

21 July 2006

Issue 31

**Commissioner loses share plan test case
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Despite 4 Federal Court judgments to the contrary, the Commissioner issued private binding rulings stating that the issuing of shares in ABC Learning Centres Limited (ABC) to the trustee of the Carers Share Plan will give rise to FBT liabilities for ABC or its licensees, the Regional Management Companies (RMCs). A company licensed with ABC as a licensed franchisee of childcare services, appealed against the rulings in the Federal Court.

In the resultant judgment in *Indooroopilly Children Services (Qld) Pty Ltd v FCT* [2006] FCA 734 (the *Indooroopilly* case), reported at 2006 WTB 26 [1118], Collier J of the Federal Court, in line with the ruling of Kiefel J in *Essenbourne Pty Ltd v FCT* (2002) 51 ATR 629, ruled that a benefit consisting of property provided to an employee share plan trustee in the absence of naming a particular employee as beneficiary in connection with the benefit provided to the trustee, is not a taxable 'fringe benefit' for the purposes of the definition in the *Fringe Benefits Tax Assessment 1986* (FBTAA).

The Commissioner's test case

The *Indooroopilly* case was a test case. The Commissioner entered into an arrangement under the ATO's test case litigation program, under which the Commissioner agreed to pay his own costs and the costs of the taxpayer.

The appeal was made by the applicant, Indooroopilly Children Services (Qld) Pty Ltd (Indooroopilly), against the objection decision made by the Commissioner under s 14ZY of the *Taxation Administration Act 1953* to disallow in full the taxpayer's objection against a private ruling, issued to the applicant for the years ended 31 March 2006 to 31 March 2011.

The ATO was of the view that the legal principles as originally enunciated by Kiefel J in *Essenbourne*, and consistently applied in 3 other Federal Court cases, were incorrect. The Commissioner confirmed that the views expressed in Taxation Ruling TR 1999/5 remained the ATO position, notwithstanding the decision in *Essenbourne*, and sought (unsuccessfully) to have the Federal Court reconsider the interpretation of 'fringe benefit' as originally articulated by Kiefel J in the *Essenbourne* case.

The Carers Share Plan

The participants in the Carers Share Plan (CSP) were employees of an RMC, who were registered as parties to an Australian Workplace Agreement (AWA) with an employer RMC; and held the positions of assistant, group leader, director or regional manager with an employer RMC. The amount and manner of shares issued to the CSP was determined by reference to a number of factors, including:

- the status of the RMC;
- the status of each employee;
- the number of RMC employees who held signed AWAs; and
- the length of service of the employees.

A key purpose of the CSP was to attract new staff from competitors to the RMCs.

Presumably, the specific exclusion from FBT contained sub-para (hb) of the definition of 'fringe benefit' in s 136(1) FBTAA would not apply to the proposed arrangement, because the participating employees were to be employees of the RMC licencees, rather than employees of a subsidiary company in the ABC group, issuing the shares to the plan trustee. Given

the increasing use of franchise and labour service contracts by Australian businesses, it is increasingly common for organisations and participants in share plans to fall outside of the requirement that the relevant plan shares be shares of the employer company or a holding company.

Government policy

The utilisation of the AWA process and incorporation into an employee equity participation plan would seem in line with the Federal Government's stated policy of:

- encouraging the use of AWAs in the workforce; and
- lifting the current level of employee equity participation from its current level of 5.9% to 11% over the next 3 years.

The *Indooroopilly* decision clears the way for the implementation of employee share plans, especially in unlisted companies, who need to utilise employee share trusts to protect and warehouse employees' share entitlements, and to provide a market for those employee shareholdings, as part of employee buyouts and succession planning, recommended in the Nelson Committee Report (refer Recommendation 5 of *Shared Endeavours: an inquiry into employee share ownership in Australia*, September 2000).

The decision of Collier J

In Collier J's view, the facts in the *Indooroopilly* case made Kiefel J's ruling in *Essenbourne* even more relevant and made the case of the taxpayer even stronger than it was in the *Essenbourne* case.

Collier J rejected the Commissioner's contention that ABC was the 'provider' of the fringe benefits to the trustee. She ruled that the 'provider' was the plan trustee who would be providing share benefits to the employees of Indooroopilly.

The fact that the trustee may have been an 'associate' of the participating employees, under the definition contained in s 26AAB (14) of the ITAA 1936, was ruled to be irrelevant. That is, irrelevant when

determining whether or not a fringe benefit had been provided by the provision of the property to the CSP trustee (refer paras 57 and 58 of the judgment).

This interpretation is on 'all fours' with Kiefel J's seminal ruling in the *Essenbourne* case.

Precedent

Collier J noted the decisions of Hill J in *Walstern Pty Ltd v FCT* (2004) 54 ATR 423, Kenny J in *Caelli Constructions (Vic) Pty Ltd v FCT* (2005) 60 ATR 542 and by Merkel J in *Spotlight Stores Pty Ltd v FCT* (2004) 55 ATR 745. She confirmed that she would follow the decisions in the *Essenbourne* and *Walstern* cases, notwithstanding the submissions of the Commissioner to the contrary.

Hill J in the *Walstern* case decisively and unambiguously agreed with the decision of Kiefel J in *Essenbourne* in respect of the FBT issues.

Hill J stated that the purpose of FBT is to provide a means of taxing benefits which are the substitute for income of a particular employee. At para 88 of *Walstern*, Hill J ruled as follows:

'It is not surprising that the legislation requires a link between the benefit and a particular employee (or associate of a particular employee) because historically the purpose of the *Fringe Benefits Tax Act 1986* (Cth) is to provide a specific means of taxing benefits which are a substitute for income to an employee and in respect of which the provisions of the ITAA 1936 and in particular s 26(e) were thought to be defective. Income tax is a tax upon the taxable income of a particular employee. While fringe benefits tax is a tax for which an employer is made liable and is payable at the maximum personal income tax rate, the theory of fringe benefits tax legislation is that it operates as a final withholding tax payable by the employer on amounts that essentially are or would be income of the employee.'

In any event, both Hill J in *Walstern* and Merkel J in *Spotlight* ruled that

they would have followed the decision of Kiefel J in the *Essenbourne* case, as a matter of judicial comity, unless they had formed the view that it was distinguishable or clearly wrong. Both judges believed the decision in *Essenbourne* to be correct and not distinguishable.

Similarly, Kenny J in the *Caelli Constructions* case (at para 61) stated that Kiefel J's ruling in *Essenbourne* '...correctly states the law on this point'.

Judicial comity

At para 51 of the *Indooroopilly* judgment, Collier J quotes the decision of French J in *Hicks v Minister For Immigration and Multicultural and Indigenous Affairs* [2003] FCR 757 at [76], where French J rules that the principle of 'comity',

'does not merely advance mutual politeness between judges of the same or co-ordinate jurisdictions. It tends also to hold the authority of the courts and confidence in the law by the value it places upon consistency in judicial decision-making and mutual respect between judges'.

There are now 5 rulings in the Federal Court which confirm that the contributions made to these types of trusts, in situations where there is no particular employee able to be identified in connection with the benefit at that particular time, will not be subject to FBT. That is, at the time the contributions of property are made to a plan trustee, the benefits to be provided under the terms of the governing trust deed are in respect of a range or class of potential participating employees, and there will be no FBT liability triggered in respect of those contributions.

Taxation Ruling TR 1999/5

Taxation Ruling TR 1999/5 (FBT: employee benefit trusts and non-complying superannuation funds - meaning of "associate" - property fringe benefits) has long been fraught with contention and doubt as to its correctness at law. Those issues have now been resolved by sagacious applications by the Courts of the general income tax anti-avoidance

provisions of Pt IVA (refer Merkel J's decision in *Spotlight* case) and the identification of fraud and evasion of income tax in the more "excessive" cases (refer Drummond J's ruling in *Kajewski v FCT* (2003) 52 ATR 455).

In most cases, the Tax Office has taken upon itself to ignore the application of TR 1999/5 and has not imposed FBT. For example, in Class Ruling CR 2004/113 concerning employer contributions to a construction industry workers' income protection fund, the Commissioner (correctly in my view) did not apply the views contained in TR 1999/5 and ruled that FBT would not apply to employer contributions to the plan trustee.

The Commissioner has also issued public advice that he will amend to nil FBT assessments on contributions to employee benefit trust arrangements, where both income tax and FBT assessments have been issued in respect of contributions to a plan trustee (refer '[Amendment to fringe benefits tax assessments for some employee benefit trust arrangements](#)' issued by the ATO on 28 February 2006, reported at 2006 WTB 9 [343]).

From a policy perspective, it seems absurd for the Commissioner to several times seek to have the Courts rule that a tax applies, be rejected on each occasion, and then to selectively apply that tax in any event in what might be considered an 'arbitrary exaction'. Could this even be considered an abuse of the taxation powers as a discretionary penalty, which in turn may bring into question the validity of FBT from a constitutional law perspective under s 51(ii) of the *Commonwealth Constitution* (refer *MacCormick v FCT* (1984) 15 ATR 437 and *DCT (Qld) v Truhold Benefit Pty Ltd (No 2)* (1985) 16 ATR 466)?

In what might be seen as only adding to the doubts surrounding Taxation Ruling TR 1999/5, it is respectfully suggested that a review of the testimonies of various senior ATO officers in [R v Petroulias](#)[2005] NSWCCA 75 (Supreme Court of NSW, Court of Criminal Appeal, Spigelman CJ, Mason P and Hunt AJA, 11 March 2005, Ref: 70076/2) reveals a disquiet with the tenor of the Ruling within the ATO itself.

Appeal lodged

The Commissioner has lodged an appeal to the Full Federal Court against Collier J's decision in the *Indooroopilly* case, as noted at para [1345] of this *Bulletin*.

Conclusion

To have the ATO pursue a course that appears detrimental to the Government's policy of raising employee equity participation, given consistent Federal Court rulings against that course, and thereby attempt to impose a double taxation on employee share benefits, is surprising.

There are now 5 decisions of the Federal Court which have decided against, and rendered nugatory, many of views of the ATO contained in Taxation Ruling TR 1999/5. Like ABC, most organisations wishing to implement an employee share plan, acting in the best interests of themselves and the participating employees, will seek tax rulings from the ATO. The Commissioner is obliged to follow the rule of law and issue those rulings in a timely manner according to the law as interpreted by the Courts; the ongoing efficacy of the self-assessment taxation system requires nothing less.

Hopefully, future private rulings of the ATO will be in accordance with current taxation law, in support of Government policy in respect of the furtherance of the various forms of employee equity throughout the Australian economy, and not seek to challenge settled, consistent and longstanding judicial interpretations of that law.

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