

HOWARD v COMMISSIONER OF TAXATION (M140/2013)

Court appealed from: Full Federal Court of Australia
[2012] FCAFC 149

Date of judgment: 26 October 2012

Date special leave granted: 8 November 2013

In early 1999, the appellant and five others were involved in a joint venture project to acquire and lease Kingston Links golf course, in such a way as to realise a “day-1” profit on the simultaneous completion of the acquisition and resale. The project required a lessee of the golf course at a sufficient rent and an equity participant who would purchase the course (using borrowed funds secured on the land, and its own equity funds) at a price based on the capitalised value of the rent. The appellant was a director of Disctronics Ltd (“Disctronics”), a delisted public company with investable funds. In early July 1999, the directors of that company proposed that, if the equity required was less than \$1.5 million, Disctronics should be the purchaser. The proposal was put to, and adopted “as a possible investment opportunity” by, a meeting of directors of Disctronics on 13 or 14 July 1999. The directors agreed that, if Disctronics took up the investment, any joint venture profit share accruing to them would be accounted for, or rebated to, Disctronics.

By the beginning of August 1999, a purchase price and a rent had been agreed in principle with the vendor and a prospective lessee, although no agreement had been executed by either. Meanwhile, two of the joint venture partners (“Edmonds and Cahill”) clandestinely negotiated a purchase and lease of the golf course by a syndicate comprising themselves and a third party. In June 2001, the directors of Disctronics commenced proceedings in the Supreme Court of Victoria for remedies consequent on the breach of fiduciary duties by Edmonds and Cahill. The proceedings were funded by Disctronics, to whom the director plaintiffs, including the appellant, assigned all benefits from the proceedings. Judgment was given in favour of the director plaintiffs at first instance, and upheld on appeal.

The issue in this application is whether the sum of \$861,853.35, received by the appellant in 2005 as his share of the award of damages was assessable income in his hands. The primary judge (Jessup J) found that the appellant received his share of the damages as fiduciary for Disctronics, and the award was therefore not assessable income in his hands.

The respondent appealed to the Full Federal Court (Middleton, Perram, and Dodds-Streeton JJ). The appellant argued that, once Disctronics had adopted the project as a potential investment, it was incumbent on the directors to do what was in their power to preserve the company’s opportunity to invest. It was inconsistent with their fiduciary duties to Disctronics to conduct themselves, in their personal capacity as participants on their own account in the joint venture, in a manner which conflicted with the interests of Disctronics. The appellant argued that there was no simple contingency according to which Disctronics would, or would not, make the investment. Disctronics had available to it \$1.5 million in non-operational investment funds. The price at which the “investor” would acquire the golf course was not an independent, objective fact dependent on external events: it was a matter for

negotiation among the joint venturers. This circumstance put the directors of the joint venture in a position of immediate and unresolvable conflict of duty and interest, because the interest of the joint venturers was to secure the highest possible purchase price from an investor, while the interest of Disctronics was diametrically opposed: it sought to secure the lowest price.

The Court did not accept this was a correct analysis, nor one that accorded with the conclusion reached by the primary judge as to the appellant's role, or fulfilment of his obligation to Disctronics. The evidence, as accepted by the primary judge, was that the appellant was responsible for having Disctronics accepted as equity participant by the other joint venturers. In that case, and only in that case, did the appellant agree to rebate his share of the "day-1" profit to Disctronics. The appellant's obligation to Disctronics only involved him using his reasonable endeavours to have it become purchaser, which obligation he discharged. Therefore, the only expectation of Disctronics was to be a potential purchaser, if and when there was a secured sale price and a tenant's agreement for a long-term lease. Disctronics' only interest arose when and if the equity required was less than \$1.5 million. In the end, Edmonds and Cahill, despite all of the endeavours of the appellant, were not prepared to accept Disctronics as equity participant and purchaser. In these circumstances, there could be no conflict of interest in the way contended for by the appellant, and no breach of his fiduciary duty to Disctronics. Accordingly, the award of damages in question had the character of assessable income in the appellant's hands, and was not received by him as trustee.

The grounds of appeal include:

- The Full Court erred in holding that the gain made by the appellant from his participation in the joint venture, being the sum awarded to him by the Victorian Supreme Court, was derived by the appellant beneficially and should have held that it was derived by the appellant as trustee for Disctronics;
- The Full Court erred in identifying as the principal issue between the parties the question whether there was a breach by the appellant of his fiduciary duty to Disctronics and should have held that the appellant accounted to Disctronics for the gain arising from his participation in the joint venture in discharge of his fiduciary duties to Disctronics and as trustee for Disctronics.

The respondent has filed a Notice of Contention on the following ground:

- that the Full Court should have decided that, if the litigation agreement between Disctronics and the appellant was effective to assign to Disctronics the right to receive any damages awarded to the appellant such that Disctronics derived those damages as income, then s102B of the *Income Tax Assessment Act 1936* applies to treat that assignment as not having been made.