

HIGH COURT OF AUSTRALIA

GLEESON CJ,
GAUDRON, McHUGH, GUMMOW, KIRBY, HAYNE AND CALLINAN JJ

THE COMMISSIONER OF TAXATION
OF THE COMMONWEALTH OF AUSTRALIA

APPELLANT

AND

PAUL MONTGOMERY

RESPONDENT

Commissioner of Taxation v Montgomery [1999] HCA 34
5 August 1999
M86/1998 and M87/1998

ORDER

In each matter:

- 1. Appeal allowed with costs.*
- 2. Set aside order of the Full Court of the Federal Court entered on 6 February 1998 and, in place thereof, order that the appeal and cross-appeal to that Court be dismissed in each case with costs.*

On appeal from the Federal Court of Australia

Representation:

G A A Nettle QC with A Richards QC and J Davies for the appellant
(instructed by Australian Government Solicitor)

N J Young QC with J W de Wijn QC and T P Murphy for the respondent
(instructed by Freehill Hollingdale & Page)

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subject to formal revision prior to publication in the
Commonwealth Law Reports.

CATCHWORDS

The Commissioner of Taxation v Montgomery

Income tax – Income – Income according to ordinary concepts and usage of mankind – Lease incentive payment received by taxpayer relocating premises – Whether income or capital – Whether receipt should be characterised as an incentive to pay greater rent – Whether receipt analogous to lease premium payment – Whether receipt part of profit-making undertaking or scheme – Whether receipt was an ordinary incident of a transaction in the course of the taxpayer's business – Whether receipt must be in the ordinary course of the taxpayer's business.

Words and phrases – "income", "profit", "gain", "profit-making undertaking or scheme".

Income Tax Assessment Act 1936 (Cth), ss 6(1), 25.

- 1 GLEESON CJ, McHUGH AND CALLINAN JJ. The question which this case raises is whether a share, received by a partner in a firm of solicitors, of an inducement payment made by the landlord of a city building to the firm on its relocation to that building, is income for taxation purposes¹.

The facts

- 2 The respondent taxpayer was a partner in Freehill Hollingdale & Page ("the firm") in Melbourne. From 1977 to 1991 the firm, as lessee, occupied premises in two separate buildings, BHP House and Nauru House. The terms of the leases relating to BHP House were to expire on 31 March 1993 and 28 February 1994².
- 3 In 1987-88, the firm had undertaken extensive refurbishment of its premises in BHP House in the expectation of remaining in occupation at least until 1994, and probably also with a view to extending its occupancy beyond that year.
- 4 In September 1988 the Australian Mutual Provident Society ("AMP"), the owner of BHP House, informed the firm that it intended to gut all levels of BHP House to clear it of asbestos. In March 1989 AMP further informed the firm that, from August 1989, it proposed to undertake a refurbishment program extending over three or more years. Work on the floors occupied by the firm was not to commence until 1991, but when it did the firm would not be able to remain in occupation of those floors while the work was being carried out. In short, a relocation of the firm's practice for some time at least was inevitable, even if it were only within BHP House. AMP offered to provide the firm with financial

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- 1 The proceedings in the Federal Court before Jenkinson J were concerned with two assessments. The first, proceeding VG 209/94, was an appeal against the Commissioner's decision to include in Mr Montgomery's assessable income for the year ending 1991 the amount of \$136,562. This sum represented his share of the part of the inducement amount paid to the firm in that income year (\$2,994,784).

The second, proceeding VG 210/94, was an appeal against the Commissioner's decision to include in Mr Montgomery's assessable income for the 1992 income year the amount of \$955,596. This sum represented his share of the part of the inducement amount received by the firm in that income year (\$26,351,746).

The assessability of Mr Montgomery's share of an earlier payment of \$5,000 in 1990 is not in issue.

- 2 The firm had used part of a floor of Nauru House to conduct its industrial relations practice from 1982. The industrial relations arm of the practice moved to Collins Street at the same time as the BHP House practice moved.

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assistance and to relocate it on other floors of the building during the refurbishment. No definite proposal was put to the firm by AMP until 2 August 1989.

5 The firm formed a "premises committee" to advise the firm's management committee whether to relocate to another building or remain in BHP House. The firm also engaged Managed Projects Pty Ltd to act as consultants to advise the firm of the best way to meet its accommodation requirements, and later to negotiate with landlords and developers, and to advise on the best financial packages for the leasing of buildings in the Melbourne central business district.

6 At a meeting on 9 August 1989 the management committee presented the partners with a report which assessed, for leasing purposes, five buildings in Melbourne. One building was discarded because it had insufficient space, and another because an incentive payment of \$8 million was thought to be inadequate. A third building, in the early stages of development, was rejected because there was some uncertainty whether it would be completed. The remaining two buildings were BHP House and a building in Collins Street then in the course of development. The authors of the report set out the perceived advantages and disadvantages of remaining in BHP House, analysed the available offers, and concluded that the better course would be acceptance of the Collins Street offer.

7 Factors considered in the report included: uncertainty as to the terms of AMP's offer to continue the existing leases; the disruption that would be caused by a move to another building as compared with the disruption that would be occasioned by the refurbishment; and financial considerations. As to the former, the committee reported, "... it could almost be as disruptive to move from one floor to another as it would be to move from one building to another". With respect to the terms of the Collins Street offer, the report stated that the committee was of the view that "the offer really reflects no more than the firm's importance as a potential tenant to any owner or developer."

8 As a result of the recommendations of the committee, on 9 August 1989 the firm resolved to enter into a lease of the Collins Street premises. The resolution was expressed to be conditional on the firm's inability to obtain an extension of the existing lease in BHP House before 11 August 1989.

9 The firm, having failed to obtain such an extension, on 14 August 1989, had its nominee and agent, Plurimus Holdings Pty Ltd, execute two agreements to lease new premises. The first agreement provided for the lease for 12 years (with an option of renewal for six years) of six floors at \$660 per square metre per annum for the lowest floor increasing by \$5 per square metre for each higher floor. The premises were to be in a "core and shell" condition and the lessee was obliged to fit them out. The second agreement provided for the payment of an "inducement

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amount" as an inducement for entry into the first agreement. This amount was originally \$15.89 million but was increased to \$21.49 million in July 1990 when the first agreement was varied to provide for the lease of two additional floors. As a consequence of the application of interest provisions in the second agreement, the "inducement amount" eventually became \$29,351,530, \$5,000 of which was paid in the income year ending 30 June 1990, \$2,994,784 of which was paid during the following income year and the balance in the income year after that.

10 These events occurred against a background of intense competition among city building developers and owners for tenants, as a result of excessive office development in the city. Substantial capital investment was required to build major office developments. In order to maintain a competitive return, developers and owners frequently sought to protect the capital value of their buildings by fixing high levels of face rental to maintain levels of rental commensurate with the long term growth (CPI) rate or better. The method chosen by some or most of them to induce prospective tenants to commit to pay rentals of that order was to offer a range of leasing incentives. These leasing incentives were, so far as the landlords were concerned, the means of obtaining the agreement of the lessee to a benchmark level of rent fixed by them and were frequently the subject of collateral agreements. What we have so far summarised is the nature or course of the business of developers of office buildings at the time. It is not a description of the firm's, or any particular tenant's, business. The evidence here does not establish that the landlord of the Collins Street premises offered the respondent's firm a range of incentives.

11 So widespread was the use of leasing incentives, that, in the valuation of commercial leases, some informed people in the industry referred to the "face" rent as being the rental specified in the lease and the "effective" rent as being the rental discounted for incentives. The evidence does not establish that incentive payments and rents were uniformly calculated, or, either generally or in this case, that a particular proportion of the rent, whether reduced to a present value or otherwise, was to equal the amount of the incentive payment on any particular percentage of it. There was no question of the firm being offered a choice between paying a higher rent and receiving an inducement payment, on the one hand, and paying a lower rent and receiving no inducement payment, on the other³.

3 Contrast *Commissioner of Taxation v Cooling* (1990) 22 FCR 42 in which there is a reference to a "formula" and an arithmetical relationship between the calculation of the quantum of the rent and the quantum of the incentive was spelled out (at 47, per Hill J); and also *Rotherwood Pty Ltd v Commissioner of Taxation* (1996) 64 FCR 313 at 322-323 where a precise arithmetical correlation was spelled out.

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12 It is not clear how the total amount of the inducement in this instance was actually calculated. Evidence was given that the amount increased during the course of negotiations. There was also evidence that it increased the higher the level of the floor to be rented. When the firm varied the lease and rented more space, the amount also increased.

13 Both in their original and in their amended forms, the agreement for lease and the incentive agreement were the subject of separate deeds. The inducement agreement recorded, in its preamble and cl 2.1, that the lessor paid the inducement payment to Plurimus Holdings Pty Ltd as an inducement for Plurimus to execute an agreement for lease in respect of levels 42 to 47 of 101 Collins Street. The preamble stated:

"A. The Lessor and the Lessee simultaneously with the execution hereof are entering into an agreement for lease with respect to the lettable areas of Levels 42, 43, 44, 45, 46 and 47 of the tower building being constructed at 101 Collins Street, Melbourne.

B. As an inducement for the Lessee to execute the said agreement for lease the Lessor has agreed to enter into this agreement to record certain financial arrangements between the parties with respect to the agreement for lease."

Clause 2.1 provided:

"2.1 As an inducement for the Lessee to enter into the Agreement for Lease, the Lessor agrees to pay to the Lessee the Inducement Amount."

By definition cl 1.1 of the inducement agreement the "Commencement Payment" was defined to mean "an amount equal to the undrawn balance of the Specified Amount from time to time ... compounded at ... 16.5% per annum with monthly rests from the date hereof until the Commencement Date". The expression "Inducement Amount" was defined to mean "the total amount payable by the Lessor to the Lessee pursuant to this Agreement" and the "Specified Amount" was defined as \$15.89 million. The inducement agreement also recorded the agreement of the parties that its terms and conditions were to be "kept confidential indefinitely".

14 The firm resolved on 9 August 1989 that, if it accepted the offer, any incentive payments received from the lessor would be maintained for the benefit of the firm as working capital, and would not be regarded as a divisible asset. It was contemplated that no partner might claim a share of the incentive payments upon ceasing to be a member of the firm. Although it appeared that, by variation of the deed of partnership dated 12 December 1990, incentive payments might be

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distributed, Jenkinson J, at first instance, accepted that this was not intended in August 1989. (The distribution was apparently made for the purposes of enabling the partners to meet the income tax assessments in respect of which these proceedings are brought, and was subject to an obligation to refund if the tax were remitted). The first substantial payment, of almost \$3 million, which was made in the income year ending 30 June 1991, consisted of authorised expenses⁴ within the meaning of that term as used in the inducement agreement and was applied towards the cost of fitting out the new premises. The balance was paid in the year ending 30 June 1992.

15 The Commissioner included the taxpayer's share of these payments in the respondent's assessable income in 1991 and 1992. The Commissioner also disallowed as deductions certain expenses incurred in relation to the negotiations for the incentive payment. This Court is not concerned with these deductions.

16 It is to be noted that, in addition to the expenses referred to in the preceding paragraph, the termination of the lease at BHP House and the move to Collins Street involved the firm in substantial costs, most of which were on capital account and could not be claimed as allowable deductions from assessable income. The precise quantification of those costs is not made clear by the evidence, and the appellant has never sought to bring to tax a net amount comprising the incentive payment less those costs. The cost of the fitout of the Collins Street premises, met by the firm, was approximately \$12.9 million. The firm, having paid for the fitout, sold it to a bank and leased it back, but this did not render it cost-free. It was presumably a financing arrangement, which carried some tax benefits. Total moving costs exceeded \$630,000. Stamp duty on the lease was approximately

4 "Authorised Expenses" was defined to mean the following categories of expense:

"(a) the Lessor's costs with respect to the Agreement for Lease payable pursuant to Clause 4.2 of the Agreement for Lease;

(b) stamp duty on the Agreement for Lease and Lease;

(c) up to \$3,000,000 in respect of expenses properly incurred with relation to the early termination of the Lessee's lease from Australian Mutual Provident Society of premises in BHP House, 140 William Street, Melbourne;

(d) reasonable expenses with regard to the design and documentation of the Lessee's Works; and

(e) reasonable consultants' and contractors' fees with respect to the Lessee's Works or relating to the Agreement for Lease."

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\$788,000. The firm lost the benefit of the 1987-1988 fitout in BHP House, which had cost more than \$3.7 million.

17 At first instance⁵, Jenkinson J found that the firm "was not devoid of choice" between leaving BHP House and remaining on the premises. His Honour found that although AMP's proposed refurbishment was one reason the firm decided to move premises, it did not compel the move. His Honour made a finding that the prospect of obtaining the inducement was also a reason for the firm's decision to move, and held that this was sufficient to bring the facts within the principles stated in *Commissioner of Taxation v Cooling*⁶ and to render the receipts liable to income tax.

18 The Full Court of the Federal Court⁷ (Davies, Lockhart and Heerey JJ), to which the respondent appealed, allowed the appeal from the decision of Jenkinson J.

The appeal to this Court

19 The Commissioner appeals to this Court on the following grounds:

- "1. The Full Court erred in holding that no profit or gain was derived from the receipt of the lease incentive payment by the partnership of which the Respondent was a member.
2. The Full Court erred in taking into account in the determination of the existence of a profit or gain, in relation to the lease inducement agreement, the obligations assumed by the Respondent's firm under other transactions.
3. The Full Court erred in failing to find that from a business and practical point of view, the receipt of the lease incentive payment in the hands of the firm was on revenue account. The Full Court should have held that, by reason of the interrelationship between the incentive payment and the rent agreed to be paid under the lease, the receipt of the incentive payment was on revenue account.

5 *Montgomery v Federal Commissioner of Taxation* (1997) 97 ATC 4287; 35 ATR 416.

6 (1990) 22 FCR 42.

7 *Montgomery v Federal Commissioner of Taxation* (1998) 152 ALR 241.

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4. The Full Court erred in failing to find that the lease incentive payment was paid to the firm in consideration of the rental agreed to be paid under the agreement for lease.
5. The Full Court erred in holding that the firm did not undertake a profit making venture the profit from which was assessable income of the partnership.
6. The Full Court erred in failing to follow the decision in *Commissioner of Taxation v Cooling*⁸.
7. The Full Court erred in finding that the receipt of the lease incentive payment by the firm was not an incident of the ordinary course of the partnership business and thus assessable income.
8. The Full Court erred in rejecting the trial Judge's findings of fact, on the evidence heard by him, as to the purpose of the partnership:
 - (a) that the potential harmful effects of asbestos were not a factor influencing the partnership to move to 101 Collins Street;
 - (b) that the partnership was not compelled by the imminent refurbishment to find new premises;
 - (c) that a substantial purpose of choosing to take a lease of 101 Collins Street was to obtain the benefit of the incentive;
 - (d) that one purpose of the partnership in entering into the transaction was to secure the gain represented by the lease incentive payment.
9. The Full Court should have upheld the trial Judge's decision, that receipt of the lease incentive amount comprised the derivation of a profit or gain and that the partnership entered into the lease transaction with a view to making that profit or gain.
10. The Full Court erred in holding that the receipt of the lease incentive payment was a receipt of capital. In particular:
 - (a) Heerey J erred in holding that a premium for the taking of a lease is generally on capital account;

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(b) Davies J erred in holding that the incentive payment derived its character from the undertaking of a new lease which he characterised as a capital transaction.

11. The Full Court erred in holding that a lease incentive is akin to a lease premium. No estate or interest in land was conferred on the payer in consideration of the payment.

12. The Full Court should have held that the lease incentive payment in the amount of \$29,351,530 was assessable income of the partnership of which the Respondent was a member and that in relation to the year of income ending 30 June 1991 the sum of \$2,994,784 so received was assessable income of the partnership."

20 At first instance, argument seems to have proceeded largely, if not exclusively, upon the basis that the issue was whether *Cooling*⁹ should be applied. Accordingly the argument there was directed mainly to factual comparisons of this case with *Cooling* and the Court was not asked to consider directly whether the principles stated in *Federal Commissioner of Taxation v Myer Emporium Ltd*¹⁰ (of which *Cooling* is an application) should be applied to this case. It may be observed at this point that the principles stated in *Myer* are themselves not without their difficulties of application¹¹. Furthermore, the respondent asserts, and the appellant does not deny, that the application or otherwise of the second limb of s 25A(1)¹² of the *Income Tax Assessment Act 1936* (Cth) ("the Act"), was not put in issue. Indeed, that seems to have been expressly disavowed as an issue by the appellant¹³.

9 (1990) 22 FCR 42.

10 (1987) 163 CLR 199.

11 See Hill, "A Pre-Bicentennial Reminder of our Heritage – Commissioner of Taxation v The Myer Emporium Ltd", (1987) 22 *Taxation in Australia* 12; Spry, "The Implications of the Myer Emporium Case", (1987) 16 *Australian Tax Review* 152.

12 Section 25A(1) provides:

"The assessable income of a taxpayer shall include profit arising from the sale by the taxpayer of any property acquired by him for the purpose of profit-making by sale, or from the carrying on or carrying out of any profit-making undertaking or scheme."

13 In the Full Federal Court the appellant's counsel said that he did ". . . not argue for a taxability of a receipt making scheme." (Full Federal Court Transcript at 52).

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21 The first submission of the appellant in this Court is that the reasoning in *Myer* dictates a conclusion in favour of the appellant in this case. He accepts that the receipt arose from a "capital transaction", which he acknowledges was of an "extraordinary" kind. What he then goes on to argue is that it was an ordinary incident of the firm's business to shift from one set of premises to another and that the change of premises was in the course of the respondent's business. The respondent on the other hand, argued that the change in the firm's premises was not an ordinary incident of, or an act done in the course of, the firm's business.

22 In support of his submission the appellant advanced the following contentions: that the partners did not consider themselves devoid of choice between staying in BHP House and moving elsewhere; that one substantial purpose of the partners was to obtain the inducement; that the inducement payment was negotiated and calculated with a view to placing the firm in the same position as it would have been in had the rents under the lease been true market rents; and it was the firm's purpose, in entering into the inducement agreement, to receive reimbursement for the artificially inflated future rental payments.

23 There were no findings in terms of the last two contentions. The appellant submits that, notwithstanding the absence of such findings, the evidence admits of no other conclusions.

24 The appellant adopts as part of his submissions on these factual matters what was said by Bowman JTCC at first instance in *Ikea Ltd v Canada*¹⁴:

"One does not need a master's degree in business administration to realize that where two economically powerful and sophisticated business persons negotiate the terms of a lease, the size of a tenant inducement payment would bear directly on the annual rent to be paid. To conclude otherwise would be to ignore economic reality."

Whether that statement is, as a broad generalisation, correct or not is beside the point. This Court is bound to look closely at, and analyse, the facts and circumstances of the case before it.

14 [1994] 1 CTC 2140 at 2151.

- 25 The passage in *Myer* which states in summary form the principle upon which the appellant relies for his submission that the receipt was a receipt of income according to ordinary concepts and within s 25 of the Act is this¹⁵:

"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 carrying on the taxpayer's business is not income. Because a business is carried on with a view to profit, a gain made in the ordinary course of carrying on the business is invested with the profit-making purpose, thereby stamping the profit with the character of income. But a gain made otherwise than in the ordinary course of carrying on the business which nevertheless arises from a transaction entered into by the taxpayer with the intention or purpose of making a profit or gain may well constitute income. Whether it does depends very much on the circumstances of the case. Generally speaking, however, it may be said that if the circumstances are such as to give rise to the inference that the taxpayer's intention or purpose in entering into the transaction was to make a profit or gain, the profit or gain will be income, notwithstanding that the transaction was extraordinary judged by reference to the ordinary course of the taxpayer's business. Nor does the fact that a profit or gain is made as the result of an isolated venture or a "one-off" transaction preclude it from being properly characterized as income¹⁶. The authorities establish that a profit or gain so made will constitute income if the property generating the profit or gain was acquired in a business operation or commercial transaction for the purpose of profit-making by the means giving rise to the profit."

- 26 The respondent challenges the appellant's summary of the relevant facts. The respondent submits that there was no finding or evidence as to "what rental payments . . . the taxpayer would otherwise have been prepared to pay", that in fact it is clear that there was no such "other rental" because, "in this case the lessors of 101 Collins Street would not in any way reduce the specified rent". Secondly, it was argued, the members of the firm had no choice but to accept or reject an offer of the kind which the landlord was making, and which a firm such as this could expect to be made, as an inducement to commit its prestige and drawing power as tenant of an expensive building under construction in the centre of Melbourne. That it might naturally be happy to accept such a sum in the circumstances, be well

15 *Federal Commissioner of Taxation v Myer Emporium Ltd* (1987) 163 CLR 199 at 209-210.

16 *Federal Commissioner of Taxation v Whitfords Beach Pty Ltd* (1982) 150 CLR 355 at 366-367, 376.

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aware of the virtual certainty that a large sum would be offered, and would want it to be as much as possible, did not mean that the sum when it was paid would be received on revenue account. The amount of the sum to be offered might be influenced by negotiation, but the offer was an occurrence independent of any action of the firm.

27 The respondent pointed out that the firm had no means of seeking to persuade the owners to accept a lower rent; the acceptance of a rental obligation at an amount determined by the landlord, and an incentive payment, were the components of the only offers that the landlord was prepared to make.

28 The respondent relied on the findings which were made in the Full Court of the Federal Court, which, it was argued, were justified. Heerey J said¹⁷:

"Nor is it suggested that there was any element of dressing up what was really a rent allowance to make it look like a premium."

Davies J said¹⁸:

"They [the members of the firm] were not given the opportunity of taking a lower rent at a lesser or no incentive."

¹⁷ *Montgomery v Federal Commissioner of Taxation* (1998) 152 ALR 241 at 260.

¹⁸ (1998) 152 ALR 241 at 243.

Lockhart J said¹⁹:

"it was not feasible for the firm to remain on the floors which it occupied in BHP House"...

"The firm had no practical alternative, when confronted with the gutting and cleansing from asbestos ... but to move out of those four floors."

29 These last two findings are correct. They recognize the reality that the firm could not remain on the floors which it had refurbished only recently and which the firm was then occupying, and that in a practical sense the firm was devoid of a choice between moving or not moving from the leased floors. The only choice was between moving internally, twice, and for an uncertain period, or moving externally and permanently.

30 The respondent relied on the findings by Lockhart J that²⁰:

"the evidence establishes that the firm's purpose in entering into the lease of the 101 Collins St premises was to secure prestigious premises in which the firm could conduct its practice as solicitors at the lowest possible cost."

And²¹:

"The purpose or object of entering into the transaction to lease the Collins St premises and to receive the inducement payment was to secure premises for the long term future of the firm, not to obtain a payment by way of inducement to be received as a profit or gain by the members of the firm."

Those findings were supported by the evidence.

31 The attention of the Court was drawn to the evidence of the landlord's agent Mr Dohnt, who never said, and to whom it was not suggested, that a different package of financial arrangements, such as a significantly lower rental in conjunction with a proportionally lower inducement payment, would have been acceptable to the landlord. Indeed, as the evidence shows, the developer's interests lay in an insistence upon high rents, which, when capitalised, would justify a high value for the building. The developer of such a major building would no doubt

19 (1998) 152 ALR 241 at 257-258.

20 (1998) 152 ALR 241 at 258.

21 (1998) 152 ALR 241 at 259.

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have other reasons for the kinds of financial arrangement that the developer was insisting upon here. The securing of a tenant such as the firm at an early stage of the development would enable the developer to exploit that fact to attract other tenants, perhaps charge higher rents to other tenants and obtain a timely, full letting of the building. The early commitment of a tenant such as the firm might also be of relevance to arrangements that a developer might have with a financier. It is not right on any view to attribute to a tenant in this situation the same motives and purposes as those of the developer, or to regard the course or incidents of a landlord's developer's business as being the same as those of a firm of solicitors carrying on a legal practice in rented premises.

Income or capital?

32 The case was argued in the courts below, and in this Court, upon the basis that the ultimate issue was whether the amounts received pursuant to the inducement agreement were, for the purposes of s 25 of the Act, income, or whether they were capital. However unscientific that distinction may be, and however difficult it may be to apply it to some particular cases, the arguments of the parties proceeded on the assumption that the distinction was decisive.

33 Notwithstanding that the appellant appears to have disclaimed reliance on s 25A in the Full Court of the Federal Court, and did not put that the firm had a purpose of entering into a scheme, we will deal with those arguments of the appellant which appear to rely upon such a suggestion.

34 In the forefront of the appellant's case was a submission that must fail for want of a factual basis. The question arising for decision in the case was said to be "whether amounts received by the firm ... as an inducement to pay inflated rent under a lease agreement, are income within section 25 [of the Act]". The question was said to turn upon the application of *Myer* and *Cooling*. What was said to make the lease incentive payment assessable was that it was received in business, as an incentive to pay greater rental payments than the taxpayer would otherwise have been prepared to pay, in circumstances where the rental payments were a deductible expense, and in circumstances where the incentive was bargained for in the natural course of carrying on the taxpayer's business.

35 For the reasons already given, the characterisation of the incentive payments as "an inducement to pay inflated rent" is not an accurate representation of the evidence. In this case, unlike *Cooling*²², there was no direct relationship between the rent and the inducement payment, and no choice of paying lesser rent and receiving no inducement payment. Furthermore, from the firm's point of view, an

22 (1990) 22 FCR 42 at 57.

inducement to take a lease of the Collins Street premises included, amongst other things, compensation for substantial costs involved in leaving BHP House, and fitting out and moving into Collins Street. Insofar as it is proper to regard the payment as a form of compensation, it was certainly not only compensation for the higher rent the firm would have to pay, and there was no demonstrated relationship between any part of the payment and some "inflated" element of the rent.

36 The appellant's primary submission fails on the facts.

37 The New Zealand case of *Commissioner of Inland Revenue v Wattie*²³ was stronger in favour of the revenue authorities than the present case. There an inducement payment by a landlord to a firm of accountants was accepted to have been made to offset above-market rental. Yet the New Zealand Court of Appeal²⁴, and the Privy Council²⁵, declining to follow *Cooling*, held that the payment was a capital receipt, and not income.

38 The first ground for decision in *Wattie* was one which appealed to two members of the Full Court, Davies and Heerey JJ, in the present case. It being agreed that, ordinarily, a payment by a lessee to a lessor of a premium for a lease is on capital account, both the Court of Appeal and the Privy Council regarded it as impossible to distinguish, in principle, a payment, on an identical occasion, moving in the other direction. It was acknowledged that, in the case of a premium, the lessee would be paying for an asset which, in a case such as the present, would form part of the structure for the conduct of a business. It was considered unsound to distinguish between acquisition and disposition. We agree. In the Privy Council, Lord Nolan, delivering the advice of the Board, referred to the leading Australian authorities on the difference between capital and income, and then considered *Regent Oil Co Ltd v Strick*²⁶ which related to premiums paid by a lessee and held to be capital. His Lordship said that, in the absence of special legislation to the contrary, a premium has always been recognised, both in the United Kingdom and New Zealand, as capital rather than revenue. His Lordship said²⁷:

23 [1999] 1 WLR 873.

24 *Wattie v Commissioner of Inland Revenue* (1997) 18 NZTC 13,297.

25 *Commissioner of Inland Revenue v Wattie* [1999] 1 WLR 873.

26 [1966] AC 295.

27 [1999] 1 WLR 873 at 882.

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"The reason has probably never been better expressed than by Viscount Cave LC in the familiar passage from his speech in *British Insulated and Helsby Cables Ltd v Atherton*²⁸ when he said:

'But when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital.'

...

Viscount Cave's reference to an 'asset or an advantage' (emphasis added) is to be noted. A payment may be capital although not made for the acquisition or disposal of a particular asset. The crucial question is whether in all the circumstances the payment or receipt can properly be attributed to a particular year. The question is crucial because income tax is charged annually upon the income or profits of each year. If the payment or receipt cannot properly be brought into the income tax reckoning for a particular year then (apart from special statutory provision) it cannot be brought into that reckoning at all."

39 In *Selleck v Commissioner of Taxation*²⁹ Beaumont J, correctly in our view, attached importance to the similarity between the nature and occasion of a receipt of an inducement payment and the nature and occasion of a premium. Both are once and for all payments made or received on the occasion of the acquisition of part of the structure of an ongoing business.

40 The second ground of the decision in *Wattie* relates to the significance, for a case such as the present, of *Myer*. The principle relied upon by the appellant is set out in the passage from *Myer* quoted earlier in these reasons. It may be compared with the language of certain of the grounds of appeal also quoted above.

41 In this connection it is necessary to refer again to the facts of the present case and, in particular, to the substantial costs associated with the firm's decision to move to Collins Street. The amounts in issue have been brought to tax on the basis that they represent, in whole, a profit or gain in business. Leaving to one side, for the moment, the relationship of the transaction with the firm's business, to treat the

28 [1926] AC 205 at 213-214.

29 (1997) 78 FCR 102.

gross receipts as profit or gain represents an inversion of what was decided in *Myer*. In that case, the taxpayer sought to confine attention to one aspect of a larger transaction. The taxpayer argued that the assignment of a right to future interest payments was made for fair value and there was thus no profit or gain. The Court rejected that argument, insisting that the entire transaction, including the original loan, be considered. Here the appellant is seeking to do what the taxpayer in *Myer* attempted. If there were a scheme or venture entered into for the purpose of making a profit, or gain, then the costs associated with the scheme or venture would have to be taken into account.

42 In *Wattie*, Lord Nolan said³⁰:

"Like the majority of the Court of Appeal their Lordships are unable to understand how the \$5m can be regarded as a profit. It could only be so regarded if it constituted a benefit or bonus accruing to Coopers & Lybrand quite independently of the other terms of the bargain between the parties. To regard it in this way would be plainly erroneous in principle".

43 In the present case the amounts brought to tax did not represent a profit or gain. They were not received in the ordinary course of the firm's business. The occasion of the receipt was agreeing to enter into, and undertaking the obligations involved in, a long term lease which was to form part of the structure within which the firm was to conduct its business. To refer to ground seven of the grounds of appeal, the fact that an inducement payment was an ordinary incident of agreeing to take a lease in circumstances such as those involved here does not make receipt of the payment an incident of the ordinary course of the partnership business. This was a singular transaction, not part of the regular means by which the firm derived income. *Myer* decided that singularity was not conclusive, but it did not decide that it was irrelevant. It 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. Unlike *Cooling*, 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.

44 We are unable to accept that the inducement payment is properly characterised as proceeding from the use or exploitation by the firm of its capital, whether the relevant capital is taken to be the agreement to lease the Collins Street premises or the goodwill of the firm. We say that for the following reasons.

30 [1999] 1 WLR 873 at 883.

45 First, such characterisation involves disregarding the entire transaction and directing attention to only part of it. This, as was noted earlier, is the opposite of the approach taken in *Myer*.

46 Secondly, the agreement to take the lease, for which the inducement payment was part of the consideration, was not, at the time of the agreement for the inducement payment, an asset of the firm capable of exploitation. The owner of the premises agreed to grant, and the firm agreed to take, the lease. The rights to be granted under the lease were to form part of the capital structure 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.

47 Thirdly, the asset of the firm which was its goodwill must be identified accurately. It is something different from the firm's size. The firm's size was not part of its capital. The goodwill of a firm has been described as "the attractive force which brings in custom"³¹. Depending upon the nature of the firm's trade or business, it may be related to a variety of factors including the premises from, or the locality in, which it operates³². What made the firm in the present case an "attractive tenancy target" was primarily its size but also, no doubt, its reputation. Those matters would have increased its bargaining power in negotiations about the size of the inducement payment, but it does not follow that it is correct to regard any part of the payment, let alone the whole of it, as the fruit of exploitation of the firm's goodwill.

48 Fourthly, there is a measure of inconsistency between the appellant's reliance on the circumstance that, in the prevailing market conditions, receipt of an inducement payment was an ordinary incident of taking up a lease of a substantial portion of a new building in Melbourne, and a contention that the payment in the present case resulted from the exploitation of the firm's goodwill. Putting all other objections to the proposition to one side, the most that could be said is that the firm's size and reputation meant that it could expect to be offered a larger payment than some other prospective tenants.

31 *Inland Revenue Commissioners v Muller & Co's Margarine Ltd* [1901] AC 217 at 224 per Lord Macnaghten; *Commissioner of Taxation v Murry* (1998) 72 ALJR 1065 at 1069; 155 ALR 67 at 72.

32 *Federal Commissioner of Taxation v Williamson* (1943) 67 CLR 561; *Box v Commissioner of Taxation* (1952) 86 CLR 387; *Duncan v Ridd* [1976] 2 NSWLR 105; *Geraghty v Minter* (1979) 142 CLR 177 at 198; *Commissioner of Taxation v Murry* (1998) 72 ALJR 1065 at 1070-1071; 155 ALR 67 at 74-75.

Gleeson CJ
McHugh J
Callinan J

18.

49 We agree with the conclusion of the Full Court of the Federal Court.

50 The appeal should be dismissed with costs.

- 51 GAUDRON, GUMMOW, KIRBY AND HAYNE JJ. The respondent ("the taxpayer") is a partner in a large firm of solicitors. From 1977 to 1991 that firm carried on its practice in Melbourne from offices in BHP House (at 140 William Street) and from offices in Nauru House (at 80 Collins Street). On 9 August 1989, the firm decided (subject to a qualification that is now irrelevant) that it would accept an offer, made by the developers of a building then under construction at 101 Collins Street, Melbourne, of a lease of some floors of that building.
- 52 On 14 August 1989, three agreements were executed: an agreement for lease of six floors of the building at 101 Collins Street; an agreement "to record certain financial arrangements between the parties with respect to the agreement for lease" and made by the lessors "[a]s an inducement for the Lessee to execute the ... agreement for lease"; and a deed of acknowledgment by which some of the members of the firm covenanted to meet all of the obligations of Plurimus Holdings Pty Ltd, the company that had agreed to take the lease. (Plurimus Holdings was treated by the parties to the appeal as having made the first two of these agreements as agent for the firm. Because only some of the members of the firm executed the deed of acknowledgment, it may not be entirely accurate to deal with the matter in this way but nothing was said to turn on it and we do not notice it further.)
- 53 Under the second of these agreements ("the inducement agreement") the lessors agreed to pay the lessee \$15,890,000, described in the inducement agreement as the "Specified Amount". The lessee was entitled to draw down part of the Specified Amount, before the term of the lease commenced, to meet certain expenses identified in the inducement agreement. The balance, together with compound interest at 16.5% per annum, was payable to the lessee at the end of the twelve week period for completion of the lessee's fitting out of its new premises at 101 Collins Street.
- 54 Both the agreement for lease and the inducement agreement were later varied to reflect (among other things) the fact that the lessee agreed to take two extra floors in the building. The Specified Amount fixed by the inducement agreement was increased from \$15,890,00 to \$21,490,000. A very small part of the money due under the varied inducement agreement was paid in the financial year ended 30 June 1990; nearly \$3 million was paid in the financial year ended 30 June 1991; the balance (which, with interest, amounted to more than \$26.3 million) was paid in the next financial year.
- 55 The appellant ("the Commissioner") assessed the taxpayer to income tax in the 1991 and 1992 financial years, first, by including in the taxpayer's taxable income an interest in the net income of the firm, which included the sums received

by the firm in those years under the varied inducement agreement, and secondly, by disallowing certain claimed deductions. The taxpayer objected to each assessment. He alleged that the sums received were capital, not income. Those objections were disallowed by the Commissioner and the taxpayer appealed to the Federal Court of Australia.

56 At first instance, Jenkinson J allowed the taxpayer's appeals against the disallowance of some of the claimed deductions³³. Otherwise the taxpayer failed in his appeal. The primary judge concluded that the amounts paid under the inducement agreement were (to the extent of the taxpayer's interest in the partnership) assessable income of the taxpayer.

57 The taxpayer appealed to the Full Court of the Federal Court. The appeals were allowed³⁴. All three members of the Court (Davies, Lockhart and Heerey JJ) held that the sums received by the firm under the inducement agreement were not income but capital³⁵ and were not properly included in the assessable income of the taxpayer. The questions about deductions were treated as depending upon the characterisation of the sums received under the inducement agreement as capital or income and were not separately considered in the reasons of the Full Court.

58 By special leave, the Commissioner now appeals to this Court where the questions argued concerned only the characterisation of the sums received as capital or income. Questions about deductions were not argued.

The Commissioner's case in this Court

59 The Commissioner's contention that the sums received under the inducement agreement were income in the hands of the taxpayer was put in several ways. It was said that because the sums received were an incident of a transaction that occurred in the course of the business activity of the taxpayer (even though it was not in the ordinary course of that business) and because the receipts were an ordinary incident of a transaction of that kind, the receipts were income. Next, it was said that the receipts were a gain from a profit-making undertaking or scheme and that a significant purpose of the taxpayer in entering the transaction was the derivation of a gain. Finally, it was said that it was an amount, received in

33 *Montgomery v Federal Commissioner of Taxation* (1997) 97 ATC 4287; 35 ATR 416.

34 *Montgomery v Federal Commissioner of Taxation* (1998) 152 ALR 241.

35 (1998) 152 ALR 241 at 244 per Davies J, 259 per Lockhart J, 266 per Heerey J.

business, as an incentive to pay greater rental payments than the taxpayer would otherwise have been prepared to pay and in circumstances, first, where the rental payments are a deductible expense and, secondly, where the incentive was bargained and negotiated for in the natural course of carrying on the taxpayer's business.

- 60 Before examining these contentions, or the taxpayer's arguments in answer, it is as well to say something about the fundamental issues that are raised by a debate about whether a particular receipt by a taxpayer is capital or income.

Income

- 61 In 1991 and 1992, the *Income Tax Assessment Act* 1936 (Cth) ("the Act") contained no definition of income, although it did define "income from personal exertion or income derived from personal exertion" and "income from property or income derived from property"³⁶. Income from (or derived from) personal exertion was defined as meaning (in part):

"income consisting of earnings, salaries, wages, commissions, fees, bonuses, pensions, superannuation allowances, retiring allowances and retiring gratuities, allowances and gratuities received in the capacity of employee or in relation to any services rendered, the proceeds of any business carried on by the taxpayer either alone or as a partner with any other person, any amount received as a bounty or subsidy in carrying on a business ... any profit arising from the sale by the taxpayer of any property acquired by him for the purpose of profit-making by sale or from the carrying on or carrying out of any profit-making undertaking or scheme ... but does not include -

- (a) interest, unless the taxpayer's principal business consists of the lending of money, or unless the interest is received in respect of a debt due to the taxpayer for goods supplied or services rendered by him in the course of his business; or
- (b) rents or dividends".

Income from (or derived from) property was defined as meaning "all income not being income from personal exertion".

- 62 The distinction between income from personal exertion and income from property was important when the two forms of income were taxed at different

36 s 6(1).

rates³⁷ and the distinction has been drawn for other purposes³⁸. But the definition of income from personal exertion "has always been used as a possible guide or test in cases where the question is whether a particular receipt is income or not"³⁹. The definition of income from personal exertion thus casts some light on what was meant by the Act when it said in s 25(1) that:

"The assessable income of a taxpayer shall include -

(a) where the taxpayer is a resident -

the gross income derived directly or indirectly from all sources whether in or out of Australia; and

(b) ...

which is not exempt income ..."

But both of the definitions in s 6 (of income from personal exertion and income from property) begin by saying the term "means income ..." or "means all income ...". Both definitions, therefore, presuppose that "income" has a meaning. It follows, then, that the question what is income cannot be answered simply by resorting to the words of these definitions.

63 Nearly a century ago Lord Macnaghten begged pardon for reminding his listeners that "[i]ncome tax ... is a tax on income. It is not meant to be a tax on anything else."⁴⁰ But, as Jordan CJ said in *Scott v Commissioner of Taxation*⁴¹:

37 See, for example, s 8(1) of the *Income Tax Act* 1974 (Cth) imposing a surcharge on income from property where the taxable income exceeded \$5,000.

38 See, for example, the provisions governing the calculation of the rebate on dividends granted to resident companies under s 46 of the Act as it stood until the *Taxation Laws Amendment Act (No 2)* 1987 (Cth).

39 *Federal Commissioner of Taxation v Dixon* (1952) 86 CLR 540 at 555 per Dixon CJ and Williams J; see also *Scott v Federal Commissioner of Taxation* (1966) 117 CLR 514 at 524 where Windeyer J said that the definition "refers to what is already by its nature income".

40 *London County Council v Attorney-General* [1901] AC 26 at 35.

41 (1935) 35 SR(NSW) 215 at 219.

"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 ordinary parlance are to be treated as income, or that special rules are to be applied for arriving at the taxable amount of such receipts⁴²."

64 Because the distinction between income and capital has so often been considered by the courts, attempts to classify a particular receipt often proceed by seeking to draw analogies with decided cases⁴³. That approach is often helpful, but resort to analogy should not be permitted to obscure the essential nature of the inquiry which is to determine whether "in ordinary parlance" the receipt in question is to be treated as income. As Jordan CJ made plain, the references to "ordinary parlance" and to the "ordinary concepts and usages of mankind" are no mere matters of ritual incantation; they identify the essential nature of the inquiry.

65 The core of the meaning of "income" in a context such as the present can be identified from what was said by Pitney J in the opinion of the Supreme Court of the United States in *Eisner v Macomber*⁴⁴:

"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. For the present purpose we require only a clear definition of the term 'income,' as used in common speech, in order to determine its meaning in the Amendment; and, having formed also a correct judgment as to the nature of a stock dividend, we shall find it easy to decide the matter at issue.

42 *A-G of British Columbia v Ostrum* [1904] AC 144 at 147; *Lambe v Inland Revenue Commissioners* [1934] 1 KB 178 at 182-183.

43 *Van Den Berghs Ltd v Clark* [1935] AC 431 at 438-439 per Lord Macmillan.

44 252 US 189 at 206-207 (1920). The Supreme Court was construing the Sixteenth Amendment to the United States Constitution which stated:

"The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

After examining dictionaries in common use (Bouv L D; Standard Dict; Webster's Internat Dict; Century Dict), we find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of 1909 (*Stratton's Independence v Howbert*, 231 US 399, 415; *Doyle v Mitchell Bros Co*, 247 US 179, 185) - 'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the *Doyle Case* (pp 183, 185).

Brief as it is, it indicates the characteristic and distinguishing attribute of income essential for a correct solution of the present controversy. The Government, although basing its argument upon the definition as quoted, placed chief emphasis upon the word 'gain,' which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived. '*Derived-from-capital*'; - 'the *gain-derived-from-capital*,' etc. Here we have the essential matter: *not* a gain *accruing to* capital, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital however invested or employed, and *coming in*, being '*derived*,' that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal; - *that* is income derived from property. Nothing else answers the description."⁴⁵

- 66 As was noted in *Federal Commissioner of Taxation v Myer Emporium Ltd*⁴⁶, both the "ordinary usage meaning" of income and the "flow" concept of income derived from trust law have been criticised⁴⁷. But both the ordinary usage meaning and the flow concept of income are deeply entrenched in Australian taxation law and it was not suggested by either party that there should be any reconsideration

45 (Emphasis in original.) Although Holmes J (with Day J) and Brandeis J (with Clarke J) dissented, the dissenting opinions, powerful as they are in relation to the particular issue that fell for decision in the case, do not detract from the validity of the propositions advanced in the opinion of the Court.

46 (1987) 163 CLR 199 at 215 per Mason ACJ, Wilson, Brennan, Deane and Dawson JJ.

47 Parsons, "Income Taxation: An Institution in Decay?", (1986) 12 *Monash University Law Review* 77.

of them. Nor was it suggested that they should be replaced by concepts of gain or realised gain⁴⁸, concepts that some economists consider preferable.

67 What can be seen from the passage from *Eisner v Macomber* is that income is often the product of exploitation of capital. But, of course, that is not always so. The worker's wages are not (except figuratively) the product of exploitation of the worker's capital. Further, as has so often been stated, income will frequently be recurrent or periodical. But again, the fact that a person only ever works for wages for one week, and receives but a single pay packet (or more likely written advice of electronic funds transfer) does not make the wages thus earned any the less income in the hands of the worker. Most receipts from carrying on a business are income. But some receipts, such as amounts paid on disposing of capital assets of the business, are properly classified as receipts on capital account.

68 Each of the general propositions we have mentioned is qualified: income is often (but not always) a product of exploitation of capital; income is often (but not always) recurrent or periodical; receipts from carrying on a business are mostly (but not always) income. Further, in a case where it is said that the receipt is from carrying on business, often there will be a real and lively question whether what has been done amounts to carrying on business or is, in truth, no more than a singular transaction of purchase and resale of property⁴⁹.

69 The search for analogous cases is, then, hardly surprising and was undertaken by both of the parties to this appeal. In doing so, each party tended to emphasise one or more features of the transactions that gave rise to the payments received by the firm. Sometimes the emphasis of one or more of these features was taken to the point of excluding any consideration of the other features of the transactions. But as Dixon and Evatt JJ said (in the more limited context of distinguishing between profits derived from carrying on or carrying out a profit-making scheme and proceeds of a mere realisation or change of investment⁵⁰) "it is necessary to

48 Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy*, (1938).

49 *Jones v Leeming* [1930] AC 415.

50 As to which see *Ruhamah Property Co Ltd v Federal Commissioner of Taxation* (1928) 41 CLR 148 at 151 per Knox CJ, Gavan Duffy, Powers and Starke JJ; *Jolly v Federal Commissioner of Taxation* (1934) 50 CLR 131 at 139 per Dixon J.

make both a wide survey and an exact scrutiny of the taxpayer's activities"⁵¹. We turn then to describe the transactions and their background in more detail.

The background to the transactions

70 The uncontradicted evidence at trial, accepted by the primary judge, was that in 1988 and 1989 it was an ordinary incident of renting premises in a new building in the centre of Melbourne to receive incentive payments of the kind paid under the inducement agreement. That finding was based on evidence given by a valuer who described what had been happening in the market for leasing commercial offices in the centre of Melbourne during this period. He said (and his evidence was not contradicted) that excessive office development in the late 1980s and early 1990s had brought about a "huge oversupply of office space in the premium or landmark building category" and that this had given rise to a period of intense competition between developers trying to obtain tenants for their buildings. He said that "faced with the unprecedented level of competition to secure tenants, the only method by which rentals could be maintained" at what he called "levels ... commensurate with the long term growth (CPI) rate or better" was by the offering of a range of leasing incentives. These incentives took various forms but included: making payments in cash or in kind to lessees, contributing to the whole or part of the lessee's costs of fitting out the premises, doing building works to suit the particular requirements of the lessee, granting rent free or reduced rent periods, and assuming the lessee's liabilities under an existing lease.

71 The agent of the lessors of the premises at 101 Collins Street gave evidence at trial that "in common with leasing patterns in the Central Business District at that time, it was the Lessors' position that the asking rental levels be maintained. This was achieved by providing incentive packages to tenants, such as cash payments, rent free periods, fitout allowances and so on. At this point in time, asking rents were still regarded as market rents by the market in general. It was my understanding that the basis for this position, that is, a lessor preserving the asking rents by offering incentives, was to maintain the capital value of the building."

72 The evidence at trial showed that a valuer, seeking to determine the market rental for premises, or their capital value, may have to decide whether any part of an incentive payment made at the time of entering into a lease should be regarded as a de facto rent reduction. It followed that to make a proper determination of market rental or capital value it may be necessary to differentiate between the "face

51 *Western Gold Mines NL v Commissioner of Taxation (WA)* (1938) 59 CLR 729 at 740.

rent" (being what the developer of a building asked, or required, to be fixed as the rent payable under the lease) and the "effective rent" (being the amount of the face rent less the worth of the incentive that was paid).

73 The primary judge found that the firm "had not the alternative means of lessening the burden of the rent [for the premises at 101 Collins Street], by seeking to persuade the owners to accept a lower rent"⁵². Although the inducement amount that was offered to a prospective lessee might be influenced by negotiation, the rent to be fixed by the lease could not.

74 The taxpayer contended at trial that the firm was obliged to move its offices from BHP House because the lessor of those premises was proposing to refurbish the building and because the firm feared that asbestos particles might be dislodged in that process and cause harm to persons in the firm's offices. These contentions were not accepted. The primary judge found that on 9 August 1989, when the firm resolved to move to 101 Collins Street, some members of the firm knew of and were worried about these matters. But the primary judge was not persuaded that concern about the harmful effects of asbestos during refurbishment of BHP House led the taxpayer or any other member of the firm to consider themselves obliged to vote to move out of BHP House. Nor was he persuaded that the disruption that would attend refurbishment of BHP House obliged the firm to move. He found that the taxpayer and his partners "did not think themselves devoid of choice on 9 August 1989 between staying in BHP House and leaving it. On the contrary, they were ... set upon making a choice between the alternatives placed before them in the papers prepared for the meeting."⁵³ Those alternatives were to move to 101 Collins Street, to move to a building then proposed to be built at the corner of Bourke and William Streets (known as Grand Central) or to stay in BHP House. (Two other possibilities had been discarded earlier.)

75 In the Full Court, Lockhart J acknowledged that the primary judge had found that the taxpayer and his partners did not think themselves devoid of choice between staying in BHP House and leaving it⁵⁴, but went on to say that "in practice it was not feasible for the firm to remain on the floors which it occupied in BHP

52 *Montgomery v Federal Commissioner of Taxation* (1997) 97 ATC 4287 at 4296; 35 ATR 416 at 426.

53 *Montgomery v Federal Commissioner of Taxation* (1997) 97 ATC 4287 at 4297; 35 ATR 416 at 426-427.

54 (1998) 152 ALR 241 at 257.

House"⁵⁵ and that "the decision to move from the four floors in BHP House was in practical terms essential to the firm"⁵⁶. If the conclusions that it was "not feasible ... to remain" in BHP House and that the decision to move was "in practical terms essential" mean no more than that the reasons for moving clearly outweighed the reasons against doing so, they are conclusions that were well open to the Full Court. But if the conclusions were intended to state some different finding from the primary judge's finding that the taxpayer and his partners "did not think themselves devoid of choice ... between staying in BHP House and leaving it", there was no sufficient basis for the Full Court to substitute its own finding on the issue. It was a finding that depended in part upon the primary judge's assessment of the oral evidence given at trial and there was no proper basis to depart from that assessment⁵⁷.

- 76 The papers presented to members of the firm for consideration at the meeting of 9 August 1989 contained detailed financial evaluations of the offers that had been made in relation to 101 Collins Street and the Grand Central Project. The papers suggested that little separated the offers, which were described as "good but not startling". Significantly, the papers went on to say that the firm "is now of a size which makes it a particularly attractive tenancy target and it should therefore expect to receive from any prospective landlord, as a bare minimum, a substantial or total fitout contribution and some initial rent incentive".

The transactions

- 77 The essential nature of the three agreements executed on 14 August 1989 has been described earlier. Some further aspects of their provisions should be noted.
- 78 The agreement for lease provided, in effect, that the lessors would perform certain works to give a "core and shell presentation" of the premises and that the lessee would have a limited period "during which the Lessee will carry out and complete the Lessee's Work" (that is, the balance of works required to enable the lessee to occupy the premises).

55 (1998) 152 ALR 241 at 257.

56 (1998) 152 ALR 241 at 257.

57 *Devries v Australian National Railways Commission* (1993) 177 CLR 472; *State Rail Authority of New South Wales v Earthline Constructions Pty Ltd (In Liq)* (1999) 73 ALJR 306; 160 ALR 588.

79 The agreement for lease provided that (subject to a qualification that does not matter now) the lease that was to be granted and taken was to be "subject to the provisions, covenants, terms and conditions set forth in the Annexed Lease". For reasons that were not explained, the document tendered in evidence did not include the "Annexed Lease" and there was, then, no evidence at trial (or on appeal) of what were the terms of the lease that was to be made pursuant to the agreement for lease.

80 Under certain provisions of the inducement agreement, the lessee was entitled to draw down parts of the inducement amount to pay certain authorised expenses, including up to \$3 million "in respect of expenses properly incurred with relation to the early termination" of the firm's lease of premises in BHP House and reasonable expenses with regard to the agreement for lease and the design, documentation and carrying out of the fitout of the premises. It was pursuant to these provisions that payments of nearly \$3 million were made in the year ending 30 June 1991. We were taken to no evidence that showed clearly what particular expenses were met in this way, but nothing turns on that.

81 The firm spent a considerable sum fitting out the premises. It was suggested in argument in this Court and in the Full Court that the amount spent was nearly \$13 million but the evidentiary basis for this assertion is not readily apparent. Again, however, nothing turns on it. When the fitout was finished, the firm sold it to a bank and leased it back.

82 The taxpayer submitted that, looked at in its entirety, the overall transaction recorded in the three agreements produced no net return or gain to the firm. It was said that the amounts received in the 1991 year of income were all on account of (and offset by) what the inducement agreement called "Authorised Expenses" and that the amount received in the next year had to be set off against various outgoings in that year. It may be doubted that all of the expenses that it was said should be put against the amount of the inducement amount received in the year ending 30 June 1992 could properly be said to be outgoings "arising from" the agreement to lease, or were incurred "because of" the move (to adopt the descriptions used in the taxpayer's submissions). Included in the outgoings were amounts paid for rent in respect of not only 101 Collins Street but also the former premises of the firm in BHP House and Nauru House. The outgoings were also said to include a sum suggested to be the loss suffered in relation to the fitout of BHP House and the lease of that fitout; that loss was shown in the 1991 return of the firm, not the 1992 return. The inclusion in the outgoings of the rent for all three sets of premises might be said to amount to double counting; the attribution of the loss sustained in 1991 to amounts received in 1992 may be open to question. It is not necessary, however, to stay to examine these aspects of the matter further. The questions debated on the hearing of the appeal to this Court focused on the characterisation

of the receipts. Clearly, the firm did incur some outgoings as a result of the making of the three agreements. The exact quantification of those outgoings can be put to one side.

Characterisation of the receipts – incentive to pay greater rent?

83 It is convenient to deal first with the Commissioner's argument that the amount was received in business as an incentive to pay greater rental payments than the taxpayer would otherwise have been prepared to pay.

84 The sums received by the firm under the inducement agreement were not received as an incentive to pay a "greater" or "inflated" rent. That statement assumes a comparison can be made between the rent that the firm agreed to pay and some other figure for rent. But no other, lesser, rent was available to the firm at 101 Collins Street; the lessors would not negotiate about the rent.

85 If there had been a similar landmark building in respect of which the owner had been willing to accept a lower rent than were the owners of 101 Collins Street, it might be that the parties to the arrangements now in question would have struck some different bargain. But the agreements that were made reflected the then state of the market and in particular reflected the fact that the lessors (like other lessors of landmark buildings in Melbourne at the time) would not negotiate about the level of rent to be fixed in the lease, only about the incentive to be provided.

86 In these circumstances, it is not accurate, at least for our purposes, to speak of some "market rent" (calculated by reducing the face rent by the worth of the incentive that was paid) as if that represented the "true" or "real" market rent for the premises with which the face rent should be compared. The argument is one that depends upon an assumption or hypothesis that is artificial, if not positively contrary to the facts. The market produced a more complicated arrangement than the simple agreement to pay rent for the lease of premises; it produced an arrangement under which the lessee agreed to pay rent and the lessor agreed to pay an incentive. To speak in these circumstances of a "market rent" calculated in the way suggested is to speak of an artificial construct. That is not to say that the product of the calculation may not have been of great utility to valuers. It may also have been a very useful tool in the hands of the business community when making business judgments. But it is not the rent for which the parties stipulated by the lease (or, in this case, their agreement for lease) and it is not the rent struck in the marketplace.

87 Further, because the agreements that were made represent the result of arm's length bargaining it must follow that the bargain struck represented what each party thought to be an acceptable set of terms. It is not useful to note that one party

to the bargain would have preferred to undertake some less onerous obligation. Almost every party to a commercial transaction would prefer to have less onerous obligations. But in the absence of some choice about what level of rent would be paid, it cannot be said that the sums paid under the inducement agreement were received in return for an agreement to pay a higher rent.

88 The absence of choice about the level of rent which is to be paid is not a helpful criterion against which the character of the lease incentives should be determined in cases such as this. The availability of choice about the level of rent depends upon behaviour in the market and that behaviour, in the nature of things, will ebb and flow with changes in the law. If availability of choice is adopted to determine the character of a receipt, that criterion will then prove to be inapplicable as market behaviour changes in reaction to earlier decisions applying it. Conceptual dangers lurk in the search for consistency in market behaviour where the range of prudent options left open to market participants is curtailed or otherwise modified to accommodate earlier court decisions. That is not because some question of the transaction being a sham intrudes⁵⁸. Rather, the concern is with the ascertainment of the legal character of a transaction by reference to availability of choice, where it may be expected that the availability of choice will be affected, if not determined, by the market's desire to reflect developments in case law as well as statute law.

89 For these reasons we do not consider that the decision of the Supreme Court of Canada in *Ikea Ltd v Canada*⁵⁹ (upon which the Commissioner relied) provides sure guidance to the proper disposition of the present matter. Although the legislative provisions governing *Ikea* differ from those that apply in this case, we doubt that much turns on those differences. But the decision appears to have proceeded from identifying a connection between the receipt of the lease inducement payment and the lessee's obligation to pay rent. Reference was made by the Court to the inducement payment being treated as if it were a "reduction of rent or consideration for the continued obligation to carry on business pursuant to the lease"⁶⁰. For the reasons we have given, we do not consider that it is possible to describe the inducement payments in this case as a "reduction of rent" and the

58 See *Scott v Federal Commissioner of Taxation (No 2)* (1966) 40 ALJR 265 at 279 per Windeyer J; *Sharrment Pty Ltd v Official Trustee in Bankruptcy* (1988) 18 FCR 449 at 453-454 per Lockhart J.

59 [1998] 1 SCR 196.

60 [1998] 1 SCR 196 at 213 per Iacobucci J.

alternative description of the payments as consideration for the *obligation* to carry on business is not apposite.

Characterisation of the receipts - a capital occasion?

90 The taxpayer submitted that the receipts were for the firm to take a long term lease of the premises from which it would conduct its professional practice. The lease, it was said, was part of the firm's profit-yielding structure and the payment was received to bring into existence an asset or advantage for the enduring benefit of the firm. This, so the argument went, was a capital occasion⁶¹.

91 That the lease of the premises was part of the profit-yielding structure of the firm's business is beyond question. But it by no means follows that any and every aspect of the several transactions associated with the obtaining of the lease is necessarily a transaction on capital rather than revenue account. To take the most obvious example, it is beyond question that rent paid under the lease would be a deductible outgoing.

92 It is important to keep well in mind that the receipts now in question were receipts associated with, or on the occasion of, the *acquisition* of part of the profit-yielding structure of the firm. That is, the receipts came in on an occasion different from many, if not most, that have fallen for consideration in other cases. In those cases the receipt is one that came in on the *disposition* of part of the profit-yielding structure. Similarly, it must be remembered that the sums now in question were *receipts* connected with the acquisition of part of the taxpayer's capital structure. In this respect, too, this occasion differs from those in other cases, where there was a *payment* to acquire part of that structure.

93 No question arises, in this case, of characterising the advantage that was sought by a taxpayer in making an expenditure⁶². This case concerns receipts not expenditures. Nor is there any question of characterising the receipts by reference to the place that property sold or realised may have had in the profit-yielding structure of the taxpayer.

94 The analogies which the taxpayer sought to draw with payments to acquire part of a taxpayer's capital structure or receipts on disposition of part of a taxpayer's

61 *British Insulated and Helsby Cables Ltd v Atherton* [1926] AC 205.

62 *G P International Pipecoaters Pty Ltd v Federal Commissioner of Taxation* (1990) 170 CLR 124 at 137 per Brennan, Dawson, Toohey, Gaudron and McHugh JJ.

capital structure are at best imperfect and may mislead. In particular, the reliance on an analogy with lease premium payments is misplaced.

Receipt analogous to premium payment?

95 The taxpayer placed some emphasis on the decision of the Privy Council in *Commissioner of Inland Revenue v Wattie*⁶³ dismissing the Commissioner's appeal from the decision of the Court of Appeal of New Zealand⁶⁴. *Wattie* concerned a lump sum inducement payment of \$5 million paid by a lessor to a firm of accountants to induce that firm to take a lease of premises in Auckland. Lord Nolan, giving the advice of the Judicial Committee, noted that in the absence of special legislation to the contrary, a premium paid to obtain a lease has always been recognised as capital. His Lordship concluded that the Court of Appeal had been right to describe the payment of \$5 million as "a negative premium" and therefore a capital receipt⁶⁵. We do not agree.

96 The character of an item of expenditure is ordinarily determined by reference to the nature of the asset acquired or the liability discharged by the making of the expenditure⁶⁶. As Dixon J pointed out in *Sun Newspapers Ltd and Associated Newspapers Ltd v Federal Commissioner of Taxation*⁶⁷, there are three matters to be considered in distinguishing between expenditures on capital account and expenditures on revenue account: the character of the advantage sought, the manner in which it is to be used, relied upon or enjoyed, and the means adopted to

63 [1999] 1 WLR 873.

64 *Wattie v Commissioner of Inland Revenue* (1997) 18 NZTC 13,297.

65 [1999] 1 WLR 873 at 883.

66 *Sun Newspapers Ltd and Associated Newspapers Ltd v Federal Commissioner of Taxation* (1938) 61 CLR 337 at 363 per Dixon J; *Colonial Mutual Life Assurance Society Ltd v Federal Commissioner of Taxation* (1953) 89 CLR 428 at 445-447 per Williams ACJ, 454 per Fullagar J; *Cooper v Federal Commissioner of Taxation* (1957) 97 CLR 397 at 404 per Kitto J (affirmed on other grounds (1958) 100 CLR 131); *G P International Pipecoaters* (1990) 170 CLR 124 at 137 per Brennan, Dawson, Toohey, Gaudron and McHugh JJ.

67 (1938) 61 CLR 337 at 363.

obtain it. Of these, the character of the advantage sought is "the chief, if not the critical, factor in determining the character of what is paid"⁶⁸ by a taxpayer.

97 A lessee who pays a premium for a lease obtains the advantage of the lease and that lease may well form part of the profit-yielding structure of the lessee's business. The amount outlaid as premium would, in those circumstances, be outlaid on capital account. But an amount *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 being part of the profit-yielding structure of the lessee's business.

98 "Whether or not a particular receipt is income depends upon its quality in the hands of the recipient."⁶⁹ The fact that the payment received is compensation for or reimbursement of an amount properly deductible under s 51(1) of the Act does not determine whether the receipt is income⁷⁰. And it is well established that a receipt may be income in the hands of the payee whether or not it is an expenditure of a capital nature by the payer⁷¹.

99 It is, therefore, wrong to assume exact congruence between the capital or revenue character of a sum as a receipt and its character as expenditure; it is also wrong to assume exact congruence between the character of a sum when received or paid by one taxpayer and its character when received or paid by another. The assertion of some such congruence or symmetry diverts attention from the fundamental inquiry in a case like the present: is the receipt income according to ordinary concepts⁷²? And reduced to its essentials the argument seeking to compare, if not equate, this receipt with a premium *paid* by a taxpayer for a lease

68 *G P International Pipecoaters* (1990) 170 CLR 124 at 137 per Brennan, Dawson, Toohey, Gaudron and McHugh JJ.

69 *Scott v Federal Commissioner of Taxation* (1966) 117 CLR 514 at 526 per Windeyer J.

70 *Allsop v Federal Commissioner of Taxation* (1965) 113 CLR 341 at 350-351 per Barwick CJ and Taylor J; *H R Sinclair & Son Pty Ltd v Federal Commissioner of Taxation* (1966) 114 CLR 537 at 542-543 per Taylor J, 545 per Owen J; *Federal Commissioner of Taxation v Rowe* (1997) 187 CLR 266 at 276-277 per Brennan CJ, Dawson, Toohey and McHugh JJ, 291-292 per Gaudron, Gummow and Kirby JJ.

71 *G P International Pipecoaters* (1990) 170 CLR 124 at 136 per Brennan, Dawson, Toohey, Gaudron and McHugh JJ.

72 cf *Rowe* (1997) 187 CLR 266 at 276-277 per Brennan CJ, Dawson, Toohey and McHugh JJ.

is an argument founded on an assertion of congruence or symmetry between whether a payment is deductible and whether a receipt is on capital account. That assertion was expressly rejected by all members of the Court in *Federal Commissioner of Taxation v Rowe*⁷³. We are therefore unable to accept the reasoning in *Wattie*.

Receipts for modification of capital structure

100 Similarly, analogies with payments received by a taxpayer on its agreeing to give up part of its profit-earning structure are apt to mislead. In such cases, the sum that is received is in return for giving up (or, in *Dickenson v Federal Commissioner of Taxation*⁷⁴, for modifying or restricting) the profit-earning structure of the business. What makes analogies with such cases inappropriate and misleading when it is sought to apply them to the present case is that in the former kind of case it is possible to discern an element of exchange: the taxpayer gives up, or gives up the use of, a capital asset in return for a receipt. By contrast, in the present case the firm gave up no part of its capital structure in return for the receipt; the firm added to its capital structure by acquiring the lease.

101 In *Dickenson* the taxpayer agreed to buy petrol and other products from only one oil company; he agreed not to buy from any other company. The taxpayer agreed to give up or sterilise part of his profit-yielding structure. In the present case, however, the firm did not agree that it would take no other premises and thereafter conduct its practice *only* from 101 Collins Street; it did not oblige itself to give up its premises in BHP House or its premises in Nauru House. So far as concerned the taxpayer's legal obligations it would have been entirely consistent with the agreements made in relation to 101 Collins Street for the firm to continue its practice from those other premises or, indeed, from any other premises. The lessors agreed to pay the amounts payable under the inducement agreement in return for the firm's agreement to take the lease – not in return for any disposal of part of the firm's capital structure.

Characterisation of the receipts – a singular transaction

102 The taxpayer contended that the receipts were on capital account because the transactions that gave rise to the receipts were not in the ordinary course of the ordinary business of the firm. The firm conducted its practice from offices in BHP

73 *Rowe* (1997) 187 CLR 266 at 276-277 per Brennan CJ, Dawson, Toohey and McHugh JJ, 291-292 per Gaudron, Gummow and Kirby JJ.

74 (1958) 98 CLR 460.

House and Nauru House from 7 March 1977 until 12 July 1991. Although the firm (or more accurately a company associated with the members of the firm) had made a number of separate leases and subleases regulating its tenancy of the premises at BHP House, there was no evidence that any inducement was paid to the firm for making any of those leases or subleases. It follows that the receipt of the sums paid under this inducement agreement could not be said to be receipts in the ordinary course of the ordinary business of the firm. But it is well established that the singularity of the receipts that now are in question, or (to put it another way) the fact that they are receipts standing apart from or outside the ordinary course of the ordinary business of the firm, does not inevitably stamp those receipts as capital receipts⁷⁵.

103 The submissions on behalf of the Commissioner (particularly the second of the contentions we have identified earlier – gain from a profit-making undertaking or scheme) placed great emphasis on this Court's decision in *Federal Commissioner of Taxation v Myer Emporium Ltd*⁷⁶ and the decision of the Full Court of the Federal Court of Australia in *Commissioner of Taxation v Cooling*⁷⁷.

104 In *Myer*, this Court said that⁷⁸:

"The important proposition to be derived from *Californian Copper* and *Ducker* is that a receipt may constitute income, if it arises from an isolated business operation or commercial transaction entered into otherwise than in the ordinary course of the carrying on of the taxpayer's business, so long as the taxpayer entered into the transaction with the intention or purpose of making a relevant profit or gain from the transaction."

The reference to "profit or gain from the transaction" attracted some attention in the course of argument. In particular there was some debate about whether the "profit" or the "gain" that was mentioned was intended to invite some calculation of a net difference between receipts and outgoings. (It was in this context that the

75 *Federal Commissioner of Taxation v Myer Emporium Ltd* (1987) 163 CLR 199; *Californian Copper Syndicate v Harris* (1904) 5 TC 159; *Ducker v Rees Roturbo Development Syndicate* [1928] AC 132.

76 (1987) 163 CLR 199.

77 (1990) 22 FCR 42.

78 (1987) 163 CLR 199 at 211 per Mason ACJ, Wilson, Brennan, Deane and Dawson JJ.

taxpayer referred to the various items mentioned earlier as amounts that he contended offset the amounts received under the inducement agreement.) As always, the references to profit or gain must be read in the context in which the references are made. In particular the often quoted questions from *Californian Copper Syndicate v Harris*⁷⁹:

"Is the sum of gain that has been made a mere enhancement of value by realising a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making?"

must be understood against the background of the then relevant legislation that brought "profit" to tax⁸⁰.

105 The references to profit and gain from a singular transaction must also be understood in the light of three later developments: the House of Lords decision in *Jones v Leeming*⁸¹, the enactment of what was, for many years, s 26(a) of the Act, and the decision of this Court in *Federal Commissioner of Taxation v Whitfords Beach Pty Ltd*⁸².

106 In *Jones v Leeming* it was held that "the profit on an isolated sale which is not a trading transaction" is a capital accretion and therefore not income⁸³. That decision depended, however, on the finding of fact that there was no "adventure or concern in the nature of trade"⁸⁴. But, as had been established in cases like *Californian Copper*, the fact that the purchase and resale of property was an isolated transaction did not necessarily mean that there was no trading adventure. All that was held in *Jones v Leeming* was that *if*, as a matter of fact, the transaction was not a trading transaction, the profit that was made on realisation of the asset was not income simply because the asset had been bought with the intention of making a profit on resale. The importance of the factual premise can be seen from

79 (1904) 5 TC 159 at 166.

80 *Ducker v Rees Roturbo Development Syndicate* [1928] AC 132 must be understood in the same light. See also *Commissioner of Taxes v Melbourne Trust Ltd* [1914] AC 1001.

81 [1930] AC 415.

82 (1982) 150 CLR 355.

83 [1930] AC 415 at 430 per Lord Macmillan.

84 *Income Tax Act* 1918 (UK), s 237.

the later decision in *Edwards (Inspector of Taxes) v Bairstow*⁸⁵ in which an isolated transaction of purchase of property for the purpose of resale at a profit was held to be an adventure in trade.

- 107 Soon after the decision in *Jones v Leeming*, the *Income Tax Assessment Act* 1922 (Cth) was amended⁸⁶ by inserting in the definition of "income" words which were later to be repeated in s 26(a) of the Act:

"The assessable income of a taxpayer shall include -

- (a) profit arising from the sale by the taxpayer of any property acquired by him for the purpose of profit-making by sale, or from the carrying on or carrying out of any profit-making undertaking or scheme".

The first limb of this provision was intended to undo the effect of *Jones v Leeming*⁸⁷ and it treated as income, profits that would ordinarily have been regarded as a capital gain.

- 108 The origin of the second limb of s 26(a) (profit-making undertaking or scheme) may, perhaps, be more obscure. Before it was enacted, it had been said in *Ruhamah Property Co Ltd v Federal Commissioner of Taxation*⁸⁸ that:

"The principle of law is that profits derived directly or indirectly from sources within Australia in carrying on or carrying out any scheme of profit-making are assessable to income tax, whilst proceeds of a mere realisation or change of investment or from an enhancement of capital are not income nor assessable to income tax ..."

The second limb of s 26(a) echoed this statement. It must, however, be noted, that in the same joint judgment in *Ruhamah Property* their Honours went on to refer to

85 [1956] AC 14.

86 *Income Tax Assessment Act* 1930 (Cth), s 2.

87 *HR Lancey Shipping Co Pty Ltd v Federal Commissioner of Taxation* (1951) 5 AITR 135 at 140 per Williams J; *White v Federal Commissioner of Taxation* (1968) 120 CLR 191 at 208 per Windeyer J; *McClelland v Federal Commissioner of Taxation* (1970) 120 CLR 487 at 499 per Lords MacDermott and Pearson; *Federal Commissioner of Taxation v Whitfords Beach Pty Ltd* (1982) 150 CLR 355 at 362 per Gibbs CJ.

88 (1928) 41 CLR 148 at 151 per Knox CJ, Gavan Duffy, Powers and Starke JJ.

"the question whether the sale was an operation of business in carrying out a scheme of profit-making"⁸⁹ but these words find no echo in the second limb of s 26(a).

109 In *Whitfords Beach* the Court examined the relationship between s 25 and s 26(a) of the Act. Much of the detail of that examination does not bear directly on the questions that now fall for decision and need not be noticed. What is important for present purposes is that in *Whitfords Beach* it was necessary to resolve what was seen to be the overlap of s 25 (and its bringing to tax of income according to ordinary concepts) and transactions falling within one or other of the limbs of s 26(a). In particular, the second limb of s 26(a) (about profit-making undertakings or schemes) was not seen as adding words to the Act that would capture profits or receipts not otherwise brought to tax as income according to ordinary concepts.

110 In addition, it is necessary also to recognise, as Mason J said in *Commercial and General Acceptance Ltd v Federal Commissioner of Taxation*⁹⁰, that:

"gross income ... includes a net amount which is income according to the ordinary concepts and usages of mankind, when the net amount alone has that character, not being derived from gross receipts that are revenue receipts".⁹¹

But that is not to say that only net amounts are properly to be regarded as income of a business⁹². Income of a business can, and usually will, comprise gross receipts. Deductions will be allowed against that income. In some circumstances, however, a net amount – not derived from gross receipts that are revenue receipts – may, according to ordinary concepts, constitute income.

89 (1928) 41 CLR 148 at 152 per Knox CJ, Gavan Duffy, Powers and Starke JJ.

90 (1977) 137 CLR 373 at 382-383.

91 See also *Whitfords Beach* (1982) 150 CLR 355 at 364-365 per Gibbs CJ.

92 *Investment and Merchant Finance Corporation Ltd v Federal Commissioner of Taxation* (1971) 125 CLR 249 at 255 per Barwick CJ, 264 per Menzies J; *Williams v Federal Commissioner of Taxation* (1972) 128 CLR 645 at 653-654 per Stephen J; *Federal Commissioner of Taxation v St Hubert's Island Pty Ltd (In liq)* (1978) 138 CLR 210 at 229-230 per Mason J; *Whitfords Beach* (1982) 150 CLR 355 at 365-366 per Gibbs CJ.

111 It may be that the distinction drawn by Mason J in *Commercial and General Acceptance Ltd v Federal Commissioner of Taxation* is not absolute. That is, there may be cases where it would be possible to characterise the same set of transactions of receipt and outgoings as either gross receipts that are revenue receipts (against which the outgoings are to be allowed as deductions) or as giving a net amount that alone is to be characterised as income. But the nature of the distinction can, perhaps, be seen as exemplified by the treatment of a singular adventure in the nature of trade or business, that is *not* undertaken in the course of some other, wider business activity. There, it may be said, that only the profit (the net amount) is income according to ordinary concepts and that the gross receipts are not revenue receipts against which deductions are to be allowed. By contrast, however, if the singular adventure is undertaken in the course of a wider business, the gross receipts, as opposed to the net profit from the adventure, are properly characterised as revenue receipts.

112 Against this background, it can be seen that the references to "profit" or "gain" are not to be read as denying that a singular transaction may give rise to a gross receipt properly classed as a revenue receipt. No doubt, as was said in *Myer*⁹³:

"The periodicity, regularity and recurrence of a receipt has been considered to be a hallmark of its character as income in accordance with the ordinary concepts and usages of mankind."

But so too, as the definition of income from (or derived from) personal exertion recognises, "the proceeds of any business carried on by the taxpayer either alone or as a partner with any other person" are income in accordance with the ordinary concepts and usages of mankind.

113 The singularity of a transaction may very well invite close attention to whether it is in business. The singularity of a transaction may suggest that there is a mere realisation of a capital asset or change of investment rather than a transaction on revenue account. The purpose of profit-making may be an important consideration in deciding these questions. But, as *Myer* demonstrates, 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

93 (1987) 163 CLR 199 at 215 per Mason ACJ, Wilson, Brennan, Deane and Dawson JJ.

a revenue receipt⁹⁴. And that is why, in *Commissioner of Taxation v Cooling*⁹⁵, the Full Court of the Federal Court rightly emphasised the fact that, in that case, the receipt was an ordinary incident of part (albeit an extraordinary and unusual part) of the firm's business activity⁹⁶.

114 It can be seen, then, that two of the different ways in which the Commissioner put his case (receipt as an ordinary incident of transaction in course of business, and gain from profit-making undertaking or scheme) intersected or overlapped. The "gain" alleged was the gross amount of the receipts under the inducement agreement. The "profit-making undertaking or scheme" was the entry into these agreements as a step in the conduct of the taxpayer's business. The receipt was, so the argument went on, a receipt from carrying on the business (albeit by means of an unusual transaction). The receipt was an ordinary incident of transactions of this kind. Its receipt was, then, neither an unexpected nor unintended by-product of the transaction; its receipt was a purpose of entering the transaction.

115 The taxpayer accepted that the agreements that the firm made in August 1989 were agreements made in the course of the business of the firm. Indeed much of his argument proceeded from this premise for it was directed to demonstrating that the agreements related to the acquisition of part of the profit-yielding structure of the business. The taxpayer (and the Full Court⁹⁷) emphasised that the transaction was not in the *ordinary* course of the business of the firm. So much is clear but, for the reasons given earlier, it does not inevitably follow that the receipts were not on revenue account.

A receipt

116 The taxpayer placed some reliance on what was said in *Commissioner of Taxation v Orica Ltd*⁹⁸ concerning the transactions that were in question in that case. As is pointed out in the joint judgment, the benefit or gain said to have been obtained by Orica Ltd was "a difference between an amount that was expended

94 *Myer* (1987) 163 CLR 199 at 215 per Mason ACJ, Wilson, Brennan, Deane and Dawson JJ.

95 (1990) 22 FCR 42.

96 (1990) 22 FCR 42 at 56 per Hill J.

97 (1998) 152 ALR 241 at 259 per Lockhart J, 266 per Heerey J.

98 (1998) 72 ALJR 969 at 987 per Gaudron, McHugh, Kirby and Hayne JJ; 154 ALR 1 at 25-26.

and an amount that would have had to be expended" but for the transactions in issue; "[s]econdly, the obligation of the taxpayer that was satisfied by the payment made by MMBW was an obligation of the taxpayer that was on capital account"; and "[t]hirdly, the transaction was a singular transaction concerning liabilities separately created by the taxpayer in raising capital for its business"⁹⁹. The present case is very different. In particular, unlike *Orica*, the taxpayer in this case received a payment. No question arises (as it did in *Orica*) of characterising some gain reflected only in the accounts of the taxpayer and not by an actual inflow of money.

The character of these receipts

117 The inducement amounts received by the firm did not augment the profit-yielding structure of the firm. The lease was acquired as part of that structure; the inducement amounts were not. There was, in the words of Pitney J in *Eisner v Macomber* "*not a gain accruing to capital, not a growth or increment of value in the investment; but a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital however invested or employed, and coming in, being 'derived,' that is, received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal*"¹⁰⁰.

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

99 (1998) 72 ALJR 969 at 986 per Gaudron, McHugh, Kirby and Hayne JJ; 154 ALR 1 at 24.

100 252 US 189 at 207 (1920) (emphasis in original).

Gaudron J
Gummow J
Kirby J
Hayne J

43.

119 The primary judge was right to hold that the amounts paid under the inducement agreement were (to the extent of the taxpayer's interest in the partnership) assessable income of the taxpayer. The appeals to this Court should be allowed with costs, the orders of the Full Court of the Federal Court of Australia set aside and in lieu it be ordered that the appeals and the cross-appeals to that Court are in each case dismissed with costs.