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Myer Income Strands at 30-Year Anniversary: Nature, Scope and Interaction with other Charging Rules

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Abstract

The thirty-year anniversary of the High Court decision in *FCT v The Myer Emporium Ltd* is approaching. Amongst other reasons, the case is significant because the decision is a joint judgment of a five-member High Court bench, the decision overturned the decision of all four judges that heard the matter in the lower courts and the fact the High Court decision canvasses some highly problematic income tax principles including the basis for measuring an income profit. It can be argued that the decision expanded the income concept and/or changed the courts' approach to characterising the income-capital boundary in regard to isolated transactions.

Many students of tax, tax academics (including the authors), tax practitioners and tax judges (at least in early days) find the income doctrines (two strands) in *Myer* difficult and problematic. This article is aimed at bringing some clarity to the income doctrines and related issues in *Myer*. This includes an examination of the nature and scope of the two income doctrines in *Myer* (now known as the two income strands of *Myer*), and the relationship between those two strands. The article also discusses the relationship between the two strands (mainly the first strand) in *Myer* and s 15-15 (profit from profit-making undertaking or plan).

1. Introduction

The 30-year anniversary of the Full High Court decision in *FCT v The Myer Emporium Ltd*[1] is approaching, and no doubt, there will be some academic and practitioner commentary canvassing the legacy of this important decision in Australian income tax jurisprudence.[2] The decision is significant for a number of reasons, including: (i) its authoritative statements on the treatment of profits and receipts from isolated transactions under the income concept (ii) its contribution to the measurement (accounting) of an income profit and (iii) its contribution to the return from property principle and/or the compensation receipts principle under the income concept in the form of the "second strand" of *Myer*.[3]

In spite of the passing of nearly 30-years and the considerable number of judicial applications of, explanations of and elaborations of the *Myer* decision, many students of tax, tax academics (including

[1] *FCT v The Myer Emporium Ltd* 87 ATC 4363 (Full High Court).
[2] The decision was handed down on 14 May 1987.
[3] As pointed out later, the Full High Court in *Myer* did not describe the two doctrines it dealt with as "strands". The description of strands only emerged in subsequent cases (e.g. *FCT v Cooling* 90 ATC 4472 at 4482; *Henry Jones (IXL) Ltd v FCT* 91 ATC 4663 at 4668).

the authors), tax practitioners and tax judges[4] find the income doctrines (two strands) in *Myer*[5] difficult and problematic. There have however been numerous helpful insights from the judiciary in subsequent "isolated transactions" cases and Australian Taxation Office (ATO) rulings.

The aim of this article is relatively modest; it provides a basis for the inevitable legacy articles and commentaries that will emerge. The key aim is to set out as clearly as possible the scope of the two income doctrines in *Myer*[6] (which have become known as the two income strands of *Myer*), and the relationship between those two strands. The article also discusses the relationship between the two strands (mainly the first strand) in *Myer* and s 15-15.[7] A lesser aim of the paper is to briefly deal with the double taxation issue arising from application of the two strands in *Myer*, and some other charging provisions[8] that could be seen as similar to the second strand.

Aside from this introduction and conclusion, the article is in four parts. Part 2 sets out the facts in *Myer*, including a diagram for ease of understanding of the transaction(s). Part 2 also provdes a brief outline as to why the transaction was structured as it was, and a brief outline of the decision. Part 3 sets out the nature of, and the scope of, the two income doctrines contained in *Myer*. In particular, the material aspects of the two doctrines (strands) is the point of focus. Part 4 deals with s 15-15,[9] the other assessable income charging provision that was held to apply in *Myer*. In particular, the scope of s 15-15 is examined and compared to the first strand of *Myer*. Mainly for comprehensiveness, Part 5 deals with the potential double taxation issue that could arise from application of the two strands of *Myer*, and other charging provisions that are similar to the second strand.

The following conclusions can be drawn from the article. First, the nature and scope of the principles comprising the first strand are fairly settled, but that does not mean there cannot be contention in its application to particular facts. Secondly, the nature and scope of the second strand is not that settled. Thirdly, there is a fairly clear line of demarcation between the first and second strand. Fourthly, the first strand is similar to, if not, identical to s 15-15. Given the priority of application to the income section, this leaves little or no role for s 15-15.

2. Facts, why transaction structured as it was and brief outline of decision

2.1 Facts

The taxpayer, Myer Emporium (Myer) was the parent company of a group of companies, including the 100% owned Myer Finance Ltd (Myer Finance).[10] The group carried on business predominantly in

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[4] For example, see the differing opinions of the majority judges (Jenkinson and Hill JJ) as opposed to the minority judge (Heerey J) in the Full Federal Court in *Henry Jones (IXL) Ltd v FCT* 91 ATC 4663 on the application of the first strand of *Myer* to the facts in that case (*Henry Jones (IXL) Ltd v FCT*). Similarly, see the disagreement between the judge at first instance (Lockhart J in *SP Investments Pty Ltd v FCT* 92 ATC 4496), and the Full Federal Court (*SP Investments Pty Ltd v FCT* 93 ATC 4170), in regard to the first strand.

[5] *FCT v The Myer Emporium Ltd* 87 ATC 4363.

[6] To repeat, the Full High Court in *Myer* did not describe the two doctrines it dealt with as "strands". The description of strands only emerged in subsequent cases (e.g. *FCT v Cooling* 90 ATC 4472 at 4482; *Henry Jones (IXL) Ltd v FCT* 91 ATC 4663 at 4668).

[7] All references to section numbers containing a dash ("-") are to the *Income Tax Assessment Act* 1997.

[8] This can include an assessable income provision (called statutory income in the legislation) or the making of a capital gain under the capital gains tax regime (CGT) within the *Income Tax Assessment Act* 1936 (ITAA 1936) or the *Income Tax Assessment Act* 1997.

[9] Section 15-15.

[10] Myer Finance was initially called Margosa Ltd: *The Myer Emporium Ltd v FCT* 85 ATC 4111 at 4114 (Supreme Court of Victoria).

retail trading and property development.[11] Myer's business was that of retailing and property development, and it also acted as financier to the group. The flow of funds under the "transaction" is set out here:

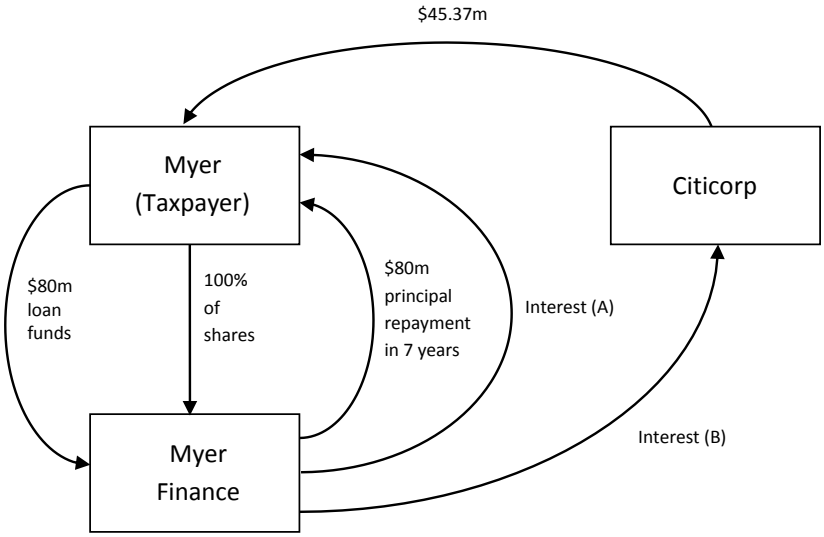

Chart 1: Myer Emporium Loan and Assignment Structure

On 6 March 1981, Myer lent $80m to Myer Finance.[12] The loan was made under a loan agreement, which provided that the principal would be repaid to Myer "on but not prior to the 30th day of June, 1988" (little more than 7-years). Myer Finance would pay interest (Interest A) to Myer at the rate of 12.5% p.a. The first payment by Myer Finance to Myer of $82,192 represented three days interest and was paid on the day the loan was created, as agreed. The loan agreement provided that Myer had the right: "...to sell, transfer or assign the Principal Amount and/or the interest payable or repayable…."

On 9 March 1981, Myer Finance assigned to Citicorp Canberra Pty Ltd (Citicorp) "absolutely the moneys due or to become due as the interest payments and interest thereon..." The consideration for the assignment was the sum of $45.37m, which was paid by Citicorp to Myer Finance on that day. The sum was calculated on the basis of the outstanding interest payable under the loan agreement, which was then discounted at the rate of 16% p.a. Myer gave notice of the assignment to Myer Finance, which thereafter paid the interest due (Interest B) under the loan agreement to Citicorp.[13] Myer remained entitled to repayment of the principal sum of $80m by Myer Finance under the terms of the loan agreement. The loan to Myer Finance would not have been made unless Citicorp was in a position to take the assignment of the interest (i.e. the two legs of the transaction(s) were pre-arranged).

It is the tax treatment of the $45.37m receipt (or the relevant profit) that was in issue, and in particular, was this sum caught by an assessable income inclusion provision? The ATO assessed the sum of $45.37m as income in the hands of Myer under s 25(1) of the ITAA 1936 (equivalent of s 6-5). In the alternative, the ATO relied upon the second limb of s 26(a) of the ITAA 1936.

[11] The Australian income tax regime did not contain a universal consolidation regime at the time. Accordingly, each company in a group of companies was a taxpayer that could enter into "taxable events" or "taxable transactions".

[12] The $80m in "funds" was said to come from the sale by Myer of shares in its property-owning subsidiaries. The shares were transferred to Myer Shopping Centres Ltd: *The Myer Emporium Ltd v FCT* 85 ATC 4111 at 4113-4114.

[13] This article makes no reference to the rules concerning assignments of choses in action, which would need to have been complied with, in order that the assignment was effective at law.

2.2 Why was transaction entered into, and why was it structured as it was?[14]

The transaction was part of a series of carefully planned transactions Myer entered into for the purpose of reorganising their business and to raise some working capital to diversify.[15] To the group (as opposed to each company involved), the transaction looked very much like a loan transaction (borrowing of $45.37m) with repayment of interest and principal over a period just over seven-years. Given the group's requirement to stay within its borrowing ratios in its debenture trust deed, the group was not permitted to raise further [explicit] borrowings, and Myer believed the transaction did not impact on its borrowing ratio limits. Therefore, in one respect, the structure of the transaction was "forced" upon the taxpayer.

The High Court emphasized that Myer always intended the transactions (or various legs of one transaction) to be interdependent. Myer would create an income stream within the group that could be sold to an external entity. The income stream would be sold for a lump sum in such a way that the lump sum payment would [hopefully] be a non-taxable capital receipt.[16] The period of the loan was chosen as just in excess of seven-years to prevent the potential application of s 102B.[17] And the loan was not repayable at will.

2.3 Decision briefly stated

The Full High Court held that the profit on the transaction was ordinary income on the basis of [what has subsequently become known as] the first strand of *Myer*.[18] The court also held that the receipt from Citicorp was ordinary income in any event under [what has subsequently become known as] the second strand of *Myer*.[19] Finally, the court also held that the second limb (not to be confused with the two strands under the ordinary income concept) of the then s 26(a)[20] also applied to include the profit in the assessable income of the taxpayer.[21] The court made no attempt to address the "triple taxation" issue.[22]

3. The two strands of *Myer* under the ordinary income concept

Importantly, what have come to be known as the two strands of *Myer* are part of the ordinary income concept within s 6-5.[23] The two strands of *Myer* must not be confused with the two limbs of the old s

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[14] Young has stated that the transaction was a mass marketed scheme: Neil J Young, The Historical Significance of the High Court's Decision in Federal Commissioner of Taxation v The Myer Emporium Ltd (2007) 31 *Melbourne University Law Review* 266 at 277. N J Young is listed as one of the Commissioner's represetatives in the Full High Court.

[15] *The Myer Emporium Ltd v FCT* 85 ATC 4111 at 4114-4115. Part of the explanation as to why the transaction was attractive to Citicorp was that it had tax losses that could be "mopped up" (used up) by the receipt of the interest from Myer Finance: *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4365.

[16] *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4370. It is worth remembering here that there was no general capital gains tax regime in Australia at the time of entry into the transaction.

[17] *The Myer Emporium Ltd v FCT* 85 ATC 4111 at 4114-4115. It is not clear to the authors how s 102B could have applied given that an indispensable condition for the application of s 102B was that a relevant assignment had to be to an associate: s 102B. ?? Authors need to research this further. ?? If s 102B applied, the assignment was treated as void (no effect) for income tax purposes.

[18] *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4369-4370.

[19] *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4371-4372.

[20] Subsection 26(a) of the ITAA 1936.

[21] *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4372.

[22] It is submitted that the Australian Taxation Office (ATO) would not seek to extract double or triple taxation of the same economic amount.

[23] At the time of the *Myer* decision, the income concept was contained in s 25(1) of the ITAA 1936.

26(a).[24] Section 26(a) was a [quite] separate charging provision (assessable income inclusion provision) from the ordinary income provision.[25]

3.1 First strand

The first strand of *Myer* deals with receipts and profits from isolated transactions. At the loss of some precision, in very broad terms, a profit from an isolated transaction will be income if it was entered into with the purpose of making a profit and the transaction is commercial in character or has the character of a business deal.

It is submitted that the first strand's underlying basis or foundation is the business proceeds principle under the income concept. As pointed out below, the conditions comprising the first strand, and in particular, their similarity to the conditions forming part of the proceeds of business principle is the basis for this assertion.

For a number of reasons, the courts have been reluctant to hold, too readily, that a profit or receipt from an isolated transaction is income (or taxable). More accurately, as the Full High Court stated in *Myer*, three strands of thought combined to deter courts from accepting the simple proposition that the existence of an intention or purpose to make profit is enough in itself to stamp the receipt as income.[26] They are: (i) the notion that the realisation of an asset was a matter of capital (ii) the apprehension that windfall gains would constitute income unless the concept of income was, apart from income from personal exertion and investment, confined to profits arising from business transactions and (iii) the idea that gains from recurrent transactions, such as a business, are income whereas a gain generated by an isolated transaction is capital.[27]

Some commentators have suggested that the first strand of *Myer* is a major development or change to the taxation of isolated transactions and thereby an enlargement of the income concept.[28] On the other hand, there are commentators that argue that *Myer* did not transform the income concept as it relates to the first strand.[29] There is no intention to debate the merits of these assertions here.[30]

3.1.1 Broad overview points or propositions from *Myer* re first strand

It is submitted that three broad propositions emerge from, or are stated in, *Myer* regarding or concerning the first strand (and business proceeds more generally). They are:

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[24] Subsection 26(a) was contained in the ITAA 1936. The predecessor to s 26(a), and the successors to s 26(a) (ss 25A and 15-15), will be referred to in Part 4 of the paper below.

[25] Subsection 25(1) of the ITAA 1936.

[26] *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4367. We will see below that the High Court was not saying that a profit making purpose alone is enough to make a profit on an isolated transaction income.

[27] *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4367.

[28] To do ???.

[29] Neil J Young, The Historical Significance of the High Court's Decision in Federal Commissioner of Taxation v The Myer Emporium Ltd (2007) 31 *Melbourne University Law Review* 266 at 294.

[30] This is really a legacy debate that will require a comparison of the pre-Myer and post-Myer tax law where the post-Myer tax law would need to incorporate all developments to the present. In a sense, Neil J Young has done this to 2007: Neil J Young, The Historical Significance of the High Court's Decision in Federal Commissioner of Taxation v The Myer Emporium Ltd (2007) 31 *Melbourne University Law Review* 266.

1. A receipt or profit made in the ordinary course of business is income (provided the realisation does not involve a structural asset/capital asset);[31]

2. A receipt or profit made outside of the ordinary course of business, but which is part of the business or profit-making business of the taxpayer, will be income if the taxpayer entered into the transaction with the purpose of making the receipt or profit;[32] and

3. A receipt or profit made outside the ordinary course of business, and outside of the business or profit-making business of the taxpayer (i.e. no connection with the business or profit-making business of the taxpayer) can only be income if two conditions are satisfied. They are: (a) the transaction must be "commercial" in character or have the character of a "business deal" and (b) the taxpayer entered into the transaction with the purpose of making the receipt or profit.[33]

The first proposition deals with the normal proceeds of business principle. This is not part of the first strand of *Myer*; and is just a restatement of long accepted law.[34] It is worth remembering that the sale of a structural asset (capital asset), even though made in the "ordinary course of business", is not income.[35]

The second and third propositions deal with isolated transactions; these are part of the first strand of *Myer*. In terms of proposition 2, a transaction becomes an isolated transaction because of its failure to fall within the taxpayer's ordinary course of business, but that it does fall within the taxpayer's business or profit-making business. In terms of proposition 3, the transaction falls both outside a taxpayer's ordinary course of business (if it has one), and outside a taxpayer's business or profit-making business. It must be taken that a taxpayer's ordinary course of business is a subset of a taxpayer's business or profit-making business.

In propositions 2 and 3, the High Court used the words "business" and "profit-making business" as the descriptor or indicator of activities that are outside the ordinary course of business.[36] With respect, the use of the term "business" in these descriptors does not provide sufficient distinction from the term "ordinary course of business". It must be remembered that the ordinary course of business is the activity from which a transaction is distinguished to give it the character of an isolated transaction. It is therefore submitted that the reference to business or profit-making business in propositions 2 and 3 are better expressed as the total operations or commercial operations of the taxpayer. It is submitted that these descriptors provide a better point of contrast with the ordinary course of business. These terms are also a better descriptor because they capture activities that are not characterized as a business. Use of the term "business" may leave some transactions out of analysis, which would not appear to have

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[31] *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4366.
[32] *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4370.
[33] *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4367.
[34] *FCT v Squatting Investment Co Ltd* (1954) 10 ATD 361 at 371; *Dickenson v FCT* (1958) 11 ATD 415; *E K White v FCT* (1968) 15 ATD 173 at 176.
[35] In *FCT v Spedley Securities Ltd* 88 ATC 4126 at 4130, the ATO argued, off the back of *Myer*, that the receipt in *Spedley Securities* should be income because it was received in the course of business operations and those operations, broadly, are directed at making profit. The argument that *Myer* represented such a broad principle was rejected: *FCT v Spedley Securities Ltd* 88 ATC 4126 at 4130. See also *Westfield v FCT* 91 ATC 4234 at 4242 on this point. The ATO has since rejected such a principle: para 44 of Taxation Ruling TR 92/3.
[36] *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4370.

been the intent of the High Court.[37] It needs to be remembered that an essential (indispensable) component for an income conclusion under both propositions 2 and 3 transactions is that the taxpayer must have the required profit-making purpose.

It is not completely clear which of the two propositions [referred to in this article] was applied to make the profit income in *Myer* under the first strand; there are comments pointing both ways in the Full High Court judgment. It probably does not matter because the transaction satisfied the essential components of propositions 2 and 3. On balance though, proposition 2 is more likely to be the basis for the High Court's income conclusion.[38]

3.1.2 Isolated transactions distinguished from transactions in ordinary course of business

One can see that it may be important to determine if the taxpayer's transaction is part of their ordinary course of business, or it is outside of the ordinary course of business. The reason is that there is no need to find a profit making purpose in regard to a transaction if it is within the ordinary course of the taxpayer's business for the receipt or profit to be income. The reasoning is that because the business is carried on for the purpose of making profit, a gain made in the ordinary course of business is invested with the profit-making purpose thereby stamping the gain as income.[39] In a sense, purpose at the global level (business) is attributed down to the micro level (transactions).

The High Court in *Myer* did not provide guidance on how one identifies a taxpayer's ordinary course of business. However, guidance can be obtained from old s 36 of the ITAA 1936. This section included in a taxpayer's assessable the market value of trading stock that was disposed of outside the ordinary course of business. Section 70-90 is the modern equivalent of s 36. In *Case R85*, Dr G W Beck said:

> "Whether or not one regards transactions as being in the ordinary course of business seems to me to depend on one's assessment of three things:
> (a) the precise nature of the business that is being carried on;
> (b) the character of transactions that one could reasonably expect to be called for in the course of going about the business; and
> (c) the character of the disputed transactions.[40]

Dr Beck went on to say that to determine these aspects calls for a careful analysis of just what had been done before and was done during the relevant years.[41]

Thus, what is a taxpayer's ordinary course of business must be ascertained by looking at the taxpayer's pattern of activities (e.g. trading) over a period of time. However, the fact the taxpayer has never entered into a particular type of transaction before does not necessarily mean that the transaction ought to be regarded as outside the ordinary course of business, and therefore seen as an isolated transaction. A business can change direction and the new transaction can still be regarded as part of the ordinary

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[37] It is possible that the High Court's use of the terms "business" and "profit-making business" was influenced by the fact that the taxpayer in *Myer* was a company, and of the widely held view that all activities of a company are necessarily a business.

[38] The statement that "The transactions in question were entered into by Myer in the course of it business." is probably the key, and the later comment that "[The fact the transactions were novel] does not take them out of the course of the carrying on of Myer's profit-making business." provides more support: *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4370.

[39] The Full High Court makes this point expressly in *Myer*: *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4366.

[40] *Case R85* 84 ATC 569 at 571.

[41] *Case R85* 84 ATC 569 at 571.

course of business.[42] Further, in some of the cases, the analysis of a transaction is put on the basis that it is an ordinary incident of the taxpayer's business to enter into such a transaction. These should also be treated as part of the ordinary course of business in the *Myer* sense of that term.

With the appropriate adjustment, it is submitted that the approach to determining the taxpayers' ordinary course of business should be applied when determining taxpayers' transactions that are part of or outside of their total operations or commercial operations. That is, a careful analysis needs to be undertaken of what has been done before and during the current income year, and the pattern of the taxpayer's transactions.

Proposition 3 seems to deal with transactions that are either entered into by a taxpayer that does not operate a business, or by a business taxpayer, but the transaction has no connection with their total operation or commercial operations. The requirement that the transaction itself has a commercial character or has the character of a business deal is a necessary requirement for the operation of this aspect of the first strand of *Myer*. Of course, the required purpose must also be present at commencement of the transaction.

It is submitted that the transaction in *Myer* was an isolated transaction and was treated as such, even though there can be some debate about it fitting within proposition 2 or 3 above.

3.1.3 Taxpayer must have required purpose at the time of entering transaction, extent of profit purpose, etc

As can be seen, purpose is relevant to both propositions that are part of the first strand. First, there is nothing in the Full High Court's articulation of the first strand in *Myer* to indicate that the nature of the taxpayer purpose requirement in the two propositions that comprise the first strand differs. Given that the commercial character or business deal aspect of proposition 3 is similar to the total operations or commercial operations (but outside ordinary course of business) aspect of proposition 2, it may be hard to argue that the purpose requirement differs.

Secondly, in order to satisfy the purpose requirement of the first strand, the taxpayer must have had a profit making purpose at the time of entering into the transaction, that is, the commencement of the transaction.[43] Where a profit is made on sale of an item, this means the required purpose must be present at the time of purchase of the item. In *Myer*, the taxpayer did have the purpose to make a profit at the time of entering the transaction. The transaction was identified as commencing when the $80m loan to Myer Finance was made. This was the time the taxpayer acquired the chose in action that was sold, namely, the right to receive the interest over the next 7-years.

At first glance, the decision in *FCT v Whitfords Beach Pty Ltd*,[44] which was some five-years before the High Court decision in *Myer*, could be seen as not conforming to the idea that the required profit making purpose must be present at the time the transaction is entered into (commencement). Briefly, in *Whitfords Beach*, company purchased land for a domestic or capital purpose so that there was no intent to sell the land at the time of purchase. Some 13-years later, developers purchased all the shares in the company (and not the land in the company), with the express purpose of getting the company to

[42] *Kosciusko Thredbo Pty Ltd v FCT* 84 ATC 4043 at 4052; *Jennings Industries Ltd v FCT* 84 ATC 4288 at 4294; *Richardson v FCT* 97 ATC 5098.
[43] *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4369.
[44] *FCT v Whitfords Beach Pty Ltd* 82 ATC 4031.

subdivide and sell the land. The High Court held that the profits made on sale of the land by the company were income in spite of the fact that the land was not acquired with the purpose of resale.

It is submitted that *Whitfords Beach* ought not to be seen as "out of step" with the idea that a taxpayer must have the required purpose of profit making at the time of acquisition of an asset for the profit to be income. The tax planning strategy in *Whitfords Beach* was essentially one of "hiding behind the corporate veil". The developers who purchased the shares conceded that had they purchased the land and subdivide the land, the profits on sale would have been income. Accordingly, the actual holding in *Whitfords Beach* must be seen in this light, so that the developers did have the required profitmaking purpose at the time of "purchasing the asset they intended to realise".[45]

Thirdly, the Full High Court did not address whether the purpose of taxpayers is subjective or objective. In many cases, it will not matter as the subjective purpose of a taxpayer is unlikely to depart too far from the purpose of a person in the taxpayer's position (objective). However, it is submitted that the taxpayer's purpose is to be ascertained objectively. The objective approach is adopted more broadly when testing the character of receipts as income.[46]

Fourthly, the Full High Court in *Myer* provided no guidance on the extent of the required purpose. In other words, did the first strand require a sole purpose, dominant purpose, not insignificant purpose, etc? This was important because of the finding at first instance that the purpose which above all motivated Myer was the immediate obtaining of working capital.[47] This should be taken as the dominant purpose of the taxpayer for entering the transaction.

Subsequent judicial commentary however indicates the profit making purpose must be at a level that it is at least "not insignificant".[48] Restated positively, the purpose must be a significant purpose of profit making. This means it need not be the sole purpose or even the dominant purpose, but it must be significant. This can raise a difficult factual question over which there can be disagreement.

In the High Court in *Myer*, the court did not expressly point out the basis on which the taxpayer had the requisite purpose. This was somewhat surprising in light of the lower court finding that the dominant purpose of entering the transaction was to obtain working capital through the sale of an income stream generated within the Myer group.[49] It appears that the Full High Court's "not insignificant purpose conclusion" supporting the application of the first strand is to be put on the basis of the interdependency of the transactions, and that it was always the taxpayer's intention to assign the right to receive interest for a lump sum once that right was created within the group.[50]

3.1.4 Transaction must be commercial or have the character of a business deal[51]

This requirement only arises in regard to proposition 3, the idea being that the commercial character of the transaction in proposition 2 is provided by the fact that the transaction is part of the total operations or commercial operations of the taxpayer.

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[45] Of course, the developer's concession is not the ratio of the income decision in the High Court.
[46] *Hayes v FCT* (1956) 11 ATD 68 at 73.
[47] *The Myer Emporium Ltd v FCT* 85 ATC 4111 at 4114.
[48] *Cooling v FCT* 90 ATC 4472 at 4484.
[49] *The Myer Emporium Ltd v FCT* 85 ATC 4111 at 4114-4115 (Supreme Court of Victoria).
[50] *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4369.
[51] In Taxation Ruling TR 92/3, the ATO ruling on isolated transactions, the ATO uses the term "business operation".

There is not a lot of guidance on this, but as the words suggest, the transaction must have a commercial character. Domestic or private types of transactions are clearly outside the notion of commercial. The line between a commercial transaction and non-commercial transaction will not always be clear, but the ATO ruling on isolated transactions[52] provides useful guidance on the factors to take into account. They include: (i) the nature of the entity involved (e.g. company, natural person) (ii) amount of money involved (iii) nature of and complexity of transaction involved (iv) involvement of professional advisers in the transaction and (v) if property was involved, the nature of the property (e.g. did it have a use aside from being an item of trade).[53]

It hardly needs to be said that the transaction in *Myer* was commercial in character. Even though not expressly pointed out by the Full High Court, it is submitted that the following factors support that conclusion: (i) taxpayer was a company (ii) the transaction was large and complex; complex in that it involved compliance with the law of assignments for its validity (iii) following on from the previous point, the transaction involved the receipt of sophisticated advice for its implementation and (v) the main counter-party was a large financial institution, and it was at arm's length to the taxpayer.

Of some importance is the fact that the ATO does not regard the purchase of shares by an individual for the purpose of resale for profit as a business operation or commercial transaction.[54]

3.1.5 Assessable amount is profit, and profit is calculated on the basis of historical cost and/or historical value

Importantly, when a transaction comes within the first strand of *Myer*, it is the profit on the transaction that is included in assessable income. If there is a loss, the loss is a deduction under the general deduction provision.[55] In other words, the more common "receipts and outgoings accounting" under the ITAAs whereby receipts enter an assessable income charging provision and expenses enter a deduction conferral provision, does not apply to the first strand. Thus in *Myer*, the profit was arrived at by adding the two "receipts" of $80m (principal repayment in just over 7-years time) plus the $45,370,000 receipt from Citicorp, which totals $125,370,000. From this is subtracted the $80m loan payment (outlay) loan made to Myer Finance. The result is a profit (surplus) of $45,370,000, which is the assessable income inclusion.[56]

In making the profit calculation, the $80m loan repayment due to Myer was taken into account at its face value even though this amount was not receivable by Myer until just over 7-years later. Myer's argument that the discounted value (present value: about $35m) of this $80m receivable should be taken into account in calculating the profit was rejected on the basis that historical cost, and not economic equivalence (present value), has been the basis for determining profit and loss under the income tax.[57] It should be remembered that the taxpayer's present value argument (no profit) was

[52] Taxation Ruling TR 92/3.
[53] Paragraphs 13 and 49 of Taxation Ruling TR 92/3.
[54] See example at paragraphs 72-73 of Taxation Ruling TR 92/3.
[55] Section 8-1. The ATO accepts this in Taxation Ruling TR 92/4.
[56] *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4372.
[57] *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4370-4371. One needs to be wary of the particular sense in which the term "economic equivalence" is used. It could refer to the character of a transaction (e.g. the dealing with Citicorp could be viewed as a borrowing). It could also be seen as "economic numerical equivalence". This latter sense is what is intended here.

accepted in the Full Federal Court, albeit in the context of determining whether there was a profit under the second limb of s 26(a).[58]

3.1.6 Cash basis of derivation

This was not addressed in the High Court decision. And, as expected, this was not addressed in the lower courts either. This will rarely be an issue of significance, or one of contention. The little authority there is on the issue supports the idea that the cash basis of income derivation (as opposed to the accruals basis) is most appropriate to the first strand.[59] This is in spite of the first strand's close similarity with the proceeds of business principle, where the accruals basis will usually apply in regard to proceeds of a continuing business.

3.2 Second strand[60]

The broad idea of the second strand is that where a taxpayer sells a right to receive income from property or from an asset they own in return for a sum of money, and the underlying property (asset) remains intact after sale, that sum of money is income. The court in *Myer* held that where a lender sells only the rights to receive interest but does not sell the underlying property (principal), then the character of the receipt for the sale of those rights is income, and not capital. The sale of the right to interest, in exchange for an upfront lump sum calculated as the present value of future interest, is revenue, and not a capital receipt. The taxpayer has converted future income into present income.[61]

The approach has been adopted in subsequent cases, for example:

> "I think Myer [second strand] must be taken as establishing that, …, an assignment of income from property without an assignment of the underlying property right will, *no matter what its form* [emphasis added], bring about the result that the consideration for that assignment will be on revenue account, as being merely a substitution for the future income that is to be derived."[62]

It is submitted that the second strand's underlying basis or foundation can be put on the return from property principle and/or the compensation receipts principle; two well-established income doctrines. The return from property principle is based on the idea that the income stream that is assigned would (absent the sale) flow to the taxpayer from an underlying asset (e.g. in *Myer*, interest from the principal sum).[63] And, because of that, the lump sum taken in place of the income stream can also be viewed as flowing from the underlying asset.

The other way to view the transaction is that the lump sum replaces what would have been income receipts when received, hence the claim of application of the compensation receipts principle. In the Full Federal Court in *Henry Jones (IXL) Ltd v FCT*, Hill J (Jenkinson and Heerey JJ agreeing) appears

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[58] *FCT v The Myer Emporium Ltd v FCT* 85 ATC 4601 at 4608 (per Fox J), at 4611 (per Lockhart J) and at 4613 (per Jenkinson J).

[59] *Moana Sand Pty Ltd v FCT* 88 ATC 4897 at 4898.

[60] Again, it should be noted that nowhere in the *Myer* judgment did the courts use the words strand to describe their analysis, and that the term "second strand" only emerged in subsequent cases.

[61] *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4371.

[62] *Henry Jones (IXL) Limited v FCT* 91 ATC 4663 at 4675.

[63] *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4371.

Again, it should be noted that nowhere in the *Myer* judgment did the courts use the words strand to describe their analysis. The term the "second strand" only emerged in subsequent cases.

to favour putting the foundation of the second strand on the compensation receipts principle.[64] Given the current state of the law, it is arguable there is no need to pin down the precise income foundation or jurisprudential foundation for the second strand.[65]

It is also submitted that the approach to characterising transactions for the purpose of testing the application of the second strand will not overly rely on the form of the transaction; a substance approach will be taken. The analysis of Hill J (Jenkinson and Heerey JJ agreeing) in the Full Federal Court in *Henry Jones (IXL) Ltd v FCT* is the authority.[66] Accordingly, the technical aspects of the law of assignments should not get in the way of a proper analysis of the transaction.[67] Nor should carelessness or inaccuracy in drafting an assignment divert from a proper characterisation of the transaction.

3.2.1 Second strand is a separate basis of income from the first strand

It is submitted that the second strand is an income principle under s 6-5 in its own right. This means it is quite independent from the first strand (itself an income principle).[68] It is clear in *Myer* that the High Court provided this second basis as an alternative for its income conclusion.[69]

3.2.2 Item sold must be rights to income

The rights sold (assigned) must involve rights to income, and not rights to capital payments. The usual examples will be rights to interest, lease rentals, royalties and licence fees. All of these would normally be on income account, but it cannot always be assumed. For example, an assignment of the right to the royalties in *McCauley v FCT* for a lump sum would not come within the second strand because the royalties involved in that case were held to be on capital account under ordinary principles.[70]

Even allowing for a "substance approach" in characterizing rights for the purpose of the second strand, if the rights purportedly assigned are mere expectancies or mere rights to future income (i.e. no subsisting property is assigned), it is submitted that the second strand cannot apply. The right to interest under a loan repayable at will is a mere expectancy, as is a dividend.[71]

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[64] *Henry Jones (IXL) Ltd v FCT* 91 ATC 4663 at 4675-4676.

[65] The High Court seems to put the second strand on a combination of the return on property principle and the compensation receipts principle: *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4372.

[66] *Henry Jones (IXL) Ltd v FCT* 91 ATC 4663 at 4675-4673.

[67] Firstly, the fact the assignor (taxpayer) retains some rights against the payer (e.g. sue for failure to make payments) post the assignment should not undermine the characterisation of the assignment as one involving the sale of rights to income if that is the legal effect of the transaction. Secondly, whether the assignment is a legal assignment or an equitable assignment also should not matter.

[68] Again, the second strand has nothing to do with the two limbs of the old s 26(a).

[69] It was stated that even if the assignment of the right to receive the interest was on capital account in the sense of the first strand, the receipt would have been income in any event: *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4369. It is clear that the income conclusion was put on the basis of the second strand (lender selling the right to receive income): *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4371.
Again, it should be noted that nowhere in the *Myer* judgment did the courts use the words strand to describe their analysis. The term the "second strand" only emerged in subsequent cases.

[70] *McCauley v FCT* (1944) 7 ATD 427. In spite of their capital nature, the royalties in this case were included in assessable income under s 26(f) of the ITAA 1936 (now s 15-20). It is worth noting the comment in *Ivanac v FCT* 95 ATC 4683 at 4691 that a capital sum paid by way of royalty is income to the recipient.

[71] *Norman v FCT* (1963) 13 ATD 13.

The tax analysis in the situation of an assignment of a mere expectancy for consideration is somewhat problematic, and it will not be examined here.[72]

Assuming all other requirements of the second strand exist (see below), it is submitted that the second strand can apply:

(i) where only part of an income stream as to amount is sold (e.g. a sale of 80% of the income stream);[73]
(ii) where only part of an income stream as to time is sold (e.g. sale of 6.5 years of income of a 7.5 year subsisting right to income);[74] and
(iii) no matter how long the right to receive income (that is sold) is designed to subsist.[75]

3.2.3 Second strand requires a sale without realisation of the underlying property that produces the income stream

This necessarily requires one to identify the underlying property from which the income flows. In many cases, this is clear, *Myer* being an example (i.e. interest flows from principal sum). The Full High Court pointed out that interest flows from the principal sum, and not the mere contractual right to interest severed from the underlying debt (principal).[76] The principal sum in *Myer* was not realized in the sale to Citicorp; the taxpayer retained its contractual rights under the loan as against Myer Finance, including the all-important right to repayment of principal.

Requiring underlying property to be intact from the assignment also requires one to identify whether there is any underlying property at all and/or whether the thing assigned is just or substantially a right to income. In the High Court in *Myer*, an annuity was identified as an exception to the second strand because the annuity payments are not derived from the sum paid to purchase the annuity. Instead, the annuity payments are derived solely from the annuity contract.[77] This led the High Court to conclude that the sale price of contractual rights to be paid an annuity is ordinarily received on capital account.[78]

The second strand analysis of an annuity can be put on the basis that there is no underlying property per se (e.g. purchase cost of the annuity has disappeared) and/or the thing assigned has also assigned the underlying property.

In *Henry Jones (IXL) Ltd v FCT*,[79] the taxpayer owned labels and trademarks under which its canned fruit products were marketed. The taxpayer granted SPC and Ardmona the right to use (licence) the labels and trade marks for a period of 10-years in return for royalties. The taxpayer assigned its right to

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[72] It is clear that when the income arises, it is derived by the assignor for income tax purposes, even though it is then held for the benefit of the assignee. Whether the assignor can obtain a deduction for the cost of handing over the amount to the assignee is then in question. Finally, analysis of the receipt of the lump sum for the expectancy is then also in issue. There is a lot to be said for assessing the lump sum as income, and ignoring the receipt and payment of the "expectancy receipt" (perhaps through simultaneous assessability and deductibility).
[73] *SP Investments Pty Limited (As Trustee of the LM Brennan Trust) v FCT* 93 ATC 4170 at 4181.
[74] In a sense, *Myer* is authority for this as three days of the subsisting right to interest was not assigned to Citicorp. On the other hand, the three days could also be seen as de minimis.
[75] *SP Investments Pty Limited (As Trustee of the LM Brennan Trust) v FCT* 93 ATC 4170 at 4181.
[76] *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4371.
[77] *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4371.
[78] *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4371. This analysis of an annuity was adopted by the Full Federal Court in *Henry Jones (IXL) Limited v FCT* 91 ATC 4663 at 4675.
[79] *Henry Jones (IXL) Limited v FCT* 91 ATC 4663.

receive the royalties to Citicorp for a lump sum. Hill J (Jenkinson and Heerey JJ agreeing) held that the second strand applied to the lump sum. In the course of his judgment, Hill J said:

> "…the mere industrial property right [in this case, the trademarks] which is licensed does not, without more, generate the income. The income is generated by the turning the (sic) right to account, for example, by licensing another to use it."[80]

In spite of this comment, which refers to the presence of an agreement to secure the right to the income stream, the royalties were seen as flowing from the trademarks.[81]

The Full Federal Court decision in *SP Investments*[82] is problematic on the underlying property issue. In brief, the taxpayer owned a right to receive royalties of 2.5% of the sale proceeds of iron ore produced by a miner from the Hamersley Iron ore venture. The venture was expected to last a considerable period. The taxpayer assigned all of its interest in its royalty rights agreement for 7-years and three months but only as to $75,000 per month of royalties, to National Mutual in return for a lump sum of about $3.9m. The taxpayer's contractual royalty rights as against the miner was all that the taxpayer owned as it had sold all of its rights, title and interest in various reserves and land including its rights to prospect or mine the reserves or land, in return for the contractual royalty rights.[83]

Not unexpectedly, the taxpayer argued that the second strand of *Myer* did not apply to the $3.9m lump sum because the situation was analogous to an annuity, namely, the royalties arose solely from the contractual rights held against the miner.[84] Put another way, the taxpayer assigned all that it had, and did not retain an underlying property right from which the royalties could be said to flow.[85]

Hill J (Burchett and O'Loughlin JJ agreeing) held the second strand applied. The key to his Honours reasoning appears to be the following:

> "In the present case, and to the extent that it is appropriate to refer to the royalty income as deriving from property at all, the property from which the income is derived (ie, chose in action) cannot, without qualification, be said to continue in the ownership of the assignor. A part only of the rights encompassed by the equitable chose in action, which the appellant had, has been assigned. The assignments are limited both as to quantum and as to period. Subject to the terms of the assignments, the underlying right to take action against the payer [miner] of the royalty remains with the assignor. In that sense it can be said that there was an assignment of a right to receive periodical sums which when received would be income, in circumstances where the underlying chose in action is retained subject to the assignment and the right is assigned in consideration of an amount calculated as the present value of the income stream. In my view, in

[80] *Henry Jones (IXL) Limited v FCT* 91 ATC 4663 at 4674.
[81] *Henry Jones (IXL) Limited v FCT* 91 ATC 4663 at 4675. This point about *Henry Jones (IXL) Limited v FCT* 91 ATC 4663 is made more explicitly in *SP Investments Pty Limited (As Trustee of The LM Brennan Trust) v FCT* 93 ATC 4170 at 4182.
[82] *SP Investments Pty Limited (As Trustee of the LM Brennan Trust) v FCT* 93 ATC 4170.
[83] *SP Investments Pty Limited (As Trustee of the LM Brennan Trust) v FCT* 93 ATC 4170 at 4172.
[84] *SP Investments Pty Limited (As Trustee of the LM Brennan Trust) v FCT* 93 ATC 4170 at 4179. Indeed, perhaps in desperation, the taxpayer also asserted that it rights to royalties were an annuity.
[85] *SP Investments Pty Limited (As Trustee of the LM Brennan Trust) v FCT* 93 ATC 4170 at 4180.

> those circumstances, the consideration should be as much seen as being income replacing the income stream assigned as was the consideration for the assignment in *Henry Jones (IXL)*."[86]

With respect, Hill J's reasoning in the above extract is far from convincing if it purports to explain the application of the second strand of *Myer* to the facts in *SP Investments*. First, in the very first sentence of the extract, Hill J appears to treat the requirement that the assigned income stream be derived from underlying property as an optional element of the second strand. It is strongly arguable this this requirement is an essential element of the second strand. Indeed, in the paragraph before that extracted above, Hill J said the decisive factor in *Henry Jones (IXL)* that led to the second strand applying was "…the retention by the assignor of the underlying property (the trademarks) from which the assigned royalties were derived."[87]

Secondly, Hill J appears to effectively elevate the assignor's retention of rights to income (quantum (only up to $75,000 per month) and period (7-years and three- months)) to underlying property. With respect, unassigned rights to income cannot amount to underlying property in the second strand sense. Indeed, Hill's analysis also seems to contradict the Full High Court's analysis in *Myer* of the assignment of a contractual right to receive interest. It was pointed out at length in that case that while the right to interest is an existing chose in action, the interest itself is not the produce of the mere contractual right to interest.[88]

Hill J's comment earlier in his judgment[89] that there is no difference in legal analysis between the assignment in *SP Investments* and the assignment in *Shepherd v FCT*[90] raises a number of questions. The statement of Hill J is correct in terms of the law of assignments, etc, in the sense that the assignments in both cases were of present property and not future property (mere expectancy) (and both were equitable assignments). However, if his Honour meant to equate or assert an analogy between the two assignments in terms of the second strand of *Myer*, it is respectfully submitted that this is problematic. *Shepherd* involved a voluntary assignment of a right to receive royalties under licence, whereby the assignor was attempting to alienate royalty income. Importantly, the taxpayer (alienator) in *Shepherd* retained the underlying property (patents over castors) from which the royalties were generated. The taxpayer in *SP Investments* did not have underlying property separate from the contractual rights to royalties.

Thirdly, Hill J's reference to the assignor's retention of the right to take action against the payer (miner) of the royalties also offers no support for retention of underlying property. This right to take action is no more than the legal machinery to ensure the payer makes payment and the assignee gets what they bargained for; this right cannot produce the royalty. The focus on this right, it is submitted, is either misguided or gives "disproportionate emphasis to the form of the transaction", the very thing Hill J counselled against in characterizing receipts under the second strand.[91]

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[86] *SP Investments Pty Limited (As Trustee of the LM Brennan Trust) v FCT* 93 ATC 4170 at 4182.
[87] *SP Investments Pty Limited (As Trustee of the LM Brennan Trust) v FCT* 93 ATC 4170 at 4182.
[88] *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4371.
[89] *SP Investments Pty Limited (As Trustee of the LM Brennan Trust) v FCT* 93 ATC 4170 at 4181.
[90] *Shepherd v FCT* (1965) 14 ATD 127.
[91] *SP Investments Pty Limited (As Trustee of the LM Brennan Trust) v FCT* 93 ATC 4170 at 4180-4182; *Henry Jones (IXL) Limited v FCT* 91 ATC 4663 at 4673.

In *SP Investments*, it is arguable that the second strand was stretched beyond its original intent or scope through its "discarding of" or "downplaying of" the underlying property requirement. This discarding/downplaying is evident in his Honour's significant focus on issues that have long concerned the compensation receipts principle, for example, purpose of lump sum was to fill the hole of lost royalties, citation of *Carapark Holdings Ltd v FCT* (mere loss of income case)[92] and the income conclusion is not based solely on consideration being computed or measured by reference to lost future income.[93] It is submitted that absent the application of the second strand, in light of the authorities, the income conclusion in *SP Investments* was not obvious.

It is submitted that if the second strand requires little or zero underlying property to survive in the ownership of the assignor after the assignment transaction, the harder it will be to put the second strand of *Myer*, even in part, on the foundational base as a return from property principle. Instead, the second strand would look much like the compensation receipts principle.

3.2.4 Gross sum received is the income (and assessable income) amount

Where the second strand of *Myer* applies to a sale of a right to receive income, the assessable income inclusion is the gross receipt received by the assignee. This is different to the first strand, where the profit from the transaction is the assessable income inclusion. There is no need that the receipt "shows a profit". In some circumstances, and *Myer* is one, the two amounts will be the same.[94]

3.2.5 Intention or purpose of taxpayer is irrelevant

The court in *Myer* appears to take the approach that the intention of the taxpayer in entering into the interlocked transactions is irrelevant in regard to the application of the second strand. The focus is solely on the underlying character of the right to receive income and its sale.

The Full Federal Court in S*P Investments*[95] applied the *Myer* second strand approach of focusing on the substance, rather than taxpayer intention, to determine the character of an assignment of part of a right to receive royalties. This approach made it clear that the consideration was received in substitution for the income assigned.[96] This income substitution approach is also known as the compensation receipts principle, whereby compensation for lost income is itself income.[97] Taxpayer intention would seem to have no role to play, the focus being on the role and function of the alleged compensation receipt.

If the traditional income foundation of the second strand is on the return from property principle, taxpayer purpose again should have no role.

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[92] *Carapark Holdings Ltd v FCT* (1967) 14 ATD 402.
[93] *SP Investments Pty Limited (As Trustee of the LM Brennan Trust) v FCT* 93 ATC 4170 at 4181-4182.
[94] The "same" conclusion is only accurate if the three days of interest received by Myer from Myer Finance is excluded from the profit calculation under the first strand, which it was.
[95] *SP Investments Pty Limited (As Trustee of the LM Brennan Trust) v FCT* 93 ATC 4170 at 4181.
[96] *SP Investments Pty Limited (As Trustee of The LM Brennan Trust) v FCT* 93 ATC 4170 at 4181.
[97] *Henry Jones (IXL) Limited v FCT* 91 ATC 4663 at 4675; *Commissioner of Taxes (Vic) v Phillips* (1936) 55 CLR 144; *Carapark Holdings Limited v FC of T* (1966-67) 115 CLR 653.

3.2.6 In the course of carrying on a business is not necessary

In *Henry Jones (IXL) Ltd v FCT*, Hill J left open (or was able to avoid) the question as to whether the operation of the second strand required the assignment to be in the course of operating a business. In that case, the taxpayer's assignment of the right to receive royalties was made in the course of its business of being a holding company.[98] However, in *SP Investments*, Hill J specifically addressed whether it was necessary for the operation of the second strand that the transaction occur in the course of carrying on business. Hill J "concluded that the second strand of *Myer* should not be seen to be so limited…."[99] Burchett and O'Loughlin JJ agreed with Hill J.

For completeness, it would seem to also follow that there would be no need for the taxpayer to be operating a business. Therefore, an assignment by a passive property income recipient who does not otherwise operate a business can fall within the second strand.

3.2.7 Cash basis of income derivation

It is likely that the sum received will be income when received by the taxpayer because the second strand will operate on the basis of the cash basis of income derivation. Given that the second strand is either a combination of a return from property situation and a compensation receipts principle situation, or one of those principles on a stand-alone basis, the cash basis would be consistent with the income derivation rules for passive income and/or the compensation receipts principle.[100] This should mean that where instalments are receivable for the sale of the right to income, each instalment should only be income when received.

4. Section 15-15 of the ITAA 1997

4.1 Overview

Section 15-15 includes in a taxpayer's assessable income a profit arising from the carrying on or carrying out of a profit-making undertaking or plan. It must be emphasized that s 15-15 is an assessable income inclusion provision quite independent from s 6-5 (ordinary income section).

However, s 15-15 does not apply where the profit is income on ordinary concepts (s 6-5).[101] Accordingly, s 15-15 gives priority of operation to s 6-5. Section 15-15 also does not apply to a profit in respect of the sale of property acquired after 19 September 1985.[102] It is debatable whether the assignment of a right to receive income from an underlying asset is likely to come within this exception.

4.2 History of the two limbs of the predecessor to s 15-15

It appears that the 1930 British case of *Jones v Leeming*[103] is what caused the introduction of a charging provision that contained an earlier version of s 15-15. In *Jones v Leeming*, the taxpayer purchased

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[98] *Henry Jones (IXL) Ltd v FCT* 91 ATC 4663 at 4675.
[99] *SP Investments Pty Limited (As Trustee of The LM Brennan Trust) v FCT* 93 ATC 4170 at 4182.
[100] *Heavy Minerals Pty Ltd v FCT* (1966) 14 ATD 282 at 286.
[101] Subsection 15-15(2((a).
[102] Subsection 15-15(2((b). The presence of s 15-15(2)(b) should not lead one to assume that the relevant profit on a post-CGT asset cannot be income under s 6-5.
[103] *Jones v Leeming* (1930) AC 415.

property (options) with the purpose of selling the property at a profit, and the taxpayer did make such a profit. It was held under the UK tax legislation that the profit was a non-taxable capital profit.

The Australian government was concerned that this decision could be followed by an Australian court when applying the income concept to an isolated transaction like the one in *Jones v Leeming*. One needs to appreciate that Australian federal income taxation was only 15-years old at the time of *Jones v Leeming*, and that Australian courts were then heavily influenced by UK court decisions. Accordingly, the government introduced s 16(ba) into the ITAA 1922-1930 (that later became s 26(a) of the ITAA 1936, and then s 25A of the ITAA 1936). Subsection 26(a) had two limbs.[104] It is important to note that these two limbs are not the two strands of *Myer*; the two strands of *Myer* are part of the ordinary income concept (now s 6-5). The two limbs under s 26(a) are (were) part of another [separate] assessable income provision.

The first limb included in a taxpayer's assessable income the profit arising from the sale of property acquired for the purpose of profit-making by sale. It was clear that the first limb was designed to "safeguard" Australia's income tax base against the adoption of a *Jones v Leeming* approach.[105] The first limb was repealed in 1998 (i.e. no longer exists).

The second limb (which is now s 15-15) included in a taxpayer's assessable income profit arising from the carrying on or carrying out of a profit-making undertaking or scheme.[106] The wording of the second limb was taken from the early cases involving the application of the ordinary income concept (income section) to isolated transactions where a profit was made.[107] In other words, there does not seem to be a compelling reason why the second limb was introduced because the second limb appeared to only legislate the ordinary income concept at the time.[108] However, given that the second limb is in an assessable income charging section separate from the income section, the courts had no choice but to interpret it and apply it to facts that arose.

4.3 Nature of the second limb (now s 15-15)

At the boundary, there are slightly differing judicial opinions as to the precise scope of the second limb, and none of those opinions are dominant. However, substantial similarity has been achieved in regard to most areas.

4.3.1 Section 15-15 is only for isolated transactions

Section 15-15 does not apply to transactions that are part of an ongoing business or continuing business.[109] The proceeds of such transactions would be dealt with under the income section. Therefore, s 15-15 is restricted to "isolated transactions".

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[104] While it is of no significance, we will refer to s 26(a), instead of s 16(ba) or s 25A, because s 26(a) was the provision operating at the time of *Myer*.

[105] See for example, *E K White v FCT* (1968) 15 ATD 89 at 101; *McClelland v FCT* 70 ATC 4115 at 4121; *FCT v Whitfords Beach Pty Ltd* 82 ATC 4031 at 4034 and 4040.

[106] The fact s 15-15 uses the word "plan" instead of "scheme", is of no significance.

[107] See *FCT v Whitfords Beach Pty Ltd* 82 ATC 4031 at 4035 and 4043 and the cases there cited.

[108] See *FCT v Whitfords Beach Pty Ltd* 82 ATC 4031 at 4035.

[109] *Investment and Merchant Finance Corporation Ltd v FCT* 71 ATC 4140 at 4142 and 4146-4147; *FCT v St Hubert's Island Pty Ltd* 78 ATC 4104 at 4114.

4.3.2 Purpose at time of entering transaction, extent of purpose, etc

Even though taxpayer purpose is not mentioned at all in the second limb, it is clear that taxpayer purpose is relevant. It is very likely that the second limb can only apply only where the taxpayer had a purpose of making a profit at the time of entry into the transaction (scheme).[110] While not completely clear, it looks like the required purpose need not be a dominant purpose.[111] It is likely that the test is a "not insignificant purpose". And, taxpayer purpose is to be determined subjectively.[112]

The purpose of the taxpayer must be to enter into or carry out profit-making undertaking or plan and which the pursuit of profit was an element. The realisation of a capital asset (structural asset), even in an enterprising way, will not satisfy this requirement. Therefore, the income-capital distinction is preserved in the second limb.

4.3.3 Transaction must be a business deal

The transaction must be a business deal.[113] It is submitted that the considerations above in determining whether a transaction is commercial or has the character of a business deal under the first strand of *Myer*, are equally relevant here.

4.3.4 Profits are taxed

Section 15-15 includes (taxes) the profit from a transaction in assessable income, and not just gross receipts.

4.3.5 Cash basis of "derivation"

It is submitted that the cash basis of assessable income recognition applies under s 15-15. There is nothing to suggest otherwise. The words, "profit arising from", in s 15-15 do not suggest the cash basis is not appropriate.

4.4 Concluding comment on s 15-15

While there is a small amount of doubt in some areas, the second limb looks very much like the first strand of *Myer* in that its essential elements are the same as or very similar to the essential elements of the first strand. There is considerable judicial support for the view that the income section (first strand of *Myer*) and the second limb (s 15-15), by and large, "cover the same ground". There are numerous isolated transaction cases where both the income conclusion and the second limb were held to apply. And, in the early days, Dixon J stated that the criterion that became the second limb was formulated by the courts under the income concept as a way of distinguishing capital profits from income profits.[114]

Given the above, it is submitted that s 15-15 has a very limited role, if any role at all today. The reason is that the scope of the second limb seems to be very similar to the scope of the first strand of *Myer*, and therefore transactions that fall within the second limb are very likely to be income anyway. And as

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[110] *XCO Pty Ltd v FCT* 71 ATC 4152 at 4155.
[111] *FCT v Bidencope* 78 ATC 4222 at 4234 (per Gibbs J). Note though that Gibbs J was in the minority in this case. See also *Crow v FCT* 88 ATC 4620 at 4626.
[112] *Macmine Pty Ltd v FCT; FCT v Macmine Pty Ltd* 79 ATC 4133 at 4140 and 4153.
[113] *McClelland v FCT* 70 ATC 4115 at 4120.
[114] *Premier Automatic Ticket Issuers Ltd v FCT* (1933) 2 ATD 383 at 393-394.

noted above, s 15-15 cannot apply when an amount is income.[115] Further, given that many profits from isolated transactions involve the purchase and sale of property, s 15-15 would be excluded from applying to these.

5. Double taxation, triple taxation and some other charging provisions[116]

5.1 Double taxation under the two strands in *Myer*

There is no guidance in *Myer*, or in the subsequent cases, on whether there is some ordering rule or ousting rule amongst the two strands of *Myer*. In other words, one does not initially apply the first strand, and then test application of the second strand; the two strands operate as independent charging criteria. Whether there should be an ordering rule or priority of operation rule is a complicated question. Some considerations are whether the taxable amount (income) is the same under the two strands and how the "balance of the transaction" is treated under the income tax more generally.

On the assumption that the taxable amount is the same under the two strands, where both strands of *Myer* apply to a transaction, which was the case on the facts in *Myer*, there is no legislative rule to prevent double taxation (double assessable income inclusion). It is submitted that s 6-25(1) does not assist with this as it appears to be dealing with two [separate] assessable income provisions (sections). That is not the case when the two strands of *Myer* apply to the one transaction. However, it is submitted that the judiciary will not permit (and the ATO will not seek) double taxation in these circumstances.[117]

5.2 Section 15-30

Briefly, even though s 15-30 is an [partial] expression of the compensation receipts principle, it is submitted that it will not apply to a transaction involving the assignment (sale) of a right to receive income. Section 15-30 includes in a taxpayer's assessable income an amount received by way of insurance or indemnity for the loss of an amount that would have been included in assessable income. The receipt by the assignor will not involve an amount received by way of insurance or indemnity, but rather by way solely of assignment.

In any event, s 15-30 does not apply where the income section applies.[118] This is effectively an ordering rule so that s 6-5 is to be tested for application first.

5.3 Section 102CA[119]

After the Full Federal Court decision in *Myer* (where it was held that the receipt/profit was not assessabe income),[120] s 102CA was introduced to ensure that receipts like the *Myer* receipt were included in assessable income. Given the High Court's second strand decision, s 102CA now seems superfluous. But, s 102CA is still in the legislation.

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[115] Subsection 15-15(2)(a).

[116] This article does not deal with the potential application of other regimes to the transaction in *Myer* (e.g. Division 16E in Part III of the ITAA 1936).

[117] See *Executor Trustee & Agency Co of SA Ltd v FCT* (1932) 2 ATD 35 at 44. See also *Richardson v FCT* (1932) 2 ATD 19 at 28. The two *Myer* strands problem is really the same as the double taxation problem that arises when an amount falls within two income "schedules" (principles), for example, as a return from property and as the proceeds of a business.

[118] Subsection 15-30(b).

[119] Section 102CA of the ITAA 1936.

[120] *FCT v The Myer Emporium Ltd* 85 ATC 4601.

Subsection 102CA(1) includes in a taxpayer's assessable income, the consideration received in return for the transfer of a right to receive income from property. Section 102CA could not apply in *Myer* because s 102CA had no retrospective operation (the facts in *Myer* occurred in 1981). However, if the facts occurred today where both the second strand and s 102CA(1) applied, s 6-25(1) would prevent double taxation and priority of operation is likely to go to s 102CA.[121] In saying this, there is no indication that the second strand of *Myer* somehow negates or excludes s 102CA from operating.

6. Conclusion

The key aim of this paper was to canvass the law regarding the two income strands of *Myer*, the relationship between those two strands and their relationship with a limited number of other charging provisions (assessable income provisions). The article asserts that the two strands of *Myer* are stand-alone charging provisions (even though both are elements of s 6-5). The article also examined the scope of s 15-15, and asserted that s 15-15 has little if any operation because its substantive elements are essentially the same as the first strand of *Myer*.

The article did not explicitly seek to articulate or assert the legacy of *Myer*, and in particular, whether *Myer* has broadened the income concept. However, it is hoped that the article provides some base from which a future examination(s) of the legacy of *Myer* can be undertaken, and whether the case has expanded the income concept.

End of Document

[121] Subsection 6-25(2), which gives priority to the assessable income provision aside from the income section.