A finding that a taxpayer carries on a business: What is required, related issues and what are the tax consequences?

Justice Richard Edmonds*

Through the prism of the High Court's decision in Spriggs & Riddell, his Honour undertakes a survey of the cases relevant to the criteria that need to be satisfied before a court finds that a business is being carried on, or whether a transaction is in the ordinary course of carrying on business, including profit motive; scale of activities; commercial character of the transaction; system and organisation; species of taxpayer; the temporal context; commitment or whether the activities are provisional only, as well as related issues such as the vehicle used and the scope and nature of the business. Finally, his Honour looks at the tax consequences of such a finding for both outgoings and losses as well as receipts and receivables.

INTRODUCTION

The catalyst for this subject was the decision of the High Court in the middle of last year that fees paid by two professional football players to their respective managers for obtaining new employment contracts with their respective clubs were incurred in carrying on a business of "commercially exploiting their sporting prowess and associated celebrity for a limited period", and it was no impediment to that conclusion, at least on the facts of the cases, "that the management fees were paid solely for the service of negotiating the playing contracts".[1]

The decision in *Spriggs & Riddell* will be addressed below. At this stage, it suffices to say that what the decision of the High Court illustrates, some may say reinforces, is that certain outgoings incurred by taxpayers in carrying on a business will be afforded more favourable tax treatment in terms of deductibility under the general provisions of the Assessment Acts, than the same outgoings when incurred by taxpayers who are not carrying on a business. That may be a natural consequence of the text of s 8-1 of the *Income Tax Assessment Act 1997* (Cth) (ITAA 1997) and its predecessor, s 51(1) of the *Income Tax Assessment Act 1936* (Cth) (ITAA 1936), and the proper construction of those provisions. But whether it accords with one's notions of fairness may be open to doubt.

I hasten to add, lest I be misunderstood, that I am not complaining about the decision in *Spriggs & Riddell*. On the contrary, I applaud it, even as a member of the intermediate appellate court which came to a contrary conclusion. It introduces a more "level playing field" between receipts or receivables which are income on the one hand, and outgoings which are deductible on the other (again a matter which will be discussed below).

WHAT IS A BUSINESS

In *FCT v Murry*, Gaudron, McHugh, Gummow and Hayne JJ said:

> A business is not a thing or things. It is a course of conduct carried on for the purposes of profit and involves notions of continuity and repetition of actions.[2]

THE EXPRESSION "CARRYING ON A BUSINESS"

In *Smith v Anderson*, Brett LJ said:

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[1] *Spriggs & Riddell v FCT* (2009) 239 CLR 1 at [69], [72]; 72 ATR 149.

[2] *FCT v Murry* (1998) 193 CLR 605 at [54]; 39 ATR 129.

> The expression "carrying on" *[business]* implies a repetition of acts, and excludes the case of an association formed for doing one particular act which is never to be repeated.[3]

To the same effect, see *Kirkwood v Gadd*,[4] *Premier Automatic Ticket Issuers Ltd v FCT*[5] and *Smith v Capewell*.[6] This is to be contrasted with the phrase "carrying on" in a different context, for example, with the word "enterprise"; in *Thiel v FCT*[7] it was held that the expression "enterprise carried on by" in Art 3(1)(f) of the Agreement between Australia and Switzerland for the Avoidance of Double Taxation with respect to Taxes on Income did not require a repetition of activity, but included both an isolated activity and a framework within which activities are engaged in, subject in the case of an isolated activity, to the conduct being an adventure in the nature of trade.[8] An adventure in the nature of trade of the kind considered in *Edwards (Inspector of Taxes) v Bairstow Holdings* will stamp the resulting profit with the character of income, even though it arises from an isolated transaction which does not constitute the carrying on of a business. As Lord Radcliffe observed:

> [T]hat circumstance [that the profit arose from an isolated transaction] does not prevent a transaction which bears the badges of trade from being in truth an adventure in the nature of trade. The true question in such cases is whether the operations constitute an adventure of that kind, not whether they by themselves or they in conjunction with other operations, constitute the operator a person who carries on a trade. Dealing is, I think, essentially a trading adventure, and the respondents' operations were nothing but a deal or deals in plant and machinery.[9]

But an outgoing incurred in the course of producing such profit, while it may be taken into account in ultimately determining the amount of the profit that is income, will not be incurred in the course of carrying on business, because there is no business; hence it will not be deductible under the second limb (s 8-1(1)(b)) in the year in which it is incurred. Moreover, the likelihood is that it will not be deductible under the first limb (s 8-1(1)(a)) in the year in which it is incurred for want of a relevant nexus between the outgoing and the income. The "uneven playing field" in the absence of a business being carried on is thus exemplified, but the example is by no means isolated or exhaustive.

THE EXISTENCE OF A BUSINESS

In *Spriggs & Riddell*, the High Court observed that the "existence of a business is a matter of fact and degree. It will depend on a number of indicia, which must be considered in combination and as a whole. No one factor is necessarily determinative".[10]

According to the High Court, relevant factors include, but are not limited to:

(1) The existence of a profit-making purpose;
(2) the scale of activities;
(3) the commercial character of the transactions;
(4) whether the activities are systematic and organised – in short, whether the activities are carried on in a business-like manner.

These "relevant factors" also come out of what Hill J said in *Evans v FTC*:

> Profit motive (but see cf *IRC v Incorporated Council of Law Reporting* (1888) 22 QBD 279), scale of activity, whether ordinary commercial principles are applied characteristics of the line of business in which the venture is carried on (*IRC v Livingston* (1926) 11 TC 538), repetition and a permanent character, continuity (*Hope v Bathurst City Council* (1980) 144 CLR 1 at 9; 12 ATR 231 at 236; *Ferguson v FCT* (1979) 9 ATR 873 at 876; 79 ATC 4261 at 4264), and system (*Newton v Pyke* (1908)

[3] *Smith v Anderson* (1880) 15 Ch D 247 at 277-278.

[4] *Kirkwood v Gadd* [1910] AC 422 at 431 (Lord Atkinson), 423 (Lord Loreburn LC).

[5] *Premier Automatic Ticket Issuers Ltd v FCT* (1933) 50 CLR 268 at 297-298 (Dixon J).

[6] *Smith v Capewell* (1979) 142 CLR 509 at 517 (Gibbs J).

[7] *Thiel v FCT* (1990) 171 CLR 338; 21 ATR 531.

[8] *Thiel v FCT* (1990) 171 CLR 338 at 352 (Dawson J), 360 (McHugh J); 21 ATR 531.

[9] *Edwards (Inspector of Taxes) v Bairstow Holdings* [1956] AC 14 at 38.

[10] *Spriggs & Riddell v FCT* (2009) 239 CLR 1 at [59]; 72 ATR 149.

> 25 TLR 127), are all indicia to be considered as a whole, although the absence of any one will not necessarily result in the conclusion that no business is carried on.[11]

It is a fair starting point, but it is not the best. For that, one has to go to what was said by Bowen CJ and Franki J in *Ferguson v FCT*:

> Section 6 of the Income Tax Assessment Act defines "business", stating that it includes any profession, trade, employment, vocation or calling, but does not include occupation as an employee. This does not afford much assistance in the present case. It is necessary to turn to the cases. There are many elements to be considered. The nature of the activities, particularly whether they have the purpose of profit-making, may be important. However, an immediate purpose of profit-making in a particular income year does not appear to be essential. Certainly it may be held a person is carrying on business notwithstanding his profit is small or even where he is making a loss. Repetition and regularity of the activities is also important. However, every business has to begin, and even isolated activities may in the circumstances *[be]* held to be the commencement of carrying on business. Again, organization of activities in a business-like manner, the keeping of books, records and the use of system may all serve to indicate that a business is being carried on. The fact that, concurrently with the activities in question, the taxpayer carries on the practice of a profession or another business, does not preclude a finding that his additional activities constitute the carrying on of a business. The volume of his operations and the amount of capital employed by him may be significant. However, if what he is doing is more properly described as the pursuit of a hobby or recreation or an addiction to a sport, he will not be held to be carrying on a business, even though his operations are fairly substantial. See generally, *Trautwein v FC of T (No 2)* (1936) 56 CLR 196; *Tweddle v FC of T* (1942) 7 ATD 186; 2 AITR 360; *Fairway Estates Pty Ltd v FC of T* (1970) 123 CLR 153; 1 ATR 726; *Thomas v FC of T* (1972) 46 ALJR 397; 3 ATR 165 at 399-401; 167-71, in all of which cases it was held the taxpayer was carrying on business; and *Martin v FC of T* (1953) 90 CLR 470; 5 AITR 548, in which it was held the taxpayer was not carrying on business.[12]

I turn to deal with each of the relevant factors referred to by the High Court and listed above.

Profit motive

This requirement would be uncontroversial until what fell from the joint judgment in *FCT v Stone*:

> If a taxpayer has a view to profit, the conclusion that the taxpayer is engaged in business may easily be reached. If a taxpayer's motives are idealistic rather than mercenary, the conclusion that the taxpayer is engaged in a business may still be reached. The "wide survey and exact scrutiny" of a taxpayer's activities that must be undertaken may reveal, as it does in this case, that the taxpayer's activities constituted the carrying on of a business.[13]

The proposition that a taxpayer's activities can constitute a business absent a profit-making motive broke new ground.[14] Previously, it had been thought that the existence of such a motive was not only a relevant factor, but an essential one.[15] Indeed, one could argue that it undermines what was said in *FCT v Myer Emporium Ltd* that "[b]ecause 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".[16]

It is unfortunate that the High Court thought it necessary to go to these lengths to uphold the Commissioner's appeal in *Stone*; it was unnecessary. The relevant grants were, arguably, income of the taxpayer, as a reward for the performance of her activities as an athlete to a high level of success, whether or not she was carrying on a business. The Commissioner, through the submissions of his counsel, no doubt took the position he did to "nail the coffin down"; to "close the gate", so to speak. But in doing so, it seems with the advent of *Spriggs & Riddell*, he closed it on himself.

[11] *Evans v FCT* (1989) 20 ATR 922 at 939.

[12] *Ferguson v FCT* (1979) 9 ATR 873 at 876-877.

[13] *FCT v Stone* (2005) 222 CLR 289 at [55]; 59 ATR 50.

[14] Compare *Ferguson v FCT* (1979) 9 ATR 873 at 876-877 (Bowen CJ and Franki J).

[15] *FCT v Murry* (1998) 193 CLR 605 at [54]; 39 ATR 129.

[16] *FCT v Myer Emporium Ltd* (1987) 163 CLR 199 at 209; 18 ATR 693.

Assuming for present purposes that a profit motive is required, it needs to be understood that the requirement is concerned with the activities being activated by an overall profit motive, that which appears in the profit and loss account, not with whether each and every transaction is attended with that profit motive. Hence, an individual transaction may be regarded as being in the ordinary course of carrying on the taxpayer's business even if that transaction is not intended to be profit-making. As Barwick CJ said in *Investment & Merchant Finance Corp Ltd v FCT*:

> [Q]uite clearly neither the attainment of profit nor the expectation of it is essential for a particular commercial transaction to form part of the business of dealing in the commodity purchased. As I have already indicated, the share transaction was effected in the course of and as part of the appellant's business as a share dealer.[17]

The scale of activities

The scale of the activities is undoubtedly a relevant factor but unlike the requirement of profit motive, not a determinative one. Thus, while the activities may be limited in terms of their scale, this will not be a bar to their characterisation as a business if the other factors identified as being relevant point to that conclusion;[18] any more than the denial of a business characterisation to large scale activities would be seen as a bar where those activities do not satisfy the other relevant factors.[19]

The commercial character of the transaction

Insofar as this raises a separate and discrete requirement to that of profit motive, it looks to whether the transaction which is said to be part of the business is explicable by reference to commercial considerations or whether it is only explicable by reference to extraneous considerations. Thus, a "loss leader" transaction in a retailing business will not itself be attended with the relevant profit motive, but it will be explicable by reference to commercial considerations and thus have the relevant commercial character.

Whether the activities are systematic and organised

This factor looks to the way in which the activities are carried on: whether they are carried on in a way which is consistent with the way in which one would expect a business to be carried on and, in particular, whether that system and organisation is directed towards the motive of profit-making in the sense referred to above. It is this factor which has, more often than not, been "the reef" upon which gambling activities have foundered in the quest for their characterisation as a business.[20]

Other relevant factors to the existence of a business

In *Spriggs & Riddell*, the High Court made it clear that the factors it referred to in its reasons as being relevant to the existence of a business were not exhaustive.[21]

In my view, they also include:

The species of taxpayer

The activities of a company are more likely to be regarded as constituting a business than the same activities of an individual, particularly where those activities are passive in nature. In *South Behar Railway Co Ltd v Inland Revenue Commissioners*, Lord Sumner said: "Business is not confined to being busy; in many businesses long intervals of inactivity occur".[22] To similar effect, in *Avondale*

[17] *Investment & Merchant Finance Corp Ltd v FCT* (1971) 125 CLR 249 at 255; 2 ATR 361. See too Parsons RW, *Income Tax Law in Australia* (Law Book Company Ltd, 1985) at [2.449] where the learned author refers to the well-known marketing strategy of a "loss leader" transaction in a retailing business.

[18] See *Ferguson v FCT* (1979) 9 ATR 873; *FCT v Walker* (1984) 2 FCR 283; 15 ATR 847.

[19] *Martin v FCT* (1953) 90 CLR 470. See also *Evans v FCT* (1989) 20 ATR 922.

[20] See *Martin v FCT* (1953) 90 CLR 470 at 480-481; *Evans v FCT* (1989) 20 ATR 922 at 942-943.

[21] *Spriggs & Riddell v FCT* (2009) 239 CLR 1 at [59]; 72 ATR 149.

[22] *South Behar Railway Co Ltd v Inland Revenue Commissioners* [1925] AC 476 at 488.

Motors (Parts) Pty Ltd v FCT, Gibbs J said: "There are cases in which it has been held that a company does not cease to carry on business notwithstanding that its activities are reduced to a minimum or indeed are almost entirely suspended".[23]

In some cases, the very nature of the business is such that its conduct may require little activity. In *Brookton Co-operative Society Ltd v FCT*, Aickin J said:

> Generally speaking it is a question of fact whether what an individual or a company does constitutes carrying on a business. It has often been said that it is easier to draw an inference that an income earning activity of a company is a business than to do so when the same activity is undertaken by an individual; see, eg, the observations of Lord Diplock delivering the advice of the Privy Council in *American Leaf Blending Co Sdn Bhd v Director-General of Inland Revenue (Malaysia)*. That was a case of a company which had closed down its tobacco business and thereafter let its premises and received the rent therefrom. In the case of a company which had no activity other than receipt of dividends from shares which it had purchased, it would ordinarily be regarded as carrying on a business even if it did not actively manage its portfolio of investments, though an individual who did the same would not necessarily be regarded as carrying on such a business; cp. *Esquire Nominees Ltd v Federal Commissioner of Taxation* per Barwick CJ and per Menzies J.[24]

That a company may carry on business as a holding company was recognised long ago in *Inland Revenue Commissioners v Korean Syndicate Ltd*,[25] and even as an intermediate holding company leasing plant and machinery and sub-leasing it to wholly owned subsidiaries at no charge in *Commissioner of Taxation v EA Marr & Sons (Sales) Ltd*.[26] It is unlikely that a passive holding by an individual of all the shares in a company, no matter how many wholly owned subsidiaries it had, would, without more, constitute a business of that individual.

It is not surprising then that companies have had more difficulty than individuals in persuading courts that their businesses have ceased at the time a relevant transaction is entered into or that the relevant transaction brings about that result and that, in consequence, the transaction is not an act in carrying on a business.[27] Indeed, the Commissioner has had more success in that regard, albeit in a different context (see *Avondale Motors*).

But even where the activities of an individual or the trustee of a trust are not passive in nature but involve, for example, the buying and selling of securities, it is less likely that a finding will be made that a sale of securities was an operation in the course of carrying on a business of investing for profit than it is in the case of a company; it is more likely that the finding will be made that the sale was a mere realisation or change of investment.[28] In the case of trusts, the position is sourced in the decision of the High Court in *Charles v FCT*[29] although arguably *Radnor* took it further because, in that case, the taxpayer was not the trustee, but an underlying investment company wholly owned by another company as trustee of three trust estates.

The temporal context

Obviously it will be easier for a court to conclude that a transaction is an act in carrying on a business where there is a previous pattern of similar activity than it will be where there is no anterior activity.

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[23] *Avondale Motors (Parts) Pty Ltd v FCT* (1971) 124 CLR 97 at 103; 2 ATR 312.

[24] *Brookton Co-operative Society Ltd v FCT* (1981) 147 CLR 441 at 469; 11 ATR 880.

[25] *Inland Revenue Commissioners v Korean Syndicate Ltd* [1921] 3 KB 258 at 276 (Atkin LJ). See also *Esquire Nominees Ltd v FCT* (1973) 129 CLR 177 at 212 (Barwick CJ), 223 (Stephen J); 3 ATR 105; *FCT v Total Holdings (Australia) Pty Ltd* (1979) 43 FLR 217 at 224-225; 9 ATR 885.

[26] *Commissioner of Taxation v EA Marr & Sons (Sales) Ltd* (1984) 2 FCR 326 at 330-331; 15 ATR 879.

[27] Compare *Commissioner of Taxation (WA) v Newman* (1921) 29 CLR 484; *Commissioner of Taxation v Unilever Australia Securities Ltd* (1995) 56 FCR 152 at 186-187 (Hill J); 30 ATR 134; but see *Modern Permanent Building and Investment Society v FCT* (1958) 98 CLR 187 at 191-192 (Williams J); *Equitable Life and General Insurance Co Ltd v FCT* 89 ATC 4972 at 4982 (Wilcox J); (1989) 20 ATR 1225.

[28] See *London Australia Investment Co Ltd v FCT* (1977) 138 CLR 106 at 118 (Gibbs J); 7 ATR 757; *Radnor v FCT* (1990) 21 ATR 608 at 620 (Davies J); on appeal (1991) 22 ATR 344 at 346 (Gummow J, with whom Sheppard J agreed).

[29] *Charles v FCT* (1954) 90 CLR 598.

However, more often than not, in the context of the income tax consequences of a transaction, the court is called upon to characterise the activity as a business or not, without the benefit of such anterior activity. As was said by Jacobs J:

> [I]t must be made quite clear that frequency of an activity is not synonymous with business. There may be no business despite frequency and on the other hand there may be a business where the activity is an isolated one. Every business must begin with an initial transaction.[30]

The decision of Barwick CJ in *Fairway Estates Pty Ltd v FCT*[31] is often cited as exemplifying the truism of the last sentence of this extract from Jacobs J's reasons. In that case, the Chief Justice concluded that the appellant was carrying on the business of lending money at the time it made the relevant advance and that that loan was the first transaction in a business of the lending of money then commenced and intended to be carried on.[32] The issue in that case concerned s 63 of the ITAA 1936 (s 25-35 of the ITAA 1997) and one of the questions the Chief Justice had to consider was whether the advance was made in the ordinary course of the business of lending money, it being submitted on behalf of the Commissioner that there had not as yet developed at the date of the loan any ordinary course in that business. In the opinion of the Chief Justice, in requiring the lending to be in the ordinary course of the business, the section did not require that the advance must conform to the usual or ordinary transaction currently carried out by the taxpayer in carrying on the business of lending money. In the words of the Chief Justice:

> It is the ordinary course of such a business of which the section speaks. The advance may be of a new type or kind so far as the taxpayer's business is concerned and yet be in the ordinary course of that business.
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> I have come to the conclusion that the decisions involving the expression "in the ordinary course of business" found in bankruptcy legislation have no direct bearing on the construction or application of s 63. Accordingly, I find no need to discuss them. However, the remarks of Rich J in *Downs Distributing Co Pty Ltd v Associated Blue Star Stores Pty Ltd* are of use in that they emphasize the notion of a common course in the conduct of a business. The requirement that the transaction be in the ordinary course of the business excludes transactions which are made for purposes other than the carrying on of the business or to achieve ends disparate from those of the business activity.[33]

As to the submission that there had not as yet developed at the date of the loan any ordinary course in the business, his Honour said:

> [I]n my opinion, there can be a course of business although as yet there is nothing more than an intention to carry on the business and a single transaction carried out in pursuance of that intention.[34]

Similar issues were raised in the recent case of *BHP Billiton Finance Ltd v Commissioner of Taxation*,[35] from which an appeal to the Full Court is currently reserved, although, in that case, the facts did not concern a first transaction, but rather two money lending transactions to affiliates which had been preceded, over a number of years, by transactions involving the lending of money to other affiliates.

Commitment – whether the activities are provisional only

Expenditure on activities to which the taxpayer is not committed and which may therefore be characterised as provisional are unlikely to be characterised as a business: expenditure on feasibility studies.[36]

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[30] *London Australia Investment Co Ltd v FCT* (1977) 138 CLR 106 at 128-129 (Gibbs J); 7 ATR 757.

[31] *Fairway Estates Pty Ltd v FCT* (1970) 123 CLR 153; 1 ATR 726.

[32] *Fairway Estates Pty Ltd v FCT* (1970) 123 CLR 153 at 165; 1 ATR 726.

[33] *Fairway Estates Pty Ltd v FCT* (1970) 123 CLR 153 at 162; 1 ATR 726.

[34] *Fairway Estates Pty Ltd v FCT* (1970) 123 CLR 153 at 166; 1 ATR 726.

[35] *BHP Billiton Finance Ltd v FCT* (2009) 72 ATR 746.

[36] See *Softwood Pulp and Paper Pty Ltd v FCT* (1976) 7 ATR 101; *Griffin Coal Mining Co Ltd v Commissioner of Taxation* (1990) 21 ATR 819; expenditure on a research project: *Goodman Fielder Wattie Ltd v FCT* (1991) 29 FCR 376; 22 ATR 26.

Related issues

The vehicle through which the business is carried on

That a taxpayer can carry on business through another as his agent, with all activity being undertaken by the agent on behalf of the principal, so that the business is that of the principal and not that of the agent, is beyond doubt.[37] That is not to say that the agent is not carrying on a business but if it is, it is separate and discrete from the activity it is carrying on, on behalf of the principal.

If a taxpayer participates in an activity in circumstances which would be regarded as the carrying on of a business by the taxpayer, the fact that the "vehicle" through which the taxpayer participates is registered as a management investment scheme pursuant to Pt 5C.1 of the *Corporations Act 2001* (Cth) will not, of itself, deny that characterisation of the taxpayer's activities.[38] A finding that the taxpayer is carrying on a business bars a conclusion that this participation should be seen as an investment of capital by way of the acquisition of a capital asset in the form of a right to share rateably in the income of the scheme.[39]

Scope of the business

It was on this particular issue where the High Court in *Spriggs & Riddell* parted company with the Full Federal Court. Whereas the Full Federal Court took the view that the playing activities of Spriggs and Riddell were separate and discrete from their non-playing activities, which were conceded to be a business, the High Court took the view that all their activities, although involving separate income-producing activities, were part of a single business; and the fact that one of those activities involved the performance of an employment contract was no bar to the aggregation of those activities in the one business.

The reasoning of the High Court is encapsulated in the following paragraphs from its reasons:

> [60] Where it is determined that a taxpayer is conducting a business, the next question will be the "scope" of that business. It may be that the taxpayer pursues two separate fields of endeavour, which are properly described as two separate businesses or a business and some other non-business activity. In *Payne*, the taxpayer conducted a deer farming business and, quite apart from that business, was employed as a pilot by an airline: the two were activities of "unrelated income derivation". On the other hand, a taxpayer may pursue separate income-producing activities as part of a single business. The question is one of fact, turning upon the degree of connection and interdependence between the activities. One must consider "the whole of the operations of the business concerned in determining questions of deductibility". To determine whether a taxpayer is conducting a business and the scope of that business, as said in a different context, "it is necessary to make both a wide survey and an exact scrutiny of the taxpayer's activities".
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> …
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> [63] In this case, the Commissioner did not dispute that the non-playing activities from which each appellant earned income constituted a "business". However, the Commissioner contended that, following *Maddalena* and in the light of the exclusion of "occupation as an employee" from the definition of business in s 995-1 of the ITAA, it was necessary to separate the appellants' Australian Rules football and rugby league playing activities, which could be characterised as employment, from their non-playing activities. On this basis, the Commissioner argued that the management fees were not incurred in the course of earning income as employees, as they were incurred to obtain new employment contracts, as in *Maddalena*. Further, it was argued that they were not incurred in the course of earning income from the non-playing businesses, because they were paid to the managers solely for procuring the new employment contracts, not for any purposes of the businesses, as characterised by the Commissioner.
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> [64] The Commissioner's arguments must be rejected.

[37] See *Commissioner of Taxation v Lau* (1984) 6 FCR 202; 16 ATR 55; *Commissioner of Taxation v Emmakell Pty Ltd* (1990) 22 FCR 157; 21 ATR 346; *Merchant v FCT* (1999) 41 ATR 116; 99 ATC 4221; *FCT v Cooke* (2004) 55 ATR 183; 2004 ATC 4268; *Lilyvale Hotel Pty Ltd v FCT* (2009) 175 FCR 491.

[38] *Hance v Commissioner of Taxation* (2008) 74 ATR 644; 2008 ATC 20-085.

[39] Compare *Clowes v FCT* (1954) 91 CLR 209; *Milne v Commissioner of Taxation* (1976) 133 CLR 526; 5 ATR 785.

> [65] It is possible to obtain and perform an employment contract as part of, and during the course of, running a business, as is illustrated by *Commissioner of Taxes (Vic) v Phillips*.
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> …
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> [68] The facts here are quite different from those in *Maddalena*. As noted above, it is not disputed by the Commissioner that the appellants' non-playing activities constitute businesses. Having regard to the indicia of a business described above, it is plain that they do. It would be artificial on the facts here to separate the stream of income from those activities, from the stream of income from the appellants' playing contracts with the clubs, as suggested by the Commissioner. The appellants' promotional activities, exploiting their celebrity, were inextricably linked to their respective employments of playing Australian Rules football and rugby league.

The court went on to distinguish *FCT v Maddalena*[40] on its facts; that there was nothing to suggest that the gaining by Mr Maddalena of his non-playing income was, together with employment by his club, part of a business. On the primary facts, the distinction is far from clear, nevertheless, the court went on to conclude:

> [69] Looking at their activities as a whole, the appellants were engaged in the business of commercially exploiting their sporting prowess and associated celebrity for a limited period. Those businesses were well established before the management fees were incurred. Neither of the appellants was exclusively or simply an employee of his club. They each exploited their sporting prowess and associated celebrity with different clubs over the years during which they played in the AFL Competition and the NRL Competition, respectively. There was a synergy between playing activities and non-playing activities, each of which was an income-producing activity.

Times have changed and I am inclined to think that if the facts of *Maddalena* had come before the same High Court that heard *Spriggs & Riddell*, the result would have been different from the 1971 result. Nevertheless, as I indicated earlier, I applaud the result in *Spriggs & Riddell* because it creates a "more level playing field" as between amounts which are income on the one hand and outgoings which are deductible on the other. If he were alive today, I am sure the late Neil Forsyth, a doyen of lawyers/advocates in the field of income tax, would have a smile on his face having argued a case for symmetry on the outgoings side to reflect the spreading concept or "stain" (as one learned commentator has called it) of income on the revenue side in *Mt Isa Mines Ltd v FCT*, only to have the argument dismissively rejected by the High Court in the following terms:

> Counsel for the taxpayer referred to a number of decisions from which it claimed to derive assistance. These cases turn on their own particular facts and are no more than illustrations of the application of the principles already discussed. It was also suggested that because the courts, in recent decisions, have extended the concept of revenue from the viewpoint of receipt and allowable deduction, it was logical and symmetrical for the Court to broaden the scope of losses and outgoings allowable as deductions pursuant to s 51. The submission is extremely elusive, to say the least of it. If one were to accept, in accordance with the submission, that there has been some extension in the concept of income, that would only be of assistance in resolving the present problem if one could demonstrate what the relevant extension was and how it embraces the facts of this particular case. At no stage did the taxpayer's argument descend to the requisite level of particularity. Certainly the argument did not succeed in establishing that the concept of income has been relevantly extended.[41]

It is important, however, not to read too much into the High Court's decision in *Spriggs & Riddell*. This was a case where the High Court found that the appellants' promotional activities, exploiting their celebrity, were inextricably linked to their respective employments of playing Australian Rules and rugby league football. At the other end of the spectrum lies *FCT v Payne*[42] involving two unrelated income derivation activities.

Nature of the business

The issue of the nature of a company's business has more frequently arisen in the context of whether a company is carrying on the "same business" as it carried on immediately before a change in the

[40] *FCT v Maddalena* (1971) 2 ATR 541.

[41] *Mt Isa Mines Ltd v FCT* (1992) 176 CLR 141 at 152; 24 ATR 261.

[42] *FCT v Payne* (2001) 202 CLR 93; 46 ATR 228.

beneficial ownership of its shares which disqualifies it from relying on "the continuity of beneficial ownership test" for the carry forward of past losses; such losses will be lost unless it can rely on "the same business test": s 80E of the ITAA 1936; s 165-210 of the ITAA 1997. But it can also be important in the context of the taxation of capital gains, for example, whether an asset, such as goodwill, is a pre or post 20 September 1985 asset may depend on whether the "same business" is being carried on at the time of sale as was being carried on pre 20 September 1985.[43] And the nature of a company's business can arise as an issue in the context of specific provisions of the 1936 and the 1997 Acts which require a business of a particular kind to be carried on before they are triggered: s 63 of the ITAA 1936 and s 25-35 of the ITAA 1997 requiring, inter alia, a business of lending money to be carried on, are examples.

What the courts have been at pains to stress in relation to the issue of the nature of a company's business is that the issue is to be determined solely by reference to the activities of the company itself, and not by reference to, if it be the case, its role in a group of companies of which it is a member, although that may set the context or scope of its business; or the fact that it is a subsidiary of a company which monitors its activities.

For example, in *FCT v Bivona Pty Ltd*, a Full Court of the Federal Court said:

> It is true that members of the group of companies to which the respondent belonged decided to borrow money from an overseas lender, that the respondent was incorporated as the vehicle for this borrowing and that immediately after borrowing the moneys it lent most of them to the holding company for use by the operating subsidiaries. But the fact is that the respondent did enter into the borrowing transaction with the overseas lender, borrowed a substantial sum of money at interest, the bulk of which it then lent to its holding company, again at interest. There was no suggestion that any of the interest rates, either on moneys borrowed or lent by the respondent, were not commercial rates. …
>
> The respondent's activities consisted principally of the borrowing and lending of money. By far the greatest proportion of its income consisted of interest on moneys lent and its largest outgoing was interest on moneys borrowed from overseas. There was no suggestion that any of the relevant transactions were shams. Even if it were right to describe the role of the respondent in its activities of lending money, as counsel for the Commissioner did, as a "conduit" for its parent company or other members of the group, that begs, not answers, the question whether the activities of the respondent are correctly characterised as its principal business consisting of the lending of money.
>
> It is not correct to say that the only conclusion reasonably open on the material before the Tribunal was that the respondent's activities either did not constitute a business at all or that, if they did, it was a business of "investment" not a business consisting of the lending of money.[44]

And as a differently constituted Full Court recently said in *Commissioner of Taxation v Tasman Group Services Pty Ltd*:

> It is a trite proposition that, where a subsidiary, even if wholly owned by a parent company, carries on a business, the business is that of the subsidiary not the parent. Irrespective of how closely it may monitor the business activities of the subsidiary, the parent does not itself carry on those activities but is engaged in the separate business of a parent or holding company which is, normally, the receipt of income in the form of dividends from the subsidiary.[45]

Of course, it may well be different if the company doing the borrowing and lending is the ultimate, or even an intermediate, parent company in the group, rather than a special purpose finance subsidiary with no underlying subsidiaries, because it may then be open for a court to find that the lending activity of the parent company is not a discrete business of lending money, but rather an adjunct, appendage or simply part of its business as a holding company (see *Total Holdings; EA Marr & Sons*) that could have significant tax consequences under the specific provisions to which I have referred and it is to those consequences, and others, that I now turn.

[43] *FCT v Murry* (1998) 193 CLR 605 at [44]-[45]; 39 ATR 129.

[44] *FCT v Bivona Pty Ltd* (1990) 21 FCR 562 at 568-569; 21 ATR 151.

[45] *Commissioner of Taxation v Tasman Group Services Pty Ltd* (2009) 180 FCR 128 at [56]; 74 ATR 739.

TAX CONSEQUENCES OF A FINDING THAT A BUSINESS IS OR IS NOT BEING CARRIED ON

Outgoings and losses

Expenditure incurred on any activities which a court declines to characterise as a business because the activities are of a provisional kind only and lack the element of commitment on the part of the taxpayer will not be deductible under the second limb of s 81(1)/s 51(1), nor under the first limb of those provisions. Examples are to be found in *Softwood Pulp and Paper; Griffin Coal Mining*, although the dissenting judgment of Davies J is, in my view, to be preferred to that of the majority, Wilcox and French JJ; and *Goodman Fielder Wattie*. The first two involved expenditure on feasibility studies; the third on a research project in which the taxpayer was an essential collaborator, both as to the provision of funds and serving on the management committee. In that case, Hill J said:

> Notwithstanding that the applicant accounted for this activity as a separate division, it is not possible, in my view, to characterise the activity as a business or, for that matter, as an activity of gaining or producing assessable income so as to fall within the first limb of s 51(1). It follows, accordingly, that it is unnecessary to determine whether the expenditure in question is of a capital nature, although in my view this would follow because the applicant was not carrying on a business in the area in which the research was carried on being a business directed at gaining or producing assessable income.[46]

A finding that a taxpayer is carrying on a business at the time the expenditure is incurred will enliven not only the second limb of s 8-1(1)/s 51(1), but also the first limb because the requirement of the first limb: "that the occasion of the outgoing should be found in whatever is productive of the assessable income or, if none be produced, would be expected to produce assessable income",[47] will, in the circumstances that the taxpayer is carrying on a business at the time the expenditure is incurred, invariably be satisfied. But for the finding, neither limb, but in particular the first limb, may not have been enlivened because the expenditure came "too soon" and was not seen as a "working expense" because it was not incurred "in [the course of] gaining or producing [the] assessable income".[48] And as Hill J pointed out in *Goodman Fielder Wattie* in the extracted quote above, such a finding may also save what would, in the absence of such a finding, be an outgoing of a capital nature. In this way, such a finding has the potential to "level the playing field" between amounts which are assessable income on the one hand and outgoings which are deductible on the other.

A finding that a taxpayer previously carried on a business which has ceased does not deny deductibility to an outgoing incurred in a year after the business has ceased in respect of a liability undertaken or incurred in the course of carrying on the business.[49]

Income

A finding that the activities of an investment company constitute a business will have the consequence that its profits are income (see *London Australia*), whereas if the activities do not amount to a business, and are not otherwise adventures in the nature of trade, the profits will not be income.[50]

A finding that property, not purchased in the ordinary course of carrying on a business, or otherwise for the purpose of profit making by sale, is ventured into a business of dealing, inter alia,

[46] *Goodman Fielder Wattie Ltd v FCT* (1991) 29 FCR 376 at 387; 22 ATR 26.

[47] *Ronpibon Tin NL v FCT* (1949) 78 CLR 47 at 57 (Latham CJ, Rich, Dixon, McTiernan and Webb JJ); replicated in *FCT v Payne* (2001) 202 CLR 93 at [9] (Gleeson CJ, Kirby and Hayne JJ); 46 ATR 228, noted in *FCT v Day* (2008) 236 CLR 163 at [30] (Gummow, Hayne, Heydon and Kiefel JJ); 70 ATR 14.

[48] *FCT v Payne* (2001) 202 CLR 93; 46 ATR 228.

[49] See *Placer Pacific Management Pty Ltd v FCT* (1995) 31 ATR 253; *FCT v Brown* (1999) 43 ATR 1; *Commissioner of Taxation v Jones* (2002) 117 FCR 95; 49 ATR 188; *Guest v Commissioner of Taxation* (2007) 65 ATR 185; 2007 ATC 4265; *FCT v R & D Holdings Pty Ltd* (2007) 160 FCR 248; 67 ATR 790.

[50] See *Trent Investments Pty Ltd v Commissioner of Taxation* (1976) 26 FLR 179; 6 ATR 201; *FCT v Equitable Life & General Insurance Co Ltd* (1990) 21 ATR 364 at 371; *Radnor v FCT* (1991) 22 ATR at 357-358 (Hill J).

with such property, will have the consequences that the profits of such dealing are income, albeit that the profits will be measured by reference to the value of the property at the time it so ventured, and not by reference to the cost of acquisition.[51]

A finding that a taxpayer carries on a business will mean that a gain made outside "the ordinary course of … business" from a transaction which has a profit-making purpose could also be considered income; even if the transaction was extraordinary, judged by reference to the ordinary course of the taxpayer's business. The High Court in Myer left the door "half open" when it said:

> Of course it may be that a transaction is extraordinary, judged by reference to the course of carrying on the profit-making business, in which event the extraordinary character of the transaction may reveal that any gain resulting from it is capital, not income.[52]

As far as I am aware, the invitation of the "half open door" has not been taken up by anyone other than Beaumont J, in dissent, in Commissioner of Taxation v Unilever Australia Securities Ltd.[53]

A finding that a business has ceased or that the disposition of the asset in question brings the business to an end, rather than continues it on, in the case of an asset not being trading stock of the business, should still lead to the result that any gain is not income (Newman), and any loss is not deductible (Modern Permanent Building Society), notwithstanding the provenance of the authorities relied upon in support of that proposition.

[51] See *FCT v Whitfords Beach Pty Ltd* (1982) 150 CLR 355; 12 ATR 692.

[52] *FCT v Myer Emporium Ltd* (1987) 163 CLR 199 at 215-216; 18 ATR 693 (see also at 209).

[53] *Commissioner of Taxation v Unilever Australia Securities Ltd* (1995) 56 FCR 152 at 175-176; 30 ATR 134.