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**[318] The "astonishing" Indooroopilly case: The Commissioner must obey the law
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In unanimous findings of 3 judges in the Federal Court (Stone, Allsop and Edmonds JJ) in the recent *Indooroopilly Children Services (Qld) Pty Ltd* case, the Full Federal Court has confirmed the decision of Collier J, as a single judge in the Federal Court, that FBT would not apply to the provision of shares to the trustees of certain employee share plans. See the report of the case at 2007 WTB 8 [306].

The 3 judges were also critical of the Commissioner's "astonishing" submissions (at 45), that he does not have to obey the law as declared by the courts, until he gets a decision he likes.

The findings in the Full Federal Court judgment are contrary to the Commissioner's views expounded in Taxation Ruling TR 1999/5.

The facts and the decision by Collier J in the *Indooroopilly* case were canvassed in an earlier article at 2006 WTB 31 [1322]. Basically, *Indooroopilly* sought a private binding ruling that the provision of shares to a dedicated employee share trust would not render them liable to FBT. Ignoring a number of decisions of single judges in the Federal Court, the Commissioner ruled that *Indooroopilly* would be subject to FBT on provision of shares to the plan trustee.

The *Indooroopilly* case and the appeal against the earlier decision of the Federal Court was a test case under the Tax Office's test case litigation program, under which the Commissioner has agreed to pay his own costs and the costs of the taxpayer.

The Full Court's decision***Taxation issues***

The taxation reasons for the judgment were delivered solely by Edmonds J. Both Stone and Allsop JJ concurred with his reasons.

Edmonds J confirmed the views of Kiefel J in *Essenbourne Pty Ltd v FCT* (2002) 51 ATR 629 and Hill J in *Walstern Pty Ltd v FCT* (2004) 54 ATR 423 that, for a benefit to constitute a taxable fringe benefit, it was necessary that a particular beneficiary be identified as the employee and beneficiary to whom a benefit is provided.

Edmonds J went on to rule (at 36), that:

"...a benefit may only be a 'fringe benefit' if it is provided by one of four possible 'providers' to one of two possible 'recipients' - the employee or an 'associate' of the employee. Even then, the benefit will only be a fringe benefit if it is in respect of the employment of an employee."

Edmonds J (at 39), stated that:

"...one cannot discern any legislative policy on the part of the Government of the day to accelerate and bring to charge (by a tax (fringe benefits tax) on the employer) a benefit which the employee may never get as against a policy of deferring tax on the benefit unless and until it comes home to the employee, when it will be taxed in their hands as assessable income."

This decision of the Full Federal Court confirms the following 6 decisions of single judges in the Federal Court and a decision of the AAT - 7 in total:

- *Essenbourne Pty Ltd v FCT* (2002) 51 ATR 629;
- *Walstern Pty Ltd v FCT* (2004) 54 ATR 423;
- *Spotlight Stores Pty Ltd* (2004) 55 ATR 745;
- *Caelli Constructions (Vic) Pty Ltd* (2005) 60 ATR 542;
- *Indooroopilly Children's Services (Qld) Pty Ltd v FCT* (2006) 63 ATR 106;
- *Cameron Brae Pty Ltd v FCT* (2006) 63 ATR 488;
- *AAT Case [2006] AATA 976, Re Benstead Services Pty Ltd and FCT.*

Other administrative issues

Edmonds and Allsop JJ (with the concurrence of Stone J) were especially critical of the Commissioner's disregard for the rule of law, as enunciated by the properly constituted courts of Australia.

As a part of his judgment, Edmonds J made particular reference to 3 submissions of the Commissioner (at 44), made in support of his maintenance of views about the provision of a taxable "fringe benefit" as expressed in TR 1999/5, which were contrary to Kiefel J's views in the *Essenbourne* case. The Commissioner's submissions stated that:

- "...the Commissioner was not compelled to follow *Essenbourne* and the other single judge decisions when he ruled on the respondent's ruling application or when he determined the objection against the ruling which was made."
- "...the fact that there are single judge decisions on the meaning of the definition of 'fringe benefit' does not mean that the Commissioner was bound to follow those decisions as against taxpayers who were not privy to those decisions."
- "...there is no principle of estoppel that would bind the Commissioner to apply the single judge decisions to which the respondent was not a party, in relation to the application

of the FBT Act to the arrangement the subject of the respondent's ruling request."

Edmonds J (at 45), dismissed those submissions, stating that:

"...a proposition that the Commissioner does not have to obey the law declared by the Courts until he gets a decision that he likes was astonishing...".

Edmonds J went on to state (at 47) that:

"...it was incumbent on the Commissioner...either to follow the construction embraced in those cases [ie *Essenbourne*, *Walstern*, *Spotlight*] or seek a declaration from the Court as to the proper construction and to apply that construction in the ruling."

Edmonds J (at 48) agreed with the comments of Allsop J, which are summarised below.

Judgment of Allsop J

As mentioned above, Allsop J concurred with the findings of Edmonds J. However, Allsop J provided strong and meaningful commentary on how the taxation laws should be administered, according to the rule of law as interpreted by the properly constituted Courts of Australia.

Allsop J (at 3) made the following statements, critical of the Commissioner and his administration of the taxation laws, in respect of the matters covered in this case:

- "From the material that was put to the Full Court, it was open to conclude that the appellant was administering the relevant revenue statute in a way known to be contrary to how this Court had declared the meaning of that statute."
- "Thus, taxpayers appeared to be in the position of seeing a superior court of record in the exercise of federal jurisdiction declaring the meaning and proper content of a law of the Parliament, but the executive branch of the government, in the form of the Australian Taxation Office, administering the statute in a manner contrary to the meaning and content as declared by the Court; that is, seeing the executive branch of government ignoring the views of the judicial branch of government in the administration of a law of the Parliament by the former. This should not have occurred".

Allsop J (at 4) states that:

"it is the function of the courts exercising federal jurisdiction to declare the meaning of statutes of the Commonwealth Parliament in the resolution or quelling of controversies."

He quotes with approval Marchall CJ, in the benchmark American case, *Marbury v Madison* 5 US 87 at 111 (1803), who stated that:

"It is, emphatically, the province and duty of the judicial department to say what the law is".

Allsop J (at 5) acknowledges that:

"This passage has been recognised as central to the administration of justice and to the relationship between the judiciary and executive in this country:"

Inspector-General of Taxation vindicated

These decisions, amongst other things, appear to strongly support the comments critical of the Tax Office's refusal to give effect to the decisions of the Federal Court, made by Mr David Vos, the Inspector-General of Taxation, in his *Review of Tax Office Management of Pt IVC litigation*: see 2006 WTB 41 [1748].

The Inspector-General, in that report (at 2.29), stated that by not following court decisions, the Commissioner was:

"undermining the communities' confidence in the tax litigation process and the Tax Office's administration generally."

Government policy

The utilisation of the Australian Workplace Agreement (AWA) process and incorporation into an employee equity participation plan, as was the arrangement proposed in the *Indooroopilly* case, would seem firmly in line with the Federal Government's stated policy of:

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

I believe many would also find the behaviour of the Commissioner, in respect of the administration of the taxation laws applying to these matters, truly astonishing. With due respect to all concerned, how the Commissioner could expect to go against the courts' rule of law and attempt to subject a legitimate and commendable employee share plan arrangement to double, and possibly triple taxation, is beyond comprehension.

The way forward

For employees and their employers, the *Indooroopilly* decision finally clears the way for the implementation of employee share plans. This is especially the case for 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, as recommended in the Nelson Committee Report (refer to Recommendation 5 of *Shared Endeavours; an inquiry into employee share ownership in Australia*, September 2000).

Commissioner's response

On Friday, 23 February 2007, the Commissioner issued a response to the decision of the Full Federal Court in the *Indooroopilly* case, stating that:

- he will not seek to appeal the decision; and
- the Tax Office will review outstanding employee benefit arrangements and modify Ruling TR 1999/5 to take account of the Court's decision.

It is good to see the Commissioner finally conceding those issues and agreeing to abide by the rule of law in respect of those matters. However, this does little to rectify the Commissioner's disregard for the rule of law in respect of these, and other taxation matters, over extended periods of time. It also does nothing to ameliorate the damage done to businesses, business owners, their employees, their families and other Government agencies, in pursuit of legitimate and legal business activities, and the achievement of the government's policies.

Conclusion

The most disturbing aspect of this process has been the contravention by the Commissioner of clear decisions of judges of the Federal Court and Members of the AAT, in the administration of the Commonwealth's taxation laws. It is acknowledged that the Commissioner does have to administer the tax laws and collect the revenue, and will, in those endeavours, form views as to the application of various tax laws and, from time to time, test those views in the courts. He may not always agree with the decisions of the courts but, as noted in the judgment, he has other avenues available to him. However, to undertake a campaign that militates against the provision of equity to employees in line with the Government's aim of doubling the level of employee equity participation in Australian businesses over the 5-year period, 2004 to 2009, is indeed "astonishing"!

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