaintiff”. He went on to say:

This is not a case where the item of the tax is absorbed in a total or composite price to be paid at all events ... This is a case where the promise of the buyer is to pay a stated price, and to put the seller in funds for the payment of a tax besides. In such a case the failure of the tax reduces to an equivalent extent the obligation of the promise.

[19] *The same idea may be expressed by saying that, in the present case, the failure of the tax involved the failure of a severable part of the consideration for which the net total amounts shown on the invoices were paid.’*

22 Their Honours made the following observations on the conscientiousness of the respondent’s retention of the moneys given that the products were sold by the appellants at prices that had the practical effect of recouping the expense they bore in paying the ‘tobacco licence fees’:

[24] There having been a failure of a distinct and severable part of the consideration for the net total payments made by the appellants to the respondent, then, as between the parties to the payments, the respondent has no right to retain the amounts in question. If the tobacco products in question remained unsold by the appellants at the time the claims for repayment arose for determination, the respondent’s obligation to make restitution would be clear. Why does it make a difference to the conscientiousness of the respondent’s retention of the moneys that the products were sold by the appellants at prices that had the practical effect of recouping the expense they bore in paying the “tobacco licence fees”? The holders of licences were those upon whom the tax was imposed, but they were always intended to pass the tax on to the consumers. As between the licensees, it was the appellants who incurred the expense, in that they were charged, and paid, a severable amount for the purpose of the tax.

[25] *The decision of this court in Commissioner of State Revenue (Vic) v Royal Insurance Australia Ltd strongly supports the appellants on this question. That was a case of moneys paid by an insurance company to a revenue authority by mistake, in the form of overpaid stamp duty. The revenue authority was held liable to refund the overpayments, even though the amounts had been passed on to policy holders. That conclusion was reached on general restitutionary principles.’*

23 Similarly, the judgment of Gummow J referred to a number of United States authorities bearing on *Moses v Macferlan*⁶ and what was said by Lord Mansfield in that case, while Kirby J canvassed, at some length, the solutions adopted in the United States, Canada and the European Union in relation to overpayments of tax held to be constitutionally invalid.

24 From an overall reading of the reasons for judgment in *Roxborough*, I do not think it could be said that recourse to foreign authority was decisive in the conclusions reached, however, at least in the case of the joint judgment, it gave comfort to a conclusion which their Honours were clearly intent on reaching.

25 In more recent times, there are a number of foreign authorities to which recourse has been made by our superior appellate courts in support of a particular process of reasoning. This has occurred in a number of areas, but I only deal with two – general anti-avoidance provisions and the concept of income – to consider the appropriateness of that recourse and, more importantly, its utility.

General Anti-Avoidance Provisions

26 The United States does not have a codified general anti-avoidance rule (GAAR) and it is therefore surprising that on the second occasion the High Court had to consider our codified GAAR (Part IVA) – *Federal Commissioner of Taxation v Spotless Services Ltd*⁷ – Brennan CJ, Dawson, Toohey, Gaudron, Gummow and Kirby JJ relied on short pithy extracts from an opinion, and a concurring opinion, of the United States Supreme Court to support the following process of reasoning⁸ –

‘The references in this passage [Cooper J in the Full Court (1995) 62 FCR 244 at 287 – 288] on the one hand to a “rational commercial decision” and on the other to the obtaining a tax benefit as the “dominant purpose of the taxpayers in making the investment” suggest the acceptance of a false dichotomy. ...

A person may enter into or carry out a scheme, within the meaning of Pt IVA, for the dominant purpose of enabling the relevant taxpayer to obtain a tax benefit where that dominant purpose is consistent with the pursuit of commercial gain in the course of carrying on a business.’

27 In support of this, the joint judgment referred to a two and a half line statement from Harlan J’s opinion, concurring with the opinion of the United States Supreme Court, in *Commissioner of Internal Revenue v Brown*⁹ that:

‘[T]he tax laws exist as an economic reality in the businessman’s world, much like the existence of a competitor. Businessmen plan their affairs around both, and a tax dollar is just as real as one derived from any other source.’

and a one line statement from the court's opinion in *Frank Lyon Co v United States*¹⁰ to the effect:

'We cannot ignore the reality that the tax laws affect the shape of nearly every business transaction.'

28 What is more surprising than anything else is that these statements are taken totally out of context, something which the High Court frequently admonishes in those who do the same.

29 For example, *Brown* involved what was colloquially known as a 'bootstrap sale' of the stock of a company to a tax-exempt charitable organisation (Institute) for \$1.3 million payable \$5,000 down from the assets of the company and the balance within ten years from the earnings of the company's assets. It was provided that simultaneously with the transfer of the stock, the Institute would liquidate the company and lease its assets for five years to a new corporation, Fortuna Sawmills, Inc., formed and wholly owned by the attorneys for the sellers. Fortuna would pay to the Institute 80% of its operating profit without allowance for depreciation or taxes, and 90% of such payments would be paid over by the Institute to the selling stockholders to apply on the \$1.3 million note. This note was non-interest bearing, the Institute had no obligation to pay it except from the rental income and it was secured by mortgages and assignments of the assets transferred or leased to Fortuna. If the payments on the note failed to total \$250,000 over any two consecutive years, the sellers could declare the entire balance of the note due and payable.

30 The United States Supreme Court said¹¹:

'Whatever substance the transaction might have had, however, the Commissioner claims that it did not have the substance of a sale within the meaning of § 1222(3). His argument is that since the Institute invested nothing, assumed no independent liability for the purchase price and promised only to pay over a percentage of the earnings of the company, the entire risk of the transaction remained on the sellers. Apparently, to qualify as a sale, a transfer of property for money or the promise of money must be to a financially responsible buyer who undertakes to pay the purchase price other than from the earnings or the assets themselves or there must be a substantial down payment which shifts at least part of the risk to the buyer and furnishes some cushion against loss to the seller.'

To say that there is no sale because there is no risk-shifting and that there is no risk-shifting because the price to be paid is payable only from the income produced by the

business sold, is very little different from saying that because business earnings are usually taxable as ordinary income, they are subject to the same tax when paid over as the purchase price of property. This argument has rationality but it places an unwarranted construction on the term “sale”, is contrary to the policy of the capital gains provisions of the Internal Revenue Code, and has no support in the cases. We reject it.’

31 Immediately after the statement from the concurring opinion of Harlan J extracted at [27] above, his Honour said¹²:

‘The Code gives the Institute a tax exemption which makes it capable of taking a greater after-tax return from a business than could a nontax-exempt individual or corporation. Respondents traded a residual interest in their business for a faster payout apparently made possible by the Institute’s exemption. The respondents gave something up; they received something substantially different in return. If words are to have meaning, there was a “sale or exchange.”’

32 The parallels with *Spotless* (the greater after-tax return by virtue of the exempt income) are self-evident and make it all the more difficult to comprehend the High Court’s reliance on a ‘two-liner’ from a concurring opinion in the United States Supreme Court, which had no impact on its ultimate outcome, to support a proposition which was going to provide a fundamental premise, not only upon which *Spotless* was decided, but also upon which the subsequent cases of *Consolidated Press Holdings Ltd & Murray Leisure Group Pty Ltd v Commissioner of Taxation*¹³ and *Federal Commissioner of Taxation v Hart*¹⁴ were decided.

33 The High Court’s reliance on the ‘one-liner’ in *Frank Lyon* is equally surprising for the same reasons. It should not be read (or quoted) out of context, and immediately before the quoted statement, the United States Supreme Court said¹⁵:

‘The fact that favourable tax consequences were taken into account by Lyon on entering into the transaction is no reason for disallowing those consequences.’

34 The opinion of the United States Supreme Court in *Frank Lyon* was concluded¹⁶ in the following terms:

‘In short, we hold that where, as here, there is a genuine multiple-party transaction with economic substance [a sale and leaseback transaction] which is compelled or encouraged by business or regulatory realities, is imbued with tax-independent considerations, and is not shaped solely by tax-avoidance features that have meaningless labels attached, the Government should honor the allocation of rights

and duties effectuated by the parties. Expressed another way, so long as the lessor retains significant and genuine attributes of the traditional lessor status, the form of the transaction adopted by the parties governs for tax purposes. What those attributes are in any particular case will necessarily depend upon its facts. It suffices to say that, as here, a sale-and-leaseback, in and of itself, does not necessarily operate to deny a taxpayer's claim for deductions.'

35 I think it is unhelpful that the High Court has had recourse to isolated selective statements from opinions of the United States Supreme Court to support a proposition which required no such support on the facts of *Spotless*. And in *Consolidated Press and Hart*, reliance on such statements in support of the 'false dichotomy' dictum has only led to distract attention from the real focus of par 177D(b) namely, to undertake a balancing exercise as between tax considerations and non-tax considerations, raised by the eight matters listed, in deciding what was the dominant purpose of a person who entered into or carried out the alleged scheme.

The Concept of Income

36 I am sure all of you are familiar with the decision of the High Court in *Federal Commissioner of Taxation v Myer Emporium Ltd*¹⁷. Briefly, the facts are set out in the head note to the CLR report of the case, in the following terms:

The respondent was the parent of a group of companies which carried on business predominantly in the areas of retail trading and property development. On 6 March 1981 it lent \$80,000,000 to a subsidiary under an agreement requiring the payment of interest at 12.5 per cent per annum and the repayment of the principal in 1988. Three days later, it assigned to Citicorp Canberra Pty Ltd "the moneys due or to become due as the interest payments and interest thereon" pursuant to the loan agreement for the sum of \$45,370,000, which was calculated as the total outstanding interest discounted at a rate of 16 per cent per annum. These transactions were part of a reorganisation of the Myer group, and were intended to raise working capital by providing a non-taxable capital receipt by the sale of an income stream. Citicorp was attracted because it could set-off the interest payments against accumulated tax losses.

The appellant assessed the sum of \$45,370,000 as income in the hands of the respondent, relying on ss 25(1) and 26(a) of the Income Tax Assessment Act 1936 (Cth). However, an objection was allowed in the Supreme Court of Victoria, and this decision was upheld by the Full Court of the Federal Court.

37 The High Court upheld the appeal. It held, *inter alia*, that a receipt itself constitutes 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 respondent's business, so long as the respondent entered into the transaction with the intention or purpose of making a relevant profit or gain from the transaction.

38 But the reasons for judgment disclosed a 'second stream' of reasoning which manifested itself in reliance on foreign authority. After distinguishing an annuity from interest payable under a loan contract¹⁸ –

'Annuity payments are not derived from the money paid for the annuity; they are derived solely from the annuity contract. And so, when a contractual right to be paid an annuity is sold for a price, the proceeds of sale are ordinarily capital in the hands of the vendor.'

the court said¹⁹:

'If the lender sells his mere right to interest for a lump sum, the lump sum is received in exchange for, and ordinarily as the present value of, the future interest which he would have received. This is a revenue not a capital item — the taxpayer simply converts future income into present income: see Commissioner of Internal Revenue v PG Lake, Inc (1958) 356 US 260 at 266–7. By a transaction consisting in the making of a loan and a sale of the right to interest on the money lent, the lender acquires at once a debt and the price which the sale of the right has fetched. The price of the right is the lender's compensation for being kept out of the use and enjoyment of the principal sum during the period of the loan and, like the interest for which it is exchanged, it is a profit. It is immaterial that the lender receives the profit not from the borrower but from the other party to the transaction, and it is immaterial that the profit is received immediately and not over the period of the loan.'

39 The High Court's attempt to distinguish the facts of the case before it from the facts in *Inland Revenue Commissioners v Paget*²⁰ are, with respect, short of being persuasive. This is perhaps exemplified in the High Court's fall back observation²¹:

'If Paget is not to be distinguished in this way, we should be unable to accept its authority for the purposes of the Act.'

40 When the High Court of Australia hands down its judgment(s) in *Federal Commissioner of Taxation v McNeil*²² in the first half of this year, recent experience suggests that it is more likely than not that the judgment, or one or more of the judgments, will refer to a 1920 decision of the United States Supreme Court, *Eisner v Macomber*²³, and, in particular, to what was said by Pitney J²⁴:

‘The fundamental relation of “capital” to “income” has been much discussed by economists, the former being likened to the tree or the land, the latter to the fruit or the crop; the former depicted as a reservoir supplied from springs, the latter as the outlet stream, to be measured by its flow during a period of time. ... “Income may be defined as the gain derived from capital, from labor, or from both combined,” provided it be understood to include profit gained through a sale or conversion of assets ...

Brief as it is, it indicates the characteristic and distinguishing attribute of income essential for a correct solution of the present controversy. The government, although basing its argument upon the definition as quoted, placed chief emphasis upon the word “gain”, which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived. “Derived-from-capital”; “the gain-derived-from-capital.” Etc. Here we have the essential matter: not a gain accruing to capital; not a growth or increment of value in the investment; but a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital, however invested or employed, and coming in, being “derived” – that is, received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal – that is income derived from property. Nothing else answers the description.’ (Emphasis added)

41 One commentator²⁵, who in 1990 referred to *Eisner v Macomber* as probably having become ‘the most cited U.S. decision in Australian tax jurisprudence’, has made the following observations on its ironic Australian legacy²⁶:

‘The real impact of Eisner v. Macomber in this jurisdiction follows from its role in developing and refining the Australian judicial concept of income. Both the fruit and tree metaphor developed by Pitney J. and selected passages from his judgment are continually cited in support of the proposition that capital gains are conceptually inseverable from the underlying capital assets from which they arise and therefore cannot constitute income, leaving them outside the scope of the ordinary charging provisions in the Australian income tax legislation ...

The ironic nature of the legacy stems from the principal proposition in support of which the case was, and continues to be, cited, namely that capital gains are inherently incapable of characterisation as “income” for tax purposes. The premise can only be derived from the case if the passage reproduced above is selectively edited to excise the crucial phrase “provided it [income] be understood to include profit gained through a sale or conversion of assets”. Without that qualification, the extract establishes the fruit and tree analogy for income and capital and ignores the conclusion that gains realised on the sale of trees are income of the same type as regular returns from the exploitation of the tree.’ (Emphasis added)

42 As the same commentator observed, the fact that Australian courts came to conclude, contrary to the conclusion in *Eisner v Macomber*, that the gain on the sale or conversion of a capital asset remained capital even after it was realised, had more to do with United Kingdom

tax precedents and trust law analogies than with tax policy arguments. The commentator concludes²⁷:

'As it turned out, the U.S. judicial approach to the definition of income was better suited to a modern effective, efficient and fair income tax. In Australia, legislative intervention was required to undo the consequences of the judicial characterisation and bring capital gains into the income tax base. With the legislative change, Australian income tax law has, in a sense, travelled a full circle. For over five decades Australian jurists relied on Eisner v. Macomber as authority for the very proposition the case was incapable of supporting. With the legislative expansion of the income tax in 1985 to embrace capital gains, the Australian income tax system has finally moved towards the tax base envisaged by the U.S. Supreme Court in Eisner v. Macomber not long after the Australian federal income tax was first adopted.'

43 These observations and conclusion were written seventeen years ago, but in the meantime a majority of the High Court has again had cause to refer to, indeed rely on, what was said by Pitney J in the passage from *Eisner v Macomber* extracted above. In *Federal Commissioner of Taxation v Montgomery*²⁸ the High Court (Gaudron, Gummow, Kirby and Hayne JJ; Gleeson CJ, McHugh and Callinan JJ dissenting) held that a lease incentive payment made by a prospective landlord to a prospective tenant (a firm of solicitors) as an inducement to enter into a lease agreement of premises in Melbourne's CBD was income according to ordinary concepts in the hands of the firm on the facts of that case. In doing so, the majority overturned a unanimous decision of a strong Full Court of the Federal Court²⁹ (Davies, Lockhart and Heerey JJ) that the sums received by the firm under the inducement agreement were not income but capital. It is beyond the scope of this talk to enter into a comparative analysis of the respective merits of the majority and minority judgments in the High Court and I do not intend to do so.

44 What is relevant, in the present context, is the majority's reliance on the passage from Pitney J's judgment in *Eisner v Macomber* to support a conclusion which, at best, had little else, and at worst, nothing to support it. Australian authority was confined to *Federal Commissioner of Taxation v Cooling*³⁰, a controversial decision³¹, the reasoning in which sought comfort in the High Court's decision in *Myer*, but which, at the end of the day, was distinguishable on its facts³². Other foreign authority to which the court was referred pointed in different directions. The decision of the Supreme Court of Canada in *Ikea Ltd v Canada*³³ (upon which the Commissioner relied) was treated by the majority as being distinguishable

on the facts even though the majority was of the view that nothing turned on the different legislative provisions under consideration³⁴. The decision of the Privy Council in the New Zealand case of *Commissioner of Inland Revenue v Wattie*³⁵ (upon which the firm relied) confirmed the New Zealand Court of Appeal's decision that the inducement payment was a capital receipt, and not income. Both courts declined to follow *Cooling*³⁶. The minority in *Montgomery* said³⁷:

'It being agreed that, ordinarily, a payment by a lessee to a lessor of a premium for a lease is on capital account, both the Court of Appeal and the Privy Council regarded it as impossible to distinguish, in principle, a payment, on an identical occasion, moving in the other direction. It was acknowledged that, in the case of a premium, the lessee would be paying for an asset which, in a case such as the present, would form part of the structure for the conduct of a business. It was considered unsound to distinguish between acquisition and disposition. We agree.'

45 On the other hand, the majority disagreed that what was described as a 'negative premium' was to take the same character as a premium going the other way – from the intending lessee to the intending lessor – which has invariably been found to be on capital account. The reasons why the majority took this view³⁸ are not relevant for present purposes although it has to be said that their focus is doubtful³⁹.

46 So, at the end of the day, what stood between the majority and the minority judgments in *Montgomery* was what the majority took from the above extract of Pitney J's judgment in *Eisner v Macomber*. This first manifested itself in the sentence⁴⁰:

'What can be seen from the passage from Eisner v Macomber is that income is often the product of the exploitation of capital.'

47 That is undoubtedly correct, but in terms of the extract from Pitney J, that exploitation extends to the gain derived from the sale of a capital asset of a business, and yet, in the same paragraph, the majority said⁴¹:

'But some receipts, such as amounts paid on disposing of capital assets of the business, are properly classified as receipts on capital account.'

48 In other words, the majority sought to embrace the United States concept of income coming out of *Eisner v Macomber* as being relevant and applicable to the Australian concept

of income, but only on a selective basis; certainly not encompassing, as the concept in *Eisner v Macomber* encompassed, a gain derived from the sale of a capital asset of a business. The majority made no reference to its selective choice.

49 It is difficult not to be cynical at what appears to be a somewhat sleight of hand in the majority's recourse to *Eisner v Macomber* in such a selective way. This is best exemplified in the conclusion of the majority as to the character of the receipts⁴²:

[117] The inducement amounts received by the firm did not augment the profit-yielding structure of the firm. The lease was acquired as part of that structure; the inducement amounts were not. There was, in the words of Pitney J in Eisner v Macomber "not a gain accruing to capital, not a growth or increment of value in the investment; but a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital however invested or employed, and coming in, being 'derived', that is, received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal".

[118] To put the matter another way, the firm used or exploited its capital (whether its capital is treated for this purpose as being the agreement to take premises or its goodwill) to obtain the inducement amounts. As the papers presented to the firm in August 1989 said, the firm was then "of a size which makes it a particularly attractive tenancy target". And it was because it was a particularly attractive tenancy target that it was suggested in those papers that the firm should receive a good inducement offer to take premises. The firm used or exploited its capital in the course of carrying on its business, albeit in a transaction properly regarded as singular or extraordinary. And the sums it received from the transaction were not as some growth or increment of value in its profit-yielding structure — the receipts came in or were derived for the separate use, benefit and disposal of the firm and its members as they saw fit. (That the firm decided to retain the sums received rather than distribute them to partners — other than to the extent necessary to meet the amounts of taxation payable by partners on account of their receipt — is of no consequence. The very fact that the firm chose to dispose of the sums in this way demonstrates that they were receipts at the disposal of the firm.)'

50 The minority judgment disagreed with the majority judgment on a number of bases, including that the firm's agreement to take the lease or its goodwill were not relevantly part of its capital or if, in the latter case, it was, the payment was not a fruit of its exploitation. In my view, a far more telling critique would have been that the majority's embrace of the concept of income in *Eisner v Macomber* necessitated its acceptance in its unexpurgated and unqualified form – as encompassing gain from the realisation of capital assets of a business

and anything less than this had to find provenance in some other source of authority. This is best illustrated by what the majority said⁴³:

‘The firm used or exploited its capital in the course of carrying on its business, albeit in a transaction properly regarded as singular or extraordinary. And the sums it received from the transaction were not as some growth or increment of value in its profit-yielding structure — the receipts came in or were derived for the separate use, benefit and disposal of the firm and its members as they saw fit.’

51 These words are equally apposite to the gain made on the sale of a capital asset of a business but the majority did not venture the logic of their reasoning process into that realm; perhaps it did not cross their minds; on the other hand, if it did, they would have apprehended that it involved overturning decades of Australian precedent. An unsatisfactory half-way house was therefore adopted.

Conclusions

52 From this limited survey of cases which have had recourse to foreign authority, the following conclusions can be drawn.

1. Whether or not a court will embrace foreign authority will ultimately depend on the object to be served by recourse to it.
2. Where the issue is one of statutory construction, it is unlikely that foreign authority will be perceived as having much to offer; that is particularly so whether the foreign authority is concerned with a different statutory regime or where the facts are different. As always, there will be exceptions where the differences are not perceived as being of significance.
3. On the other hand, where the issue is not one of statutory construction, but rather the approach that should be adopted in characterising a particular transaction in the context of a charge to tax, foreign authority, particularly in the absence of Australian authority, is likely to be embraced, unless the approach is considered to be wrong.
4. The courts have shown a willingness to have recourse to foreign authority on a selective basis – by embracing extracts from reasons for judgment – even though

those extracts, read in context, by reference to both the facts and the process of reasons from which they are taken, provide little utility in clarifying the correct position in Australia. This exemplifies the adage that recourse to foreign authority in deciding Australian tax cases is not always helpful on a going forward basis.

¹ [2006] HCA 29; (2006) 227 ALR 398

² [2005] FCAFC 63

³ (1994) 182 CLR 51

⁴ [2006] FCAFC 191 (20 December 2006, unreported)

⁵ [2001] HCA 68; (2001) 208 CLR 516

⁶ (1760) 2 Burr 1005; 47 ER 676

⁷ (1996) 186 CLR 404

⁸ At 415

⁹ (1965) 380 US 563 at 579, 580

¹⁰ (1978) 435 US 561 at 580

¹¹ At 570

¹² At 580

¹³ (2001) 207 CLR 235

¹⁴ (2004) 217 CLR 216

¹⁵ At 580

¹⁶ At 581

¹⁷ (1987) 163 CLR 199

¹⁸ At 218

¹⁹ At 218, 219

²⁰ [1938] 2 KB 25

²¹ At 219

²² In the Full Federal Court; (2005) 144 FCR 514

²³ (1920) 252 US 189

²⁴ At 207

²⁵ R Krever, “The Ironic Australian Legacy of *Eisner v. Macomber*”, (1990) 7 Australian Tax Forum 191

²⁶ At 199, 200

²⁷ At 205, 206

²⁸ (1999) 198 CLR 639

²⁹ (1998) 152 ALR 241

³⁰ (1990) 22 FCR 42

³¹ See R F Edmonds, ‘Cooling: A Correct Decision?’, 25 Taxation in Australia, 734 - 741

³² At [35]

³³ [1998] 1 SCR 196

³⁴ At [89]

³⁵ [1991] 1 WLR 873

³⁶ At [57]

³⁷ At [38]

³⁸ At [95] – [99]

³⁹ With respect, the majority’s proposition (at [99]) that the argument (accepted by the minority) seeking to equate the receipt with a premium paid by a taxpayer for a lease is an argument founded on an assertion or congruence of symmetry between whether a payment is deductible and whether a receipt is on capital account – an assertion rejected by all members of the court in *Federal Commissioner of Taxation v Rowe* – does not withstand scrutiny. Indeed, the cynical would say that that symmetry was in fact applied by the majority because the incentive would undoubtedly have been deductible to the lessor

⁴⁰ At [67]

⁴¹ At [67]

⁴² At [117] – [118]

⁴³ At [118]