Administrative Appeals Tribunal

DECISION AND REASONS FOR DECISION

RGGW and Commissioner of Taxation (Taxation) [2017] AATA 238 (20 February 2017)

Division: TAXATION & COMMERCIAL DIVISION

File Number(s): **2015/4095, 2015/4096, 2015/4097, 2015/4098, 2015/4099, 2015/4100, 2015/4101, 2015/4102**

Re: **RGGW**

APPLICANT

And **Commissioner of Taxation**

RESPONDENT

DECISION

Tribunal: **Deputy President S E Frost**

Date: **20 February 2017**

Place: **Sydney**

1. The objection decisions in relation to the income tax assessments are affirmed.

2. The objection decisions in relation to administrative penalty (or, for the 1996 to 2000 years, additional tax) are set aside. Instead the objections are allowed in part, so as to reflect the Tribunal's findings that:

   (a) the shortfalls resulted from recklessness;

   (b) ss 226X and 226Z of the *Income Tax Assessment Act 1936* apply for the income years 1997 to 2000;

   (c) ss 284-220(1)(c), 284-225(2) and 284-225(3)(a) in Schedule 1 to the *Taxation Administration Act 1953* apply for the income years 2001 to 2003.

.....[sgd].....

Deputy President S E Frost

Catchwords

TAXATION – carry forward losses – whether tax losses available – continuity of ownership – multiple formulations of test – continuity of ownership period – same business test – same business test period – complex family corporate structure – tax shortfalls – intentional disregard – recklessness – objection decisions in relation to income tax assessments affirmed – objection decisions in relation to administrative penalty set aside

Legislation

Income Tax Assessment Act 1936 ss 79E(3)(c), 80A(2)-(3), 80E(1)(b), 226H, 226J, 226X, 226Z, 227(3)

Income Tax Assessment Act 1997 ss 162-12(1), (5), (6), 165-13(2), 165-150(1), 165-155(1), 165-160(1), 165-165

Taxation Administration Act 1953 ss 14ZZK, 220(1)(c), 284-85(2), 284-90(1), 284-220(1)(c), 284-225(2), (3)(a), 298-20

Cases

Avondale Motors (Parts) Pty Ltd v Commissioner of Taxation (1971) 124 CLR 97

BRK (Bris) Pty Ltd v Commissioner of Taxation [2001] FCA 164

Nixon v Federal Commissioner of Taxation 79 ATC 4377

Price Street Professional Centre Pty Ltd v Commissioner of Taxation [2007] FCA 345

REASONS FOR DECISION

Deputy President S E Frost

20 February 2017

INTRODUCTION

1. This is a case about carry forward prior year tax losses.

2. The Applicant was a 50% partner in a **Partnership** that was established to develop a shopping centre in suburban Sydney. By the time the development was completed, the combination of increasing interest rates, overruns in the cost of development and the receipt of lower than expected rental income from tenants put the Partnership in a parlous financial position. The end result was the appointment of a receiver and manager to the Partnership and the placing of the Applicant into administration.

3. The Applicant claims that the Partnership incurred tax losses at least during the tax years 1990 to 1995, and that the Applicant's share of those tax losses is something in excess of $25 million.

4. During the tax years 1996 to 2003 inclusive (the **relevant years**) the Applicant lodged tax returns which, disregarding the tax losses claimed, declared positive taxable income on which income tax would ordinarily be payable. However, because of the tax losses the Applicant claimed were available to it, the tax liability that would otherwise have arisen in each of those years was extinguished.

5. The Commissioner did not accept the claims for the tax losses; not only were assessments made on the basis that the losses were not allowable, but administrative penalty was imposed as well. The Applicant objected against the various assessments but the objections were disallowed. The Tribunal is now asked to review the objection decisions.

6. I have decided to affirm the objection decisions in relation to the income tax assessments but to reduce the amounts of administrative penalty. My reasons follow.

THE ISSUES

7. Apart from the question of administrative penalty, there are three broad issues for determination:

   - whether tax losses are available to the Applicant through application of the **continuity of ownership test**;

- whether, in the alternative, tax losses are available to the Applicant through application of the **same business test**;
- whether, assuming losses are available, the Applicant has established the quantum of its entitlement.

8. The taxpayer bears the burden of proving the assessments are excessive: s 14ZZK of the *Taxation Administration Act 1953* (**TAA**).

CONTINUITY OF OWNERSHIP TEST

9. There are two different formulations of the continuity of ownership test across the relevant years.

10. The first one, found in s 80A of the *Income Tax Assessment Act 1936* (the **1936 Act**), applies in respect of the 1996 and 1997 tax years. This formulation calls for an analysis of the beneficial ownership of shares in two different tax years – the year in which the loss was incurred (**loss year**), and the year in which the loss is claimed as a deduction (**income year**). That analysis must satisfy the Commissioner (or the Tribunal on review) that, at all times during both of those years, the same persons beneficially owned shares in the company carrying between them:

- the right to exercise more than one-half of the voting power in the company;
- the right to receive more than one-half of any dividends that may be paid by the company; and
- the right to receive more than one-half of any distribution of capital of the company.

11. The continuity of ownership test may also be satisfied by tracing indirect interests held by individual natural persons through interposed companies, trustees and partnerships: s 80A(2) and (3) of the 1936 Act.

12. The second formulation is found in s 165-12 of the *Income Tax Assessment Act 1997* (the **1997 Act**), and applies in respect of the 1998 and later years. This formulation introduces the concept of the **ownership test period**, which is specified in s 165-12(1) to be the period from the start of the loss year, to the end of the income year in question. To come

within this formulation there must be persons who, at all times during the ownership test period, had:

- more than 50% of the voting power in the company;
- rights to more than 50% of the company's dividends; and
- rights to more than 50% of the company's capital distributions.

13. To determine if s 165-12 is satisfied at all times during the ownership test period, s 165-12(5) requires the **primary test** to be applied, unless s 165-12(6) requires the **alternative test** to be applied.

14. The primary test requires that at all relevant times there are persons who beneficially own between them shares that carry between them the right to exercise more than 50% of the voting power, the rights to more than 50% of the company's dividends and the rights to more than 50% of the company's capital distributions: ss 165-150(1), 165-155(1) and 165-160(1) of the 1997 Act.

15. The alternative test requires at all relevant times that there are, or it is reasonable to assume that there are, persons (none of them companies or, in some cases, trustees) who between them (whether directly, or indirectly through one or more interposed entities) control or are able to control the voting power in the company, have the right to receive for their own benefit more than 50% of any dividends that the company may pay, and have the right to receive for their own benefit more than 50% of any distributions of capital of the company.

16. While the broad test in each of the 1936 Act and the 1997 Act – more than 50% voting power, rights to more than 50% of dividends and rights to more than 50% of capital distributions – is the same, under the 1997 Act the continuity of ownership is required not only in the loss year and the income year, but in all the intervening years as well.

17. Furthermore, s 165-165(1) of the 1997 Act currently says that in tracing ownership from the loss year to the income year, interests cannot be taken into account unless they are 'exactly the same interests and are beneficially owned by the same persons'. The current

s 165-165 was introduced by Act No. 89 of 2000.[1] Like its predecessor, which was introduced by Act No. 169 of 1999 (the **1999 amendment**),[2] it applies to 'tax losses […] or deductions claimed in a return for a year of income ending after 21 September 1999'[3] (which, in the Applicant's case, means the return for the 2000 year and any subsequent year). However, for any returns prior to that – in other words, those for the 1998 and 1999 years – the previous s 165-165 applied. It provided in subsection (1):

> *A person need not beneficially own exactly the same shares at all times during the ownership test period for the primary test for a condition to be satisfied.*

18. The Applicant submits in its Written Submissions in Reply, at [7]-[12], that to apply the post-1999 amendment version of s 165-165 to any events that occurred well before the passage of the 1997 Act would amount to an impermissible retrospective operation of the law. I reject this submission. Whatever presumption there may be against the retrospective operation of legislation, such a presumption is rebutted where there is a clear legislative intention to the contrary. Here, the clear legislative intention is expressed in the 'application' provisions referred to in [17] above.

Ownership

19. The Applicant sat within a very complex family corporate structure which, for convenience, I will refer to as the **Marshall Group**.[4] In broad terms the Marshall Group is owned by the Marshall family. The patriarch of the Marshall family is Ronald Marshall.

20. Two simplified charts which are said to trace ownership of the companies within the Group – one chart (**Chart 1**) setting out the ownership prior to 20 December 1994, and one (**Chart 2**) covering the period from 20 December 1994 onwards – have been provided to the Tribunal at pages 1 and 2 of Exhibit A8.[5] The date 20 December 1994 is significant since it is the date of a **Share Sale Agreement** under which **C2** Limited (in liquidation)

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[1] *New Business Tax System (Miscellaneous) Act (No. 2) 2000*

[2] *New Business Tax System (Integrity and Other Measures) Act 1999*

[3] See Act No. 169 of 1999, Schedule 6, item 16, and Act No. 89 of 2000, Schedule 1 – Part 1, item 22, and Schedule 1 – Part 3, item 68(2).

[4] The hearing of these applications was conducted in private under s 14ZZE of the TAA. I am obliged by s 43 of the *Administrative Appeals Tribunal Act 1975*, as modified by s 14ZZJ of the TAA, to ensure, as far as practicable, that these reasons for decision are framed so as not to be likely to enable the identification of the Applicant. I have therefore allocated pseudonyms to the family, to the corporate group, and to any companies or individuals referred to in these reasons.

[5] Similar charts, but with more detail, are found at Tab S2 of Exhibit A3

sold its shares in **C1** Limited to **V1** Pty Ltd.[6] Prior to that sale, C1 owned 100% of the shares in the Applicant; the shareholders of C1 were C2 and C2's wholly-owned subsidiary **K1** Pty Ltd (as to 50% each). After the sale, according to Chart 2, the Applicant's owner became **D1** Pty Ltd, a wholly-owned subsidiary of V1.

The 1960 Trusts

21. Included in the ownership structure are several trusts for the benefit of various members of the Marshall family. Six of these trusts were settled in 1960 (the **1960 Trusts**). The trust deeds[7] are in almost identical terms, save for the beneficiaries named in each of them – the children of Ronald Marshall (at the time there were three – Harry, Oliver and Zara (who took the married name Campbell)). The trustees in each case are Ronald Marshall and his then wife, Irene. Each of the children is named as the beneficiary in two of the trust deeds, although one deed for each child has half of the income and capital vesting in that child at the age of 28 and the remaining half at the age of 35, while the other deed specifies the ages of 25 and 30.[8]

22. In 1969 each of the trust deeds for the 1960 Trusts was amended, so as to grant to Ronald Marshall the power to remove any trustee and to appoint new trustees.[9] That power was exercised, so that from March 1969 Irene Marshall was removed as a trustee and replaced by three individuals who were not members of the Marshall family. Ronald Marshall remained a trustee of each of the 1960 Trusts.[10]

23. Harry Marshall, one of the children of Ronald and Irene, says he has a 'clear recollection' that 'the original trustees of the 1960 Trusts were replaced by [**V3** Pty Ltd], the directors of which were then [Ronald Marshall] and [Harry Marshall]'. However, it is quite clear from the Deed of Appointment of New Trustees[11] that one of the original trustees of the 1960 Trusts had already been replaced in 1969, as detailed above. To that extent, therefore, Harry Marshall's recollection is faulty. Nevertheless, even if I take his statement to mean that the substituted trustees were replaced by V3, he does not say when that occurred or

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[6] Exhibit A2, Tab V25
[7] Tabs V29 to V34 of Exhibit A1
[8] Clause 4(d) of each deed
[9] Tabs S7 and S9 of Exhibit A3
[10] Tab S8 of Exhibit A3
[11] Tab S8 of Exhibit A3

the mechanism by which it occurred. He did acknowledge that some of the material relating to the 1960 Trusts could not be located.[12]

24. Harry said that in about December 1995, V3 was replaced as trustee of the 1960 Trusts by **V2** Pty Ltd, but again, the relevant documentation could not be located.[13]

The 1990 Trust

25. Next there is the **1990 No. 1 Trust**, which was made on 4 December 1990. Neither the original Deed nor a complete copy of it has been located. Amendments were made to the Deed in October 1995. There is an incomplete version of what is claimed to be a copy of the original Deed, with handwritten deletions and amendments on it,[14] from which I am invited to infer the terms of the original. A very significant omission from the incomplete document is a large part of clause 3.1, the very clause specifying the terms on which the Trust Fund and any income earned on it are to be held. The document does, however, contain references to both Ronald Marshall's first wife, Irene, and his second wife, Marion, in a way that suggests some provision was made for each of them.

26. The 1995 amendments appear to have removed all references to Harry, Irene and Marion and to result in the Trust Fund being held on trust:

- as to one-third for Oliver Marshall's 'beneficiaries' (in practical terms, Oliver and his extended family);
- as to one-third for Zara Campbell's 'beneficiaries' (in practical terms, Zara and her extended family); and
- as to one-third for Ronald Marshall's 'beneficiaries' (in practical terms, Ronald and his extended family).

27. The Applicant says that the original trustee of the 1990 No. 1 Trust was V3, but that after the 1995 amendments the trustee was V2. Harry Marshall was a director of V3 until 17 August 1995,[15] and a director of V2 until 28 April 1994.[16]

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[12] Exhibit A1 at [22]
[13] Exhibit A1 at [24]
[14] Tab V35 of Exhibit A1
[15] Tab V27B of Exhibit A2

The ownership of shares in V3

28. Harry Marshall gave evidence that the Marshall Group was adversely affected by the economic recession of the early 1990s and that there was a concern that personal guarantees given by his father might be called upon, owing to loan defaults. Therefore, as 'part of the process of protecting the interests of the [Marshall] Family', two solicitors who had acted for the Marshall family over the years:

> *agreed to hold the legal interest in the issued shares of [V3] and some other companies. All such shares held [by those individuals] were beneficially owned by members of the [Marshall] family and not by them or either of them. Whatever may be shown in the records of ASIC (which apparently shows them each beneficially owning one share each in the capital of [V3]), at no time did they (or either of them) beneficially own shares in [V3] …*[17]

29. One of those solicitors (the other is now deceased) swore an affidavit on 14 March 2016[18] which included the following:

> *Although I was the legal owner of one share in [V3], the share was held by me in trust, as a nominee of [Ronald Marshall] and family, and at no stage was I the beneficial owner of the share.*
>
> *To the best of my knowledge and belief, [the second solicitor] also held one share in [V3] in trust, as a nominee of [Ronald Marshall] and his family and never beneficially owned the share held in his name.*

30. The affidavit contains no reference to a timeframe within which the shares were so held (it simply says 'I was a shareholder of [V3]').[19] The annual return of V3 for 1993[20] notes, as Harry Marshall indicated, and contrary to the content of the solicitor's affidavit, that both shares were held beneficially by the two solicitors at 30 June 1993.

The 1995 Trusts

31. Additional trusts were established in October 1995 (the **1995 Trusts**), with **F1** Pty Ltd as trustee. They are in materially identical form to each other. One of the trusts is the

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[16] Tab 14 of Exhibit A2
[17] Exhibit A1 at [19]
[18] Exhibit A5
[19] Exhibit A5 at [4]
[20] Tab AR7 of Exhibit A8

Marshall Family Trust, for the benefit of Ronald Marshall. The second is the Campbell Family Trust and the third is the O Marshall Family Trust.

32. Harry Marshall said in his oral evidence that 'no-one outside the family[21] got any benefit' from any of the trusts 'established for the various members of the [Marshall] family' but he accepted that in respect of any trustee resolutions that were made for the purposes of the 1960 Trusts or the 1990 No. 1 Trust after his period of directorship of V2 or V3, his knowledge was based on his 'general idea of what went on afterwards'[22] and on whatever he was told by the directors from time to time. He was not asked any specific questions about the 1995 Trusts but he was never a director of F1 anyway so he could not have had first-hand knowledge of the affairs of those trusts.

What the Charts say about ownership of other companies in the Group

33. Immediately prior to the Share Sale Agreement, according to Chart 1, V3 owned 92% of the shares (92 out of a total of 100) in **S1** Ltd. The remaining eight shares in S1 were owned by **Marshall Holdings** Pty Ltd (five shares), and by Ronald Marshall, Harry Marshall and Harry's wife Ursula (one share each). S1, in turn, owned 61.7% of the shares in C2. C2, it will be recalled, owned 50% of the shares in C1, which owned all the shares in the Applicant. The remaining 38.3% of the shares in C2 were owned by **L1** Pty Ltd.

34. After the Share Sale Agreement, according to Chart 2, all of those companies – Marshall Holdings, S1, V3, C1, C2 and L1 – disappeared from the structure. V1 (which owned D1, the owner of the Applicant) became owned by F1 (purportedly as trustee of the 1995 Trusts) to the extent of 200,000 shares, and by V2 (purportedly as trustee of the 1960 Trusts and the 1990 No. 1 Trust) to the extent of 1,000 shares. Curiously, it was not until 23 October 1995 that F1 asked V1 to issue a total of 200,000 shares to it (in three separate parcels).[23] Therefore, that part of the structure of Chart 2 dealing with F1 and the holdings beneath it cannot represent the state of affairs immediately after implementation of the Share Sale Agreement.

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[21] The 'family' was identified as Harry himself, his father Ronald, his brother Oliver, his sister Zara Campbell (nee Marshall), and members of their families. Audio 25 July 10:39:30

[22] Audio 25 July 10:42:30

[23] Tab S10 of Exhibit A3

Consideration of the continuity of ownership test

35. The continuity of ownership question needs to be considered separately for the following groups of income years:

- the 1996 and 1997 years, where the test is found in s 80A of the 1936 Act;
- the 1998 and 1999 years, where the test is found in s 165-12 of the 1997 Act (without the further restrictive requirement in the current s 165-165[24]); and
- the 2000 to 2003 years, where the test is found in s 165-12 of the 1997 Act, but subject to the requirement in the current s 165-165.

36. The last of those groups, the 2000 to 2003 income years, can be disposed of briefly. A simple comparison of Chart 1 with Chart 2 reveals that the current version of s 165-165[25] cannot be satisfied for those years, because whatever interests were held by the various members of the Marshall family during any of the loss years (although to some extent that must be the subject of speculation or assumption – see [38] below) are fundamentally different from interests held in any of the 2000 to 2003 income years.

37. Turning then to the 1996 and 1997 years, the requirement for each of those income years is that the Tribunal be satisfied that the same people have the requisite level of beneficial ownership throughout the income year as throughout the loss year. Since any losses that are available must be taken into account in the order in which they were incurred (s 79E(3)(c) of the 1936 Act), the first loss year to consider is the 1990 year.

38. Logically, the starting point for this particular enquiry is the ownership position at the beginning of the 1990 year – and that is where the difficulty arises. Charts 1 and 2 focus on the position immediately before, and immediately after, the Share Sale Agreement dated December 1994. They do not say anything at all about the position five and a half years earlier, when the 1990 financial year commenced.

39. Nevertheless, let me assume for a moment (in the Applicant's favour) that the structure as at 1 July 1989 is the same as is depicted in Chart 1 as at December 1994. One part of

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[24] See [17] of these reasons
[25] See [17]-[18] of these reasons

the ownership chain is traced through L1 and Marshall Holdings. Marshall Holdings was deregistered, and ceased to exist, on 28 August 1995 – which is during the 1996 year.[26] The Commissioner submits, and I agree, that this particular part of the chain of ownership cannot be relied on by the Applicant.

40. That leaves for consideration the alternative part of the chain of ownership through V3 and the various trusts of which it is claimed to have been the trustee. On this side of Chart 1 it is said that V3, as trustee of the 1960 Trusts and the 1990 No. 1 Trust, owned 92 of the 100 shares in S1. Since S1 owned 61.7% of the shares in C2, the arithmetic for the holdings of the Marshall family members who are beneficiaries of the trusts would be 61.7% x 92% = 56.76%.

41. However, it is quite clear that V3's 92% shareholding in S1 (as depicted in Chart 1) was not in place until some time during the 1993 financial year. I draw that conclusion because the claimed shareholding is not reflected in any documentation prior to the 1993 annual return for S1 – where V3 is reported to be the non-beneficial owner of 92 of the 100 shares on issue.[27] In contrast, the 1992 annual return for S1[28] shows V3 holding only five shares (and beneficially at that), with Marshall Holdings also holding five shares (also beneficially), and Ronald, Harry and Ursula Marshall holding one each. (Inexplicably, Note 8 to the accounts for S1 for the year ended 30 June 1992[29] shows only five shares on issue – so the position prior to the 1993 financial year is anything but clear. And there is no documentation at all regarding the shareholding throughout, or even at any time during, the 1990 financial year.)

42. Given the uncertainty as to the beneficial ownership in the 1990 loss year (owing to the gaps in the documentation and the vagueness of the witness statements and oral evidence), I am not satisfied that continuity of ownership is established between that year and either the 1996 or 1997 income year. I reach the same conclusion in respect of the 1998 and 1999 income years, bearing in mind the more stringent requirement under the 1997 Act that the continuity of ownership must be established not only for the loss year and the income year but in all the intervening years as well.

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[26] Tab V16 of Exhibit A2
[27] Tab AR2 of Exhibit A8
[28] T37-445
[29] T37-455

43. That means that any losses incurred in the 1990 financial year cannot be taken into account in any of the 1996 to 1999 income years.

44. The uncertain ownership position in 1990 continues through at least until the point during the 1993 year when V3 became the non-beneficial owner of the 92 shares in S1. So, for the same reasons as for 1990, any losses incurred in the 1991, 1992 or 1993 financial years cannot be taken into account in any of the 1996 to 1999 income years.

45. The final loss years that need to be considered are 1994 and 1995. For these two years a favourable outcome for the Applicant depends on my acceptance that:

- V3 (or, later, V2) was the trustee of the 1960 Trusts;
- prior to the Share Sale Agreement in December 1994, V3 held the shares in S1 on trust for the 1960 Trusts and the 1990 No. 1 Trust; and
- after the Share Sale agreement, V2 held the shares in V1 on trust for the 1960 Trusts and the 1990 No. 1 Trust.

46. The documentary support for any of those propositions is strikingly absent. For that reason I cannot accept that continuity of ownership is established between either of the claimed loss years of 1994 and 1995 and any of the 1996 to 1999 income years.

47. The Applicant says the burden it bears under s 14ZZK of the TAA does not place 'a weight upon the taxpayer similar to that placed upon Atlas, who carried the whole weight of the heavens as well as the globe of the earth upon his shoulders', quoting David Hunt J in *Nixon v Federal Commissioner of Taxation* 79 ATC 4377 at 4381.[30] Be that as it may, s 14ZZK does not excuse a taxpayer from the obligation to make good its case on some satisfactory basis other than speculation, guesswork or corner-cutting. Even allowing for the fact that the first claimed loss year (1990) is now over a quarter of a century ago, it is surely not unreasonable to expect that a case put forward in support of tax losses of almost $5 million should be supported by more than assertions and broad-brush submissions. As the Commissioner noted, the Applicant was part of a large and sophisticated corporate group that would have been expected to keep proper accounting and corporate records. That it did not do so is not explained away by the effluxion of time.

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[30] Applicant's Written Submissions in Reply at [35]

48. I therefore conclude that none of the losses are available under the continuity of ownership test.

SAME BUSINESS TEST

49. Once again there are two different statutory formulations to consider.

50. The first one, found in s 80E of the 1936 Act, applies in respect of the 1996 and 1997 tax years. Section 80E provides that, if the continuity of ownership test is not satisfied by reason of a change in beneficial ownership of shares in the loss company or some other company, the losses can still be taken into account provided:

- at all times during the income year, the loss company carried on the same business as it carried on immediately before the change took place; and
- the loss company did not at any time during the income year derive income from a business of a kind that it did not carry on, or from a transaction of a kind that it had not entered into in the course of its business operations, before the change took place.

51. I pause here to note that the availability of s 80E may not have been triggered in any event since it is not clear that the failure to satisfy the continuity of ownership test is 'by reason of a change in beneficial ownership of shares'.

52. The second formulation is found in s 165-13 of the 1997 Act, and applies in respect of the 1998 and later years. Under this provision, a company satisfies the same business test if, throughout the **same business test period** (the income year in which the tax loss is to be claimed), the company carried on the same business as it carried on immediately before the **test time**: s 165-13(2). If it is the case that item 1 in the table in s 165-13(2) applies, then the test time is the latest time it is possible to satisfy the continuity of ownership test before it is failed. If item 1 in the table does not apply then the test time is the start of the loss year. The Applicant has not made any submission as to whether item 1 in the table does or does not apply to its circumstances, and as a result it is difficult to fix upon a test time with any degree of comfort.

53. Despite the uncertainties identified in the two preceding paragraphs, and approaching the issue on a substantive basis, the evidence does not support the availability of the same business test on either formulation.

Activities in the loss years (up to and including the 1995 financial year)

54. The Applicant notes that its Memorandum of Association gave it all the powers of a natural person and the power to do any act authorised by law.[31] But that is of little significance; the more important question is: what did it actually do?

55. The directors' report for each of the years ended 30 June 1991[32] and 30 June 1992[33] includes the following statement:

> *The principal activity of the company is investment in [the] Partnership which is involved in the development of a site for the purpose of constructing a [shopping centre] and other commercial buildings.*

56. The text changed slightly in 1993[34] to read as follows:

> *The principal activity of the company is investment in [the] Partnership which developed a [shopping centre] and other commercial buildings for sale.*

57. The notes to the accounts of the Applicant for the year ended 30 June 1991[35] indicate as follows:

> *The principal activity of the company is property acquisition, development and investment.*

58. But in the two following years the description had changed to the following[36]:

> *The principle (sic) activity of the company is property development.*

59. The shopping centre was sold in August 1993.[37] As far as I can tell, that left the Applicant with no assets. There is no evidence that any business activity was carried on after the

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[31] Tab V40 of Exhibit A1
[32] Tab V44 of Exhibit A1
[33] Tab V45 of Exhibit A1
[34] Tab V46 of Exhibit A1
[35] Note 8 to the accounts, Tab V44 of Exhibit A1
[36] Note 6 to the accounts, Tab V45 of Exhibit A1 (1992); Note 6 to the accounts, Tab V46 of Exhibit A1 (1993)
[37] Exhibit R3

sale of the shopping centre, and I find that the Applicant was dormant from that time until the later activities commenced (see immediately below).

Activities in the income years (from the 1996 financial year onwards)

60. During 1995 Ronald Marshall received a proposal relating to an opportunity to invest in a number of service stations to be leased to a major oil company. Mr Marshall acted on the proposal which ultimately resulted in the acquisition of the service stations.

61. The acquisition was made in a trust structure. **B1** Pty Ltd, as trustee of the **B Trust**, owned all the ordinary units in the trust that was the ultimate owner of the service stations. The Applicant owned all the issued units in the B Trust. The Applicant received the rental income from the service stations by way of income distributions from the B Trust. That income was assessable income of the Applicant and it seems that it was declared in the Applicant's income tax returns.

Consideration of the same business test

62. The Applicant's attempted characterisation of its pre-1996 business as a business of 'investment' is not an accurate one. Quite apart from the fact that to characterise the business in that way does not find unqualified support in the Applicant's own documentation (and in particular the annual returns for 1991 to 1993), it seems to me that a more accurate characterisation is as a business of property development. In fact, that is the way the business was identified in the notes to the Applicant's accounts, at least in the 1992 and 1993 years (see [58] above), and that seems to be precisely the business that the Applicant was involved in.

63. The post-1995 business, on the other hand, is accurately described as investing in units in a trust. There is no element of property development involved in any of the activities undertaken by the Applicant after the service station investment was decided upon and made.

64. The earlier business of the Applicant is not the same as the later one.

65. Even if I had accepted that the earlier business of the Applicant had been, or had included, a business of 'investment', I would nevertheless have concluded that the later

business was not the same. In *Avondale Motors (Parts) Pty Ltd v Commissioner of Taxation* (1971) 124 CLR 97, the High Court (Gibbs J) held that the words 'same business' in what became s 80E(1)(b) of the 1936 Act mean precisely that; as his Honour said at 106, 'mere similarity of kind is not enough'. That is not to say that a business may not change the way it carries on its activities, provided the earlier business is the same business as the later one. That is clearly not the case here.

66. There is the added problem for the Applicant arising from its dormant status between August 1993 and the recommencement of activities during the 1996 financial year. This is because:

- Under the 1936 Act it is necessary to identify the business carried on by the Applicant 'immediately before the [change of ownership] took place'. If that point in time is during the Applicant's dormancy, then no such business is capable of being identified;
- A similar issue arises under the 1997 Act if the 'test time' falls within the dormancy period.

67. Accordingly I conclude that none of the losses are available under the same business test.

ADMINISTRATIVE PENALTY

68. There are two different penalty regimes covering the relevant years.

69. The regime covering the 1996 to 2000 years is in the 1936 Act, while the regime covering the 2001 to 2003 years is in Division 284 in Schedule 1 to the TAA.

70. The earlier provisions talk about taxpayers having a 'tax shortfall'. In the TAA the expression used is 'shortfall amount' and that is the label I will use from now on, to cover either concept. In both legislative schemes, penalty is imposed (in the 1936 Act it is called 'additional tax' but I will just use the expression 'penalty') when a taxpayer makes a false or misleading statement to the Commissioner and less than the right amount of tax is calculated as a result.

71. Penalty was assessed at the rate of 75% for the 1996 year and 90% for the other years. The statutory basis for the penalty was:

- for the 1996 year – s 226J of the 1936 Act: 'intentional disregard' of a taxation law;
- for the 1997 to 2000 years – s 226J, plus a 20% uplift under s 226X because penalty had been imposed for an earlier year;
- for the 2001 to 2003 years – table item 1 in s 284-90(1) in Schedule 1 to the TAA: once again, 'intentional disregard', plus a corresponding 20% uplift under s 284-220(1)(c) in Schedule 1.

72. In addition to that, in each case, the penalty was reduced by 80% because of a voluntary disclosure: s 226Z of the 1936 Act and s 284-225(3)(a) in Schedule 1 to the TAA.

73. The central question is whether the shortfall amount resulted from the Applicant's 'intentional disregard' of the law. In *Price Street Professional Centre Pty Ltd v Commissioner of Taxation* [2007] FCA 345, Collier J said at [43]:

> *As made clear by the Explanatory Memorandum to the Taxation Laws Amendment (Self Assessment) Bill 1992 which introduced s 226J, s 226J requires knowledge by the taxpayer that, for example, it has claimed a deduction knowing that it is not allowable. Accordingly, 'intentional disregard' of the ITAA 1936 or regulations requires, inter alia, an understanding by the taxpayer of the effect of the relevant legislation or regulations, an appreciation by the taxpayer of how that legislation or regulation applies to the circumstances of the taxpayer, and finally, deliberate conduct of the taxpayer so as to flout the ITAA 1936 or regulations. The legislation treats 'intentional disregard' differently from, and more seriously than, negligence to comply with the Act (cf s 226G) or recklessness with regard to the correct operation of the Act (cf s 226H).*

74. I am satisfied that the shortfall amounts did not result from intentional disregard of the taxation law by the Applicant or its agent.

75. Instead, I think the shortfall amounts resulted from recklessness as to the operation of a taxation law: s 226H of the 1936 Act and table item 2 in s 284-90(1) in Schedule 1 to the TAA.

76. In *BRK (Bris) Pty Ltd v Commissioner of Taxation* [2001] FCA 164, Cooper J said at [77] that recklessness in the context of the administrative penalty regime means:

> *… to include in a tax statement material upon which the [relevant] Act or regulations are to operate, knowing that there is a real, as opposed to a fanciful, risk that the material may be incorrect, or be grossly indifferent as to whether or not the material is true and correct, and that a reasonable person in the position of the statement-maker would see there was a real risk that the Act and regulations*

> *may not operate correctly to lead to the assessment of the proper tax payable because of the content of the tax statement. So understood, the proscribed conduct is more than mere negligence and must amount to gross carelessness.*

77. That is the case here.

78. I therefore consider the proper starting point for the imposition of penalty is that the shortfall amount resulted from recklessness as to the operation of the relevant law. There is no reason why the uplift applied by the Commissioner for each of the 1997 to 2003 years, and the 80% voluntary disclosure reduction for every year, should not be retained. There are no grounds for any further remission under either s 227(3) of the 1936 Act or s 298-20 in Schedule 1 to the TAA.

79. Nevertheless, applying those concepts to the current law leads to what seems a surprising result. The relevant provision is s 284-85(2) in Schedule 1 to the TAA, which specifies the following formula:

> BPA + [BPA x (Increase % – Reduction %)]
>
> where:
>
> ***BPA*** is the base penalty amount.
>
> ***increase %*** is the percentage increase (if any) under section 284-220.
>
> ***reduction %*** is the percentage reduction (if any) under section 284-225.

80. On that basis, the final penalty rate is calculated as follows, with decimal fractions used for the percentages:

> Penalty = 0.5 + [0.5 x (0.2 – 0.8)]
>
> = 0.5 + [0.5 x (-0.6)]
>
> = 0.5 – 0.3
>
> = 0.2, or 20%.

81. Comparing that outcome with the outcome for a hypothetical 'non-uplift' year is where the surprise becomes apparent, because the comparison is between a 10% rate (50% with an 80% reduction) and a 20% rate, as shown above. That is a 100% increase. Still, that is

what the law says, and, as I have already indicated, there are no grounds for further remission.

82. Effectively the same outcome was reached through the Commissioner's application of the prior law in the 1936 Act (but bearing in mind the Commissioner's starting point of 75% for intentional regard). For each of the 'uplift' years, the final penalty amount was equal to 30% of the tax shortfall – which, again, is a 100% increase on the 15% for the 'non-uplift' year of 1996, and which is, again, surprising.

83. Whether that outcome under the 1936 Act provisions is correct is another question. Those old provisions are quite cumbersome, but ultimately the issue is whether 'the amount of the additional tax because of the shortfall', referred to in s 226Z (and which is the amount to which the 80% reduction is applied) is:

(a) the raw amount of additional tax calculated at 75% (under s 226J) or 50% (under s 226H); or

(b) that amount plus the 'further additional tax equal to 20% of [that] amount' as provided in s 226X.

84. This issue was not the subject of any detailed analysis or submission by the parties (and for which I do not criticise them), but I must say that on the face of it alternative (b) seems more likely to be the right answer. Since I have concluded that the correct starting point is 50%, rather than 75%, of the shortfall, there will need to be fresh penalty assessments for 1996 to 2000 in any event, following the partial allowance of the objections. The Commissioner will need to think carefully about the recalculation of penalty for the 1997 to 2000 years, having regard to the discussion in this and the previous paragraph.

DECISION

85. The objection decisions in relation to the income tax assessments are affirmed.

86. The objection decisions in relation to administrative penalty (or, for the earlier years, additional tax) are set aside. Instead the objections will be allowed in part, so as to reflect the Tribunal's findings that:

(a) the shortfall amounts resulted from recklessness;

(b) ss 226X and 226Z of the 1936 Act apply for the income years 1997 to 2000;

(c) ss 284-220(1)(c)[38], 284-225(2) and 284-225(3)(a) in Schedule 1 to the TAA apply for the income years 2001 to 2003.

I certify that the preceding 86 (eighty-six) paragraphs are a true copy of the reasons for the decision herein of Deputy President S E Frost

.....[sgd].....

Dated: 20 February 2017

Date(s) of hearing:	**25 & 27 July 2016**
Date final submissions received:	**25 August 2016**
Counsel for the Applicant:	**Mr S McMillan, instructed by Wong & Mayes Chartered Accountants**
Counsel for the Respondent:	**Mr A O'Brien**
Solicitors for the Respondent:	**Gadens Lawyers**

[38] The uplift applies to the 2001 year by operation of the transitional provisions in s 3 of Schedule 1 to the *A New Tax System (Tax Administration) Act (No. 2) 2000*, which introduced the current administrative penalty provisions. This is because the reference in s 284-220(1)(c) to items 1, 2 or 3 in the table in s 284-90(1) is taken to be a reference to s 226J, 226H or 226G of the ITAA 1936.