The Tax Institute

The Tax Summit

The Tax Summit

Session 5.3: When is something on revenue account — revenue vs capital

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Preface

The "capital v revenue" distinction must be honoured when required by the text of the legislation:

> There are over a hundred years of case law, for example, on what is meant by the distinction between capital and income and one does not jettison all that each time the relevant provisions are brought forward into a new consolidating taxes Act.
>
> - *Fisher v Revenue & Customs Commissioners* [2023] UKSC 44; [2024] AC 1150 at 1173 [30] per Lady Rose JSC (Lord Reed PSC, Lord Hodge DPSC, Lord Sales and Lord Stephens JJSC agreeing).

But what is the organising principle: *trees and fruit … alchemy … a philosopher's stone ... coin spin*?

> The only questions decided by the judge which arise on this appeal are the questions whether the proceeds [of an assignment of right to receive rents] constituted a capital or income receipt... The judge analysed the capital/income issue in these terms. … [T]he judge drew the hallowed distinction between the fruit of a tree and the tree itself. …;
>
> In the context of capital and income (more precisely, in the context of converting income into capital), the House of Lords has used the word "alchemy", and it has to be observed that this court has not yet found the philosopher's stone, if one exists. One eminent Master of the Rolls, Lord Greene MR, expressed the view "somewhat cynically" (per Lord Upjohn in *Strick (Inspector of Taxes) v Regent Oil Co Ltd* [1966] AC 295) that "in many cases it is almost true to say that the spin of a coin would decide the [the question whether a receipt was income or capital] almost as satisfactorily as an attempt to find reasons" (*CIR v British Salmson Aero Engines Ltd*, (1938) 22 TC 29 at 43). A number of cases have been cited on this appeal on either side of the line. It is difficult at first sight to discern any organising principle ... However, the decided cases certainly shed light on the qualities of capital and income.
>
> - *Commissioners of Inland Revenue v John Lewis Properties plc* [2002] EWCA 1869; [2003] Ch 513 at [8] and [16] per Lady Justice Arden (Schiemann and Dyson LLJ agreeing).

In borderline cases, reasonable minds can differ

> In a very carefully prepared judgment, [Thawley J] made the following critical findings and conclusions:
>
> (1) ..the .. shares had been acquired .. for the purpose of obtaining a profit .. from their subsequent sale;
>
> (2) .. the acquisition of the .. shares was nonetheless not made in a "business operation or commercial transaction" or "commercial dealing" within the *Myer Emporium* principle. The acquisitions went no further than a private investment in listed shares …
>
> … I respectfully disagree with the second conclusion, but only after much hesitation. It raises a difficult issue of characterisation and a question of law as to what is required for a transaction to merit the description of being a "business operation" or "commercial dealing". ..

- *Greig v* Commissioner of Taxation [2020] FCAFC 25; (2020) 275 FCR 445 at [224]-[225] per Justice Steward.

1. Introduction

This paper has been prepared for presentation in the Next Generation stream for the Tax Summit. The object of this paper is therefore to deliver practical insights to assist those seeking a refresher on the topic or to build sound foundations for a successful career in tax.

All legislative references are to the *Income Tax Assessment Act 1997* (Cth) (**ITAA 1997**) unless otherwise stated.

1.1 Tax treatment conditioned on character of amount or asset

The capital / revenue distinction permeates the tax legislation. It is not within the scope of this paper to catalogue provisions that draw the distinction and provide for different treatment of gains and losses, receipts and expenditures, and assets, conditioned on whether they are of a capital or revenue nature. A few examples suffice to demonstrate the importance of the distinction.

1.1.1 Gains and profits: ordinary and statutory income

A resident taxpayer's assessable income includes "income according to ordinary concepts" known as "ordinary income": s 6-5(1)-(2). A foreign resident's assessable income includes ordinary income from an Australian source, or which a provision otherwise includes in a foreign resident's assessable income. Ordinary income will not generally include gains made on dealings with assets of a capital nature. Those gains will only be included in a resident taxpayer's assessable income if other provisions of the legislation expressly provide so: s 6-10(2). Those provisions include Parts 3-1 and 3-3 which provide for the tax treatment of gains or losses in respect of "CGT events" which are specified events (see s104-5) that occur in respect of "CGT assets" (broadly defined in s 108-5). There are circumstances in which a "CGT event" may result in a gain on both capital and revenue account – not always in the same amount. In those circumstances the "anti-overlap" provisions will generally apply to reduce the capital gain to avoid double taxation (s 118-20).

Exemptions and concessionary treatment of certain gains on capital account motivate taxpayers to characterise the gain as one of capital. As to the categories of exemptions, see s 100-30. Exemptions and concessions are generally found in Div 104 (e.g. in respect of pre-CGT assets: s 104-10(5)), Sub-Div 115-A (discount capital gains), Sub-Div 118-A (general exemptions), Sub-Div 118-B (main residence exemption), Sub-Div 118-D (insurance and superannuation), Sub-Div 118-D (Venture capital investment), and Div 152 (Small business relief). Other exemptions include the entitlement of foreign residents to disregard capital gains (and losses) where the gain happens in relation to a CGT asset that is not "taxable Australian property": s 855-10(1) (the "TARP provisions").

1.1.2 A comment on losses and outgoings of a capital nature

Turning specifically to losses or outgoings, a loss or outgoing incurred in gaining or producing assessable income, or necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income, is deductible *but not to the extent that* "it is a loss or outgoing of capital, or of a capital nature": s 8-1(1) and (2)(a)).

Where the loss or outgoing is not deductible under s 8-1(1), a taxpayer may be entitled to deduct amounts referable to the decline in value of depreciating assets used or installed for use for a taxable purpose: s 40-25(1). A *depreciating asset* is an asset that has a limited effective life, save for land, trading stock (s 70-10), and intangible assets (with certain exceptions such as some mining rights, IP): s 40-30(2). A *taxable purpose* includes the purpose of producing assessable income: s 40-25(7). Business capital expenditure not otherwise taken into account is deductible over 5 years: s 40-880 ("blackhole expenditure"). Capital works on assessable income producing buildings may be deducted over 25 or 40 years under Division 43.

1.1.3 And sometimes the distinction matters not

Certain regimes within the tax legislation dispense with the capital / revenue distinction, for example, the Taxation of Financial Arrangements provisions in Div 230 ("TOFA"): refer s 230-1 (guide).

1.2 Scope of paper and further reading

In that context, the balance of this paper seeks to address in a practical way the common issues that arise in practice, and identify the organising principles applicable to the resolution of the distinction. The paper first addresses the character of receipts, and then of outgoings or losses.

There are many excellent treatises on this topic. For initial further reading, I recommend:

- The Hon. G.T. Pagone AM KC, *Income and Capital Distinction*, Paper presented at the Tax Institute of Australia, South Australian Convention (9 May 2009).[1]
- Daniel McInerney KC, *Capital vs Revenue – when are we going to work this out?*, Paper presented at the Tax Institute's 2021 WA Tax Forum (17-18 June 2021).
- Chris Kinsella, *"Fuzzy law" in the tax world*, 23(5) The Tax Specialist (Red Journal) 288 (June 2020).

[1] Available at: https://www.google.com/url?sa=t&source=web&rct=j&opi=89978449&url=https://www.austlii.edu.au/cgi-bin/viewdoc/au/journals/VicJSchol/2009/8.pdf&ved=2ahUKEwjX1KOvkLSPAxXbrlYBHT6tDuYQFnoECBYQAQ&usg=AOvVaw3eCDwUH0aubc9kYnU1I_Wl

2. The character of receipts

2.1 Character depends on quality in hands of recipient

It is a general principle of taxation law that:

> whether a particular receipt has the character of the derivation of income depends upon its quality in the hands of the recipient
>
> - *Commissioner of Taxation v* ***McNeil*** (2007) 229 CLR 656 at 663 [20] per Gummow A-CJ, Hayne, Heydon and Crennan JJ.

It is a corollary of that principle that proceeds from disposal of a right or asset generally take the character of the asset or right disposed of. Where an undissected lump sum payment is received by way of compensation for multiple claims of a different character (e.g. loss of profits or income; property damage; damage to reputation; personal injury), and it is not possible to attribute or apportion parts of the lump sum to the different heads of compensation, the whole of the amount will generally be treated as on capital account: refer *Allied Mills Industries Pty Ltd v Commissioner of Taxation* (1998) 20 FCR 288 and the authorities there referred to. This is subject to legislative provisions to different effect: see, for example, Div 82 (employment termination payments or ETPs).

2.2 Income according to ordinary concepts: the recognised categories

The starting point for identifying receipts of an income nature is to identify what is income according to ordinary concepts (s 6-5(1)).

There is no single test that is determinative of whether a receipt is ordinary income. There are 3 well-recognised categories.

2.2.1 Income from personal services or employment

First, income derived from personal services or employment. In *Blank v Commissioner of Taxation* [2016] HCA 42; (2016) 258 CLR 439 at 458-459 [56]-[57], the Court (French CJ, Kiefel, Gageler, Keane and Gordon JJ) made the following observations in the context of assessment of deferred employment compensation:

> Section 6-5(1) of the 1997 Act provides that a person's "*assessable income* includes income according to ordinary concepts, which is called *ordinary income*" (emphasis in original). "Some things are so obviously income that their nature is unchallengeable." One is the reward for services rendered in the form of remuneration or compensation. The characterisation of the reward for services rendered as income is not lost because the reward is paid in a lump sum, because the payment is deferred or because it is payable upon the occurrence of a particular event. An amount paid as a lump sum because a person has retired from an office or employment, or has had their office or employment terminated, is income of that office or employment if it is deferred remuneration. That proposition was "well established" by 1975; its correctness is not in dispute.
>
> The question in this case is one of characterisation. The question is "whether the amount received in a lump sum was part of the consideration for the services rendered in the office or employment". If the answer is "yes", it is income according to ordinary concepts even though payment is deferred.

2.2.2 Income from carrying on a business

Second, "a profit made in the ordinary course of carrying on a business constitutes income": *Commissioner of Taxation v **Myer Emporium** Ltd* (1987) 163 CLR 199 at 209 per Mason ACJ, Wilson, Brennan, Deane and Dawson JJ. We return to *Myer Emporium* below.

***London Australia*: profits or gains made as an ordinary incident of business**

This includes a profit made as an ordinary incident of a business, including gains on sales of assets that were not acquired with the intention or purpose of realising a profit on disposal.

In ***London Australia** Investment Co Ltd v Commissioner of Taxation* (1977) 138 CLR 106, a majority of the High Court (Gibbs J and Jacobs J; Barwick CJ dissenting) concluded that gains made on disposals of shares acquired and disposed of in accordance with an investment policy of producing dividend income for distribution to shareholders, and not part of a share trading operation, were nevertheless assessable as ordinary income. As Gibbs J stated in *London Australia* at 116:

> To apply this criterion it is necessary "to make both a wide survey and an exact scrutiny of the taxpayer's activities": *Western Gold Mines NL v C of T (WA)* (1938) 59 CLR 729 at 740 .

2.2.3 Income from property including dividends, interest and rent

Amongst the famous propositions articulated by Professor Ross Parsons in his seminal work *Income Tax in Australia* (1985)[2] is "Proposition 12" (at [2.228] *et seq*):

> A gain derived from property has the character of income …

Professor Parsons proceeds to identify dividends (at [2.235]), interest (at [2.270]), and rent (at [2.297]) as ordinary income based on this principle.

See *McNeil* at 663 [21].

2.3 The *Myer Emporium* principle: profits from a commercial dealing

A short extract from the oft-cited passage in *Myer Emporium* at 209 is reproduced above as authority for the proposition that profit from carrying on a business is ordinary income.

The full passage (at 209-211) proceeds to identify a separate principle that commonly gives rise to controversy. It is reproduced below (bold added):

> Although it is well settled that a profit or gain made in the ordinary course of carrying on a business constitutes income, it does not follow that a profit or gain made in a transaction entered into otherwise than in the ordinary course of carrying on the taxpayer's business is not income. Because a business is carried on with a view to profit, a gain made in the ordinary course of carrying on the business is invested with the profit-making purpose, thereby stamping the profit with the character of income. But **a gain made otherwise than in the ordinary course of carrying on the business which nevertheless arises from a transaction entered into by the taxpayer with the intention or purpose of making a profit or gain may well constitute income. Whether it does depends very much on the circumstances of the case**. Generally speaking, however, it may be said that if the circumstances are such as to give rise to the inference that the taxpayer's intention or purpose in entering into the transaction was to make a profit or

[2] *Income Tax in Australia* is now available free on-line: https://open.sydneyuniversitypress.com.au/9780455206011/index.html.

> gain, the profit or gain will be income, notwithstanding that the transaction was extraordinary judged by reference to the ordinary course of the taxpayer's business. Nor does the fact that a profit or gain is made as the result of an isolated venture or a "one-off" transaction preclude it from being properly characterised as income: *FCT v Whitfords Beach Pty Ltd* (1982) 12 ATR 692 at 698-9, 705; 150 CLR 355 at 366-7, 376. The authorities establish **that a profit or gain so made will constitute income if the property generating the profit or gain was acquired in a business operation or commercial transaction for the purpose of profit-making by the means giving rise to the profit**.
>
> The celebrated decision in *Californian Copper Syndicate v Harris* (1904) 5 TC 159 makes the point. There, the Copper Syndicate bought a mining property for the purpose of exploiting it so that the Syndicate could re-sell it at a profit. The profit was held to be income because the Syndicate never intended to work the property with a view to deriving income from mining operations on the property. The transaction, though one which the Syndicate was authorised to enter into under its articles of association, and therefore one which fell within the business which it was empowered to carry on, was an isolated transaction. Nonetheless the profit was income. The Lord Justice-Clerk (the Right Honourable JHA Macdonald) drew a distinction between a mere realisation or change of investment and "an act done in what is truly the carrying on, or carrying out, of a business." His Lordship went on to express the distinction in this way (at 166):
>
> > "Is the sum of gain that has been made a mere enhancement of value by realising a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making?"
>
> This test was approved by the Privy Council in *Comr of Taxes v Melbourne Trust Ltd* [1914] AC 1001 at 1010 and was applied by the House of *Lords in Ducker v Rees Roturbo Development Syndicate* [1928] AC 132 at 140. There a company was formed primarily for the purpose of acquiring, developing and exploiting an invention relating to a centrifugal turbine pump by way of granting manufacturing licences under patents. In the course of its business the company acquired additional English and foreign patents in connection with the invention. Although its main business was the grant of manufacturing licences, the company always contemplated the possibility of a sale of its interest in the foreign patents. Receipts from the sale of that interest were held to constitute income. Lord Buckmaster stated (at 141-2) that this was not "a mere accidental dealing with a particular class of property" but "was part of their business which, though not of necessity the line on which they desired their business most extensively to develop, was one which they were prepared to undertake".
>
> The **important proposition** to be derived from *Californian Copper* and *Ducker* is that **a receipt may constitute income, if it arises from an isolated business operation or commercial transaction entered into otherwise than in the ordinary course of the carrying on of the taxpayer's business, so long as the taxpayer entered into the transaction with the intention or purpose of making a relevant profit or gain from the transaction.**

Where the gain or profit is *not* made in the ordinary course of business, a profit-making purpose alone is not sufficient to invoke the principle and give the profit the character of income.

More is needed. The gain profit must also arise from an isolated business operation or commercial transaction.

2.4 *Myer Emporium*: the most recent word from a man named *Greig*

The principle drawn from *Myer Emporium* has been considered and as appropriate applied in a number of subsequent cases.

The most recent authoritative word on the principle comes from the Full Federal Court's decision in ***Greig*** *v Commissioner of Taxation* [2020] FCAFC 25; (2020) 275 FCR 445. The prior authorities are canvassed in the reasons of the various members of the Full Court. However, for the reasons outlined by

Kenny J in *Greig* at [27] (see also *Morton* below [144]), each case turns on its particular facts and examining prior cases for analogous facts is of limited utility and may unhelpfully distract from the task of applying the well understood principles to the facts of the case under consideration (bold added):

> While the principle in *Myer Emporium* is clear, it may fairly be said that **previous decisions provide limited assistance** as to its application in a case such as this. This is, however, of no special moment because **a question of characterisation of the kind now arising will always turn on the facts of the particular case**. In their joint judgment in *Federal Commissioner of Taxation v Montgomery* (1999) 198 CLR 639 (Montgomery), Gaudron, Gummow, Kirby and Hayne JJ made much the same point when they said (at [68]-[69]):
>
> > "[I]ncome is often (but not always) a product of exploitation of capital; income is often (but not always) recurrent or periodical; receipts from carrying on a business are mostly (but not always) income. Further, in a case where it is said that the receipt is from carrying on business, often there will be a real and lively question whether what has been done amounts to carrying on business or is, in truth, no more than a singular transaction of purchase and resale of property.
> >
> > The search for analogous cases is, then, hardly surprising and was undertaken by both of the parties to this appeal. In doing so, each party tended to emphasise one or more features of the transactions that gave rise to the payments received by the firm. Sometimes the emphasis of one or more of these features was taken to the point of excluding any consideration of the other features of the transactions. But as Dixon and Evatt JJ said (in the more limited context of distinguishing between profits derived from carrying on or carrying out a profit-making scheme and proceeds of a mere realisation or change of investment) [in *Western Gold Mines NL v Commissioner of Taxation (WA)* (1938) 59 CLR 729 at 740] 'it is necessary to make both a wide survey and an exact scrutiny of the taxpayer's activities'."(Citations omitted.)
>
> The need for "a wide survey and an exact scrutiny" of the taxpayer's activities in determining a question of characterisation was reiterated in *Federal Commissioner of Taxation v Stone* (2005) 222 CLR 289 at [19], citing *Montgomery* and *Western Gold Mines NL v Commissioner of Taxation (WA)* (1938) 59 CLR 729.

2.4.1 Facts

Mr Greig was an experienced businessman in the mining sector. He held shares in a number of companies as long term investments. Separately, he wanted to identify undervalued stocks that he could acquire in decent volumes and sell in the short term at a profit: see [10] and [250]. He made a significant investment through a large number of transactions in the shares of a company, Nexus. The trial judge accepted that he had a profit-making purpose in doing so. Nexus did not perform as Mr Greig hoped and eventually a deed of company arrangement (or DOCA) was proposed by creditors which would have resulted in Mr Greig's shares being acquired for nil consideration. Mr Greig unsuccessfully contested the DOCA through legal action. Mr Greig made a loss of $11.8 million on the shares and incurred legal fees of approximately $500,000.

2.4.2 Taxpayer's case: Losses deductible under s 8-1(1) – on revenue account

Mr Greig claimed that he was entitled to a deduction under s 8-1(1) on the losses and outgoings on the basis that they were incurred in respect of a venture in the nature of a business undertaken with a profit-making purpose: at [22].

2.4.3 Determination at trial: no business operation

The trial judge accepted that Mr Greig had a profit-making purpose but rejected that the loss was made in the course of a venture in the nature of a business, with the result that the losses and outgoings were not deductible under s 8-1.

Mr Greig appealed.

2.4.4 Appeal allowed: acquisitions in the nature of a business operation

Mr Greig's appeal was allowed by a majority of the Court on the basis that Steward J (with whom Kenny J agreed; Derrington J in dissent) concluded that Mr Greig's acquisitions of Nexus shares were in the nature of a "business operation" or "commercial dealing": at 503 [225]. Steward J observed in this regard at 514 [248]:

> …[T]he taxpayer acted in acquiring shares in Nexus as a "business person" would. He engaged professional help; he researched and monitored the value of his shares; he used his own business knowledge as a managing director to acquire more shares; he pursued a plan to exploit the unrealised value [a Nexus] asset; and he took steps to defend the value of his investment in court. His activities, I find, were entirely commercial and business-like. The evidence demonstrates "system and organization" in relation to the acquisition of Nexus shares, to borrow the language of Bowen CJ and Franki J in *Ferguson*. His share trading was not a hobby; it was not a pastime; it was not private gambling or gaming. And it was more than a "mere" realisation of an asset. I find it constituted a business dealing that would engage the principle in *Myer Emporium*.

2.4.5 Analysis of the concept of a "business operation"

Steward J observed that prior decisions had not tended to focus on the issue of whether the gain was made in the course of a business operation or commercial dealing: at 503 [227]; and see 507-8 [236]-[238] concerning *Williams v Commissioner of Taxation* (1972) 128 CLR 645.

His Honour then proceeded to observe as follows (bold added):

> [228]. The "commercial dealing" requirement, it would appear, is a test derived from English revenue law. According to Parsons' … it was introduced into domestic law by the Privy Council in ***McClelland*** *v Federal Commissioner of Taxation* (1970) 120 CLR 487 in the context of former s 26(a) of the *Income Tax and Social Services Contribution Assessment Act* 1936-1963 (Cth) (the "1936 Act"). In that case, the appellant had inherited land with her brother. She wished to keep the land, but the brother did not. He wanted to sell his half as soon as possible. She needed to sell off part of the land to buy the brother out. She did this and made a profit. [Section 26(a) included profits from a "profit-making scheme or undertaking" in a taxpayer's assessable income].
>
> [229] … Their Lordships [the majority constituted by Lord Donovan, Viscount Dilhorne and Lord Wilberforce] advised that a gain made from a profit-making scheme, in order to be assessable, must "exhibit features which give it the character of a business deal". They explained why at 494-495 as follows:
>
>> "It is clear in the first place that not all such undertakings or schemes are caught by the section. Otherwise every successful wager would be within it. So also would the purchase of investments bought by a private investor as a hedge against inflation and sold — perhaps long afterwards — at more than the purchase price. The participator in a lottery would also be liable if he drew the winning ticket. The undertaking or scheme, if it is to fall within s. 26(a), must be a scheme producing assessable income, not a capital gain. **What criterion is to be applied to determine whether a single transaction produces assessable income rather than a capital accretion?** It seems to

> their Lordships that an 'undertaking or scheme' to produce this result must — at any rate where the transaction is one of acquisition and resale — **exhibit features which give it the character of a business deal**. It is true that the word 'business' does not appear in the section; but given the premise that the profit produced has to be income in its character their Lordships think the notion of business is implicit in the words 'undertaking or scheme'."
>
> The foregoing passage supports the proposition that the purpose of the "business deal" test was to prevent s 26(a)from taxing gains made from waging, from a lottery and from an investment by a "private investor" made as a hedge against inflation. It was not at that time concerned with the notion of income according to ordinary concepts.

Steward J then considered a number of subsequent authorities, including Mason J's observations in *Commissioner of Taxation v* ***Whitford's Beach*** *Ltd* (1982) 150 CLR 355 at 378-379 concerning the above passage from *McLelland* (at 507 [235]):

> "Unfortunately there is an element of ambiguity in the expressions 'business deal' and 'operation of business' as there is in the adjectives 'business', 'commercial' and 'trading' which have about them a chameleon-like hue, readily adapting themselves to their surroundings, different though they may be. In some contexts 'business deal' and 'operation of business' may signify a transaction entered into by a person in the course of carrying on a business; in other contexts they denote a transaction which is business or commercial in character. …. [The majority in *McClelland* by referring] to 'business deal' and 'operation of business' necessarily mean a transaction entered into in the course of carrying on a business.
>
> It is of importance to note their Lordship's statement that not only are wagers and lottery tickets excluded from profit-making undertakings or schemes, but 'also … the purchase of investments bought by a private investor as a hedge against inflation and sold — perhaps long afterwards — at more than the purchase price', and the further statement [(1970) 120 CLR 487 at 495] that 'The undertaking or scheme, if it is to fall within s. 26(a), must be a scheme producing assessable income, not a capital gain.' There are two separate strands of thought embedded in these observations: (1) that the transaction must have about it some business or commercial flavour — the purchase of an investment by a private investor is not enough; and (2) the profit in view must be an income, not a capital, gain, according to ordinary concepts.

Steward J then commented that there are indications in the above passage from Mason J (bold added):

> that the requirement that a transaction be a "business deal" or "commercial transaction" involves only a **low threshold**. It certainly works to exclude gains made from wagers and lotteries from being taxed by s 26(a), however Mason J doubted whether it also excluded the type of private investment referred to in *McClelland*. In that respect, **the authorities appear to contrast a profit-making scheme from an investment**. An investment connotes something to be held over time, which might then be sold "long afterwards", to use the language of *McClelland*.

2.4.6 The test is not whether the profit from an "adventure in the nature of trade"

Notably, Steward J disavowed that the relevant inquiry was whether the profit arose from an "adventure in the nature of trade": at 504-5 [230]-[231] referring to *Commissioner of Taxation v Visy Industries USA Pty Ltd* (2012) 205 FCR 317 at [52].

2.4.7 Distinguishing a business deal from "mere realisation"

In the course of his judgment, Steward J drew attention to the distinction drawn by Gibbs J in ***Steingberg** v Commissioner of Taxation* (1978) 134 CLR 640 at 699 between a business deal and the "mere realisation of a capital asset"; elaborated upon in *Commissioner of Taxation v **Bidencorpe*** (1978) 140 CLR 533 at 552.

This distinction is further explored in Section 2.6 below in the context of property developments.

2.4.8 A business deal may involve holding an asset for several years

The fact that the taxpayer may not have a specific timeframe in mind for the holding of an asset, and may indeed hold it for several years, is not antithetical to the acquisition and subsequent disposal being in the nature of a business operation or commercial dealing. As Steward J observed at 513 [246] in *Greig* (bold added):

> The fact that the taxpayer intended to hold his Nexus shares until he could secure his profit, whether in the "long term or any term", does not detract from the conclusion I have reached. The taxpayer's purpose was not to hold the shares as a long-term investment and to receive dividends over time. **His plan was to sell the shares at a profit** at least, I infer, up to the time of his retirement. If the profit had emerged quickly, I find that that is when he would have sold the Nexus shares. In that respect, I observe that some **profit-making schemes can take many years** to complete. In *Whitfords Beach*, the profit-making plan commenced in late 1967 and assessable profits were made from 1971 over a period of years. It is not antithetical to a profit-making undertaking for a taxpayer to wait for the profit to become realisable, so long as that was the profit the taxpayer planned to secure. **Waiting, without more, will not convert the profit eventually realised into an affair of capital.**

2.4.9 Conclusion: guide to whether gain ordinary income

Applying the following propositions will assist in determining whether a profit or gain outside of the recognised categories of ordinary income (see Section 2.1 above) is otherwise ordinary income:

1. It is necessary to make a wide survey and exact scrutiny of the taxpayer's affairs to determine the scope of any business the taxpayer conducts: *London Australia*.

2. A gain or profit that is incidental to the ordinary course of business, even if not a profit that the business actively pursues, is ordinary income: *London Australia*.

3. A profit or gain will be ordinary income in accordance with the principles in *Myer Emporium* if the taxpayer enters upon a course of action:

   - with a profit-making purpose (see 4 below); and

   - that is in the nature of a business operation or commercial dealing (see 5 below).

4. The relevant intention must be to make a profit of a particular kind, such as buying an asset with the intention of making a profit by selling it. This is to be distinguished from a private investment where the taxpayer has the purpose of holding an asset to derive income (e.g. rent or dividends) and may hope to sell at some time in the future and realise a gain: *McLelland* at 494-5; *Whitford's Beach* at 378-8; *Greig* at 507 [235]. Mere realisation of a gain by disposing of a capital asset does not give the gain the character of income: *Steingberg* and *Bidencorpe*.

5. The gain must be realised as a result of a transaction in the nature of a business operation or commercial dealing. This requires a low threshold: factors such as taking advice, and the employment of a system and organisation, will often suffice. It must however be more than a hobby or pastime: refer *Greig* at 514 [248].

2.5 *Whitford's Beach* to *Morton*: developing property disputes

These principles are currently being put to the test in the context of long-term landowners usually conducting agricultural businesses entering into "Development Rights Agreements" whereby another entity (whether a third party or an associate) undertakes the development activities in consideration for reimbursement of costs and a share of the proceeds of sale of the land.

The Commissioner has taken the approach that profits or gains paid to the landowner where the arrangements are implemented in respect of large-scale landholdings are ordinary income (see *Morton* at [116] below).[3]

This approach denies concessionary treatment for capital gains.

Following is a survey of the key cases in which there has been a dispute as to the character of the proceeds of sale of real property, and the relevant principles to be applied in determining the character of the gain or profit in the hands of the landowner.

2.5.1 *Whitford's Beach*

Overview

Whitfords Beach was concerned with the character of the profit from a land development.

The Court concluded that the taxpayer had derived ordinary income from the disposals.

The facts on which that conclusion was based are outlined in detail in the judgment of Wilson J (from 387). The taxpayer acquired the land in 1954 with no intention of subdivision and sale (at 387). In 1967, three entities acquired all the shares issued by the taxpayer (at 388). The entities did so with the intention and a detailed business plan to subdivide and sell the subdivided lots (at 388-393) on which some houses were built not by the taxpayer but by the development managers (two of the shareholders) appointed by the taxpayer to carry out the development (at 399). One of the shareholders advanced a loan to the taxpayer to meet the substantial development costs (at 393). Mason J observed that the "subdivision took place on a massive scale, involving the laying out and construction of roads, the provision of parklands, services and other improvements … [T]he subdivision of broad acres into marketable residential allotments involves much more in the way of planning, development and improvement than was formerly the case": at 385.

Judgment

Mason J (as his Honour then was) stated that (at 372) (bold added):

> "It has been a long-settled principle of revenue law that, unless a sale of property is made in an operation of business, the resulting profit will not be income according to the ordinary concepts and usages of

[3] Refer ATO website (Tax consequences on sales of property): https://www.ato.gov.au/businesses-and-organisations/assets-and-property/property/tax-consequences-on-sales-of-property

mankind. The principle was expressed by the Lord Justice Clerk in *Californian Copper Syndicate v. Harris* [(1904) 5 Tax Cas 159 at 165-166], in these terms:

> " … where the owner of an ordinary investment chooses to realise it, and obtains a greater price for it than he originally acquired it at, the enhanced price is not profit … assessable to Income Tax. But it is equally well established that enhanced values obtained from realisation or conversion of securities may be so assessable, where what is done is not merely a realisation or change of investment, but an act done in what is truly the carrying on, or carrying out, of a business … What is the line which separates the two classes of cases may be difficult to define, and each case must be considered according to its facts; the question to be determined being — Is the sum of gain that has been made a mere enhancement of value by realising a security, or is it a gain made in an operation of business in carrying out a scheme of profit making?"

To similar effect is the following extract from the judgment of Gibbs CJ at 361 (bold added):

> "The question whether the profits were income within ordinary concepts depends on the application of the tests laid down in *Californian Copper Syndicate v. Harris* and in the cases that have followed that decision. **Was what was done merely a realization of the taxpayer's asset, or was it something done in what was truly the carrying on or carrying out of a business?** In other words the question is "**whether the facts reveal a mere realization of capital, albeit in an enterprising way, or whether they justify a finding that the" [taxpayer] "went beyond this and engaged in a" [business of profit-making] "in land albeit on one occasion only**": see *McClelland v. Federal Commissioner of Taxation* where however the words used are "a trade of dealing in land"; the words which I have ventured to substitute seem more consonant with the Australian authorities.

Wilson J (at 400) adopted the articulation of the question by Fisher J in the Full Court below:

> "[T]he true question is whether the taxpayer in proposing to maximize the amount of money which it received on sale of the land committed the land to a business venture or to a profit-making undertaking or scheme or merely sold the land to the best advantage."

In this respect, Wilson J observed that (also at 400):

> "It remains a question of degree whether the proceeds of that business constitute income according to ordinary concepts, and the answer depends, in my opinion, whether what happens to the subject land in the course of conducting that business is such as to take the process beyond what may properly be described as mere realization."

The concept of "mere realisation" was taken from a passage from the decision of the Court (Knox CJ, Gavan Duffy, Powers and Starke JJ) in *Ruhamah Property Co Ltd v Commissioner of Taxation* (1928) 41 CLR 148 at 151 (bold added):

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

In *Whitfords Beach*, the Chief Justice elaborated on the concept of “mere realisation” at 367-368:

> The words “merely” and “mere” in these statements seem to me to be an important part of the definition of the line between profits that are taxable and those that are not. If the taxpayer does no more than realize an asset, the profits are not taxable. It does not matter that the taxpayer goes about the realization in an enterprising way, so to secure the best price. As I have said in *Federal Commissioner of Taxation v. Williams* [(1970) 120 CLR 487 at 496]:
>
> > “The situation is not altered by the fact that the landowner seeks and acts upon the advice of an expert as to the best method of subdivision and sale or by the fact that he carries out work such as grading, levelling, road building and the provision of reticulation for water and power to enable the land to be sold to its best advantage.”

To similar effect, Mason J observed that (at 383-384):

> The principal, if not the essential … is whether more is involved than the **mere realization** of an asset. As Deane J. noted in his dissenting judgment in the Federal Court, we must not overlook the importance and the scope of the word **“mere”**. …[T]he Commissioner does not need to show that the respondent was carrying on a business. As we have seen, it is enough to answer the statutory description that there **was a profit-making undertaking or scheme which exhibited the characteristics of a business deal, even though it did not amount to the carrying on of a business**. If what has happened amounted to no more than the mere realization of an asset then it was not a profit-making undertaking or scheme.

Mason J (at 385) also referenced the nature and scale of the activities in concluding that the taxpayer’s activities in *Whitfords Beach* amounted to more than “mere realisation”:

> “Deane J was right in pointing to the circumstance that the asset was divided and improved in the course of a business of dividing and improving the asset. In this respect I do **not** agree with the **proposition** which appears to be founded on remarks in some of the judgments that **sale of land which has been subdivided is necessarily no more than the realization of an asset merely because it is an enterprising way of realizing the asset to the best advantage**. That may be so in the case where an area of land is merely divided into several allotments. But it is not so in a case such as the present where the planned subdivision takes place on a **massive scale**, involving the **laying out and construction of roads, the provision of parklands, services and other improvements**. All this amounts to **development and improvement of the land** to such a marked degree that it is **impossible to say that it is mere realization of an asset**. We need to bear in mind that the subdivision of broad acres into marketable residential allotments involves much more in the way of planning, development and improvement than was formerly the case.

Gibbs CJ’s focus was less on the magnitude of the activities than on the taxpayer’s participation in the operation of the business (368):

> “[T]he mere magnitude of the realization does not convert it into a business: *Commissioner of Taxes v. British Australian Wool Realization Association* [[1931] AC 224 at 252]. But **if the taxpayer does engage in an operation of business, the proceeds are income** and taxable.”

Wilson J similarly stated (at 399) that:

> “the mere extensiveness of the organization set up to realize an asset does not of itself cause the realization to become a business. …But that is not to say that the magnitude of the operation is wholly irrelevant to the determination of its nature, in answering the question whether more than mere realization is involved in the treatment of a capital asset.”

Principles

The decision in *Whitfords Beach*, as applied in *Myer Emporium* (see above), reinforces that the ordinary principles applicable to determining the character of a gain or profit apply in the context of gains or profits from realisations of real property. In summary:

1. Profits derived by a taxpayer in the ordinary course of carrying on a business are ordinary income: see *Myer Emporium* at 213.
2. Profits derived by a taxpayer resulting from a profit-making undertaking or scheme which exhibited the characteristics of a business deal are ordinary income: *Whitfords Beach* at 361 (Gibbs CJ), 383-384 (Mason J), 400 (Wilson J); see also *Crow v Commissioner of Taxation* (1988) 88 ATC 4620 at 4625 per Lockhart J.
3. The “mere realisation” of a profit, even where realisation is achieved in an enterprising manner to secure the best advantage, is not a profit-making undertaking or scheme: *Whitfords Beach* at 367-368 (Gibbs CJ), 383-385 (Mason J), and 400 (Wilson J).
4. Whether the steps taken are a “mere realisation” or a profit-making scheme is a matter of fact and degree: *California Copper*; *Whitfords Beach* at 400 (Wilson J).

These principles have been applied in several subsequent decisions concerning subdivision and sale of land.

2.5.2 Stratham

In ***Statham*** *v Commissioner of Taxation* (1988) 89 88 ATC 4070, the Full Federal Court (Woodward, Lockhart and Hartigan JJ) allowed a taxpayer’s appeal on the basis that the subdivision and sale of land acquired for agricultural purposes was not a profit-making scheme. In this regard, the Court stated the relevant principles as follows (at 4075):

> “It is well established by the reported cases … that the mere realisation of an asset at a profit does not necessarily render the profit taxable. The profit must arise from the carrying on of a business or a profit-making undertaking or scheme. The mere magnitude of the realisation does not convert it into such a business, undertaking or scheme; but the scale of the realisation activities is a relevant matter to be taken into account in determining the nature of the realisation, i.e. in determining whether the facts establish a mere realisation of a capital asset or a business or profit-making undertaking or scheme.

The facts of the case at set out at 4073. The catalyst for subdividing and selling the property was the inability to profitably conduct agricultural activities. The subdivision process was *relatively simple*. The taxpayer needed only provide a bond. The Council undertook all necessary subdivision work including roads, earthworks, sewerage and electrical works. No contractors were engaged. Sales were effected through local real estate agents. The court considered it significant that the owner was willing but unable to sell the land as a single parcel and no moneys were borrowed. Limited works were required and these were carried out by the Council. The owners had no business infrastructure and did not erect buildings on site. The Court concluded (at 4077) that these matters “strongly suggest .. that the owners were not conducting a business or engaging in a profit-making undertaking or scheme.”

2.5.3 Stevenson

In the subsequent decision of ***Stevenson*** *v Commissioner of Taxation* (1991) 29 FCR 282, Jenkinson J found that the Tribunal made no error of law in arriving at the opposite conclusion based on facts disclosing the taxpayer's significant personal involvement (see 289):

> [The taxpayer] was the sole decision-maker in respect of all matters of consequence in relation to it; he obtained professional advice but, except for the submission of the original planning application early in 1975, he chose for himself and directed the course of action to be followed. Thus at all times he fixed the price to be asked for the land. He sought and obtained finance and subsequently, having been refused further finance by that lender, he personally sought and obtained it from another source. He controlled the marketing of blocks after subdivision; he dealt personally with many prospective purchasers when they came to inspect the land. On many occasions over the years he dealt directly with the .. Shire Council and its officers about the subdivision of the land and their requirements in relation to it. He similarly dealt personally with the State Rivers and Water Supply Commission; he personally proposed to it the cheaper way of building the sea-wall and convinced it to accept his proposal. In addition to his management role, at times in the course of the development he did work on the land himself to save the cost of employing a labourer. For instance, he personally cut and cleared the bull-rushes growing in the lake adjacent to the land.

Jenkinson J concluded that what was done by the owner (taxpayer) was relevant to the statutory inquiry as to whether the profit was made as a result of a profit-making venture: at 290. Jenkinson J also accepted that there was no error in the Tribunal having regard to the magnitude of the activities in arriving at its conclusions (at 291-2).

2.5.4 Casimaty

In ***Casimaty*** *v Deputy Commissioner of Taxation* (1996) 151 ALR 242, Ryan J concluded that the subdivision and sale of land formerly worked as a farm was a "mere realisation" not giving rise to ordinary income. Works carried out to prepare the land for subdivision included applying for consent to subdivide, construction of access and internal roads, fencing, extension of water and electricity services. Works were carried out under the supervision of surveyors and engineers engaged by the taxpayer (at 247) The taxpayer did no more than required by Council to prepare the lots for sale (at 246). As to the construction of roads and other works, Ryan J observed that in *Stevenson* no principle was distilled to the effect that "a subdivision involving a hundred or more lots, the construction of roads and the reticulation of water to each lot would never amount to a mere realisation of a capital asset (at 258). Rather, it is a question of fact. In *Casimaty*, Ryan J concluded in favour of the taxpayer by reference to the taxpayer having acquired the land for farming, he had no coherent plan for the subdivision, and the works went no further than what was necessary to obtain consent and sell. Notably, Ryan J commented that (at 261) :

> "Had he constructed dwelling houses, internal fencing or other improvements, it would have been easier to impute to him an intention to carry on a business of land development and improvement. Similarly, had he set up his own sales organization or advertised or conducted sales himself instead of entrusting those activities entirely to his traditional agents, Roberts Ltd, the inference would have been more strongly available that he had gone into the business of selling farmlets or rural residential allotments."

The taxpayer's minimalist approach both to the operations he established to pursue the sales, and the development works to ready the lots for sale, were material factors in the Court concluding that there was not profit-yielding scheme.

2.5.5 Morton (subject to appeal)

The most recent decision is that of Wheelahan J in ***Morton*** *v Commissioner of Taxation* [2025] FCA 336. Wheelan J concluded that in the context of "development rights agreements" (DRAs) whereby a landowner carrying on an agricultural business entered into DRAs pursuant to the terms of which a developer undertook development activities of the taxpayer's land in consideration for a share of profits that the profits received by the landowner were on capital account. The activities were "one a very extensive scale, culminating in the creation of 1,632 lots": at [162].

The Commissioner's case was that the profit was ordinary income. He submitted that Mr Morton was actuated by a profit-making motive (at [118]). The Commissioner contended that the activities were (at [117]):

> .. not a mere subdivision; rather, it was a coordinated development on a massive scale, involving significant planning and consultation, and the construction of roads, parkland, services, and other improvements. The Commissioner characterised the development of [the farm] as a "staged part" of the broader development of the [farm].

In this regard, the Commissioner pointed to the design and regulatory work, earthworks, installation of sewerage and drainage and other utilities (water, gas, NBN access, street lighting), landscaping and construction of parks, construction of roads including bridges and footpaths: refer [58].

Wheelahan J undertook a detailed survey of the authorities at [125]-[143] and concluded that the following factors were significant in determining the character of the profits made by Mr Morton:

- Mr Morton did not acquire the land with the intention of profiting from its sale: at [147].
- Mr Morton's decision to engage with property developers was prompted by changes to the farm that spelled the end of the viability of his farming business: at [150].
- Mr Morton did not pursue the "maximum available" return from the sale. Rather, he imposed conditions that "left profit on the table" because he was not willing to permit the land to be pledged as security for finance; and he required that he receive a fixed percentage of the proceeds: at [151].
- Mr Morton continued his farming activities which informed the nature of his business activities. There was no evidence that he did so to obtain a tax advantage: at [152].
- Mr Morton played little active role in the development of the farm. The developer was not acting as his agent or partner in carrying out most of the activities, and the limited scope of the activities in which the developer acted as agent (e.g. execution of documents) were not sufficient to support the contention that Mr Morton was carrying on a business of property development: see [166]-[180]. That he was provided with reports and budgets, and required that the activities be carried out in a business-like manner, was of limited significance. It was in Mr Morton's interests that the development was carried in accordance with the budget and in a business-like manner: at [154]-[155]. Mr Morton's role in setting the sale price did not bear on the question; nor did his execution of sale contracts, nor his negotiation of the DRAs: [156]-[158].
- Mr Morton's non-involvement in the obtaining of finance to carry out the development was "a very significant factor" telling against the suggestion that he was in the business of property development: at [159]-[161].
- Wheelahan J was unpersuaded that the significant "scale of the development of [the farm] ultimately charges the overall complexion of Mr Morton's activities": at [162]. In this regard, Wheelahan J observed:

  > The development of the [farm] occurred on a very extensive scale, culminating in the creation of about 1,632 lots. The scale of the subdivision and sale of the [farm] was a product of the size and

> nature of the [farm] as an asset, in combination with forces prevailing in the market for residential property in Tarneit over the relevant period. I do not accept that, without more, the acreage or the number of lots involved indicates that Mr Morton was engaged in a business of land subdivision and development. As the Full Court said in *Stratham* at 233, mere magnitude does not convert an undertaking of realisation into a business.

- As to whether Mr Morton was carrying on a business of property development, Wheelahan J concluded that repetition as a "badge of trade" was absent: at [163]-[165] referring to *Puzey v Commissioner of Taxation* (2003) 131 FCR 244 at [47]-[48] in the context of what is repetition in a one-off transaction.

- Mr Morton was not carrying on a business of property development, even taking into account the limited activities undertaken by the developer as agent for Mr Morton: see [166]-[182].

With respect, the reasons and conclusions of Wheelahan J appear entirely orthodox.

The Commissioner has lodged an appeal.

2.6 Summary of principles

The matters the authorities have taken into account as relevant to determining the question of whether there has been a mere realisation or alternatively a profit-yielding scheme in the context of activities involving the subdivision and sale of land are:

1. The purpose for which the land was acquired: *Statham; Casimaty*; *Morton*.
2. Whether the taxpayer was prepared to sell the land in an unsubdivided state: *Statham*.
3. Whether the taxpayer had a coherent plan for the subdivision and sale: *Casimaty*.
4. Whether the taxpayer was one of the decision-makers directing the activities: *Stevenson*.
5. Whether the plan involved the "development and improvement" of the land (*Whitfords Beach* at 385), or sale of vacant lots meeting minimum approval condition requirements (*Casimaty*).
6. The size and scale and the planned activities: *Statham*; *Stevenson; Whitfords Beach*; cf *Morton*.
7. Whether the taxpayer applied to have the land subdivided.
8. Whether the activities required construction of infrastructure such as roads, services and other improvements: *Whitfords Beach*; *Casimaty*; *Morton*.
9. Who was responsible for funding the activities: *Statham; Stevenson; Morton*.
10. -Whether the taxpayer intended to borrow funds to meet the costs of the activities: *Statham; Stevenson*; *Morton*.
11. Whether the taxpayer was required to give security in respect of the activities or was otherwise at risk: *Morton*.
12. Whether the taxpayer carried out the activities themselves, or established an organisation or premises for the carrying out of the activities. *Statham; Stevenson; Casimaty; Morton*.
13. Whether contractors were engaged and, if so, by whom: *Statham*.

The question is fact dependent and a matter of impression.

3. The character of outlays or losses

3.1 Section 8-1(1) and 2(a): loss or outgoing of capital nature not deductible

As referred to above, under the general deduction provisions, a loss or outgoing incurred in gaining or producing assessable income, or necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income, is deductible *but not to the extent that* "it is a loss or outgoing of capital, or of a capital nature": s 8-1(1) and (2)(a)).

3.2 When is an outgoing on capital account?

The relevant principles have been considered in a number of recent cases, including the High Court's decision in *Commissioner of Taxation v **Sharpcan*** (2019) 269 CLR 370

3.2.1 *Sharpcan*

In *Sharpcan*, the Court (Kiefel CJ, Bell, Gageler, Nettle and Gordon JJ) identified the principles to be applied at 387 [18] (select citations only; bold added):

> Authority is clear that the test of whether an outgoing is incurred on revenue account or capital account **primarily depends on what the outgoing is calculated to effect from a practical and business point of view** [***Hallstroms*** *Pty Ltd v Commissioner of Taxation* (1946) 72 CLR 634 at 648]. Identification of the advantage sought to be obtained ordinarily involves consideration of the manner in which it is to be used and whether the means of acquisition is a **once-and-for-all outgoing for the acquisition of something of enduring advantage** or a periodical outlay to cover the use and enjoyment of something for periods commensurate with those payments [***Sun Newspapers*** *Ltd v Commissioner of Taxation* (1938) 61 CLR 337 at 363]. Once identified, the advantage is to be characterised by reference to the **distinction between the acquisition of the means of production and the use of them**; between establishing or **extending a business organisation and carrying on the business**; between the **implements employed in work and the regular performance of the work** in which they are employed; and between an **enterprise itself and the sustained effort of those engaged in it** [*Hallstroms* at 647]. Thus, an indicator that an outgoing is incurred on capital account is that what it secures is **necessary for the structure of the business** [***AusNet*** *Transmission Group Pty Ltd v Commissioner of Taxation* (2015) 255 CLR 439 at 472 [66].

The Court in *Sharpcan* at 393-4 [33] also clarified the nature of the inquiry to be made as regards the counterfactual (bold added):

> … the identification of what (if anything) is to be acquired by an outgoing ultimately requires a **counterfactual,** not an historical, analysis: specifically, **a comparison of the expected structure of the business after the outgoing with the expected structure *but for* the outgoing**, not with the structure *before* the outgoing. Other things being equal, it makes no difference whether the outlay has the effect of expanding the business or simply maintaining it at its present level. If a once-and-for-all payment is made for the acquisition of an asset of enduring advantage which, once acquired, forms part of the profit-earning structure of the business, the payment is incurred on capital account.

The Court in *Sharpcan* essentially agreed with Thawley J, who was in dissent in the Full Federal Court: (2018) 262 FCR 151. There Thawley J (at 211-213 [277]-[279]) set out the relevant principles as follows, drawing on the decision in *AusNet* (bold added):

> [277] The general principles relevant to whether expenditure is on capital or revenue account were recently set out by the majority .. in [*AusNet*] at [14]-[30], where their Honours noted the question calls for an evaluative judgment: at [14]. The following principles are relevant:
>
> (1) *First*, the distinction “may require a weighing of factors including the form, purpose and effect of the expenditure, the benefit derived from it and its relationship to the structure, as distinct from the conduct, of a business”: at [15]. Some factors may point in one direction, others in a different direction.
>
> (2) *Secondly*, a “once and for all payment” might tend to indicate the expenditure was a capital outlay, particularly when made with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade; a “recurrent payment” might tend to indicate the expenditure was of a revenue nature: at [15]. However, the fact that a payment is recurrent is not determinative. …
>
> (3). *Thirdly*, a payment which is part of the consideration for the purchase of a business is generally capital, even if paid in a manner which can be seen to be recurrent: at [17], [18]. “The fact that a payment can be viewed as part of the consideration for the acquisition of a business or capital asset weighs heavily in favour of its character as a capital outlay”; however “**the question must always be asked — was the payment made ‘for’ the acquisition**?”: at [18].
>
> (4) *Fourthly*, the fact that the asset acquired is a “wasting asset” does not necessarily deprive the asset of its capital character: at [20]. In [*Sun Newspapers*], the contested expenditure of Sun Newspapers secured, from its potential competitor, a non-compete covenant which was limited in duration and spatial coverage. The covenant secured, so far as possible, a monopoly and obtained a real advantage, namely the exclusion of what might have been serious competition. The covenant was held to have been acquired on capital account.
>
> (5) *Fifthly*, referring to *Sun Newspapers* at 359 (per Dixon J), “the distinction between capital and revenue account expenditure corresponded with the distinction between the **business entity, structure or organisation set up or established for the earning of profit** and the process by which such an organisation operates to obtain regular returns by means of regular outlay”: *AusNet* at [21]. Thus, “an intangible asset might, according to its nature and function in the conduct of the business, be properly characterised as forming part of the structure of the business and the cost of its acquisition as a capital cost”: *AusNet* at [21]. It was noted, by reference to *Henriksen*, that a licence, essential to the conduct of the business, may fall within that description.
>
> (6). *Sixthly*, their Honours in *AusNet* at [22] noted that Dixon J in *Sun Newspapers* at 363 had referred to three factors and a fourth in *Hallstroms* at 648:
>
> > (i) the character of the advantage sought, and in this its lasting qualities may play a part;
> >
> > (ii) the manner in which it is to be used, relied upon or enjoyed, and in this and under the former head recurrence may play its part;
> >
> > (iii) the means adopted to obtain it; that is, by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payment so as to secure future use or enjoyment; and
> >
> > (iv). **what the expenditure is calculated to effect from a practical and business point of view**, rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process. Their Honours in *AusNet* at [22], however, cautioned that “the emphasis placed by

Dixon J on the 'practical and business point of view' does not mean that it is unnecessary to examine the legal rights (if any) obtained by the expenditure".

(7) *Seventhly*, their Honours emphasised the importance of the "advantage sought by the taxpayer by making the payments" and the "character of the advantage sought by the expenditure": at [23]. Their Honours referred to the decision of Fullagar J in ***Colonial Mutual*** *Life Assurance Society Ltd v Federal Commissioner of Taxation* (1953) 89 CLR 428 at 454 to the effect that payments forming part of the purchase price of an asset, which form part of the fixed capital of a business, are outgoings of capital. Their Honours referred to Fullagar J in *Colonial Mutual* at 454 who identified the questions commonly arising as:

"(1) What is the money really paid *for*? — and (2) Is what it is really paid for, in truth and in substance, a capital asset?"

(Emphasis in original.)

[278]. In *AusNet*, Gageler J stated at [73]-[74]:

"73. The distinction between expenditure that is an outgoing of a capital nature and expenditure that is an outgoing of a revenue nature is sufficiently stated for present purposes as 'the distinction between the acquisition of the means of production and the use of them' [*Hallstroms* at 647]. The distinction 'depends on what the expenditure is calculated to effect from a practical and business point of view' [*Hallstroms* at 648].

74. To characterise expenditure from a practical and business perspective is not to disregard the legal nature of any liability that is discharged by the making of that expenditure [*GP International Pipecoaters Pty Ltd v Commissioner of Taxation* (1990) 170 CLR 124 at 137]. It is not to inquire into whether the expenditure is similar or economically equivalent to expenditure that might have been incurred in some other transaction. It is to have regard to the 'whole picture' of the commercial context within which the particular expenditure is made [*BP Australia Ltd v Federal Commissioner of Taxation* (1965) 112 CLR 386 at 399], including most importantly the commercial purpose of the taxpayer in having become subjected to any liability that is discharged by the making of that expenditure. It is, where necessary, to 'make both a wide survey and an exact scrutiny of the taxpayer's activities' [*Western Gold Mines NL v Commissioner of Taxation (WA)* (1938) 59 CLR 729 at 740]."

(Some footnotes omitted.)

[279] His Honour, referring to *Cliffs International Inc v Federal Commissioner of Taxation* (1979) 142 CLR 140 and *Federal Commissioner of Taxation v Citylink Melbourne Ltd* (2006) 228 CLR 1, stated (at [77]-[78]):

"77. Those cases can be taken to illustrate the negative proposition that the fact that a promise to make the expenditure formed part of the consideration for the acquisition of an asset does not foreclose the question of whether the expenditure when made is calculated to effect the acquisition of the asset. Other considerations — including the frequency of the expenditure, the circumstances in which it is to be paid and the method by which it is to be calculated — might yet lead to the conclusion that the expenditure when made is more appropriately to be characterised from a practical and business perspective as referable to the subsequent use of the asset or to some other circumstance.

> 78. Beyond that, I do not think that there is any general proposition to be taken from them. 'The proper conclusion in each case in this particular area of the law', Barwick CJ observed as a member of the majority in Cliffs, '**is peculiarly dependent upon the particular facts and circumstances of that case**'. Writing for the majority in *Citylink*, Crennan J made the same point when she endorsed the observation that there was '**danger in arguing by analogy'**."

3.2.2 Clough

Subsequently in ***Clough** Limited v Commissioner of Taxation* [2021] FCAFC 197, Thawley J (with whom Kenny and Davies JJ agreed) restated the general principles at [65]-[70]:

> [65] The general principles relevant to whether expenditure is on capital or revenue account have been considered reasonably recently .. in [*AusNet*] and .. [*Sharpcan*]. As with the positive limbs, the task is again one of characterisation. In [*Sun Newspapers*] at 359 , Dixon J made the following general observation:
>
>> The distinction between expenditure and outgoings on revenue account and on capital account corresponds with the distinction between the business entity, structure or organization set up or established for the earning of profit and the process by which such an organization operates to obtain regular returns by means of regular outlay, the difference between the outlay and returns representing profit or loss.

Thawley J then set out the principles drawn from *Sun Newspapers* and *Hallstroms* outlined in the sixth point of his reasons (in dissent) in *Sharpcan* (above), and continued (certain citations omitted):

> [68] The statement by Dixon J in *Hallstroms* at 648 does not mean that an examination of the relevant legal rights is irrelevant or unimportant in the process of characterisation ... An examination of the legal rights is important, it being part of the circumstances relevant to a proper characterisation of the expenditure and capable of informing what the expenditure is calculated to effect from a practical and business point of view.
>
> [69] Characterising expenditure from a practical and business perspective, having regard to the legal nature of the various rights created, used or brought to an end by that expenditure, requires regard to be had to the whole commercial context. It involves "both a wide survey and an exact scrutiny of the taxpayer's activities": *Western Gold Mines (NL) v Cmr of Taxation (WA) (*1938) 59 CLR 729 at 740. One reason it is necessary to have regard to the whole context is that "expenditure of a kind ordinarily treated as being on revenue account in one set of circumstances may be treated as on capital account in another set of circumstances": *AusNet* at [19] (French CJ, Kiefel and Bell JJ).
>
> [70] The question of characterisation must be approached from the perspective of the person incurring the outgoing. An inquiry into the character of the receipt of the outgoing in the hands of the recipient at best distracts attention from the critical task of characterisation. As Dixon J stated in *W Nevill & Co Ltd v FCT* (1937) 56 CLR 290 at 306 : "there is no necessary connection between the two questions and, indeed, an attempt to obtain guidance in the solution of one by considering the other is not without danger"; see also: *Federal Cmr of Taxation v Rowe* (1997) 187 CLR 266 at 291 –292 ; AusNet at [66] (French CJ, Kiefel and Bell JJ).

3.3 Summary of principles

As for the task of characterising receipts, the authorities recognise that each case turns upon its facts and there are real dangers in arguing by analogy.

One must apply the principles endorsed in the authorities. It is beyond this author to better Thawley J's summaries in *Sharpcan* and *Clough*, which at the risk of oversimplification identify the following principles:

1. characterisation calls for an evaluative judgment;
2. the "one off" or recurrent nature of the outgoing may be indicative of character but not determinative;
3. the question is "what was the payment for?" – the purchase of a business will generally be on capital account, the purchase of a wasting asset does not deny that it may be of a capital nature;
4. an outgoing to acquire or support the business structure is an outgoing of capital – an outgoing to operate the business is not;
5. the character and lasting nature of the advantage sought to be secured is relevant;
6. what is the outlay calculated to effect from a practical and business point of view.

3.4 A selection of recent cases

The following selection of recent cases illustrate the application of the principles but are of limited utility given that each case must turn on its particular facts.

3.4.1 *Ausnet* (2015)

The taxpayer undertook to pay quarterly statutory charges as the holder of a electricity transmission licence pursuant to the terms of an agreement under which it acquired electricity transmission assets including the licence. Failure to pay the fee could have resulted in revocation of the licence. "Without it, acquisition of the rest of the assets was pointless. If it were revoked after acquisition, the whole business structure would collapse": at 473 [66]. In other words, the licence was a critical aspect of the taxpayer's business structure. Unsurprisingly, the majority concluded that the licence fees were on capital account.

3.4.2 *Sharpcan* (2019)

In *Sharpcan*, the question was whether payments made to secure gaming machines rights for a hotel for a period of 10 years were on revenue or capital account. The Court concluded that the gaming machines licences were part of the profit-making structure of an integrated hotel business. Consequently, the payments were outgoings of a capital nature.

3.4.3 *Healius* (2020)

The taxpayer operated medical centres. It paid lump sums to medical practitioners in consideration for their promise to conduct their medical practices from the taxpayer's medical centres. Under the terms of the arrangements, the taxpayer was able to control the manner in which the medical practitioners conducted their practices (other than medical judgements). This enabled the centres to be operated in a particular manner in order to attract patients from whose custom the taxpayer derived its income. Securing the medical practitioners’ commitments was critical to the taxpayer’s business. Together with the premises, these commitments comprised the taxpayer’s business structure. Consequently, the payments were considered to be capital in nature.

3.4.4 *Mussali* (2021)

The issue in *Mussali v Commissioner of Taxation* (2021) 284 FCR 516 was whether upfront payments made by a franchisee to secure lower ongoing rent was an outgoing of a capital or revenue nature. The Full Federal Court held that it was of a capital nature because it secured for the taxpayer the enduring benefit of a lower cost business structure.

3.4.5 *Clough* (2021)

In *Clough*, the taxpayer had issued shares and options to employees under an employee share plan. The taxpayer’s majority shareholder wished to acquire the minority interests and this required dealing with the employee shares and options. Ultimately payments of approximately $15 million in aggregate were made to employees to cancel the employees’ shares and options. Thawley J (with whom Kenny and Davies JJ agreed) concluded that the payments were not deductible under s 8-1(1) by reason being on capital account (at [18]-[19]) (bold added):

> The difficulty this case presents is that the payments were made both to facilitate a change in control of Clough and also to honour legal or commercial obligations to employees arising out of the fact that Clough had granted options and rights to its employees in the course of running its business and for the purpose of rewarding and incentivising those employees. For the reasons which follow, **in a practical business sense, the payments are better characterised as payments made pursuant to an agreement to secure a change in control rather than as meeting employee entitlements on a change of control.** The payments were made to effect a reorganisation of the capital structure of Clough, through a takeover … and the delisting of Clough from the ASX. The bringing to an end of the various rights of the employees under the employee schemes was necessary to secure the reorganisation of the company's capital structure for the enduring advantage of the business. There is no doubt that the payments would not have been made unless the employees had entitlements under the employee schemes and that those schemes had been designed to incentivise and reward those employees. The rights were granted to the employees in gaining or producing assessable income. However, the occasion of the outgoings lay in the takeover and the object behind making the payments was the bringing to an end of the employees' rights, at the one time, to facilitate the takeover … and the delisting of Clough.
>
> Accordingly, the payments were not deductible. The payments did not fall within the positive limbs of s 8-1 and were payments on capital account.

4. Conclusion

When is something on capital or revenue account? It depends on the particular facts of the case, and the application of by-and-large well-established principles.

Nevertheless, the Commissioner's appeal in *Morton* demonstrates that the particular facts of individual cases may give rise to differing views and in borderline cases unpredictable outcomes. This is a function of the manner in which the courts have developed the principles over the years, as was acknowledged by the majority in *Ausnet* at 450-1 [14]-[15] (citations omitted):

> The evaluative judgment required to distinguish between expenditure on capital or revenue account is made under the guidance of approaches developed in decisions of this Court over many years. Those approaches have necessarily been expressed with a degree of generality sometimes criticised for unpredictability in the outcomes they yield …
>
> The distinction between capital and revenue expenditure is readily discerned in cases close to the core of each of those concepts. A once and for all payment for the acquisition of business premises would be treated as an outlay of capital. A rental payment under a lease of the same premises would be treated as an outgoing on revenue account. The distinction is not so readily apparent in penumbral cases. They may require a weighing of factors including the form, purpose and effect of the expenditure, the benefit derived from it and its relationship to the structure, as distinct from the conduct, of a business. Some of those factors may point in one direction and some in another. Definitive and specific criteria are not, and never have been, in abundance in Australia…

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