

LAWS8421, Income Tax
Group Collaboration and Seminar Participation

ASSESSMENT TASK 3

JUDGMENT

- Weighting:** 40% of the final mark for the course
- Due:** Wednesday, 10 August 2022, at 5pm (ACT time)
- Word Limit:** 2,500 including all headings, text and citations
- Referencing:** ‘In-text’ citations of cases and statutes should conform with generally accepted legal conventions
- Task:** Write a judgment on the matter set out below as if you were a judge sitting at first instance in the Federal Court of Australia
- Asst Criteria:** Students will be evaluated on their ability to:
- Summarise the facts and identify the relevant tax law issues
 - Analyse the relevant legal principles, citing statutory provisions and case law, as appropriate
 - Apply the legal principles to the factual situation, highlighting any indeterminacy in the law or policy anomalies
 - Explain and justify the decision reached
 - Communicate effectively in writing

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Following the negotiations undertaken during the intensive, Murgatroyd and the Australian Taxation Office (ATO) reached agreement as to the basis upon which Murgatroyd should be assessed to tax in each of the years of income ending 30 June 2012, 2013, 2014, 2015, 2016, 2017, 2019, 2020, 2021, and 2022.

Unfortunately, they were unable to resolve their differences in relation to the year of income ending 30 June 2018. That is because the ATO has taken the view that Murgatroyd was carrying on a business of land development in those years or, in the alternative, that he was engaged in an isolated profit-making venture. Murgatroyd, however, holds to the view that he had not acquired the land for the purposes of profit-making by sale and that in subdividing the land he was doing no more than realising it to its best advantage.

The ATO has amended Murgatroyd's original income tax assessment for the year ending 30 June 2018, under s 170 *Income Tax Assessment Act 1936* (Cth) (ITAA 1936),¹ to increase Murgatroyd's assessable income: first, by excluding the net capital gain of \$922,159 returned by Murgatroyd pursuant to s 102-5 *Income Tax Assessment Act 1997* (Cth) (ITAA 1997) and, second, by including an amount of \$1,840,000 being that part of the proceeds received by Murgatroyd from the sale of the four lots which the Commissioner contends was ordinary income in Murgatroyd's hands, assessable under s 6-5 of the ITAA 1997. The amount included by the Commissioner equals the net profit realised by Murgatroyd when he completed the sales of the four lots.²

Murgatroyd agrees that he realised a profit from selling the four lots but has objected, in accordance with s 14ZU of the *Taxation Administration Act 1953* (Cth) (TAA), against the Commissioner's notice of amended assessment. Murgatroyd's objection is based on the ground that the profit did not constitute an amount of ordinary income in his hands, assessable under s 6-5 ITAA 1997.

Unfortunately for Murgatroyd, the Commissioner has decided to disallow Murgatroyd's objection. Murgatroyd has appealed to the Federal Court, under s 14ZZ of the TAA, against the Commissioner's decision to disallow Murgatroyd's objection. The matter is now before the Court. You are the judge who must decide the matter.

Murgatroyd is contending that the Commissioner's assessment is excessive on the basis that the profit did not constitute ordinary income in his hands. More specifically, Murgatroyd has advanced three contentions.

- 1) He held the land on capital account and the sale of the lots was no more than the mere realisation of a capital asset or assets, albeit in an enterprising way. Murgatroyd relies on the statement of principle to this effect, enunciated by the Lord Justice Clerk in *Californian Copper Syndicate v Harris* (1904) 5 TC 159 and cited with approval by the High Court of Australia in *Commissioner of Taxation v Myer Emporium* (1987) 163 CLR 199 (*Myer Emporium*).
- 2) He did not acquire or venture the land in a 'business operation or commercial transaction' for the purpose of profit-making by the means which gave rise to his profit, such as would cause the profit to be ordinary income under the principles stated by the High Court in *Myer Emporium*.
- 3) At no time did he carry on a business of land development, or a business in the nature of land development, such as would attract the character of ordinary income to his profit in accordance with the principles stated by the High Court in *Myer Emporium*.

The Commissioner, on the other hand, is contending that the profit was ordinary income in Murgatroyd's hands. Specifically, the Commissioner asserts that Murgatroyd:

¹ Note, as mentioned previously, we have taken some liberties with the way we are applying s 170 ITAA 1936. On a strict application of the provision the amendment period for an individual assessment is limited to either two or four years, from the date of assessment, depending on the complexity of the taxpayer's affairs (unless there is a question of fraud or evasion).

² You do not need to concern yourself with the details of the net profit calculation. You can assume it is correct and undisputed by Murgatroyd.

- 1) realised the profit in the ordinary course of carrying on a business of land development, or as a normal incident of that business, with the consequence that the profit was stamped with the character of ordinary income in accordance with the principles stated by the High Court *Myer Emporium*; or
- 2) realised the profit by selling a portion of land which he had committed, in July 2015, to a 'business operation or commercial transaction' entered into with the purpose of profit-making by the means by which the profit was in fact realised; as such, it was ordinary income within the principles stated by the High Court in *Myer Emporium*.

In the alternative, the Commissioner has contended that if he is wrong that the profit on the sale of the lots was ordinary income, then it must follow that Murgatroyd made a capital gain on the disposal of each of the lots resulting in net capital gains assessable as statutory income, under s 102-5 ITAA 1997, in each of the years ending 30 June 2017 and 2018. On that basis, the Commissioner contends that the marketing, rates and interest expenses, incurred by Murgatroyd in each of the years of income ending 30 June 2016, 2017, and 2018, an otherwise deductible under s 8-1 ITAA 1997, would not be deductible by operation of s51AAA ITAA 1936.

Murgatroyd has responded to the Commissioner's alternative argument in the following way:

- 1) he accepts that if he did not hold the land on revenue account then s 51AAA ITAA 1936 would operate to deny him an allowable deduction for the rates in each of the 2016, 2017 and 2018 income years and for the marketing expenses in the 2018 income year; and
- 2) he rejects the proposition that the whole of his interest expense would be denied a deduction by the operation of s 51AAA ITAA 1936. Murgatroyd argues that his interest expense is deductible to the extent it is attributable to monies borrowed to purchase the 7 ha block of land which he used in carrying on a glamping business for the purpose of gaining or producing assessable income. Murgatroyd submits that the fact that the glamping business has ceased does not disturb the ongoing nexus between the interest expense and that business; he relies upon the principles established in *Commissioner of Taxation v Brown* (1999) 43 ATR 1 and *Ronpibon Tin NL v FCT* (1949) 78 CLR 47.

In closing submissions, both parties agreed that if the Court were to allow the appeal on the basis that the profit on the sale of the four lots was not ordinary income then the matter should be remitted³ to the Commissioner to give effect to that determination and to deal with any outstanding matters, including by:

- 1) quantifying the amount of any net capital gains that should be included in Murgatroyd's assessable income pursuant to s 102-5 ITAA 1997, and with respect to which years of income;

³ This means you do not have to deal with these matters in the judgment. For example, you do not have to try and calculate the net capital gains nor do you have to decide the time of any CGT events. Further, you do not need to put a \$ amount on any interest expenses which you think might be deductible (ie. deductible at a level of principle).

- 2) quantifying the amount of interest, if any, allowable as a deduction to Murgatroyd based on the application of any principles stated by the court, and in which years of income; and
- 3) amending Murgatroyd's assessments in the relevant years, in the relevant particulars, to give effect to the court's orders.

In considering the matter before you, you should assume that the facts set out in the document titled 'Practical Scenario' have been established in evidence before you and, further, that the arguments you heard put during the course of intensive were oral submissions made to you by the parties during the hearing.

The list of authorities relied upon by Murgatroyd's counsel are:

Californian Copper Syndicate v Harris (1904) 5 TC 159, *FCT v Myer Emporium* (1987) 163 CLR 199, *Commissioner of Taxation v Whitfords Beach* (1982) 150 CLR 355, *Scottish Australia Mining Co v FCT* (1950) 81 CLR 188, *Ruhama Property Co Ltd v FCT* (1928) 41 CLR 148, *McClelland v Commissioner of Taxation* (1970) 120 CLR 487, *Statham v FCT* (1988) 20 ATR 228, *Westfield Ltd v Commissioner of Taxation* (1991) 28 FLR 333, *Casimaty v Commissioner of Taxation* (1997) 37 ATR 358, *FCT v Munro* (1926) 38 CLR 153, *Steele v FCT* (1999) 197 CLR 459, *Commissioner of Taxation v Brown* (1999) 43 ATR 1, *Ronpibon Tin NL v FCT* (1949) 78 CLR 47

The authorities relied upon by the Commissioner's counsel are:

Californian Copper Syndicate v Harris (1904) 5 TC 159, *FCT v Myer Emporium* (1987) 163 CLR 199, *Commissioner of Taxation v Whitfords Beach* (1982) 150 CLR 355, *Whitfords Beach v Commissioner of Taxation* (1979) 10 ATR 549 (per Deane J), *Official Receiver in Bankruptcy v FCT (Fox's Case)* (1956) 96 CLR 370, *McClelland v Federal Commissioner of Taxation* (1969) 118 CLR 353, *Steinberg v FCT* (1975) 134 CLR 640, *Moana Sand Pty Ltd v FCT* (1988) 19 ATR 1853, *Stevenson v Commissioner of Taxation* (1991) 29 FCR 282, *Greig v Commissioner of Taxation* (2020) 275 FCR 445, *Fletcher v FCT* (1991) 173 CLR 1, *FCT v Riverside Road* (1990) 21 ATR 499, *Ronpibon Tin NL v FCT* (1949) 78 CLR 47

Technical Notes

When formulating your views, please **disregard** the possible operation of the following provisions: Division 70 ITAA 1997 (trading stock); Division 35 ITAA 1997 (non-commercial losses); and s 26-102 ITAA 1997 (losses or outgoings relating to holding vacant land).

You should be able to locate the authorities relied upon by the parties in any one of the following databases (accessible through the ANU Law Library or the internet): Westlaw AU, LexisNexis Advance, AustLII.