The meaning and nature of goodwill in the tax context

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This article examines the meaning and nature of goodwill in several tax contexts. It examines the concept of goodwill as it relates to the relevant areas of tax legislation, rather than examining these areas of legislation themselves. First the legal concept of goodwill is examined based on relevant case law in the United Kingdom and Australia, and consideration is given to the important High Court case of FCT v Murry, as well as to the accounting concept of goodwill where appropriate. Goodwill is then examined in the following contexts: stamp duties; income tax including capital expenditures; the consolidation regime; and the goods and services tax. While the legal concept is found to apply generally in taxation, accounting and other conceptions also play a part in appropriate circumstances.

INTRODUCTION

The legal concept of goodwill has arguably undergone significant changes in recent years, particularly since the 1998 landmark decision of the High Court of Australia in *FCT v Murry*.[1] The critical principle from *Murry* is that goodwill, as one indivisible item of personal property in a business, is separate from other property of that business, including property that may be its sources. Moreover, goodwill is inseparable from the business; it cannot be dealt with independently of that business. This view of goodwill has had a significant impact on several areas of tax law, including stamp duties, income tax – including capital gains tax (CGT) – and, to a lesser extent, goods and services tax (GST).

This article examines the concept of goodwill in several tax contexts. Its purpose is not specifically to examine the provisions of the various areas of legislation, but rather to examine the concept of goodwill as it relates to these provisions.[2] In other words, the focus of this article is on the meaning and nature of goodwill in these tax contexts, rather than on the areas of tax themselves which provide the context. First, the meaning and the nature of goodwill are examined, including specific consideration of the important High Court case of *Murry*. Then goodwill is considered in the following areas of tax: stamp duties; income tax involving capital expenditure, the consolidation regime, and the concept of an active asset; and finally the GST. While the focus is on the legal concept of goodwill as largely befits taxation, consideration is also given to the accounting concept where appropriate.

THE MEANING OF GOODWILL

The meaning of goodwill in Australia owes it origins to the English jurisdiction where the legal concept of goodwill evolved into its largely modern form during the 19th century.[3] First, the concept of goodwill as property tentatively emerged during the first half of that century,[4] culminating in

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[1] *FCT v Murry* (1998) 193 CLR 605; 39 ATR 139.

[2] For an examination of goodwill and taxation with a tax emphasis, see Walpole M, "Goodwill and Taxation Issues" (2008) 11(3) *The Tax Specialist* 201 and for further analysis and reform proposals see Walpole M, *Proposals for the Reform of the Taxation of Goodwill in Australia* (ATRF, 2009).

[3] For a review of the development of the legal concept of goodwill in its early stages, see Tregoning I, "Lord Eldon's Goodwill" (2004) 15(1) *King's College Law Journal* 93.

[4] See, for example, *South v Finch* (1837) 3 Bing (NC) 506; 132 ER 505.

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statements that goodwill was clearly property in later cases such as *Potter v CIR*[5] and *CIR v Angus & Co*.[6] The final word on the question of goodwill as property in England may be found in the 1901 House of Lord's case of *CIR v Muller & Co's Margarine Ltd*,[7] where Lord Macnaghten stated that it was difficult to say that goodwill was not property, being the subject of sale every day. These were stamp duty cases, but the view that goodwill was property had equal application to other areas of law. This is the position in Australia today as noted by the High Court of Australia in *Murry* where the majority said: "Goodwill is correctly identified as property … because it is the legal right or privilege to conduct a business in substantially the same manner and by substantially the same means that have attracted custom to it."[8]

While it had become clear that goodwill was property, the critical questions of its relationship to other property of the business and to the business itself remained. These questions, together with the recognition of goodwill as property, are fundamental to the modern concept of goodwill. The modern concept may be traced to the abovementioned case of *Muller* wherein Lord Macnaghten provided the classic definition of goodwill in English law:

> It [goodwill] is the attractive force which brings in custom. It is the one thing which distinguishes an old-established business from a new business at its start. The goodwill of a business must emanate from a particular centre or source. However widely extended or diffused its influence may be, goodwill is worth nothing unless it has power of attraction sufficient to bring customers home to the source from which it emanates. Goodwill is composed of a variety of elements. It differs in its composition in different trades and in different businesses in the same trade. One element may predominate here and another element there.[9]

Thus, the House of Lords defined goodwill as essentially "the attractive force which brings in custom". This remains the essence of the definition of goodwill in both the English and Australian jurisdictions. However, this does not help our understanding much in the legal context. What is primarily important, particularly in the context of a range of taxing statutes, is the concept of goodwill as one whole item of property, as well as its relationship to other property of the business as its sources, and its relationship to the business itself.

GOODWILL AS ONE WHOLE ITEM OF PROPERTY

In the above cited passage from *Muller*, Lord Macnaghten stated that goodwill is composed of a variety of elements which may differ in composition between trades and businesses. However, this should not be taken to mean that goodwill may be broken down into separate elements; goodwill remains one whole item of property regardless of its elements. Lord Macnaghten himself made this clear in saying: "The goodwill of a business is one whole … and must be dealt with as such".[10] This is also the view in Australia where the High Court has held goodwill to be an indivisible whole.[11]

Some of these elements of goodwill have been used to label various aspects or categories of goodwill, notably site goodwill, personal goodwill, name goodwill and monopoly goodwill. Hill J of the Federal Court identified these aspects from the authorities in a survey of the law on goodwill in *FCT v Krakos Investments Pty Ltd*.[12]

[5] *Potter v CIR* (1854) 10 Ex 147; 156 ER 392.

[6] *CIR v Angus & Co* (1889) 23 QBD 579.

[7] *CIR v Muller & Co's Margarine Ltd* [1901] AC 217 at 223.

[8] *FCT v Murry* (1998) 193 CLR 605 at 615; 39 ATR 139.

[9] *CIR v Muller & Co's Margarine Ltd* [1901] AC 217 at 223-224. Previously, in *Trego v Hunt* [1896] AC 7 at 24, Lord Macnaghten had warmed to the task of defining goodwill by referring to it as "the very sap and life of the business, without which the business would yield little or no fruit. It is the whole advantage, whatever it may be, of the reputation and connection of the firm, which may have been built up by years of honest work or gained by lavish expenditure of money".

[10] *CIR v Muller & Co's Margarine Ltd* [1901] AC 217 at 224.

[11] See, for example, *Geraghty v Minter* (1979) 142 CLR 177.

[12] *FCT v Krakos Investments Pty Ltd* (1995) 61 FCR 489; 32 ATR 7.

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1. *Site goodwill* is that aspect which relies on the habit of customers in resorting to a particular site of business. Hill J invoked the joint judgment of Dixon CJ and Williams, Fullagar, and Kitto JJ of the High Court in *Box v FCT* wherein it was proposed that premises may have site goodwill as a result of being favourably located such that customers become accustomed to attending a site over a number of years.[13] Because it relates to the location of the business, such goodwill is sometimes referred to as "local" goodwill.
2. *Personal goodwill* depends on the personal characteristics of a person or persons associated with the business. It is these personal qualities which attract the customers. This aspect of goodwill, relying on the person, is independent of the business premises and other sources of the goodwill. As will be discussed in this article, personal goodwill is the subject of several contentious issues in the tax field.
3. *Name goodwill* relates to the name or reputation which attaches to a business and attracts custom to it. This aspect of goodwill involves a name, brand, or trademark, which may be recognised and protected by law. Here Hill J passed an opinion obiter that the owner might turn this form of goodwill to account without necessarily selling or leasing the business, thus moving away from the traditional view that goodwill is not severable from the business.[14]
4. *Monopoly goodwill* is that form of goodwill which arises from a monopoly conferred on a trader. The trader may in consequence develop a custom which is tied to that monopoly. Hill J cited patents and statutory licences as examples of such monopolies.

These categories may be used for general convenience and provide a useful conceptual framework for dealing with goodwill. However, it must be remembered that goodwill remains one whole item of personal property; these categories in fact represent major sources of the goodwill as noted by the High Court in *Murry*, and will be discussed below. As will be noted later, the identification of these categories has led to a degree of confusion about the nature of goodwill, particularly in respect of site goodwill and personal goodwill. There has been a distinct tendency to treat these categories as items of goodwill in themselves, contrary to the settled jurisprudence concerning goodwill as one whole item of property separate from its sources.

FCT v Murry

In *Murry*, the High Court was called upon to consider whether a taxi licence was goodwill for the purpose of a goodwill concession in the capital gains provisions of the income tax legislation applicable at the time.[15] This concession took the form of a 50% reduction in the capital gain arising from the sale of the goodwill of a small business with a net value below a certain threshold. The taxpayer had acquired in partnership with her husband what was described as a "taxi business", comprising a licence to hire issued by the appropriate State authority and shares in a taxi co-operative company operating within a defined area. The taxpayer and her husband did not operate the business themselves, but purported to lease the taxi licence to another person, the owner of the taxi vehicle, for a fixed monthly fee. Several years later the partnership entered into an agreement to sell this business comprising the licence and the shares. At the same time the owner of the vehicle agreed to sell it to the

[13] *Box v FCT* (1952) 86 CLR 387. In fact, site goodwill constitutes the first definition of goodwill from *Cruttwell v Lye* (1810) 17 Ves Jun 335 AT 346; 34 ER 129 per Lord Eldon LC who said: "The good-will, which has been the subject of sale, is nothing more than the probability that the old customers will resort to the old place."

[14] This opinion was rejected by the High Court as being contrary to the fundamental premises of the law of goodwill that it has no existence independent of the business and it cannot be severed from that business: see *FCT v Murry* (1998) 193 CLR 605 at 619-620; 39 ATR 139.

[15] Under the CGT provisions which applied at the time, a capital gain on disposal of goodwill might be subject to concessionary treatment in the form of a 50% reduction pursuant to s 160ZZR(1) of the *Income Tax Assessment Act 1936* (Cth) (ITAA 1936). To qualify for this concession, it was required that the taxpayer dispose of a business, or an interest in a business, that included goodwill, or an interest in goodwill, and that the net value of the business, or the interest in the business, be less than a stipulated exemption threshold for the year in question. This threshold was calculated in accordance with s 160ZZRAA which set the threshold at $2,000,000 before the 1993-1994 income year and indexed it from that year. This treatment was continued in rewritten legislation in the *Income Tax Assessment Act 1997* (Cth) (ITAA 1997) until its repeal in 1999-2000 in favour of a broader range of small business concessions enacted in response to recommendations from the Ralph Review of Business Taxation.

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purchasers and the assets of both vendors were entered on the one sale form provided by the State authority. The form contained details of the vehicle for a sale price of $6,000, the shares for $25,000, and the licence for $189,000. The reference to the licence was part of the printed form and was described as "Goodwill (Licence Value)".

The question before the court was whether the amount received for the licence, or some part of that amount, constituted a payment for goodwill for the purpose of the relevant provision. The majority of the High Court decided that the taxpayer and her husband had not disposed of a business as required to qualify for the concession; rather, they found that she and her husband had sold a licence to use a taxi together with shares in a taxi co-operative company.[16] These assets did not constitute a business, thus the taxpayer could not have disposed of a business and its goodwill in order to gain the concession.

However, in their joint judgment, the majority of the High Court deliberated in detail on the nature of goodwill and its relationship with the business and its other assets.[17] Their Honours' fundamental view of the place of goodwill in a business may be found early in their judgment where they said:

> Goodwill is inseparable from the conduct of the business. It may derive from identifiable assets of a business, but it is an indivisible item of property, and it is an asset that is legally distinct from the sources – including other assets of the business – that have created the goodwill. Because that is so, goodwill does not inhere in the identifiable assets of a business, and the sale of an asset which is a source of goodwill, separate from the business itself, does not involve any disposition of the goodwill of the business.[18]

In reviewing the nature of goodwill and its relationship to the business, the majority referred to several cases from the 19th and early 20th centuries, the most notable being the House of Lords' case of *Muller*. The Lords' major contribution to the legal concept of goodwill was that goodwill is one whole item of property which is inseparable from the business. But, notwithstanding the importance of the Lords' statements on the nature of goodwill in *Muller*, they appear not to have had a significant impact on the understanding of goodwill in Australian stamp duty cases.[19] Thus it has been left to *Murry* to provide a reminder of the established jurisprudence concerning the nature of goodwill as an

[16] See *FCT v Murry* (1998) 193 CLR 605 at 608-609; 39 ATR 139. The majority comprised Gaudron, McHugh, Gummow and Hayne JJ. Kirby J dissented.

[17] While strictly these deliberations were made obiter, they may be taken as considered statements of judicial principle in the form of "judicial" dicta. That is, these deliberations amounted to a considered exposition of the legal nature of goodwill and, as such, may be seen as persuasive "judicial" dicta rather than mere obiter dicta. This important distinction is explained in *Halsbury's Laws of England* (4th ed), Vol 26, p 294: "Statements which are not necessary to the decision, which go beyond the occasion and lay down a rule that is unnecessary for the purpose in hand are generally termed 'dicta'. They have no binding authority on another court, although they may have some persuasive efficacy. Mere passing remarks of a judge are known as 'obiter dicta', whilst considered enunciations of the judge's opinion on a point not arising for decision, and so not part of the ratio decidendi, have been termed 'judicial dicta'." Inglis emphasised the importance of these dicta in *Murry* by saying that the actual decision in that case became secondary to them: see Inglis M, "Michael Inglis on Tax" (1998) 69(10) *Charter* 28. The actual *ratio* based on the finding that the taxpayers had not disposed of a business may be seen as somewhat moot because it is arguable that sufficient assets were sold to constitute a business: see, for example, an expression of this view in Raitt G, "Licences, Goodwill and CGT" (1998) 72(8) LIJ 78. Nonetheless, the "judicial dicta" are what is important (and they could arguably be taken to constitute an alternative *ratio* because they would lead to the same decision).

[18] *FCT v Murry* (1998) 193 CLR 605 at 608-609; 39 ATR 139.

[19] The irony of this is that *Muller* itself was a stamp duty case.

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indivisible whole item of property, inseparable from the business but separate from its sources.[20] If *Murry* has added anything to this jurisprudence, it is the definitive view that goodwill is legally separate from its sources.[21]

The sources of goodwill

While the House of Lords saw goodwill as having elements, the High Court of Australia took the view, more precisely, that goodwill has *sources* rather than elements. The sources of goodwill are those qualities of a business which generate the goodwill. They may be other property of the business and also non-proprietary things such as effective marketing, superior management, and good customer relations.[22] The identification of goodwill as having sources represents a notable and significant contribution to the jurisprudence of goodwill by the High Court. It enables goodwill to be posited as an item of property in its own right, separate from the sources which generated it, including other property of the business. However, as already noted, the major elements of goodwill may be used as the framework for an examination and understanding of the legal concept of goodwill. Of course, these elements may now be recognised as major *sources* of goodwill in the wake of *Murry*.

The relationship of goodwill to the business

It has been clear from at least the time of *Muller* that goodwill is inseparable from the business to which it belongs. That is, a fundamental characteristic of goodwill is that it is an item of property which is attached inseparably to the business; it cannot exist independently of that business. A consequence of this characteristic is that goodwill cannot be sold or transferred apart from the business. Furthermore, while goodwill may have considerable value to a business, the value would amount to nothing without the business. In this regard, Lord Lindley pronounced in *Muller* that "goodwill is inseparable from the business to which it adds value".[23] This view was supported by Lord Macnagthen in the same case where he proposed:

> The goodwill of a business is one whole, and … must be dealt with as such … goodwill has no independent existence. It cannot subsist by itself. It must be attached to a business.[24]

That these authoritative statements from the Lords have become the established law may be clearly gleaned from various pronouncements on the matter by the High Court of Australia. For example, in the relatively early case of *The Bacchus Marsh Concentrated Milk Company Ltd (in liq) v Joseph Nathan & Company Ltd*, Isaacs J said that: "Goodwill … is inseparable from a particular business."[25] And in *Geraghty v Minter*, Barwick CJ said "goodwill is not something which can be conveyed or held in gross: it is something which attaches to a business. It cannot be dealt with separately from the business with which it is associated".[26] Stephen J also expressed the same view in that case. In *Hepples v FCT*, McHugh J relied upon *Muller* and *Geraghty v Minter* in holding: "Goodwill … is inherently inseverable from the business to which it relates … It does not survive the

[20] It should be noted that *Murry* did not introduce a new jurisprudence, but essentially restated the law based on long-established authority: see, for example, Bevan C, "Resuscitating the Old Jurisprudence on Goodwill" (1998) 27 AT Rev 148. Nonetheless, this established authority was largely overlooked in the stamp duty cases pre-*Murry*.

[21] The Federal Commissioner of Taxation publicly recognised this view in the Australian Taxation Office (ATO), *Income tax: Capital gains: Goodwill of a business*, Taxation Ruling TR 1999/16 (1999) issued in the wake of the High Court's decision in *Murry*. See, for example, para 97 of that ruling.

[22] In respect of typical sources of goodwill, the High Court said in *FCT v Murry* (1998) 193 CLR 605 at 616; 39 ATR 139: "Many of the sources of goodwill are not themselves property. Nor are they assets for accounting purposes. Thus, manufacturing and distribution techniques, the efficient use of the assets of a business, superior management practices and good industrial relations with employees, may be sources of the goodwill of a business because they motivate service or provide competitive prices that attract customers. Yet they are neither property, nor assets for accounting purposes."

[23] *CIR v Muller & Co's Margarine Ltd* [1901] AC 217 at 235.

[24] *CIR v Muller & Co's Margarine Ltd* [1901] AC 217 at 224.

[25] *The Bacchus Marsh Concentrated Milk Company Ltd (in liq) v Joseph Nathan & Company Ltd* (1919) 26 CLR 410 at 438.

[26] *Geraghty v Minter* (1979) 142 CLR 177 at 181; see also Stephen J at 193.

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cessation of the business and cannot be dealt with independently of that business."[27] Similarly, the majority in *Murry* proclaimed that "[i]t is the right or privilege that is inseparable from the conduct of the business". Hence, there is overwhelming weight of authority for the rule that goodwill cannot be severed from the business to which it is attached.[28]

STAMP DUTIES

Stamp duties, as imposts on instruments or their underlying transactions,[29] constitute a significant source of revenue for the Australian States and Territories. With the exceptions of Victoria and Tasmania,[30] all other jurisdictions impose duty, at ad valorem rates, on conveyances of goodwill. This situation of itself does not present any issues. However, issues have arisen regarding the relationship between goodwill and land where revenue offices have endeavoured to include the value of goodwill in the value of land on the sale of businesses for the purpose of assessing duty.

The situation pre-Murry

In the period before the decision in *Murry*, there was a distinct tendency to include the value of site goodwill in the value of land in imposing stamp duties. In Victoria, in particular, the revenue office routinely included the value of site goodwill in the value of land. The motive for this, of course, was to impose duty effectively on the value of the goodwill attributable to the site or location of the business, remembering that goodwill itself is not dutiable in that State. The argument in support of this approach was that site goodwill was part of the land, and therefore dutiable as such on conveyance of that land in the sale of the business located on it.[31]

While the issue of including site goodwill in land for direct assessment purposes was largely confined to Victoria, at least in more recent times, there was a broader issue concerning the so-called "land rich" provisions which apply in all jurisdictions. These are essentially anti-avoidance provisions which apply to the transfer of shares in certain companies or units in unit trusts where (1) those entities hold land whose unencumbered value reaches a stipulated threshold amount, and (2) that land value in relation to the total value of their property reaches a stipulated threshold percentage. (These thresholds vary between the jurisdictions, ranging from nil to $2 million for the value of the land and either nil or 60% for the percentage.) These provisions apply ad valorem rates of duty to the transfer of the shares or units, as effectively the conveyance of land, rather than the lower rates payable on shares and units. Here there was a strong temptation on the part of the revenue offices to include the value of site goodwill in the value of the land in order to meet the threshold requirements of these provisions.

The situation post-Murry

However, since the decision in *Murry*, the courts have generally held that the value of site goodwill should not be included in land for duty purposes, consistent with the view of goodwill from that case. Furthermore, site goodwill was not to be counted in the value of land for the purpose of the "land rich" provisions applicable in all the jurisdictions. This change in approach by the courts has resulted from recognition of the principle that goodwill is property in its own right and separate from its

[27] *Hepples v FCT (No 2)* (1991) 173 CLR 492 at 542; 22 ATR 465; 91 ATC 4808.

[28] See also *CT (Qld) v Ford Motor Company of Australia Pty Ltd* (1942) 66 CLR 261 at 272 (Latham CJ and Rich J).

[29] South Australia and the Northern Territory retain the traditional approach of imposing duty on the instruments effecting transactions, while the other jurisdictions have changed to imposing the duty on the value of the transactions themselves. However, this change from an instruments-based approach to a transactions-based approach has no bearing on matters under consideration in this article.

[30] Duty on goodwill in Tasmania was removed from 1 July 2008.

[31] For example, *Tooth & Co Ltd v CSD (NSW)* (1909) 9 SR (NSW) 652 and *Morvic Pty Ltd v CSR (VIC)* (2002) 50 ATR 64, where site goodwill was held to be part of land value. Furthermore, the Victorian cases of *CSR (Vic) v Uniqema Pty Ltd* (2004) 9 VR 523; 56 ATR 19 and *Palace Hotel (Hawthorn) Pty Ltd v CSR (Vic)* (2004) 8 VR 439; 55 ATR 534, amongst others, represent examples of attempts by the Commissioner of State Revenue, albeit unsuccessful, to include goodwill in land value.

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sources, including land.[32] As a consequence of goodwill being recognised as separate property, the argument for including it in land becomes untenable. Moreover, it is clear that the jurisprudence on goodwill, holding it to be separate from other property of the business, was in fact well-settled in the period before *Murry*, dating back to the beginning of the 20th century at least. It should be remembered that *Murry* did not produce a new jurisprudence on legal concept of goodwill; rather, it served as a reminder of the settled jurisprudence with the added clarification that goodwill did not strictly consist of elements but instead these so-called elements were in fact the sources of the goodwill.

Capital expenditure and goodwill

Goodwill has featured, and continues to feature, in specific ways in the CGT system where it is defined as an asset. Originally, for example, there was the concession by way of a reduction of the capital gain made on the sale of goodwill in the sale of a small business. This was the concession which gave rise to the important CGT cases of *FCT v Krakos Investments Pty Ltd*[33] and, most significantly, *Murry* which reminded us of the meaning of legal goodwill as discussed earlier in this article. This concession has been repealed in favour of a range of small business concessions considered in the following section of this article.

The CGT provisions are contained in Pt 3-1 of the *Income Tax Assessment Act 1997* (Cth) (ITAA 1997). Goodwill is specifically included in the definition of a CGT asset in s 108-5(2)(b), expressly to avoid any doubt.[34] However, given that the fundamental definition of a CGT asset is “any kind of property” in s 108-5(1)(a), and clearly goodwill is property, this specific inclusion seems redundant. There can be no doubt goodwill is property and an asset for the purposes of law, of which CGT and tax in general are part, and is also an asset for accounting purposes.

Since goodwill is a CGT asset, its disposal as part of the sale of a business will constitute a CGT event A1, the disposal of a CGT asset, as set down in s 104-10. In accordance with s 104-10(4), the capital gain or loss is calculated by deducting the relevant cost base from the capital proceeds as worked out under Div 116 (the details of which are not relevant for this discussion). The cost base and reduced cost base are worked out under the rules set down in Div 110. The cost base is used to calculate a capital gain and may consist of up to five elements: see s 110-25(1). The reduced cost base, on the other hand, is used to calculate a capital loss. For the purpose of this discussion, the elements of both cost bases may be taken to be the same,[35] with the fourth element being the relevant one. The fourth element includes capital expenditure incurred for the purpose of increasing or preserving the asset’s value: see s 110-25(5).[36] However, s 110-25(5A) provides that subs (5) does not apply to capital expenditure incurred in relation to goodwill. Thus capital expenditure relating to both increasing and preserving the value of goodwill specifically may not be included in its cost base.

However, capital expenditure to preserve, but not enhance, the value of goodwill of a business may be claimed under s 40-880[37] which allows business capital expenditure to be deducted on a straight line basis over five years: s 40-880(2). This deduction is made on the basis that the

[32] See, for example, the “land rich” cases of *Kizleap Pty Ltd v CSD (NSW)* (2001) 46 ATR 323 and *HSH Hotels (Australia) Ltd v CST (SA)* (2005) 58 ATR 276 where the courts declined to accept that goodwill should be included in the value of land.

[33] *FCT v Krakos Investments Pty Ltd* (1995) 61 FCR 489; 32 ATR 7.

[34] In s 100-25(3) of the ITAA 1997, also, goodwill is listed as a “not so well known” CGT asset.

[35] The rules for working out the reduced cost base are found in s 110-55. As noted in s 110-55(2), all the elements of the reduced cost base (except the third one) are the same as for the cost base.

[36] Subsection 110-25(5) was amended, and s 110-25(5A) inserted, by the *Tax Laws Amendment (2006 Measures No 1) Act 2006* (Cth), effective from 1 July 2005. Previously, there was no specific exclusion of expenditure on goodwill from the fourth element. However, such expenditure was effectively excluded because it had to be reflected in the state or nature of the asset – a requirement not possible in the case of an intangible asset such as goodwill.

[37] Section 40-880 was also amended by the *Tax Laws Amendment (2006 Measures No 1) Act 2006* (Cth). The present version of s 40-880 has broader application to business capital expenditure than its predecessor, which also excluded from deduction expenditure incurred in relation to a lease or other legal or equitable right. However, the present s 40-880 at least allows a deduction for such expenditure where it preserves the value of goodwill.

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expenditure cannot be claimed under any other provision (or be included in a cost base) as stipulated in s 40-880(1). In other words, this section provides deductions of last resort for what is commonly termed "blackhole" expenditure. There are specific exclusions from deduction of expenditure in s 40-880(5) including para (d) which refers to capital expenditure in relation to a lease or other legal or equitable right. This exclusion, however, does not apply to expenditure incurred to preserve (but not enhance) the value of goodwill if the expenditure is in relation to a legal or equitable right and the value of the right is solely attributable to the effect that the right has on goodwill: see s 40-880(6).[38]

Consequently, capital expenditure on rights to preserve the value of goodwill may be deductible under s 40-880,[39] but not expenditure on these rights that increase or enhance the value of goodwill. Given that s 40-880 is a deduction provision of last resort, this means that such expenditure that increases or enhances the value of goodwill fails to be deductible and accordingly remains in a "black hole". The Explanatory Memorandum to the *Tax Laws Amendment (2006 Measures No 1) Act 2006* (Cth) explains in para 2.71 that expenditure in relation to a right to enhance the value of goodwill, or has an inherent value in itself, is not deductible because it "does not represent a loss to the taxpayer". This indicates that the type of capital business expenditure which is to be deductible under s 40-880 must be of a type that does not contribute to the creation or enhancement of an asset which itself has value.[40] Normally, of course, this expenditure on rights would be excluded from deduction under s 40-880 by s 40-880(5) because it would be deductible elsewhere or be included in the asset's cost base, particularly in the fourth element in s 110-25(5). These rights are property and assets in themselves, while also being sources of the goodwill of the business. Furthermore, other sources of goodwill may be expenditures which are revenue in nature, rather than capital, and so may be deductible under s 8-1. This situation has been recognised by the High Court in *Sun Newspapers Ltd v FCT*[41] and in *Murry*.

Notwithstanding issues about the treatment of capital expenditures on rights which affect goodwill, the essential issue for the purpose of this article is the nature of this goodwill. In this respect, there is nothing to indicate that goodwill is understood to be anything other than the legal concept as defined by the High Court in *Murry*. In fact, the important idea of goodwill as having sources comprising, inter alia, other assets is found in the provisions of s 40-880.

CGT SMALL BUSINESS CONCESSIONS

As noted elsewhere in this article, there was originally a small business CGT concession in the form of a 50% reduction in the capital gain arising from goodwill on the sale of the business. This concession, however, was repealed from 21 September 1999 as part of the reforms recommended in the Review of Business Taxation; in its place several more generous small business concessions were introduced in Div 152 of the ITAA 1997. While these concessions involve goodwill, together with

[38] The previous version of s 40-880, effective from 1 July 2001, was amended by the *Taxation Laws Amendment Act (No 5) 2002* (Cth) to insert, inter alia, subs (3)(d) which excluded capital expenditure on leases and rights similarly to subs (5)(d) of the present s 40-880. The reason for this exclusion provided in the Explanatory Memorandum to this Act at [3.67] was that the treatment of such expenditure was subject to government review arising out of recommendations by the Review of Business Taxation and was to be determined as part of that review. Some details of that review and consideration of the treatment of leases or other legal or equitable rights may be found in ATO, *Capital Allowances: Business related costs – limitation of deduction – lease or other legal or equitable right*, Interpretative Decisions ID 2007/93 (2007); ATO, *Capital Allowances: Business related costs – limitation of deduction – lease or other legal or equitable right*, ID 2007/111 (2007).

[39] An example of expenditure to preserve goodwill may be found in *Broken Hill Theatres v FCT* (1952) 85 CLR 423. In this case, legal expenses incurred by a movie theatre in opposing an application by a competitor to show movies were held to be capital because the expenses were incurred to protect the theatre's business. As these expenses were outlaid to defend the business from competition, they could therefore be taken to preserve its goodwill. Such capital expenditure should now be deductible under s 40-880. However, another way of looking at this type of expenditure is that it should qualify as typical "blackhole" expenditure deductible under s 40-880. The point to be made under this approach is that such expenditure, if deemed to relate to goodwill, would be taken to preserve that goodwill rather than enhance it. Thus the expenditure would not be precluded from deduction under s 40-880.

[40] For an analysis of the law and policy relating to s 40-880, see Augustinos N, "Blackhole Expenditures and the Application of Section 40-880" (2009) 38 AT Rev 100.

[41] *Sun Newspapers Ltd v FCT* (1938) 61 CLR 337 at 360-361 (Dixon J).

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other business assets, they do not relate specifically to the goodwill as did the original more limited concession. It is not the purpose here to deal in detail with these concessions. Rather, the purpose is to examine the place and nature of goodwill in the context of these concessions. Nevertheless, a brief outline of the concessions is necessary to provide this context. Division 152 provides four concessions as listed in s 152-1:

(1) The 15-year exemption (in Subdiv 152-B). Broadly, this concession grants a full exemption to the disposal of a business CGT asset which has been owned by the taxpayer for at least 15 years and the owner has reached the age of 55 years and has retired or is permanently incapacitated. The exemption is effected by disregarding the any capital gain arising from the relevant CGT event, consistent with the method of exemption throughout the CGT system.

(2) The 50% reduction (in Subdiv 152-C). This reduction by 50% in a capital gain arising from the disposal of a CGT asset may be applicable where the basic conditions in s 152-10(1) (below) have been satisfied. This reduction may be applied on top of any general 50% discount available to individuals, thus reducing the capital gain to 25%. It should be noted that this concession is rendered redundant where the full exemption in Subdiv 152-B above is applied.

(3) The retirement concession (in Subdiv 152-D). This concession is designed to encourage a taxpayer to contribute funds to his or her retirement. It enables the taxpayer to disregard any capital gains arising from business assets up to a limit of $500,000. This concession would be expected to be applied after any available reductions from Subdiv 152-C have been taken into account.

(4) The roll-over (in Subdiv 152-E). This concession enables a small business to defer the recognition of a capital gain from the disposal of a CGT asset where a replacement asset is acquired within stipulated time limits.

Before any of these concessions may be applied, however, the basic conditions set out in s 152-10(1) must be satisfied. The essence of the concessions is that a capital gain from a CGT event may be reduced or disregarded if these conditions are satisfied, subject also to satisfying specific requirements in the concessions themselves. These basic conditions are: (a) a CGT event happens to a CGT asset of the taxpayer's in an income year; (b) the event would (apart from Div 152) have resulted in a capital gain; (c) the taxpayer is a small business entity or satisfies a maximum net asset value test; and (d) the CGT asset is an active asset.

The important matters for the purpose of this discussion are the meaning of *active asset*, the last of the basic conditions in s 152-10(1), and whether goodwill qualifies as such an asset. If goodwill qualifies, then it may be subject to the appropriate concessions. The definition of an active asset is provided in s 152-40(1)(b) which deals with intangible assets – an intangible asset will be an active asset where it is "inherently connected with a business" carried on by the taxpayer or an affiliate. Goodwill is in fact given as an example of such an asset in that paragraph. In view of the very nature of goodwill as an asset inseparable from the business and having no existence apart from it, it is clear that it is inherently connected with that business.[42] Accordingly, it may be concluded that the concept of goodwill employed here is consistent with the concept at common law. Furthermore, the disposal of goodwill to gain a relevant concession would require the sale of the business, involving all the necessary assets to transfer a going concern, given the relationship of goodwill to the business. While many other assets may be disposed of individually and separately from the business, this is not possible with goodwill.

[42] The nature of goodwill as inseparable from the business also means that it is not a "tainted asset" for the purposes of Pt X of the ITAA 1936 dealing with controlled foreign companies. Paragraph (c) of the definition of "tainted asset" in s 317(1) excludes assets "used solely in carrying on a business". Given the nature of goodwill and its relationship to a business, this exclusion must apply to goodwill, a view stated in ATO, *Disposal of goodwill: Tainted asset*, ID 2006/181 (2006). Moreover, for similar reasons, goodwill is not a tainted asset for the purposes of s 23AH(3) of the ITAA 1936 which exempts capital gains of foreign branches: see ATO, *Capital Gains Tax: Disposal of goodwill by a branch to another entity*, ID 2006/17 (2006).

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GOODWILL AND THE CONSOLIDATION REGIME

The consolidation regime is contained in Pt 3-90[43] – "Consolidated Groups" – of the ITAA 1997, having effect from 1 July 2002. This regime comprises a long and complex set of provisions which enable wholly-owned Australian resident subsidiaries of an Australian head company to consolidate into a group for the purpose of being treated as a single entity[44] for income tax.[45] A detailed examination of this regime is outside the scope of this article, but an outline of its operation is necessary to create the context for an examination of the concept, the valuation, and the treatment of goodwill within it.

The head company is treated as the single taxpayer on behalf of the consolidated group and accordingly lodges the one tax return and pays the tax for the group including consolidated tax instalments. Consolidation broadly involves: the attribution of all income and deductions to the head company; the pooling of losses and franking credits; the maintenance of the one franking account; and the disregarding of transactions between group members. Further, the head company is taken to own group members' assets (and liabilities) and is liable to account for balancing adjustments and capital gains and losses in relation to the disposal of these assets.[46] The term "asset" is not defined in the ITAA 1997 for the purposes of Pt 3-90. However, in Taxation Ruling TR 2004/13, it is stated that the meaning of asset is to be found in its commercial or business context (para 4).[47] This meaning is not limited to assets that would be recognised under accounting standards or statements of accounting concepts. Consequently, internally generated goodwill may be recognised for consolidation, although not recognised for accounting.[48] However, it is noted in this ruling that assets recognised for purposes of the tax legislation will be assets for Pt 3-90: these include CGT assets which in turn include goodwill (see s 108-5(2)(b)). Specifically, it is the treatment of goodwill as a CGT asset which is relevant to this topic.

There are three basic situations which may be encountered in consolidations: (1) an entity joining an established group; (2) the formation of a group; and (3) an entity leaving a group.[49]

An entity joining a group

Under the single entity rule in s 701-1 assets of a joining entity are treated as the head company's assets for the purpose of determining their tax treatment in the consolidated group. Subject to some exceptions, the assets of a joining group are classed as *reset cost base assets* in terms of s 705-35(1). In accordance with s 701-10(4), these assets are liable to have their costs reset at the time the entity joins the established group as a subsidiary member. Consequently, an *allocable cost amount* (ACA) is spread across the value of the joining entity's assets to reset their costs in the group. The ACA is

[43] ITAA 1997, Pt 3-90 comprises Divs 700-721.

[44] See the single entity rule in ITAA 1997, s 701-1.

[45] Not only is the regime complex, it is subject to constant review and change. For example, the *2009 Australian Master Tax Guide* (44th ed, CCH, Sydney) at [14-000] lists 25 modifications which the government intends to proceed with. In this regard, the Board of Taxation issued a discussion paper (Board of Taxation, *Post-implementation Review into Certain Aspects of the Consolidation Regime* (2009)), dealing with key elements of the regime involving the single entity rule, the interaction between consolidation and other parts of the income tax law, and the inherited history rules. For a useful introduction to the consolidation regime, see ATO, *Consolidation: The meaning and application of the single entity rule in Part 3-90 of the Income Tax Assessment Act* 1997, TR 2004/11 (2004). For an examination of the treatment of the group as a single entity specifically, the so-called "single entity rule", see Slater A and Murray P, "Tax Consolidation and the Single Entity Rule" (2004) 7(4) *The Tax Specialist* 206.

[46] Consolidation involves a complex set of accounting transactions; for an explanation see Betkowski F, "Accounting for the Consolidation System" (2003) 7(1) *The Tax Specialist* 39.

[47] ATO, *Income tax: The meaning of an asset for the purposes of Part 3-90 of the Income Tax Assessment Act 1997*, TR 2004/13 (2004) at [4]. See also at [6].

[48] See the Australian Accounting Standards Board AASB 138, *Intangible Assets* at [48]. (However, at [11] of AASB 138 some recognition is given to assets not recognised for accounting in the financial reports but for which a purchaser is prepared make payment in a business combination.)

[49] The treatment of goodwill in these situations is dealt with detail in ATO, *Income tax: Goodwill: Identification and tax cost setting for the purposes of Part 3-90 of the Income Tax Assessment Act 1997*, TR 2005/17 (2005).

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calculated in accordance with s 705-60 and consists of the cost of the group's membership interests in the joining entity plus the value of the joining entity's liabilities and several other amounts, the details of which are not relevant to this analysis. The reset cost base assets will have their costs reset by a *tax cost setting amount* (TCSA), determined under s 705-35, which broadly involves having the ACA allocated to these assets in proportion to their market values. The TCSA will constitute the cost base or reduced cost base for general CGT purposes: s 701-55(5).

Goodwill is classed as a *reset cost base asset* of a joining entity in terms of s 705-35(1) and accordingly the goodwill of this entity would be subject to cost resetting as outlined above. This is the goodwill of joining entity's business and which has its value reset for tax purposes. However, beyond this relatively straightforward situation, there are specific rules applicable to goodwill in s 705-35(3) which relates to what is generally called "synergistic" goodwill. As explained in s 705-35(3), this goodwill results from the head company's ownership and control of the joining entity and is associated with synergies arising out of the assets and businesses of the joined group. This is deemed to be a separate amount of goodwill of the joining entity and hence an asset of the head company under the single entity rule of s 701-1(1): see s 705-35(3)(b)(i). In accordance with s 705-35(3)(a), this goodwill is taken into account for *head company core purposes* in terms of s 701-1(2), namely to work out the head company's income tax liability, and its *tax cost* is set at joining time at its TCSA.

A TCSA is calculated for this synergistic goodwill as a separate (deemed) asset by allocation of an amount of ACA in proportion to its market value. This market value, in accordance with Taxation Ruling TR 2005/17, should be determined using the "commercial residual value approach".[50] This is the standard accounting valuation approach of subtracting the value of identifiable assets of the business from the total value of the business, leaving the value of goodwill as a residual amount.

The formation of a group

This situation involves the original formation of a consolidated group, rather than an entity's joining an already formed group as in the situation above. It is stated in TR 2005/17 that synergistic goodwill in terms of s 705-35(3) "has no application to an entity when it forms part of a consolidated group where the residual value method of identifying goodwill is used and the businesses of the entity are valued using a valuation method based on the cash flow of each business".[51] However, the goodwill assets of the members of the group are reset at their appropriate TCSAs, as noted above.

An entity leaving a group

Where an entity leaves a group, that entity takes with it goodwill attached to its business and also adjustments must be made to any synergistic goodwill of the head company which has been recognised under s 705-35(3). The cost base of this synergistic goodwill is calculated in accordance with s 711-25(2) to reflect any reduction in its value resulting from the loss of economic benefit of the leaving entity.[52] In addition, the leaving entity will have its own goodwill associated with its business and also may have had synergistic goodwill from the economic benefits from being associated with the other group members. Details of these calculations, however, are not necessary for this analysis which is focused on the nature and treatment of the goodwill in these settings. Furthermore, there may be specific capital gains or losses arising from these events, but these also are not relevant to this analysis.[53]

[50] ATO, TR 2005/17, n 49 at [12]; see also ATO, *Income tax: Consolidation: In working out the market value of the goodwill of each business of an entity that becomes a subsidiary member of a consolidated group, should the value of related party transactions of each business of the entity be recognised on an arm's length basis?*, TD 2007/1 (2007).

[51] ATO, TR 2005/17, n 49 at [14].

[52] ATO, *Income tax: Consolidation: Is the cost base of the goodwill referred to in subsection 711-25(2) of the Income Tax Assessment Act 1997 limited to the cost base of goodwill previously identified under subsection 705-35(3) of that Act?*, TD 2007/27 (2007) explains the complementary relationship between s 705-35(3) and s 711-25(2).

[53] Detailed consideration of the implications of leaving a group may be found in twin articles by Scott H and Spence K, "Consolidation and Exits – the Other End of the Food Chain, Part 1" (2004) 8(1) *The Tax Specialist* 30; and Scott H and Spence K, "Consolidation and Exits – the Other End of the Food Chain, Part 2" (2004) 8(2) *The Tax Specialist* 81.

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The nature of goodwill in consolidations

The particular requirements of the complex consolidation regime involving the combining of separate entities, including their assets and liabilities, to constitute the one economic entity for income tax purposes lead to several issues concerning goodwill. While the fundamental legal concept of goodwill, as the attractive force which brings in custom, is the one that would apply to the separate entities of a consolidated group for legal purposes, it is arguably the accounting concept which holds sway in consolidation. This is because it is the value of goodwill in determining its cost in the consolidation process which is taken into account in this regime.

However, as noted by the High Court in *Murry*, the value of legal goodwill and accounting goodwill may be identical in the case of a profitable business.[54] The situation may differ in the view of the High Court, however, where the business is unprofitable and accordingly "there may be a marked difference between the value of goodwill for legal purposes and its value for accounting or commercial purposes".[55] The High Court explained this difference thus:

> That is because goodwill for legal purposes includes everything that adds value to business – "every positive advantage" as Wood V-C pointed out in *Churton v Douglas*. As a result, a business may have valuable goodwill in the eyes of the law although an accountant would conclude that the business either has no goodwill or that, if it has, it is of nominal value only … Having regard to the likely future of the business, often it may have only nominal value.[56]

While the accounting concept of goodwill is arguably more applicable than the legal concept for consolidation, this concept itself is not entirely applicable either. As noted above, the concept of an asset goes beyond the accounting concept of goodwill to encompass also assets not recognised under accounting standards, that is, assets found and recognised in a commercial or business context. This view, expressed in Taxation Ruling TR 2004/13, enables internally generated goodwill, for example, to be taken into account, whereas it is not recognised for accounting purposes.[57] Here the situation therefore becomes a little more complex, because internally generated goodwill may be recognised for legal purposes.[58] Accordingly, goodwill in this context is not encompassed entirely by either concept, but may amount in effect to an amalgam of both concepts.

Furthermore, the so-called "synergistic" goodwill, by its very nature a creature of consolidation, is not an asset for either accounting or law. This view was endorsed by the National Tax Liaison Group (NTLG) Consolidation Subcommittee which saw synergistic goodwill not as an asset but as a value which is allocated to a joining entity's goodwill, where that value is a premium arising from the synergy generated by the group.[59] Thus synergistic goodwill is a value for allocation across assets of the group and not an asset in itself.

What these matters amount to is that goodwill for the requirements of consolidation may be a range of concepts to suit the process of valuing assets, and deemed assets, in the joining or leaving of a group. Thus the consolidation regime takes multiple views of goodwill, not all of which are consistent with the standard concepts for either accounting or law. However, there is no need for consistency in a situation where there these views represent specific statutory requirements. There is nothing in the consolidation regime which should be taken to add anything new or different to the general accounting or legal concepts of goodwill. Nonetheless, consolidation reveals that there may be some consistency, and a degree of synthesis, between the accounting and legal concepts of goodwill, particularly in the area of value.

[54] See *FCT v Murry* (1998) 193 CLR 605 at 624; 39 ATR 139.

[55] *FCT v Murry* (1998) 193 CLR 605 at 624; 39 ATR 139.

[56] *FCT v Murry* (1998) 193 CLR 605 at 625; 39 ATR 139.

[57] See AASB, n 48 at [48]. Accounting conservatism militates against the recognition of this form of goodwill because no cost can be reliably determined for it.

[58] For example, internally generated goodwill may apply in the case of passing-off and in partnership dissolution settlements.

[59] Per NTLG Consolidation Subcommittee, *Meeting Minutes* (8 June 2006), Agenda Item 3, "Synergistic goodwill".

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Goodwill as an active foreign business asset

Division 768 of the ITAA 1997 provides CGT concessions for capital gains or losses of resident companies arising from CGT events happening in relation to specified interests, for example, shares, in foreign companies.[60] Thus a typical situation would involve the sale of shares by a resident company in a foreign company. The concession may take the form of a full exemption from capital gains (and the disregarding of any capital losses where appropriate) or, alternatively, a proportional reduction in capital gains or losses, depending on the circumstances. The concession depends on several conditions, including the resident company's holding a direct voting percentage in the foreign company of at least 10%, the holding of the specified interest for a continuous period of 12 months in the two years before the CGT event, and the extent to which the business activities of the foreign company may be classified as active. The last condition concerning active business of the foreign company, which determines the extent of the exemption, is the critical one for the purposes of this topic.

The concession is based on an *active foreign business asset percentage* calculated under s 768-510. It is this percentage that is the basis of the amount of reduction in the capital gain or loss accruing to the resident company. The active foreign business asset percentage is, broadly, the value of the active foreign business assets of the foreign company expressed as a percentage of the value of the total assets of the company. An *active foreign business asset* is defined in s 768-540 which specifically includes goodwill in s 768-540(1)(b)(ii). This inclusion is consistent with the definition in s 152-40 of an *active asset* as an asset which is used in the course of carrying on a business and, in the case of an intangible asset such as goodwill, is inherently connected with that business: see s 152-40(1)(b). As noted earlier in relation to the CGT small business concessions, where the same definition was considered, goodwill by its very nature is inherently connected with the business in keeping with its common law concept.

Goodwill and GST

Subdivision 38-J of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (GSTA), comprising only s 38-325, provides an exemption[61] from the GST for the supply of a going concern: s 38-325(1). A *supply of a going concern* is defined in s 38-325(2) as a supply under an arrangement under which the supplier supplies to the recipient all of the things that are necessary for the continued operation of an enterprise: see s 38-325(2)(a). Further, s 38-325(2)(b) requires the supplier to carry on the enterprise until the day of supply to satisfy the definition. An *enterprise*, in turn, is defined in s 9-20; the essential meaning may be taken to be an activity in the form of a business[62] as in s 9-20(1)(a). As one commentator has described it,[63] the exemption provided in s 38-325 is intended for the case of a sale of a business on a "walk in-walk out" basis, thus relieving the recipient (purchaser) of the need to obtain additional funds for a bridging period to cover the GST that would otherwise be included in the price of the business, until recovered as a tax credit.[64]

[60] Division 768 was introduced by the *New International Tax Arrangements (Participation Exemption and Other Measures) Act 2004* (Cth) with effect from 1 April 2004.

[61] While the general term "exemption" has been used, the term actually used in the GSTA is "GST-free" which is defined in ss 9-30(1) and 38-1. If a supply is GST-free, then no GST is payable on the supply and any entitlement to input tax credits in respect of making the supply is not affected.

[62] In keeping with tax legislation generally, business is not defined in any meaningful way in the GSTA so that its meaning must be determined from case law: see *Ferguson v FCT* (1979) 9 ATR 873; 79 ATC 4261. An *enterprise* as defined in s 9-20, however, may include activities other than those of a business as ordinarily understood. For example, leasing property may constitute an enterprise in accordance with s 9-20(1)(c), but such activity would not normally constitute a business at common law. Goodwill can only exist in relation to a business, and not to other income-producing activities, so the analysis of the Subdiv 38-J exemption in this article is confined to business. For consideration of broader issues of an enterprise for GST, see Hill P, "Commencing or Terminating an Activity – a Critical GST Analysis" (2004) 7(4) *The Tax Specialist* 181.

[63] Evans M, "The Australian Going Concern Concession: When is a 'Supply of a Going Concern' GST-free?" (2001) 30 AT Rev 100.

[64] See also ATO, *Goods and services tax: When is a "supply of a going concern" GST-free?*, GSTR 2002/5 (2005) at [11].

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The exemption requires that the supplier supplies to the recipient "all of the things that are necessary" for the continued operation of the business: s 38-325(2)(a). This requirement raises the question of what things are necessary to transfer a business as a going concern. The Australian Taxation Office addresses this question in the Goods and Services Tax Ruling GSTR 2002/5, which states that where the enterprise is a business, "goodwill is supplied as one of the things that is necessary for the continued operation of that enterprise".[65] Further, it holds that "[g]oodwill which emanates from the personality, reputation, skills or attributes of an individual is not transferable".[66] That is, according to the Ruling, personal goodwill cannot be supplied. However, the same paragraph goes on to state that "goodwill emanating from other sources will continue to draw custom to the enterprise and can be supplied". This statement represents and continues a misunderstanding of the nature of goodwill.[67] As discussed elsewhere in this article, goodwill is one indivisible item of property, regardless of its sources. The case law authority[68] is clear on this. Therefore, the sources of the goodwill are not relevant to the ability at law to transfer the goodwill of a business. Quite simply, if the business is transferred, then the goodwill is also transferred because it is attached to that business and inseparable from it. GSTR 2002/5, in fact, recognises that goodwill attaches to the business,[69] but that recognition has not prevented the Ruling from perpetuating the misconception about the non-transferability of so-called personal goodwill.

As a consequence, the Ruling on this question is somewhat confusing and at variance with the law. As noted above, it recognises that goodwill is attached to the business and then recognises the High Court's view of goodwill as the legal right or privilege to conduct a business in the manner designed to attract custom to it.[70] Then, logically it seems, it goes on to state: "So, if the 'identified enterprise' is a business, goodwill is supplied as one of the things that is necessary for the continued operation of that enterprise." If this paragraph is taken to mean that if a business is supplied then the goodwill will necessarily be supplied with it, the Ruling to this point may be taken as consistent with the law. However, it follows with the incorrect view of "personal" goodwill, with an example of the treatment of personal goodwill provided.[71] The example concerns a small business with most of the goodwill emanating from the personal attributes of the proprietor. The Ruling states that "this part of the goodwill" is not transferable – an incorrect view of the legal concept of goodwill, as noted above. However, the Ruling continues by way of the example, goodwill from other sources may still be supplied,[72] therefore apparently satisfying the "going concern" requirements for exemption. But, as argued above, the transfer or supply of a business as a going concern simply takes the goodwill (as one indivisible item of property) with it. Reducing goodwill to constituent parts, emanating from different sources, serves no purpose in determining the application of the exemption and is also, most importantly, in conflict with the legal concept. There is nothing by way of a definition of goodwill in the GSTA to indicate that anything other than its common law concept is applicable.[73]

[65] ATO, GSTR 2002/5, n 64 at [11].

[66] ATO, GSTR 2002/5, n 64 at [12].

[67] A similar view is stated in ATO TR 1999/16, n 21 at [59].

[68] For example, see *CIR v Muller & Co's Margarine Ltd* [1901] AC 217; *Geraghty v Minter* (1979) 142 CLR 177; *FCT v Murry* (1998) 193 CLR 605; 39 ATR 139.

[69] ATO, GSTR 2002/5, n 64 at [10].

[70] Refer to *FCT v Murry* (1998) 193 CLR 605 at 615; 39 ATR 139 for the High Court's view on goodwill as a property right and its inseparable attachment to the business.

[71] ATO, GSTR 2002/5, n 64 at [12]-[14].

[72] See the qualification in ATO, GSTR 2002/5, n 64 at [12].

[73] However, as noted in ATO, GSTR 2002/5, n 64 at [10], the concept of goodwill for the particular purposes of consolidation is broader and multi-faceted. Nonetheless, this broader concept arises from the requirements of consolidation, rather than from any specific definition.

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In summary, whether a business is supplied as a going concern is a question of fact;[74] but once it has been established that such a business has been supplied or transferred,[75] the goodwill, including "personal" goodwill, is of necessity transferred also.[76] Thus there is no need to analyse the question of the supply of the business from the viewpoint of asking whether the goodwill has been transferred. In fact, this is the wrong way of looking at it. The focus should not be on the goodwill; rather, the focus should be on the business as a whole (as a going concern) and its supply.[77]

On a final note, a fundamental problem in this area appears to relate to the previously discussed identification of goodwill in terms of its major sources, that is, personal goodwill, site goodwill (arising from location), name goodwill (from brands and trademarks, etc), and monopoly goodwill (from exclusive licences, etc). These are convenient labels for various "types" of goodwill, based on their major sources, and they provide a useful framework for analysis, but care needs to be taken not to see them as separate items of goodwill. Goodwill is one indivisible item of personal property and is attached to the business, regardless of its sources. This is the important message from the High Court in *Murry*.

CONCLUSION

For the purposes of taxation, the legal concept of goodwill as espoused by the High Court is the one which has general application. This is the case even though value plays an important part in the context of taxation where usually this value has to be taken into account for assessment. The notion of value brings the legal concept closer to the accounting concept and, as noted in *Murry*, the two

[74] In *Kenmir Ltd v Frizzell* [1968] 1 All ER 414 at 418 it was stated that: "In deciding whether a transaction amounted to the transfer of a business, regard must be had to its substance rather than its form, and consideration must be given to the whole of the circumstances, weighing the factors which point in one direction against those which point in another. In the end, the vital consideration is whether the effect of the transaction was to put the transferee in possession of a going concern, the activities of which he could carry on without interruption." Moreover, it may be that what is necessary to transfer a business is contained in two or more contracts dealing with different assets of the business, with these separate contracts being treated as substantially the one contract of sale and accordingly the one supply. Thus in *Debonne Holdings Pty Ltd v FCT* (2006) 64 ATR 1154; [2006] AATA 886, for example, the taxpayer entered into two contracts to purchase a hotel – one contract dealing with the land and improvements and the other contract relating to a range of necessary hotel assets including the goodwill. The company taxpayer argued that supply of the land was not GST-free under s 38-325 of the GSTA as it did not constitute the supply of a going concern, that being effected by the other contract, and so it was entitled to an input tax credit on the purchase of the land. However, the Administrative Appeals Tribunal held that both contracts were required to supply all of the things that are necessary to continue the business and dismissed the taxpayer's claim. On the other hand, an example of a situation which did not constitute a supply of a going concern may be found in *Allen Yacht Charters Ltd v CIR* (1994) 16 NZTC 11270 where the High Court of New Zealand, in considering a similar exemption in the New Zealand GST legislation, held that the sale of a charter boat did not entail the supply of a business as a going concern, even though the boat was the essential asset of the business. The court explained: "There was no payment for goodwill, there was no transfer to the purchaser of forward bookings, there was no examination of the accounts of the business, there were no steps taken for [the purchasers] to take over [the vendor's] customers, and there was little evidence that [the purchasers] had any detailed knowledge of the nature of the business" (at 11276). See also Chiert G, "Murry: Ending the Mysteries of Goodwill or Creating New Commercial Pitfalls" (1999) 73 ALJ 659; Walpole M, "The Fate of Goodwill after Ralph" (2000) 3(5) *Journal of Australian Taxation* 344; *Westpac Banking Corp v CSD (Qld)* (2003) 55 ATR 50; 2004 ATC 4135 for consideration of what constitutes the transfer of a business.

[75] In cases where the vendor is not in a position supply all of the things necessary to constitute fully a business as a going concern, such as where licences and leases cannot be transferred but have to be issued anew to the purchaser, this should not detract from satisfying the exemption requirements of s 38-325 of the GSTA. Businesses are often sold on the condition that necessary licences and leases will be provided to the purchaser by third parties such as government agencies responsible for licences and landlords for leases.

[76] Small businesses which rely significantly for custom on the person of the owner/vendor are routinely sold. Of course, the personal characteristics of the vendor cannot be transferred, but those characteristics themselves do not constitute the goodwill; rather they are a source of the goodwill. As a practical matter, there are ways to effect the transfer of "personal" goodwill such as, for example, having the vendor work in the business for a period to introduce and recommend the new owner to the customers in order to transfer their allegiance and also having the protection of restrictive covenant where appropriate. To the extent that the transfer of a personal following may be difficult to effect, it would be expected that the goodwill in the sale would be valued appropriately to reflect that difficulty.

[77] Subsection 9-10(1) of the GSTA defines *supply* as "any form of supply whatsoever". This broad definition would include the supply of a business which typically consists of a range of property (goods). Business itself is not property but rather a course of conduct: see *FCT v Murry* (1998) 193 CLR 605 at 626; 39 ATR 139.

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concepts may be very similar in a profitable business. Moreover, for the specific requirements of consolidations goodwill takes on a broader concept which may go beyond both the legal and accounting concepts. Nonetheless, the legal nature of goodwill as one whole item of personal property separate from its sources, but inseparably attached to the business, remains the essence of the concept in the general field of tax.

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