THE HISTORICAL SIGNIFICANCE OF THE HIGH COURT'S DECISION IN *FEDERAL COMMISSIONER OF TAXATION v THE MYER EMPORIUM LTD*

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*[*Federal Commissioner of Taxation v The Myer Emporium Ltd *('*Myer*') marked a significant change in approach in tax jurisprudence. Since 1987, virtually every case dealing with the characterisation of receipts as income or capital has cited* Myer*, usually at some length. But it is going too far to suggest that* Myer *transformed the way in which income is characterised. The decision in* Myer *reflects a reduced emphasis on formalism and legal technicalities, the mainstream approach of the courts. Under that approach, the characterisation of amounts as income or capital is determined as a matter of commercial substance, and not by subtleties of drafting, or by unduly literal or technical interpretations. While some prominent cases could have been decided the other way on their facts, it is inherent in the fact-intensive distinction between income and capital that hard cases will arise which are capable of being decided either way. This circumstance does not detract from the enduring importance of the decision in* Myer.*]*

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I INTRODUCTION

It is almost 20 years since the High Court handed down its decision in *Federal Commissioner of Taxation v The Myer Emporium Ltd* ('*Myer*').[1] It is therefore easy to forget that the decision aroused real controversy and apprehension amongst tax practitioners. The decision was seen as a landmark in tax jurisprudence and the immediate reaction was that a reappraisal of traditional distinc-

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[1] (1987) 163 CLR 199.

tions between revenue and capital was required.[2] As late as 1993, one experienced practitioner claimed that the decision had greatly enlarged the concept of income.[3]

The fear that the decision would be destructive of traditional doctrine has abated. So much so that in 2002, a commentator expressed the view that '[i]n retrospect … the decision [was] merely illustrative of a more pragmatic and realistic understanding by the judiciary of modern business and its many facets and is quite consistent with the general approach now taken by the courts.'[4]

From this distance, it is possible to see, much more clearly, that the controversy that initially surrounded the *Myer* decision was the product of the era that immediately preceded it; rather than that of any remarkable extension or innovation worked by the decision in terms of traditional tax jurisprudence. The decision remains a landmark in tax jurisprudence; it is important for the cogency and practicality of its reasoning, and for a shift in approach that returned tax jurisprudence to its roots.

II THE CONCEPT OF INCOME

The *Income Tax Assessment Act 1936* (Cth) ('*ITAA 1936*') has never contained any definition of 'income' or, for that matter, 'capital'. The closest it comes is to define 'income from personal exertion' and 'income from property'.[5] Both definitions presuppose that income has a recognised meaning.[6]

Much the same approach has been adopted in the *Income Tax Assessment Act 1997* (Cth) ('*ITAA 1997*'). Section 6-5(1) provides that assessable income includes 'income according to ordinary concepts, which is called ordinary income'. There is no further definition of 'ordinary income'. As stated in the Explanatory Memorandum to the Income Tax Assessment Bill 1996 (Cth), Parliament has left it to the courts to develop principles for determining what is 'ordinary income'.[7]

In *Scott v Federal Commissioner of Taxation*, Jordan CJ said:

> The word 'income' is not a term of art, and what forms of receipts are comprehended within it, and what principles are to be applied to ascertain how much of those receipts ought to be treated as income, must be determined in accordance with the ordinary concepts and usages of mankind, except in so far as the statute states or indicates an intention that receipts which are not income in or-

[2] See, eg, I C F Spry, 'The Implications of the *Myer Emporium Case*' (1987) 16 *Australian Tax Review* 152; D Graham Hill, 'A Pre-Bicentennial Reminder of Our Heritage: *Commissioner of Taxation v The Myer Emporium Ltd*' (1987) 22 *Taxation in Australia* 12.

[3] A H Slater, 'A Spreading Stain: The Character of Income' (1993) *Australian Tax Review* 132, 144–5.

[4] Richard Krever, 'Dissected Debt: Developing a Better Legislative Response to *FCT v Myer Emporium Ltd*' (2002) 31 *Australian Tax Review* 128, 132.

[5] *ITAA 1936* s 6(1).

[6] *Federal Commissioner of Taxation v Montgomery* (1999) 198 CLR 639, 660–1 (Gaudron, Gummow, Kirby and Hayne JJ) ('*Montgomery*').

[7] Explanatory Memorandum, Income Tax Assessment Bill 1996 (Cth) 40.

> dinary parlance are to be treated as income, or that special rules are to be applied for arriving at the taxable amount of such receipts.[8]

In a similar vein, the High Court observed in *Arthur Murray (NSW) Pty Ltd v Federal Commissioner of Taxation* that '[t]he word "income", being used without relevant definition, is left to be understood in the sense which it has in the vocabulary of business affairs'.[9]

In ordinary usage, income is conceptualised as a flow that is detached from capital. In the United States Supreme Court case *Eisner v Macomber*, Pitney J resorted to mixed metaphors to explain the dichotomy between income and capital:

> 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.[10]

This dichotomy was deeply entrenched in Australian law well before 1987, as it was in the United Kingdom and New Zealand. However, it has not avoided criticism. In 1986, Ross Parsons suggested that the taxation system would be much more efficient and predictable if it embraced economic concepts which draw no distinction between gains on revenue and capital account.[11] In 1998, the Review of Business Taxation considered that economic income provided the ideal taxing base, on the grounds that the same economic transaction should be taxed in the same way regardless of its particular form.[12] But neither the Commonwealth Parliament nor the courts have followed that path. In *Montgomery*, the majority judgment of Gaudron, Gummow, Kirby and Hayne JJ resisted the notion that the courts should adopt the concepts of gain or realised gain that are favoured by economists.[13]

The terms 'income' and 'capital' do not have definite or comprehensive meanings in the world of business affairs. As a result, it has been left to the courts to work out the precise boundaries of these concepts on a case-by-case basis. As Dixon J said in *Hallstroms Pty Ltd v Federal Commissioner of Taxation* ('*Hallstroms*'), the courts have proceeded in the 'traditional way of stating what positive factor or factors in each given case led to a decision assigning the expenditure to capital or to income as the case might be.'[14]

[8] (1935) 35 SR (NSW) 215, 219.

[9] (1965) 114 CLR 314, 320 (Barwick CJ, Kitto and Taylor JJ). See also *Commissioner of Taxes (SA) v Executor Trustee & Agency Co of South Australia Ltd* (1938) 63 CLR 108, 152 (Dixon J) ('*Carden's Case*').

[10] 252 US 189, 206 (1920).

[11] Ross Parsons, 'Income Taxation — An Institution in Decay?' (1986) 12 *Monash University Law Review* 77, 78–9.

[12] Review of Business Taxation, *A Strong Foundation: Establishing Objectives, Principles and Processes*, Discussion Paper No 1 (1998) [2.13], [6.47]–[6.57].

[13] (1999) 198 CLR 639, 662. See also *Federal Commissioner of Taxation v CityLink Melbourne Ltd* (2006) 228 ALR 301, 322 (Crennan J).

[14] (1946) 72 CLR 634, 646.

In *GP International Pipecoaters Pty Ltd v Federal Commissioner of Taxation*,[15] a unanimous High Court canvassed the basic principles which determine whether receipts or outgoings are on revenue or capital account. They held that '[w]hether or not a particular receipt is income depends upon its quality in the hands of the recipient … [a] receipt may be income in the hands of a payee whether or not it is expenditure of a capital nature by the payer.'[16]

Similarly, the use to which a receipt is put is not determinative of its character as a 'taxpayer may apply income in the acquisition of a capital asset or, conversely, apply a capital receipt to discharge a liability of a non-capital nature.'[17] The High Court then observed:

> To determine whether a receipt is of an income or of a capital nature, various factors may be relevant. Sometimes, the character of receipts will be revealed most clearly by their periodicity, regularity or recurrence; sometimes, by the character of a right or thing disposed of in exchange for the receipt; sometimes, by the scope of the transaction, venture or business in or by reason of which money is received and by the recipient's purpose in engaging in the transaction, venture or business. The factors relevant to the ascertainment of the character of a receipt of money are not necessarily the same as the factors relevant to the ascertainment of the character of its payment.[18]

As to outgoings, the Court said:

> The character of expenditure is ordinarily determined by reference to the nature of the asset acquired or the liability discharged by the making of the expenditure, for the character of the advantage sought by the making of the expenditure is the chief, if not the critical, factor in determining the character of what is paid.[19]

This passage picks up the principal factor identified by Dixon J in *Sun Newspapers Ltd v Federal Commissioner of Taxation*.[20] Dixon J also referred to two other factors: first, the manner in which the advantage is to be used, relied upon or enjoyed; and secondly, the means adopted to obtain the advantage, that is to say by providing a periodical reward or outlay to cover its use or enjoyment or by making a final provision or payment so as to secure future use or enjoyment. These three principles were approved and applied by the Privy Council in *BP Australia Ltd v Federal Commissioner of Taxation [No 2]* ('*BP Australia*')[21] and they have been applied repeatedly in Australia since 1938.

In *BP Australia*, the Privy Council made the following cautionary observations:

15 (1990) 170 CLR 124, 136 (Brennan, Dawson, Toohey, Gaudron and McHugh JJ).
16 Ibid. See also *Scott v Federal Commissioner of Taxation* (1935) 35 SR (NSW) 215, 226; *McLaurin v Federal Commissioner of Taxation* (1960) 104 CLR 381, 391 (Dixon CJ, Fullagar and Kitto JJ).
17 *GP International Pipecoaters Pty Ltd v Federal Commissioner of Taxation* (1990) 170 CLR 124, 136 (Brennan, Dawson, Toohey, Gaudron and McHugh JJ).
18 Ibid 138 (Brennan, Dawson, Toohey, Gaudron and McHugh JJ).
19 Ibid 137 (Brennan, Dawson, Toohey, Gaudron and McHugh JJ) (citations omitted).
20 (1938) 61 CLR 337, 363.
21 [1966] AC 224, 261 (Lords Reid, Morris, Pearce, Upjohn and Wilberforce).

> The solution to the problem is not to be found by any rigid test or description. It has to be derived from many aspects of the whole set of circumstances some of which may point in one direction, some in the other. One consideration may point so clearly that it dominates other and vaguer indications in the contrary direction. It is a commonsense appreciation of all the guiding features which must provide the ultimate answer. Although the categories of capital and income expenditure are distinct and easily ascertainable in obvious cases that lie far from the boundary, the line of distinction is often hard to draw in border line cases; and conflicting considerations may produce a situation where the answer turns on questions of emphasis and degree.[22]

The same kind of cautionary note was struck in *Montgomery*[23] and *Federal Commissioner of Taxation v CityLink Melbourne Ltd*.[24]

The effect of all these authorities was summarised by the late Justice D G Hill in 1995 when he said, extrajudicially, that the

> determination of capital and income, whether in the field of assessability or deductibility, will involve a close examination of all the circumstances, a common sense appreciation of all guiding factors and a balancing of all relevant considerations.[25]

To set the scene for a discussion of *Myer*, it is helpful to identify some factors relevant to the characterisation of income and capital receipts that were established by the case law prior to 1987. In a variety of situations, net amounts were recognised as ordinary income. Examples of these situations include:

- profits of an investment company where the shares in question were not trading stock;[26]
- exchange gains and losses;[27] and
- profits from the sale of land not purchased for the purposes of resale at a profit, but sold as a business activity.[28]

Another line of authority recognised that a receipt paid in substitution for other receipts which had the character of ordinary income may take on the character of the substituted receipt.[29] This principle was applied with caution because a sum

22 Ibid 264 (Lords Reid, Morris, Pearce, Upjohn and Wilberforce).
23 (1999) 198 CLR 639, 663 (Gaudron, Gummow, Kirby and Hayne JJ).
24 (2006) 228 ALR 301, 313 (Kirby J), 323 (Crennan J).
25 Justice D G Hill, 'Income and Capital: Have the Goal Posts Been Moved?' (1995) 4 *Taxation in Australia: Red Edition* 8, 11 (emphasis omitted).
26 *London Australia Investment Co Ltd v Federal Commissioner of Taxation* (1976) 138 CLR 106; *Commercial & General Acceptance Ltd v Federal Commissioner of Taxation* (1977) 137 CLR 373.
27 *Avco Financial Services v Federal Commissioner of Taxation* (1981) 150 CLR 510; *International Nickel Australia Ltd v Federal Commissioner of Taxation* (1976) 137 CLR 347.
28 *Federal Commissioner of Taxation v Whitfords Beach Pty Ltd* (1981) 150 CLR 355 ('*Whitfords Beach*').
29 *Federal Commissioner of Taxation v Dixon* (1952) 86 CLR 540; *Keily v Federal Commissioner of Taxation* (1983) 32 SASR 494; *Carapark Holdings Ltd v Federal Commissioner of Taxation* (1966) 115 CLR 653, 664 (Kitto, Taylor and Owen JJ).

of money is not to be treated as ordinary income simply because it was computed or measured by reference to loss of future income.[30]

In several English cases, receipts derived in isolated business transactions were held to be assessable as ordinary income.[31]

Finally, there was a line of authority to the effect that the proceeds of a mere realisation of a capital asset would not constitute ordinary income, even if the realisation was carried out in an enterprising way so as to secure the best price. On the other hand, profits derived in a business operation or commercial transaction carrying out a profit-making scheme are income.[32]

The traditional approach to the determination of income and capital avoids the risk that propositions of law will be expressed in terms that prove to be unduly wide, but it has other problems. In *Hallstroms*, Dixon J observed that it is one thing to identify particular factors which have been recognised in past cases as tending to support a specific legal characterisation, but it is fallacious to infer that the absence of a particular factor from the case at hand necessarily places that case outside the relevant category and gives it an opposite description.[33] There is also a risk that subsequent cases will treat factors that are in truth factual criteria as if they were propositions of law.[34] More broadly, the traditional approach is so heavily dependent on the characterisation of the facts in each case that the process of drawing a distinction between income and capital is difficult and uncertain in borderline cases.[35]

III TAX JURISPRUDENCE IN THE 1970S

The significance of *Myer* cannot be fully appreciated without recognising that there were a number of decisions during the 1970s in which legal technicalities appeared to triumph over substance. Two main lines of authority illustrate this proposition.

The first concerns s 26(a) of the *ITAA 1936* which was subsequently re-enacted as s 25A. The provision was introduced to overcome the effect of *Jones v Leeming* in which the House of Lords held that an isolated transaction with a profit-making intent did not give rise to the receipt of income on ordinary principles.[36] In 1930, in introducing the Bill that inserted s 26(a), the Treasurer

30 *Commissioner of Taxes (Vic) v Phillips* (1936) 55 CLR 144, 156 (Dixon and Evatt JJ).

31 *Californian Copper Syndicate Ltd v Harris* (1904) 5 TC 159 ('*Californian Copper*'); *Ducker v Rees Roturbo Development Syndicate Ltd* [1928] AC 132, 141–2 (Lord Buckmaster) ('*Ducker*'); *Edwards v Bairstow* [1956] AC 14.

32 *Californian Copper* (1904) 5 TC 159; *Scottish Australian Mining Co Ltd v Federal Commissioner of Taxation* (1950) 81 CLR 188; *Ruhamah Property Co Ltd v Federal Commissioner of Taxation* (1928) 41 CLR 148, 151–4 (Knox CJ, Gavan Duffy, Powers and Starke JJ); *McClelland v Federal Commissioner of Taxation* (1970) 120 CLR 487, 495–6 (Lord Donovan, Viscount Dilhorne and Lord Wilberforce); *London Australia Investment Co Ltd v Federal Commissioner of Taxation* (1976) 138 CLR 106, 115–16 (Gibbs J); *Whitfords Beach* (1982) 150 CLR 355, 366–7 (Gibbs CJ), 376 (Mason J).

33 (1946) 72 CLR 634, 646.

34 See Slater, above n 3, 133.

35 See, eg, *Commissioners of Inland Revenue v British Salmson Aero Engines* [1938] 2 KB 482, 498 (Greene MR); *Regent Oil Co Ltd v Strick* [1966] AC 295, 343 (Lord Upjohn).

36 [1930] AC 415, 421 (Lord Buckmaster), 425–6 (Lord Warrington), 427–8 (Lord Thankerton).

said that the section was a statutory declaration of the approach which for many years had been accepted as settled law in Australia.[37] The first limb of s 26(a) directly targeted the decision in *Jones v Leeming*,[38] and the second limb can be traced to *Ruhamah Property Co Ltd v Federal Commissioner of Taxation*[39] and *Californian Copper*.[40] Despite the origins of s 26(a) and the fact that the House of Lords had overturned *Jones v Leeming* in *Edwards v Bairstow*,[41] Australian courts in the 1960s and 1970s were disposed to accept technical or semantic arguments that limited the reach of s 26(a).[42] The first limb of s 26(a) was construed so as to require that the property sold to yield a profit must be the same as that which was acquired by the taxpayer for the purpose of profit-making by sale. The second limb was confined to schemes having the character of an operation of business and it only caught profits that were not attributable to gross income already captured by s 25.[43] The history of both limbs of s 26(a) was examined by the High Court in its decision in *Whitfords Beach*.[44]

The second illustration concerns the basic anti-avoidance provision in s 260 of the *ITAA 1936*. Several decisions by the High Court during the 1970s, including those in *Mullens v Federal Commissioner of Taxation*,[45] *Slutzkin v Federal Commissioner of Taxation*[46] and *Cridland v Federal Commissioner of Taxation*,[47] largely emasculated s 260. By 1985, new anti-avoidance provisions had been enacted in Part IVA of the *ITAA 1936*, and the High Court was endeavouring to limit the impact of these earlier cases on s 260.[48]

IV THE DECISION IN *MYER*

The facts in *Myer* were straightforward. The Myer Emporium Ltd ('Myer') lent $80 million to its subsidiary, Myer Finance Ltd, at interest and for a term in excess of seven years.[49] Three days later, it assigned to Citicorp Canberra Pty Ltd ('Citicorp') the moneys due or to become due as interest under the loan agreement for a consideration of $45.37 million.[50] Citicorp paid the consideration on the same day. The consideration was calculated as the value at the date of the assignment of the right to interest over the period of the loan. The loan

37 See *Blockey v Federal Commissioner of Taxation* (1923) 31 CLR 503.
38 [1930] AC 415.
39 (1928) 41 CLR 148.
40 (1904) 5 TC 159.
41 [1956] AC 14.
42 *Steinberg v Federal Commissioner of Taxation* (1972) 134 CLR 640, 695 (Gibbs J); *AL Hamblin Equipment Pty Ltd v Federal Commissioner of Taxation* (1974) 131 CLR 570; *Federal Commissioner of Taxation v Bidencope* (1978) 140 CLR 533.
43 See *McClelland v Federal Commissioner of Taxation* (1970) 120 CLR 487; *Investment & Merchant Finance Corporation Ltd v Federal Commissioner of Taxation* (1971) 125 CLR 249; *Federal Commissioner of Taxation v Bidencope* (1978) 140 CLR 533.
44 (1981) 150 CLR 355.
45 (1975) 135 CLR 290.
46 (1977) 140 CLR 314.
47 (1977) 140 CLR 330.
48 See *Federal Commissioner of Taxation v Gulland* (1985) 160 CLR 55.
49 *Myer* (1987) 163 CLR 199, 205 (Mason ACJ, Wilson, Brennan, Deane and Dawson JJ).
50 Ibid 205–6 (Mason ACJ, Wilson, Brennan, Deane and Dawson JJ).

agreement and the assignment were interdependent: in the sense that Myer would not have entered into the loan agreement unless it knew that Citicorp would immediately thereafter take an assignment of the moneys that would become due under the loan agreement as interest payments.

In a joint judgment, the Court (comprising Mason ACJ, Wilson, Brennan, Deane and Dawson JJ) held that the consideration that Myer received for the assignment constituted income under s 25(1) of the *ITAA 1936*, and was also assessable as a profit arising from the carrying out of a profit-making undertaking or scheme under s 26(a).[51]

Myer essentially advanced two arguments. First, it submitted 'that a gain made as the result of a business deal or a venture in the nature of trade is not income unless it is made in the ordinary course of carrying on a business'.[52] Secondly, it submitted that the assignment transaction involved the realisation of a capital asset and, consequently, the amount of $45.37 million that Myer received represented a receipt on capital account.[53] Myer coupled this argument with a submission that the amount it received exactly reflected the value of the capital asset it had realised, so there was no profit to be taxed.[54]

The High Court relied upon longstanding authority to reject the first argument. The Court first observed that although it is well settled that a profit or gain made in the ordinary course of carrying on a business constitutes income, it does not follow that a profit or gain made in a transaction entered into otherwise than in the 'ordinary course … [of] the taxpayer's business is not income.'[55] A 'gain … in the ordinary course of the business' has a profit-making purpose and is considered income as the purpose of a business is to profit.[56] However, a gain outside 'the ordinary course of … business' from a transaction which has a profit-making purpose could also be considered income.[57] The determination 'depends very much on the circumstances of the case.'[58]

The Court said that if the circumstances give rise to the inference that the taxpayer's intention was to profit, the profit will be income even if the transaction was extraordinary judged by reference to the ordinary course of the taxpayer's business.[59] The fact that the 'gain is made as the result of an isolated venture or a "one-off" transaction' does not preclude it from being properly characterised as income.[60] The Court cited *Whitfords Beach*,[61] *Californian Copper*[62] and *Ducker*[63] as authority for this statement.[64]

51 Ibid 220 (Mason ACJ, Wilson, Brennan, Deane and Dawson JJ).
52 Ibid 209 (Mason ACJ, Wilson, Brennan, Deane and Dawson JJ).
53 Ibid.
54 Ibid 208–9 (Mason ACJ, Wilson, Brennan, Deane and Dawson JJ).
55 Ibid 209 (Mason ACJ, Wilson, Brennan, Deane and Dawson JJ).
56 Ibid.
57 Ibid.
58 Ibid.
59 Ibid.
60 Ibid.
61 (1982) 150 CLR 355.
62 (1904) 5 TC 159.
63 [1928] AC 132.
64 *Myer* (1987) 163 CLR 199, 211 (Mason ACJ, Wilson, Brennan, Deane and Dawson JJ).

The Court concluded that the weight of 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.[65]

The Court elaborated on this conclusion later in its judgment:

> 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.[66]

Applying these principles to the facts, the Court concluded that the loan agreement and the assignment transaction were integral elements in an overall profit-making scheme. 'Once the two transactions are seen as integral elements in one profit-making scheme, it is apparent that Myer made a relevant profit, that profit being the amount payable on the assignment.'[67] The Court stated that Myer had made a profit of the 'first interest payment … and the … [amount] paid for the assignment,' as a result of the two transactions.[68] While the value of 'the right to recover was substantially less than the amount of the principal' as there was no obligation to repay, 'this circumstance cannot affect the character of the consideration for the assignment.'[69] Such a circumstance 'exists in every case where money is lent for a fixed term.'[70] The same process of reasoning supported the Court's conclusion that the amount also constituted assessable income under the second limb of s 26(a).[71]

The most contentious aspect of this reasoning is whether the overall scheme generated a commercial profit. Plainly, the Court was right to conclude that the loan and assignment transactions were integers in a single scheme, and that Myer was actuated by the purpose of deriving a lump sum receipt of $45.37 million. Regarded as a single scheme, it is not to the point that Myer received that sum from Citicorp rather than from the borrower.[72] As the Court had already noted, the authorities provide ample support for the view that an isolated or extraordinary transaction that is undertaken for profit-making purposes in the context of carrying on a business, or carrying out a business operation or commercial

65 Ibid 209–10 (Mason ACJ, Wilson, Brennan, Deane and Dawson JJ).
66 Ibid 215 (Mason ACJ, Wilson, Brennan, Deane and Dawson JJ).
67 Ibid 216 (Mason ACJ, Wilson, Brennan, Deane and Dawson JJ).
68 Ibid.
69 Ibid.
70 Ibid.
71 Ibid 220 (Mason ACJ, Wilson, Brennan, Deane and Dawson JJ).
72 Ibid 219 (Mason ACJ, Wilson, Brennan, Deane and Dawson JJ).

transaction, can give rise to income on ordinary concepts.[73] However, the rest of the Court's analysis presupposes that the overall scheme generated a profit.

The Court conceded that, if the assignment were to be regarded as a separate and independent transaction, no relevant profit would be generated from it. This is because the consideration payable for the assignment reflected the true value of the chose in action that Myer assigned.[74] But when the two transactions were regarded as integral elements in a single scheme, the Court considered that a relevant profit had been generated. The Court came to this conclusion on an accounting analysis rather than any kind of economic analysis. It acknowledged that, in economic terms, the value of the chose in action represented by the right to recover the principal sum of $80 million was substantially less than its face value because there was no obligation to repay the principal until 30 June 1988.[75] But it concluded that this circumstance did not affect the character of the consideration for the assignment.[76] On ordinary accounting principles, a debt is brought to account in the same amount as the face value of the debt; the right to interest on the money lent is not treated as an asset.

Having regard to the way in which the case was run, these conclusions were open to the Court. Myer's published accounts treated the $45.37 million as part of its operating profit. No evidence was adduced that the receipt of $45.37 million could not be regarded as a profit at the point of receipt on ordinary commercial and accounting principles. Nonetheless, the decision is open to the criticism that it takes a narrow view of profit; certainly a narrower view than that which might have been justified by appropriate evidence.[77]

The joint judgment contains a second strand of reasoning that addresses Myer's argument that there had simply been a realisation of a capital asset that produced a capital receipt. Their Honours said that '[i]f 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.'[78] This they considered to be 'revenue not a capital item — the taxpayer simply converts future income into present income'.[79] They explained that a transaction consisting of a loan and a sale of the right to interest on the money lent means that 'the lender acquires at once a debt and the price which … the sale of the right has fetched'.[80] This price 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.'[81] They further stated that first, it is immaterial that the profit is received from a party

73 Ibid 213, 215 (Mason ACJ, Wilson, Brennan, Deane and Dawson JJ).
74 Ibid 216 (Mason ACJ, Wilson, Brennan, Deane and Dawson JJ).
75 Ibid.
76 Ibid.
77 Cf *Federal Commissioner of Taxation v Becker* (1952) 87 CLR 456; *Carden's Case* (1938) 63 CLR 108, 152 (Dixon J); *Steinberg v Federal Commissioner of Taxation* (1972) 134 CLR 640. See also Hill, 'Income and Capital', above n 25, 14.
78 *Myer* (1987) 163 CLR 199, 218 (Mason ACJ, Wilson, Brennan, Deane and Dawson JJ).
79 Ibid (citations omitted).
80 Ibid.
81 Ibid 218–19 (Mason ACJ, Wilson, Brennan, Deane and Dawson JJ).

other than the borrower.[82] Secondly, it is also 'immaterial that the profit is received immediately and not over the period of the loan.'[83]

The reference in the above passage to a mere right to interest refers to the assignment of the right to interest severed from the debt itself. The High Court distinguished that transaction from the sale of an annuity. An annuity derives solely from an annuity contract, whereas interest derives not from the loan agreement but from the principal sum.[84] On this basis the High Court distinguished *Inland Revenue Commissioners v Paget* ('*Paget*')[85] but added that, if *Paget* could not be distinguished in this way, the Court could not accept its authority for the purposes of the *ITAA 1936*.[86]

This ground does not depend on any characterisation of the receipt of $45.37 million as a profit. It simply applies the readily understandable principle that the conversion of a mere right to interest into a lump sum payment will not alter the character of the receipt; the recipient will simply have converted future income into present income.

There is nothing surprising about the result in *Myer*, or about the two strands of reasoning that led to it. Each strand was supported by previous authority. The factual conclusions reached by the Court were open to it. In my view, however, the second strand provides the more robust ground for the decision.

Myer did not submit that the integrated transactions should be assessed in accordance with their economic effect. In economic terms, the effect of the two transactions was that Myer borrowed just over $45 million from Citicorp, with the principal sum of $45.37 million being paid to one member of the group, and repaid by another member of the group making periodical payments of principal and interest to the financier. The apparent purpose of the scheme was to enable the Myer group to borrow $45 million, make payments of interest and principal to the lender, and deduct the entirety of those payments.[87] Similarly, the Commissioner did not mount any argument that the scheme should be assessed on the basis of its economic substance, and instead submitted that Myer should be assessed on the amount it received from Citicorp.

Early in its judgment, the High Court assumed that the scheme made commercial sense for Citicorp because it 'was able to set [off] the interest payments that it received from Myer Finance … against [its] accumulated tax losses'.[88] There is no reason to think that the High Court's analysis would have been any different if Citicorp had not had accumulated losses to offset the income stream. But, in any event, it is likely that Citicorp would have treated the transaction for both financial accounting and income tax purposes in the same way as lease financing is treated. Under the method of accounting appropriate for finance leases, Citicorp would have offset progressively the amount it paid to Myer

82 Ibid 219 (Mason ACJ, Wilson, Brennan, Deane and Dawson JJ).
83 Ibid.
84 Ibid 218 (Mason ACJ, Wilson, Brennan, Deane and Dawson JJ).
85 [1938] 2 KB 25, 44–5 (Lord Romer read by MacKinnon LJ).
86 *Myer* (1987) 163 CLR 199, 219 (Mason ACJ, Wilson, Brennan, Deane and Dawson JJ).
87 See Krever, above n 4, 131.
88 Hill, 'A Pre-Bicentennial Reminder of Our Heritage', above n 2, 17.

against the income stream it received, thereby bringing its real profit progressively to account as assessable income.[89]

The other interesting aside is that the scheme undertaken by Myer was in fact a widely marketed tax avoidance scheme. Shortly prior to the High Court appeal in *Myer*, Parliament introduced s 102CA into the *ITAA 1936* to shut down the scheme. It yields an identical result to that achieved by the High Court's decision. This circumstance explains one commentator's observation that the High Court in *Myer* 'used traditional doctrines in a slightly creative fashion to thwart an audacious, if not blatant, avoidance scheme.'[90]

V APPLYING THE DECISION IN *MYER*

Myer has been referred to and applied numerous times. Most of the subsequent cases involve factual applications of the principles established in *Myer*. There are, however, several important decisions that more precisely define the scope of each of the two distinct strands of reasoning in *Myer*. Most of these decisions operated more by way of limitation than extension. Within a decade, it became apparent that there are limits to the operation of the *Myer* decision and that it had not radically altered the way in which courts approach the characterisation of transactions as income or capital.

Immediately following *Myer*, the Commissioner argued that the case established a new principle that all gains made by a business entity were assessable. In *Federal Commissioner of Taxation v Spedley Securities Ltd* ('*Spedley*'), the Full Federal Court rejected this contention.[91] The Commissioner had used *Myer* to argue that the amount in question was received in the course of business operations, the operations, taken broadly, being intended to produce a profit.[92] The Federal Court held this contention was wrong as the phrase 'in the course of' involves a temporal connection.[93] The Federal Court also said that the proposition 'would mean any receipt by a business would necessarily be of an income nature' and this was 'contrary to authority, to the Act itself and to basic concepts concerning the distinction between capital and income.'[94] In *Myer*

> what was received related solely to income by way of interest on a loan made by the taxpayer, the amount received being for a transfer of the right to receive the interest in the future. The High Court did not base its decision on Myer being, in a broader sense, a profit making company. The purpose of profit making must exist in relation to the particular operation.[95]

The Commissioner has not sought to reargue this contention. In fact, in para 44 of Taxation Ruling TR 92/3, the Commissioner disavows the argument.

89 Ibid 18; Krever, above n 4, 132–3.
90 Krever, above n 4, 133.
91 (1988) 19 ATR 938, 942 (Fox, Fisher and Sheppard JJ).
92 Ibid.
93 Ibid.
94 Ibid.
95 Ibid.

In the next few years, several cases were decided on the first limb of *Myer*. For the most part, they focused on the criterion of profit-making purpose, addressing questions such as when must that purpose exist, how specific must it be, and what level of substantiality will suffice. None of the subsequent cases have thrown up the thorny issue of how profit is to be calculated for the purposes of the first strand in *Myer*.

In *Moana Sand Pty Ltd v Federal Commissioner of Taxation* ('*Moana Sand*'), the taxpayer 'acquired the land with the twofold purpose of working and selling surplus sand [on it] and thereafter holding the land until some time in the future when it became appropriate to sell it at a profit.'[96] Many years later, a Coastal Protection Board expressed interest in preserving the land and, after some negotiations, the Board resumed the land for $500 000.[97] The Commissioner included the $500 000, less the cost of the land and certain expenses, in the taxpayer's assessable income.[98] The Full Federal Court held that the net profit constituted income on ordinary concepts.[99] It did so despite finding that the dominant purpose of the taxpayer in acquiring the land was not to resell it at a profit.[100] The Court applied *Myer* on the ground that the $500 000 represented a profit from a business operation undertaken for the purpose of deriving that profit.[101]

The next significant decision was that of the Full Federal Court in *Federal Commissioner of Taxation v Cooling* ('*Cooling*').[102] Hill J, with whom Lockhart and Gummow JJ agreed, applied *Myer* to hold that a lease incentive payment was assessable as ordinary income. The crux of this decision was that the incentive transaction was entered into by the firm as a commercial transaction forming part of its business activity, and a not insignificant purpose of it was the obtaining of the commercial profit by way of the incentive payment.[103] The other critical consideration was that the Court found, as a matter of fact, that '[t]he firm had the alternative of paying less rent and therefore obtaining a smaller tax deduction for its outgoings or paying a higher rent' coupled with the incentive payment.[104] I will return to the case in the context of a broader discussion of the lease incentive cases.[105]

In *Westfield Ltd v Federal Commissioner of Taxation* ('*Westfield*'), the main activity of the taxpayer was the design, construction, letting and management of shopping centres.[106] Westfield purchased a parcel of land for $450 000. It subsequently sold the land for $735 000 to an insurance company which engaged

96 (1988) 19 ATR 1853, 1857 (Sheppard, Wilcox and Lee JJ).
97 Ibid 1854 (Sheppard, Wilcox and Lee JJ).
98 Ibid.
99 Ibid 1859 (Sheppard, Wilcox and Lee JJ).
100 Ibid 1861 (Sheppard, Wilcox and Lee JJ).
101 Ibid 1860 (Sheppard, Wilcox and Lee JJ).
102 (1990) 22 FCR 42.
103 Ibid 57 (Hill J).
104 Ibid.
105 See below Part VII.
106 (1991) 28 FCR 333, 334 (Hill J).

the taxpayer to design and build a shopping centre on the land.[107] The Full Federal Court held that the profit from selling the land was not assessable as ordinary income because the developer had not acquired the land for the purposes of selling it.[108]

Again, Hill J wrote the leading judgment, with which Lockhart and Gummow JJ agreed. His Honour reiterated the view expressed in *Moana Sand* and *Cooling* that it does not follow from *Myer* 'that every profit made by a taxpayer in the course of his business activity will be of an income nature. To so express the proposition is to express it too widely, and to eliminate the distinction between an income and a capital profit.'[109]

Turning to the facts of the case, Hill J found that the resale of the land was not part of the ordinary business activity of Westfield or a necessary incident of its business activity.[110] Relevantly, its business activity consisted of the construction of shopping centres, their leasing or management.[111] Next, Hill J considered what is meant by profit-making in the context of the *Myer* principles.[112] His Honour concluded that where a transaction falls outside the ordinary scope of a business, so as not to be part of that business there must exist a purpose of profit-making 'by the very means' by which the profit was in fact made. Hill J considered that so much is implicit in the High Court's decision in *Myer*.[113] On the facts of the case, this requirement was not satisfied.

Hill J also considered what level of proof might suffice to establish the purpose of making a profit by the very means by which the profit was in fact made.[114] His Honour said that the mode of achieving the profit must be one contemplated by the taxpayer as at least one of the alternatives by which the profit could be realised. In *Steinberg v Federal Commissioner of Taxation*,[115] which was decided under the second limb of s 26(a), it was held that a profit-making purpose could be established, even though the taxpayer might not have foreseen or planned every step which culminated in the making of the profit.[116] Hill J added that any concerns that this approach goes too far were unfounded, as it was clear that the *Myer* principles would not be satisfied if at the time of acquiring property the taxpayer did not have a purpose of resale, and there was no more than a possibility that the land may be resold.[117] That possibility would exist in every acquisition of land. In Hill J's view, *Myer* did not extend to such a case; it is concerned with gains acquired in an operation of a business or a commercial transaction 'for the purpose of profit-making by the means

107 Ibid 335–6 (Hill J).
108 Ibid 344 (Hill J).
109 Ibid 342.
110 Ibid 342–4.
111 Ibid.
112 Ibid.
113 Ibid 344.
114 Ibid.
115 (1972) 134 CLR 640.
116 Ibid 670 (Mason J), 699–700 (Gibbs J), 704–5 (Stephen J).
117 *Westfield* (1991) 28 FCR 333, 344.

giving rise to the profit'.[118] The Commissioner's application for special leave to appeal in *Westfield* was refused by the High Court.

The Full Federal Court's decision in *Henry Jones (IXL) Ltd v Commissioner of Taxation* ('*Henry Jones*')[119] turned on the second limb of *Myer*. In that case, the taxpayer assigned to Citicorp for a lump sum consideration the whole of its right, title and interest under a licence agreement which granted the licensee the right to use certain trade marks in return for a royalty. Hill J held that, on the evidence, the taxpayer had not entered into the licence agreement with the purpose of profit-making by a sale of it.[120] Consequently, the first strand of the *Myer* decision was inapplicable.

As to whether the amount received by the taxpayer for the assignment constituted income in accordance with the second strand of *Myer*, Hill J concluded:

> Notwithstanding some doubt, I think *Myer* must be taken as establishing 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. Thus, the fact that the future income may be secured by an agreement, and that the assignment is of the right title and interest of the assignor in that agreement, will not affect the result.[121]

His Honour continued that the principle so stated 'is consistent with the development of the law in cases involving compensation for rights of income. Amounts received as compensation for an income right, amounts which thus fill the hole of income … have the character of income'.[122] Hill J then observed that, if the foregoing proposition needs to be qualified, 'by restricting it to receipts in the course of a business', that qualification was satisfied on the facts before him.[123]

Hill J did not see any conflict between the principle articulated and the decision in *Commissioner of Taxes (Vic) v Phillips*.[124] Hill J pointed out that while Dixon and Evatt JJ had said that it is an erroneous method of reasoning 'to treat a sum of money as income because it is imputed or measured by reference to a loss of future income',[125] that proposition was not expressed absolutely.[126] Dixon and Evatt JJ went on to observe that

> where one right to future periodical payments during a term of years is exchanged for another right to payments of the same periodicity over the same period of years, the fact that the new payments are an estimated equivalent of

[118] *Westfield* (1991) 28 FCR 333, 345, citing *Myer* (1987) 163 CLR 199, 210 (Mason ACJ, Wilson, Brennan, Deane and Dawson JJ).
[119] (1991) 31 FCR 64.
[120] Ibid 71.
[121] Ibid 78.
[122] Ibid.
[123] Ibid.
[124] Ibid. See *Commissioner of Taxes (Vic) v Phillips* (1936) 55 CLR 144.
[125] *Commissioner of Taxes (Vic) v Phillips* (1936) 55 CLR 144, 156.
[126] *Henry Jones* (1991) 31 FCR 64, 78 (Hill J).

> the old cannot but have weight in considering whether they have the character of income which the old payments would have possessed.[127]

Hill J observed that 'where … a taxpayer assigns a chose in action … derived from' a retained 'underlying property' and assigns the 'right in consideration of the amount … calculated as the present value of the income stream', the 'consideration should be seen as being as much income as the stream it replaces'.[128] This is 'notwithstanding that it is paid in a lump sum rather than by periodical payments … in substitution for the income stream.'[129] Jenkinson and Heerey JJ agreed with Hill J.[130]

In *S P Investments Pty Ltd v Federal Commissioner of Taxation* ('*S P Investments*'),[131] Hill J (with whom Burchett and O'Loughlin JJ agreed) returned to the question which his Honour left open in *Henry Jones*: whether the substitution principle was restricted to receipts in the course of business. His Honour concluded that the second strand of *Myer* was not so limited, although 'the fact that the profit occurs in the course of business would be not irrelevant to the outcome of a particular case.'[132]

S P Investments concerned an assignment of mining royalty rights by the taxpayer to National Mutual Life Association for a period of seven years and three months for a lump sum payment of $4 million. Hill J held that the first strand of *Myer* had no application because the royalty agreement was independent of the subsequent assignment transaction.[133] His Honour concluded that the second strand of the reasoning in *Myer* applied for the following reasons.

First, 'the assignment here was not an assignment to enure for the whole of the period subject to the assignor's rights, but merely for a limited term of relatively short duration.'[134] This fact, 'coupled with the restriction to a defined amount of income, … makes it clear [in the present case] that the consideration was received in substitution for the income assigned'.[135] The amount can be said to fill 'the "hole" of income created by virtue of the assignment.'[136] Here, '[t]he purpose of the assignment, like the purpose of the insurance in *Carapark Holdings Ltd v Commissioner of Taxation*[,] was to fill the place of the revenue receipts which the assignment prevented from arising.'[137]

Secondly, and also significantly, 'the substance of the agreements entered into with National Mutual is that the assignor … assign[s] a precise amount of income out of its right to receive royalty for a period of years'.[138] This assignment was also 'in consideration of a sum calculated at the present value of that

127 *Commissioner of Taxes (Vic) v Phillips* (1936) 55 CLR 144, 156.
128 *Henry Jones* (1991) 31 FCR 64, 79.
129 Ibid.
130 Ibid 64 (Jenkinson J), 79 (Heerey J).
131 (1993) 41 FCR 282.
132 Ibid 297.
133 Ibid 290.
134 Ibid 296 (Hill J).
135 Ibid.
136 Ibid.
137 Ibid (citations omitted).
138 Ibid.

income stream and in circumstances where the assignor sought to substitute for income receivable in the future the present value of that income.'[139]

Thirdly, 'the fact that the assignor entered into the second agreement at the end of the year of income to deal with the next $25 000 of income when it had become apparent that the royalty income would exceed $50 000 per month'[140] puts it beyond all doubt that the purpose was to substitute a lump sum payment for future income. Hill J continued:

> So to characterise the receipt is not simply to treat the consideration as income because it was computed or measured by reference to loss of future income: cf *Commissioner of Taxes (Vic) v Phillips* (1936) 55 CLR 144 at 156. In any event, as I pointed out in *Henry Jones (IXL)*, what is there said is not expressed as stating an unequivocal principle (see *Henry Jones (IXL)* at FCR 79).[141]

After discussing *Henry Jones*, Hill J elaborated on the reasoning.

> In the present case, and to the extent that it is appropriate to refer to the royalty income as deriving from property at all, the property from which the income is derived (ie, the chose in action) cannot, without qualification, be said to continue in the ownership of the assignor.[142]

Hill J continued by saying that only part of the 'rights encompassed by the equitable chose in action … ha[d] been assigned. The assignments are limited both as to quantum and … period.'[143] Furthermore, 'the underlying right to take action against the payer of the royalty remains with the assignor.'[144] Thus, it can only be said that 'an assignment of a right to receive periodical sums which when received would be income … where the underlying chose in action is retained subject to the assignment' and 'the right is assigned in consideration of an amount calculated as the present value of the income stream.'[145] Hill J expressed the view that where these two circumstances exist, 'the consideration should be seen as being income replacing the income stream' that was assigned.[146]

It is interesting to compare *S P Investments* with the decision in *Inland Revenue Commissioners v John Lewis Properties plc* ('*John Lewis 2002*').[147] There, the taxpayer company was the property holding company of a group and it leased five properties to the group's trading company. It entered into an agreement with a bank whereby it assigned the right to receive the rents from the properties to the bank for a period of five years. In return, the taxpayer received a lump sum payment of £25.5 million calculated by reference to the discounted value of the rents. At first instance, Lightman J held that the lump sum payment was a capital

139 Ibid.
140 Ibid.
141 Ibid 296.
142 Ibid 297.
143 Ibid.
144 Ibid.
145 Ibid.
146 Ibid.
147 [2002] 1 WLR 35.

receipt. In posing the question of whether the substitution principle is restricted to receipts in the course of business, Lightman J in *John Lewis 2002* drew a comparison with *S P Investments*. The payment of a lump sum in consideration of the sale of an income stream together with the underlying asset producing the income stream is a capital receipt.[148] But here, the lump sum was paid in consideration for an income stream arising from an underlying asset retained by the vendor.[149] The issue was whether the same description applies despite retention by the vendor of the underlying asset.[150] Lightman J felt compelled by the decisions in *Paget*,[151] *Inland Revenue Commissioners v McGuckian*[152] and *MacNiven v Westmoreland Investments Ltd*[153] to conclude 'that a lump sum payment received in return for the sale of an income stream … constitutes capital [even] where the underlying asset is retained by the vendor'.[154] This was because the taxpayer was entitled

> to structure its commercial transaction with the bank so that in place of an income receipt … it received a capital sum. There is no broad 'economic equivalence test' entitling the court to treat a capital [sum] as income because it is the economic equivalent of income …[155]

Lightman J concluded this section of the judgment by saying that his Honour had 'sympathy with the approach of the revenue that the price obtained for a temporary disposal … of the produce of an income producing asset should be taxed as income', in line with the Australian cases.[156]

On appeal, a divided Court of Appeal held that the payment was one of capital and not income.[157] All members of the Court agreed that the question whether a payment was to be regarded as capital or income depended on the nature of the transaction and the factual matrix in which it was set. Both the judgments of Dyson LJ (with whom Schiemann LJ agreed) and Arden LJ approved the tests enunciated by Dixon J in *Hallstroms*. They stressed that the Court must 'look at all the circumstances of the particular case and apply judicial commonsense in reaching a conclusion as to how a receipt is to be classified'[158] from a practical and business point of view.[159] Neither Dyson LJ nor Arden LJ considered that the Court was bound by *Paget* and neither treated the lease premium cases as decisive. Schiemann LJ agreed generally with Dyson LJ's judgment, but attached greater weight to the lease premium cases.[160] The majority judgments did not discuss the Australian cases. Arden LJ referred to *Myer* and *Henry Jones* but did

148 Ibid 45 (Lightman J).
149 Ibid.
150 Ibid.
151 [1938] 2 KB 25.
152 [1997] 3 All ER 817.
153 [2003] 1 AC 311.
154 *John Lewis 2002* [2002] 1 WLR 35, 51 (Lightman J).
155 Ibid 50 (Lightman J).
156 Ibid 51.
157 *Inland Revenue Commissioners v John Lewis Properties plc* [2003] Ch 513 ('*John Lewis 2003*').
158 *McClure v Petre* [1988] 1 WLR 1386, 1389 (Browne-Wilkinson V-C).
159 See *John Lewis 2003* [2003] Ch 513, 521–2, 531 (Arden LJ), 541–2 (Dyson LJ).
160 Ibid 551.

not place any particular reliance upon them.[161] Her Honour regarded *Myer* as a decision on its facts which did not establish any immutable principle for the purposes of English law.[162]

The majority judgments and the dissenting judgment differed in their assessment of the factors which were decisive on the question of characterisation. Dyson LJ identified five decisive factors: (1) the duration of the asset disposed of; (2) the value of the asset assigned; (3) the extent to which the assignment causes any diminution in the assignor's interest; (4) whether the payment for the assignment was received as a single lump sum or a series of recurring payments; and (5) whether the disposal was accompanied by a transfer of risk to the assignee. Dyson LJ concluded that the cumulative effect of these considerations was that the payment for the assigned rents was received by the taxpayer as a capital payment. The payment by the bank to the taxpayer was of a single and substantial lump sum — it was made in return for the assignment by the company of its rights to receive six years' rent for its properties — the assignment had the effect of diminishing the value of the taxpayer's reversionary interest in those properties and the risk of non-payment of the rents was transferred by the taxpayer company to the bank.[163]

On the other hand, Arden LJ concluded that '[w]hat the transaction was intended to effect, from a practical and business point of view, was an accelerated payment of the rents, discounted for early payment.'[164] In Arden LJ's view, 'the fact that the assignment transferred an interest in property and choses in action [was] not [the] determining consideration since it is not the juristic classification' that governs the characterisation of a receipt as income or capital.[165] Furthermore, the assignor did not dispose of anything of an enduring nature and at the end of the assignment period, the assignor would receive the properties back entire and intact. Thus, the 'resultant diminution in the market value of the properties was only a temporary fluctuation in value.'[166] Arden LJ's pithy conclusion was that 'all that happened here was, comparatively speaking, but a ripple in the rental stream, and, when the full circumstances are examined, the assignment did not as a commercial matter change the nature of the receipt from income to capital.'[167]

The decision vividly illustrates that reasonable minds can easily differ as to the characterisation of a receipt as income or capital in the circumstances of any given case.

161 Ibid 534–5.
162 Ibid 535 (Arden LJ).
163 Ibid 549–50 (Dyson LJ).
164 Ibid 540.
165 Ibid 539.
166 Ibid.
167 Ibid 540. Given the contrasting result in *Myer*, it is worth noting that one British commentator has said that the Court of Appeal's decision would have made more commercial sense if the receipt had been spread over the assignment period, and progressively taxed as revenue in accordance with the applicable accounting principles: see Graeme Macdonald, '*IRC v John Lewis Properties plc*: Cutting the Gordian Knot of "Income or Capital?"' (2003) 3 *British Tax Review* 204–6. See also *John Lewis 2003* [2003] Ch 513, 519, 539 (Arden LJ).

VI THE COMMISSIONER'S TAXATION RULING

In Taxation Ruling TR 92/3, the Commissioner set out his views regarding the proper application of *Myer*. By and large, the Taxation Ruling contains a useful summary of the principles established by *Myer*. In some respects, however, it unduly extends those principles.

One extension concerns the specificity of the purpose which must be demonstrated to attract the principles in *Myer*. As mentioned above, the Full Federal Court held in *Westfield* that there must exist a purpose of profit-making by the very means by which the profit was in fact made.[168] Taxation Ruling TR 92/3 discusses further passages in *Westfield* in which Hill J considered the case where the profit was derived by one of a number of alternative methods contemplated by the taxpayer.[169] Using this discussion as a launching pad, the Taxation Ruling asserts that a profit made in either of the following situations is income:

> (a) a taxpayer acquires property with a purpose of making a profit by whichever means prove most suitable and a profit is later obtained by any means which implements the initial profit-making purpose; or
>
> (b) a taxpayer acquires property contemplating a number of different methods of making a profit and uses one of those methods in making a profit.[170]

The Taxation Ruling then goes a step further and states that an assessable profit will arise if a taxpayer enters into a transaction or operation with a purpose of making a profit by one particular means, but actually obtains the profit by a different means.[171] This last proposition is contradicted by the Full Court's decision in *Westfield*.

In relation to the substitution principle, Taxation Ruling TR 92/3 notes that the reasoning in *Myer* and *Henry Jones* emphasises that the right to income was severed from the underlying property.[172] However, the Ruling contends that the second strand of reasoning in *Myer* will also apply if the transferor previously disposed of the underlying property to which the right to income relates, retains a right to income that constitutes a capital asset, and subsequently disposes of that right to income.[173] This contention also seems to go beyond the decided cases.

VII LEASE INCENTIVES

Cooling[174] was the first of several cases concerning lease incentives. In aggregate, these cases demonstrate the limits of the *Myer* principles.

The critical considerations in *Cooling* were that the firm had no need to move and a 'not insignificant purpose' of moving was to obtain a commercial profit by

168 (1991) 28 FCR 333, 344 (Hill J).
169 Taxation Ruling TR 92/3, [53].
170 Ibid [56] (citations omitted).
171 Ibid [57].
172 Ibid [67].
173 Ibid [70].
174 (1990) 22 FCR 42.

way of incentive payments.[175] It was not disputed that the whole of the incentive payment represented a profit by the taxpayer. However, the decision in *Cooling* is not altogether satisfactory. Hill J's reasoning involves a logical slide from the proposition that incentive payments were 'an ordinary incident of leasing premises in a new city building in Queensland in 1985' to the proposition that they were therefore 'an ordinary incident of part of the business activity of the firm'.[176]

The facts in *Rotherwood Pty Ltd v Federal Commissioner of Taxation*[177] allowed for a straightforward application of the principles in *Myer*. In the context of one solicitor's service trust replacing another, the trustee of the first service trust arranged to receive a payment of $6 million for the surrender of a head lease.[178] The Court found that the head lease had no marketable value at the time of its surrender.[179] It also found that while the transaction was an extraordinary one, it was nonetheless a business operation that carried out a profit-making scheme.[180] It was not a mere surrender of a lease for a capital sum that represented the value of the leasehold asset. Thus, the first two cases turned on the finding that there was a business operation undertaken for the purpose of profit-making.

In *Lees & Leech Pty Ltd v Commissioner of Taxation* ('*Lees & Leech*'), Hill J held that the lease incentive in issue in that case was not assessable as ordinary income.[181] His Honour stressed that any application of the principles in *Myer* requires 'a wide survey and exact scrutiny of the taxpayer's activities'.[182] In Hill J's view, *Myer* makes it clear that 'a gain made otherwise than in the ordinary course of carrying on a business may … give rise to income. But whether it does depends very much on the circumstances of the case.'[183] It also 'makes it clear … that profit-making is an essential ingredient in the characterisation of an amount as income[,] where the transaction is one not in the ordinary course of business.'[184] Accordingly, Hill J identified the key issue in the following way:

> So, the present case comes down to the question whether, in entering into a transaction designed to achieve that which it did achieve, the applicant had a profit-making purpose from which it received a profit or gain. This can, for present purposes, resolve itself into a single question namely whether the applicant made a profit or gain in the relevant sense, since if it did there is no dispute that the applicant intended the nature and consequence of its actions.[185]

175 Ibid 57 (Hill J).
176 Ibid 56.
177 (1996) 64 FCR 313.
178 Ibid 319 (Lees J).
179 Ibid 322 (Lees J).
180 Ibid 325 (Lees J).
181 (1997) 73 FCR 136, 151.
182 Ibid 145. See also *Western Goldmines NL v Commissioner of Taxation (WA)* (1938) 59 CLR 729, 740 (Dixon and Evatt JJ).
183 *Lees & Leech* (1997) 73 FCR 136, 147.
184 Ibid.
185 Ibid.

On the facts, Hill J held that there was no relevant profit-making purpose and no ultimate gain. The taxpayer covenanted to effect improvements to the rented premises and the payment received was reimbursement for those expenses. There was 'no direct gain to [the taxpayer] other than what appear[ed] to be a valueless right at the expiration of the lease' to remove certain facilities.[186] The payment was simply part reimbursement for the cost of work on the premises.[187]

The Full Federal Court reached much the same result in *Selleck v Federal Commissioner of Taxation* ('*Selleck*').[188] Two major law firms merged and set about obtaining a lease for new premises. A lease was entered into with the Australian Mutual Provident Society Ltd ('AMP') on the basis that the new law firm would receive a lease incentive of $1 million, which it was contractually bound to apply to meet fit-out expenses. Upon completion of the fit-out, which cost $2.5 million, the fit-out was sold for $1.5 million to a financier and leased back. The Full Federal Court held unanimously that the incentive payment of $1 million was not assessable. Lockhart J (with whom Black CJ concurred) held that there was no profit-making purpose and no profit-making scheme. The firm's 'only purpose [in] entering into the lease … was to obtain premises from which the new firm would conduct its legal practice.'[189] Beaumont J held that there was no profit: the fit-out cost exceeded the amount of the AMP contribution.[190] Thus, there was no profit or profit-making purpose in the transaction. Beaumont J also attached significance to the similarity between an incentive payment and a premium paid for the grant of a lease — they were both once and for all payments made or received on the occasion of the acquisition of part of the capital structure of an ongoing business.[191]

The final and most authoritative decision in this group of cases is the High Court's decision in *Montgomery*.[192] By a majority of four to three, the High Court held that the lease incentive paid to the law firm, Freehills, was assessable as ordinary income.

On the facts, *Montgomery* was not very far removed from *Selleck*. Freehills' existing premises were being gutted of asbestos, and it was not feasible for the firm to remain on the four floors it occupied at BHP House.[193] The choice that confronted the firm was between, on one hand, moving internally twice and for an uncertain period, or on the other hand, moving externally and permanently.[194] The landlord refused to negotiate the rent it required for the new premises, although it was prepared to negotiate the amount of the incentive.[195] Unlike

186 Ibid 151 (Hill J).
187 Ibid.
188 (1997) 78 FCR 102.
189 Ibid 105 (Lockhart J).
190 Ibid 127.
191 Ibid 129. See also *Montgomery* (1999) 198 CLR 639, 655 (Gleeson CJ, McHugh and Callinan JJ).
192 (1999) 198 CLR 639, followed in *O'Connell v Commissioner of Taxation* (2002) 121 FCR 562, 597–600 (Goldberg J).
193 *Montgomery* (1999) 198 CLR 639, 652 (Gleeson CJ, McHugh and Callinan JJ).
194 Ibid 665 (Gaudron, Gummow, Kirby and Hayne JJ).
195 Ibid 645 (Gleeson CJ, McHugh and Callinan JJ).

Cooling, the taxpayer never had the option of paying greater rent and not receiving any incentive.[196] The incentive payment was much larger at $21.49 million, but the cost of the fit-out of the new premises was $12.9 million.[197] Prior to the completion of the fit-out period, the incentive payment could only be drawn down by the firm to meet fit-out expenses.[198] Additionally, the move to the new premises involved heavy expenses for the firm, including losing the benefit of the fit-out at its old premises and ongoing rent commitments under the lease of its old premises.[199]

At trial, Jenkinson J found that the prospect of obtaining an inducement was a reason for the firm's decision to move and this was sufficient to bring the case within the principles stated in *Cooling*.[200] On appeal, the Full Federal Court held that the incentive was not assessable as ordinary income. Lockhart J found that the purpose or object of entering into the transaction was to secure premises for the long-term future of the firm, and not to obtain a payment by way of an inducement which would be received as a profit or gain by the members of the firm.[201] The majority in the High Court failed to squarely address these factual findings, perhaps because they did not decide the case on the same basis as the trial judge. The majority judgment discusses *Myer* at some length, but the decision does not turn on a direct application of either strand of reasoning in *Myer*. In particular, the majority did not explicitly find that the leasing and incentive transactions amounted to a profit-making scheme undertaken for the purpose of deriving the profit represented by the incentive payment.

In the High Court, the majority rejected the Commissioner's principal argument that the incentive should be treated as revenue since it was received in return for an agreement to pay higher rents which would be deducted as revenue outgoings. The factual premise for this argument simply did not exist as the firm never had the option of paying less rent.[202] Furthermore, it can be inferred from observations made by the majority later in their reasons that the Commissioner's argument would be unsound even if a proper factual basis existed for it: the fact that a payment is compensation for or reimbursement of an amount properly deductible under s 51(1) of the *ITAA 1936* does not determine whether the receipt is income.[203]

The majority rejected the submission that lease premium payments and lease incentive payments should be treated consistently as payments on capital

196 Ibid 654 (Gleeson CJ, McHugh and Callinan JJ), 667–8 (Gaudron, Gummow, Kirby and Hayne JJ).
197 Ibid 647 (Gleeson CJ, McHugh and Callinan JJ).
198 Ibid 658 (Gaudron, Gummow, Kirby and Hayne JJ).
199 Ibid 647 (Gleeson CJ, McHugh and Callinan JJ), 667 (Gaudron, Gummow, Kirby and Hayne JJ).
200 Ibid 647–8 (Gleeson CJ, McHugh and Callinan JJ).
201 Ibid 652–3 (Gleeson CJ, McHugh and Callinan JJ).
202 Ibid 653–4 (Gleeson CJ, McHugh and Callinan JJ), 667–9 (Gaudron, Gummow, Kirby and Hayne JJ).
203 *Federal Commissioner of Taxation v Rowe* (1997) 187 CLR 266, 291–2 (Brennan CJ, Dawson, Toohey and McHugh JJ).

account. This is the position in England and NZ.[204] It was also the position favoured by the Full Federal Court in *Montgomery*. Essentially, the High Court majority said that the analogy with lease premiums was misplaced, because a premium involves an outgoing to obtain a capital asset, whereas an incentive involves a receipt that is associated with the acquisition of a capital asset.[205] Their Honours said that it does not follow that any and every aspect of the several transactions associated with obtaining a lease are necessarily a transaction on capital rather than revenue account, giving what they said was the 'obvious example' of rent paid under a lease being a deductible outgoing.[206] The example is difficult to understand because rental outgoings are not payments made to obtain a lease.[207]

More generally, the majority's reasoning on the treatment of lease premiums and lease incentives is unconvincing. Further on in their judgment, the majority seemed to accept that a lease premium would be outlaid on capital account if the purpose of the payment is to obtain a lease that forms part of the profit-yielding structure of the lessee's business.[208] The majority then said that a lease incentive received by a lessee on agreeing to take a lease is not necessarily of the same character even if the lease is properly regarded as part of the profit-yielding structure of the lessee's business. The majority did not examine the question of when it would, or would not, have the same character. Instead, the majority suggested that the analogy with lease premiums depends on an assumption that there must be exact congruence between the capital or revenue character of receipts and expenditures.[209] The origins of this assumption are obscure. The only argument about symmetry or congruence was the Commissioner's rejected argument that the incentive payment offset inflated payments of rent that would be payments on revenue account.

The reference to congruence discloses a confused understanding of the cases on lease premiums. When the Privy Council in *Wattie* examined the character of lease premiums, it applied Dixon J's observations in *Hallstroms* by asking 'what the premium payment [was] calculated to effect from a practical and business point of view'.[210] The Privy Council was not endorsing any need for there to be symmetry between the tax treatment of a prospective tenant's premium payment and the landlord's receipt of that payment. It was simply explaining that there was longstanding authority in Australia and England to the effect that, similar principles apply to payments and to receipts within the context of the same business.[211] This proposition is unexceptional.

204 *Regent Oil Co Ltd v Strick* [1966] AC 295; *Commissioner of Inland Revenue v Wattie* [1999] 1 WLR 873 ('*Wattie*'). See also Andrew Maples, 'Are Lease Incentives Taxable? — A Trans-Tasman Comparison' (2000) 3 *Journal of Australian Taxation* 208.

205 *Montgomery* (1999) 198 CLR 639, 669–70 (Gaudron, Gummow, Kirby and Hayne JJ).

206 Ibid 669 (Gaudron, Gummow, Kirby and Hayne JJ).

207 See Maples, above n 204, 222.

208 *Montgomery* (1999) 198 CLR 639, 670–1 (Gaudron, Gummow, Kirby and Hayne JJ).

209 Ibid 671 (Gaudron, Gummow, Kirby and Hayne JJ).

210 [1999] 1 WLR 873, 880 (Lord Nolan for Lords Mackay, Jauncey and Hoffmann and Sir Christopher Staughton).

211 Ibid.

Turning back to the principles discussed in *Myer*, the majority in *Montgomery* did not closely scrutinise the evidence as to whether the firm made a profit or had a profit-making purpose when it entered into the new lease and the associated inducement agreement. The majority accepted that part of the incentive payment was applied to fit out the new premises and that other outgoings were incurred as a result of the making of the new lease agreement.[212] However, it said that '[t]he exact quantification of those outgoings can be put to one side'.[213] The majority never reconciled these findings with its conclusion that the whole of the incentive payment could be treated as an assessable gain.

It also seems that the majority misunderstood the evidence that Freehills had no practical alternative but to move out of the four floors it occupied at BHP House. Contrary to the majority's observation,[214] the Full Federal Court did not find that it was not feasible for the firm to remain in BHP House;[215] it recognised that Freehills had an option of relocating elsewhere within BHP House.[216] However, the significant point revealed by the evidence was that the asbestos problem at BHP House meant that Freehills had to move either externally or elsewhere in the same building; and if it moved elsewhere it had no option but to accept an incentive payment because it was not able to negotiate any variation in rents.

The majority stated that *Myer* demonstrates that a singular transaction in business, even if unusual or extraordinary when judged by reference to the transactions in which the taxpayer usually engages, can generate a revenue receipt.[217] So much is clear. But while incentive payments were an ordinary incident of leasing transactions in Melbourne at the relevant time, the majority did not find as a fact that the incentive payment received by Freehills was an ordinary incident of the operations by which the firm generated revenue.

Ultimately, the majority's reasoning is quite amorphous. First, it reasoned that the inducement amounts received by the firm did not augment its profit-yielding structure — the lease was acquired as part of that structure but the inducement amounts were not.[218] It is unclear where this proposition leads. The sale of a capital asset for a capital return does not augment a firm's profit-yielding structure but it is a receipt on capital account. The proposition also disregards the fact that, in large part, the inducement amounts were applied in fitting out the premises and in that sense they did augment the profit-yielding structure of the firm. Secondly, and decisively, the majority said that the firm had used or exploited its capital — whether its capital be treated as the agreement to take premises or its goodwill — to obtain the inducement amounts.[219] That exploitation of capital took place in the course of carrying on the firm's business, albeit

212 *Montgomery* (1999) 198 CLR 639, 666 (Gaudron, Gummow, Kirby and Hayne JJ).
213 Ibid 667 (Gaudron, Gummow, Kirby and Hayne JJ).
214 Ibid 665 (Gaudron, Gummow, Kirby and Hayne JJ).
215 Cf ibid 652 (Gleeson CJ, McHugh and Callinan JJ).
216 Ibid.
217 Ibid 676 (Gaudron, Gummow, Kirby and Hayne JJ).
218 Ibid 671–2 (Gaudron, Gummow, Kirby and Hayne JJ).
219 Ibid 678 (Gaudron, Gummow, Kirby and Hayne JJ).

in a transaction that was properly regarded as singular or extraordinary. It follows, so the majority reasoned, that the sum the firm received from the transaction was not as some growth or increment of value in its profit-yielding structure, but was received as ordinary income.[220] This reasoning is not directly related to the kind of analysis undertaken in *Myer*.

The notion that the incentive amount was 'severed from the capital' has its problems. As a matter of fact, it is artificial to separate the incentive payment from the leasing transaction. And, as a matter of principle, it is, as the dissenting judgment says, an inversion of the approach adopted in *Myer* to separate the two parts of the transaction.[221] It makes more sense to recognise the close association between the incentive payment and the onerous obligations in the lease: just as the Privy Council did in *Wattie* in recognising that the incentive was commercially and financially (and in that case mathematically) linked to the rental obligations under the lease.[222]

The majority's reasoning is open to doubt, as demonstrated by the reasons given by the minority. In their joint judgment in *Montgomery*, Gleeson CJ, McHugh and Callinan JJ said that they were unable to accept that the inducement payment is properly characterised as proceeding from the use or exploitation by the firm of its capital.[223] They gave four reasons for this conclusion. First, the majority's characterisation involved disregarding the entire transaction and directing attention to only part of it, which was the opposite of the approach taken in *Myer*. Secondly, the agreement to take the lease, for which the inducement was part of the consideration, was not at that point an asset of the firm. The receipt of the inducement payment accompanied, and was occasioned by, the lease agreement but it did not constitute an exploitation of the agreement. This proposition seems to be undeniable. Thirdly, the asset of the firm constituted by its goodwill was something different from the firm's size. The firm's size and reputation may have made it an attractive tenancy target and given it increased bargaining power, but it does not follow that any part of the incentive payment represented an exploitation of the firm's goodwill. Fourthly, the minority judgment refers to the fact that the inducement payment was an ordinary incident of taking up a lease in Melbourne at that time. This hardly suggests that the payment was the result of the firm's exploitation of its goodwill.

The dissenting judgment of Gleeson CJ, McHugh and Callinan JJ provides some powerful reasons why the case falls outside the proper scope of the decision in *Myer*. They stated that 'in the present case, the amounts … were not received in the ordinary course of the firm's business' and 'did not represent a profit or gain.'[224] Their Honours gave three reasons for this. First, '[t]he occasion of the receipt was agreeing to enter in, and undertaking the obligations … of a long-term lease which was to form part of the structure within which the firm

220 Ibid.
221 Ibid 655 (Gleeson CJ, McHugh and Callinan JJ).
222 [1999] 1 WLR 873, 882 (Lord Nolan for Lords Mackay, Jauncey and Hoffmann and Sir Christopher Staughton).
223 *Montgomery* (1999) 198 CLR 639
224 Ibid 656 (Gleeson CJ, McHugh and Callinan JJ).

was to conduct business.'[225] Secondly, 'the fact that an inducement payment was an ordinary incident of agreeing to take a lease in circumstances such as those [in this case] … does not make receipt of the payment' incident to 'the ordinary course of the partnership business.'[226] Thirdly, the transaction here was 'singular … not part of the regular means by which the firm derived income.'[227]

The dissenting judgment supported the third reason by stating that '*Myer* decided that singularity was not conclusive, but it did not decide that it was irrelevant.'[228] Furthermore, the dissenting judges stated that *Myer* 'also decided that, in identifying a trading purpose of making a profit or gain, the whole transaction, and not merely part of it is to be considered.'[229] The dissenting judges also distinguished *Cooling* and stated that

> the present is not a case where it is apt to characterise the firm's change of accommodation as having the (or even a) purpose of obtaining the inducement payment. The payment was but one aspect of a wider transaction which was activated by practical necessity.[230]

Plainly, the majority and the minority judgments differ in their assessment of the facts. The minority took the view that the critical facts did not bring the case within the sweep of the *Myer* principles. The majority took a different view, but it did so by putting to one side facts which were regarded as crucial in other cases. In my assessment, the majority decision takes an unwarranted view of the evidence and involves a strained application of the principles discussed in *Myer*. The majority judgment also avoids dealing with the question whether there was any overall gain or profit when all of the relevant facts were taken into account.

In the end, it is unclear what assistance the majority derived from their repeated references to *Eisner v Macomber* and the concept of 'gain'.[231] In the US, *Eisner v Macomber* provides authority for the judicially developed principle that realised capital gains constitute income.[232] That is not the position in Australia and there is nothing in *Myer* to suggest that the majority was embracing that concept of 'gain'.

VIII CAPITAL GAINS TAX

Prior to the enactment of Part IIIA of the *ITAA 1936* in 1986, much greater consequences attached to the distinction between income and capital. Part IIIA and the corresponding provisions in Chapter 3 of the *ITAA 1997* include net capital gains, which are expansively defined, in a taxpayer's assessable income. They apply where a taxpayer acquires the asset on or after 20 September 1985 and the disposal of the asset occurs after that date.

225 Ibid.
226 Ibid.
227 Ibid.
228 Ibid.
229 Ibid.
230 Ibid.
231 See ibid 661–2, 677 (Gaudron, Gummow, Kirby and Hayne JJ).
232 252 US 189 (1920).

When Part IIIA was enacted, s 25A (the old s 26(a)) was amended to include a new s 25A(1A) that provided that the section does not apply in respect of the sale of property acquired on or after 20 September 1985. There is, however, considerable scope for the continuing operation of s 25A. It includes in assessable income, a profit arising from carrying on or carrying out a profit-making undertaking or scheme whenever that scheme commences, except to the extent that the scheme involves the sale of property acquired after 20 September 1985. Further, it also continues to apply to profits arising from profit-making schemes that involve the sale of any property acquired prior to 20 September 1985.

In appropriate cases, capital gains can be brought to account under the capital gains provisions or under ss 25 or 25A or equivalent provisions of the *ITAA 1997*. A major difference between these taxing regimes is that Part IIIA and the successor provisions in Chapter 3 of the *ITAA 1997* only bring the indexed net capital gain to account, whereas a taxpayer does not have the benefit of any indexation if the income provisions apply.

In *Cooling*, Lockhart and Gummow JJ held that the incentive transaction created a capital gain that was liable to taxation by virtue of s 160M(7) of the *ITAA 1936*.[233] The receipt of the incentive by the taxpayer was sufficiently linked with the entry into the lease and the giving of guarantees by the taxpayer and his partners to satisfy the requirements of s 160A and s 160M(7)(a). The requirements were that the taxpayer receive a sum by reason of acts and transactions that have taken place in relation to an asset.[234]

In *Montgomery*, the Commissioner of Taxation assessed the whole of the incentive under s 25 rather than Part IIIA. The taxpayer argued that any net gain arising from the incentive payment would be subject to capital gains tax so that there was no need to strain the principles in *Myer* to reach an appropriate tax result. Neither of the judgments in the High Court refers to the possible application of Part IIIA. *Montgomery* demonstrates that the Commissioner will usually prefer to bring a gain to account, if possible, under the ordinary income provisions of the Act, rather than under Part IIIA or the provisions of Chapter 3 of the *ITAA 1997*.

IX A New Tax Climate?

It has been suggested that *Myer* created a climate which has made the Court more inclined to find that borderline receipts are of an income character.[235] Various cases have been invoked to support this thesis beyond those mentioned above.

In *Allied Mills Industries Pty Ltd v Commissioner of Taxation*,[236] the Full Federal Court (Bowen CJ, Lockhart and Foster JJ) held that a lump sum payment received by a company as consideration for surrendering all of its rights under a

233 (1990) 22 FCR 42, 43 (Lockhart J), 45 (Gummow J).
234 Ibid 43 (Lockhart J), 44–5 (Gummow J). See also *Hepples v Commissioner of Taxation* (1990) 22 FCR 1.
235 Slater, above n 3, 134, 144–5.
236 (1989) 20 FCR 288.

sole distribution agreement was assessable as ordinary income. While acknowledging that payments made as compensation for the termination of a contract may often have the character of capital, the Court said that whether that is so in any particular case depends on 'the nature of the contract which generated the payment, and the way in which that contract relate[s] to the structure and business of the taxpayer.'[237] The Court considered that it was part of the [taxpayer's] business to provide distribution services and the distribution contract was made in the ordinary course of its business. The payment was regarded as income because it was 'designed to compensate the [taxpayer] for the loss of … anticipated profits flowing from the contract.'[238]

The lease equipment cases that were decided by the Full Federal Court in the period immediately following *Myer* arrived at differing conclusions. In *Memorex Pty Ltd v Federal Commissioner of Taxation*[239] and *Federal Commissioner of Taxation v GKN Kwikform Services Pty Ltd*,[240] the Full Federal Court ruled that profits from the sale of leased equipment were of an income nature. On the other hand, in *Federal Commissioner of Taxation v Cyclone Scaffolding Pty Ltd*[241] and *Federal Commissioner of Taxation v Hyteco Hiring Pty Ltd*,[242] the Court held that profits from the sale of leased equipment were of a capital nature. The different outcomes were the product of different factual findings and the different ways in which the Court characterised the relevant businesses and their ordinary incidents.

In my view, cases such as these do not establish any new principles of law. They merely demonstrate that the application of the principles established in *Myer* depends heavily on the characterisation of the facts of each particular case.

X CONCLUSION

Myer undoubtedly marked a significant change in approach in tax jurisprudence. Virtually every case dealing with the characterisation of receipts as income or capital, cites *Myer*, usually at some length.[243] But it is going too far to suggest that *Myer* transformed the way in which income is characterised. I agree with Hill J's assessment that '[t]he perception that the Australian courts have broadened the concept of income and, in consequence, narrowed the concept of capital is, at the end, merely a perception.'[244]

237 Ibid 312 (Bowen CJ, Lockhart and Foster JJ).
238 Ibid.
239 (1987) 77 ALR 299.
240 (1991) 21 ATR 1532.
241 (1987) 18 FCR 183.
242 (1992) 39 FCR 502.
243 See, eg, *Commissioner of Taxation v Glennan* (1999) 90 FCR 538, 548, 554–5 (Hill, Sackville and Hely JJ); *Integrated Insurance Planning Pty Ltd v Federal Commissioner of Taxation* (2004) 205 ALR 120, 139–41 (R D Nicholson J); *Willemse Family Co Pty Ltd v Deputy Commissioner of Taxation* [2003] 2 Qd R 334; *O'Connell v Federal Commissioner of Taxation* (2002) 121 FCR 562, 593–4 (Goldberg J); *Federal Commissioner of Taxation v CSR Ltd* (2000) 104 FCR 44, 59 (Lee, Cooper and Lindgren JJ).
244 Hill, 'Income and Capital', above n 25, 16.

However, what *Myer* does reflect is a reduced emphasis on formalism and legal technicalities. The mainstream approach of the courts after *Myer* demands that the characterisation of amounts as income or capital be determined as a matter of commercial substance, and not by subtleties of drafting, or by unduly literal or technical interpretations. The courts do not adopt a test of economic equivalence,[245] but they pay close regard to all the circumstances of the transaction without undue emphasis upon its form.[246]

Since the decision in *Myer*, there have undoubtedly been cases which on their facts could have been decided the other way. It is inherent in the fact-intensive distinction between income and capital that hard cases will arise which are capable of being decided either way, but this circumstance does not detract from the enduring importance of the decision in *Myer*.

[245] *Mullens v Federal Commissioner of Taxation* (1975) 135 CLR 290, 301 (Barwick CJ).

[246] See, eg, *S P Investments* (1993) 41 FCR 282, 295 (Hill J); *Commissioner of Taxation v Glennan* (1999) 90 FCR 538, 554 (Hill, Sackville and Hely JJ).