



Decision Impact Statement

Allen & Anor v Federal Commissioner of Taxation

Court Citation(s):

[2011] FCAFC 118
2011 ATC 20-277
195 FCR 416
[2012] HCA Trans 25

Venue: Full Federal Court

Venue Reference No: QUD 82 of 2008

Judge Name: Kean CJ, Greenwood and Middleton JJ

Judgment date: 7 September 2011

Appeals on foot: No.

Taxpayer application for special leave to appeal to the High Court was refused on 10 February 2012.

Decision Outcome: Partly favourable to the Commissioner

Administrative Treatment (Implication on current Public Rulings and Determinations)

Relevant Rulings/Determinations:

- TR 2006/7
- MT 2008/2

Subject References:

Special income
Income derived
Reasonably arguable position
Shortfall penalties

Précis

Outlines the ATO's response to this case which concerned whether certain income of a superannuation fund received in its capacity of beneficiary of a trust estate was special income of the fund.

Brief Summary of Facts

From 1 January 2003, Mr and Mrs Allen were trustees of the Allen's Asphalt Staff Superannuation Fund (the Super Fund) replacing Allen's Asphalt Pty Ltd, the original trustee. The arrangements in issue in the case also involved two other trusts, one referred to as the Hybrid Trust, and the other as the Fixed Trust.

The Hybrid Trust was settled on 28 June 2001. The trustee of the Hybrid Trust was a corporation of which Mr Allen was the sole director.

The declaration of trust which created the Fixed Trust was made on 28 June 2002. The declaration was made by

Astonglen Pty Ltd, of which Mr Allen was a director. The schedule to the trust deed nominated Allen's Asphalt Pty Ltd, in its capacity as trustee of the Super Fund, as the "absolute beneficiary" of the Fixed Trust with a 100% vested and indefeasible interest in the income of the trust estate of the Fixed Trust.

By deed of variation signed by Mr Allen on 28 June 2002, the deed of the Hybrid Trust was amended to add a new class of "discretionary beneficiaries". These discretionary beneficiaries included the Fixed Trust.

During the 2003 income year the Hybrid Trust realised a capital gain on the sale of an asset. The Fixed Trust received a sum of \$2,500,005 by way of a distribution from the Hybrid Trust, referable to the capital gain of the Hybrid Trust. The Super Fund received a distribution of \$2,500,005 by virtue of the Super Fund's fixed entitlement to 100% of the income of the Fixed Trust.

The establishment of the trust structures and flow of funds through these trusts to the Super Fund occurred pursuant to legal advice obtained by the taxpayers.

Issues decided by the Court

The Court decided that within the meaning of section 273(7) of the Income Tax Assessment Act 1936 the Super Fund had derived income that was 'special income' to the extent of \$2,500,005. In consequence the trustee was liable to pay tax at the rate of 47% on this amount.

The taxpayer had submitted that the term 'income' as used in section 273 referred to income according to ordinary concepts and as the amount of \$2,500,005 was not ordinary income of the Super Fund, but rather included in its assessable income as statutory income, it did not satisfy the description of income derived for section 273 purposes.

The taxpayer also submitted that other conditions of subsection 273(7) were not satisfied. In particular, there was no 'acquisition' of the fixed entitlement, because the entitlement was obtained passively, and there was no 'dealing' between the parties because any arrangement consisted merely of unilateral acts of Mr Allen.

The Commissioner had submitted that having regard to the Parliamentary intent in enacting subsection 273(7) and the statutory context in which the section appears, 'income derived' must be regarded as encompassing assessable income more generally, and not just income according to ordinary concepts. The Commissioner submitted that as a general rule the Act operates to include amounts in the assessable income of a beneficiary of a trust estate as statutory income via the mechanism of Division 6 (combined with the operation of Divisions 102 and 115 in the context of capital gains of a trust) and limiting the operation of section 273 to income according to ordinary concepts would defeat the operation of the section.

The Commissioner further submitted that the reference to 'acquisition' in subsection 273(7) included a passive acquisition, and that on the facts there were dealings between the various parties to the arrangement.

With respect to the meaning of 'income derived' in subsection 273(7), the Court had regard to the context in which the section appears, and the mischief at which the section is aimed. In particular, the Court observed at [52] that it was as statutory income under section 6-10 that an amount was included in the assessable income of the Super Fund as beneficiary of the Fixed Trust by reason of sections 95 and 97. On this basis the court accepted the Commissioner's submissions that the reference to income derived in subsection 273(7) had to be understood as extending to include statutory income.

The Court concluded that 'acquisition' included a passive acquisition, noting at [68] that 'where a beneficiary under a declaration of trust obtains an entitlement in respect of the trust estate, the beneficiary need not, and usually will not, play an active role in that acquisition.'

The Court observed at [72] that it was unnecessary to show that the superannuation fund itself had been dealing on non-arm's length terms. It was sufficient that there was some non-arm's length dealing by other parties to the arrangement. Nevertheless, it was accepted at [73] that the superannuation fund had not been entirely passive, because it had received a distribution it had chosen not to disclaim.

The Court determined that no penalty should be imposed, because, contrary to the conclusion of the primary judge,

the taxpayer's position was reasonably arguable. In this respect, the Court distinguished between the taxpayer's position on the 'income derived' issue, and its other arguments. The Court said if the taxpayers' arguments had been confined to the arguments about arrangements, acquisition, dealings and undervalue, it would not have reached the conclusion that its position was reasonably arguable.

ATO view of Decision

Special income provisions

The Court's reasons for concluding that the relevant amount was special income are consistent with the ATO view set out in TR 2006/7.

The taxpayer's application for special leave to appeal to the High Court was refused. In respect of the question of whether 'income' used in the provision was confined to income according to ordinary concepts, French CJ observed that '[t]he Full Court adopted the construction which it did by reference to both purpose and context. In so doing, in our opinion, it applied correct principle.'

Penalty

The ATO considers that the approach of the Court on the issue of 'reasonably arguable position' is essentially consistent with the position outlined in Miscellaneous Taxation Ruling 2008/2 Shortfall penalties: administrative penalty for taking a position that is not reasonably arguable ('MT 2008/2') and the majority decision of the Full Federal Court in *Cameron Brae Pty Ltd v Federal Commissioner of Taxation* [2007] FCAFC 135 ('Cameron Brae'). We do not consider that any further changes are required to MT 2008/2, given that it already incorporates guidance from Cameron Brae.

The Full Court in Allen did not depart from nor overturn the fundamental propositions outlined by Hill J in *Walstern Pty Ltd v Commissioner of Taxation* [2003] FCA 1428 ('Walstern'), which were endorsed by two later Full Federal Courts (*Pridecraft Pty Ltd v Commissioner of Taxation* [2004] FCAFC 339 and Cameron Brae).

Rather, the ATO sees the reference in *Allen* at [75] to the approach taken in Cameron Brae as being 'somewhat less strict than that suggested by Hill J in *Walstern*', as being specific to context and distinguishing the *Walstern* case on its facts. As noted by the Full Court in *Allen*, at [77]:

The present case, like Cameron Brae, and in contrast to Walstern, turns on questions of statutory construction. Walstern was a case where the erroneous position advanced in a taxpayer's return was founded upon an unreasonable view of, or a disregard for, the facts. See Walstern at [113].

In both *Allen* and *Cameron Brae*, the questions of statutory construction were free from authority squarely covering the point. In *Allen*, in deciding the taxpayer had a reasonably arguable position, the Full Court stated that the 'taxpayers' position in respect of the income derived issue was 'debatable' (at [78]), there was 'the availability of rational grounds' (at [81]), 'there was room for a real and rational difference of opinion...' (at [81]) and that resolution of the issue required 'a close examination of the statutory context in which the provision was to be interpreted' (at [81]).

It may be noted that the reference to 'a real and rational difference of opinion' is also included in the principles outlined in *Walstern* (at [108]).

Paragraphs 43-4 of MT 2008/2 discuss the position where there is absence of authority for a particular position. Paragraph 42 contains the following sentence, extracted from paragraph 1.26 of the Revised Explanatory Memorandum to the A New Tax System (Tax Administration) Bill (No. 2) 2000:

What is required in such cases is that the entity has a well-reasoned construction of the applicable statutory provision which it could be concluded was about as likely as not the correct interpretation.

Paragraph 44 of MT 2008/2 incorporates paragraph 70 from the Full Court decision in *Cameron Brae* , which is shown below:

In our view, the question of construction and interpretation of section 82AAE [Income Tax Assessment Act 1936] was reasonably open and arguable. No authority squarely covered it. The proper interpretation depended upon the construction of section 82AAE informed by a full appreciation of the statutory history. The argument about the applicability or satisfaction of section 82AAE was arguable...If it be necessary to decide, we are also prepared to conclude that the issue as to the characterisation of the outgoing as capital or revenue was arguable. Whilst in our view it is clear that it was payment of a capital nature, the question is open to debate in the sense of being arguable.

Notwithstanding some minor differences in language between the reasoning of the Full Court in Allen and MT 2008/2, the ATO view is that the approach of the Full Court is essentially consistent with MT 2008/2.

Administrative Treatment

Implications for ATO precedential documents (Public Rulings & Determinations etc)

None

Implications on Law Administration Practice Statements

None.

Your comments

We invite you to advise us if you feel this decision has consequences we have not identified, including if any other precedential decision such as a Public Ruling or an ATO ID requires reconsideration or amendment. Please forward your comments to the contact officer by the due date.

Date Issued:	16 May 2012
Due Date:	13 June 2012
Contact officer:	Andrew Orme
Email address:	Andrew.Orme@ato.gov.au
Telephone:	(03) 9285 1164
Facsimile:	(03) 9285 1943
Address:	2 Lonsdale St Melbourne VIC 3000

Legislative References:

Income Tax Assessment Act 1936
Former section 273

Taxation Administration Act 1953
Section 284-75 of Schedule 1

Case References:

Walstern v. FCT
[2003] FCA 1428
2003 ATC 5076
(2003) 54 ATR 423

Pridecraft Pty Ltd v. FCT
[2004] FCAFC 339
2005 ATC 4001
(2004) 58 ATR 210

Cameron Brae Pty Ltd v. FCT
[2007] FCAFC 135
2007 ATC 4936
(2007) 67 ATR 178

© Commonwealth of Australia

This work is copyright. You may download, display, print and reproduce this material in unaltered form only (retaining this notice) for your personal, non-commercial use or use within your organisation. Apart from any use as permitted under the Copyright Act 1968, all other rights are reserved.

Requests and inquiries concerning reproduction and rights should be addressed to Commonwealth Copyright Administration, Attorney General's Department, Robert Garran Offices, National Circuit, Barton ACT 2600 or posted at <http://www.ag.gov.au/cca>