

FEDERAL COURT OF AUSTRALIA

News Australia Holdings Pty Ltd v Commissioner of Taxation [2017] FCA 645

File number: NSD 1126 of 2016

Judge: **PAGONE J**

Date of judgment: 8 June 2017

Catchwords: **TAXATION** – method of accounting – whether income derived on receipts or accruals basis – whether accruals basis only to be applied to entities in the business of money lending – whether the lending money was an aspect of the taxpayer’s business

Legislation: *Income Tax Assessment Act 1936* (Cth)
Income Tax Assessment Act 1997 (Cth)
Taxation Administration Act 1953 (Cth)

Cases cited: *Arthur Murray (NSW) Pty Ltd v The Federal Commissioner of Taxation* (1965) 114 CLR 314
Brent v Federal Commissioner of Taxation (1971) 125
Commissioner of Taxes (SA) v The Executor Trustee and Agency Company of South Australia Limited (1938) 63 CLR 108 (“*Carden’s Case*”)
CTC Resources NL v Federal Commissioner of Taxation (1994) 48 FCR 397
Federal Commissioner of Taxation v Ashwick (Qld) No 127 Pty Ltd (2011) 192 FCR 325
Leigh v Inland Revenue Commissioner [1927] 1 KB 73
Permanent Trustee Co v Federal Commissioner of Taxation 2 (AITR) 109
Saint Lucia Usines and Estates Company Limited v Colonial Treasurer of Saint Lucia [1924] AC 508

Date of hearing: 1 February 2017

Registry: New South Wales

Division: General Division

National Practice Area: Taxation

Category: Catchwords

Number of paragraphs:	40
Counsel for the Applicant:	Mr M Richmond SC with Mr CJ Peadon
Solicitor for the Applicant:	Allens
Counsel for the Respondent:	Mr J Hmelnitsky SC with Mr G O'Mahoney and Mr A Cosgrove
Solicitor for the Respondent:	Australian Government Solicitor

ORDERS

NSD 1126 of 2016

BETWEEN: **NEWS AUSTRALIA HOLDINGS PTY LTD**
Applicant

AND: **COMMISSIONER OF TAXATION**
Respondent

JUDGE: **PAGONE J**

DATE OF ORDER: **8 JUNE 2017**

THE COURT ORDERS THAT:

1. The application be dismissed.

Note: Entry of orders is dealt with in Rule 39.32 of the *Federal Court Rules 2011*.

REASONS FOR JUDGMENT

PAGONE J:

- 1 The issue in this appeal is whether SRC Holdings Limited (“SRC”) derived interest income due to it from News Limited during the year of income ended 30 June 2010. The issue arises in the context of the controlled foreign corporation provisions of the *Income Tax Assessment Act 1936* (Cth) (“the 1936 Act”). The interest income will be assessable to the applicant in this proceeding, News Australia Holdings Pty Ltd, because the applicant was the provisional head company of a multiple entry consolidated group which included News Limited and SRC. News Limited was a wholly owned subsidiary of the applicant and owned all of the shares in SRC between 2003 and 2011. During that period SRC, a company incorporated in the Cayman Islands, was a controlled foreign corporation in relation to that group. The effect in this case of the controlled foreign corporation provisions is to attribute to the applicant the income derived by SRC in the 2010 year of income.
- 2 Interest income in the sum of US\$66,023,141 (A\$75,028,696) accrued to SRC as a debt in the 2010 year of income under the terms of a loan agreement dated 28 April 2006 between News Limited and SRC (“the News loan agreement”). That interest, however, was not paid until the 2011 year of income on 2 July 2010, and on 8 July 2010 SRC paid Australian withholding tax of A\$7,502,870 in respect of that interest. The Commissioner contended in this proceeding that SRC was to be assessed on an accruals basis for the interest income which accrued in the 2010 year notwithstanding that the interest was not received by SRC until the 2011 income year. It is common ground between the parties that the applicant was assessable to interest income in the amount of US\$66,023,141 (A\$75,028,696) if SRC derived the interest income in the 2010 year when the interest accrued due rather than in the 2011 year when it was paid. It is also common ground between the parties that an amount of A\$7,502,870 would also be included in the applicant’s assessable income in the 2010 year under s 770-135 of the *Income Tax Assessment Act 1997* (Cth) (“the 1997 Act”) if the interest income was assessable in the 2010 year.
- 3 Section 6-5 of the 1997 Act brings to tax as assessable income “income according to ordinary concepts”. Section 6-5 provides:

Income according to ordinary concepts (ordinary income)

(1) Your *assessable income* includes income according to ordinary concepts, which is called *ordinary income*.

Note: Some of the provisions about assessable income listed in section 10-5 may affect the treatment of ordinary income.

- (2) If you are an Australian resident, your assessable income includes the *ordinary income you* derived directly or indirectly from all sources, whether in or out of Australia, during the income year.
- (3) If you are a foreign resident, your assessable income includes:
 - (a) the *ordinary income you* derived directly or indirectly from all * Australian sources during the income year; and
 - (b) other *ordinary income that a provision includes in your assessable income for the income year on some basis other than having an* Australian source.
- (4) In working out whether you have derived an amount of * ordinary income, and (if so) when you derived it, you are taken to have received the amount as soon as it is applied or dealt with in any way on your behalf or as you direct.

The corresponding provision in the 1936 Act was s 25 which included in the assessable income of a resident taxpayer the “gross income derived” directly or indirectly from all sources. In each case the word “derived” had its ordinary meaning. In *Brent v Federal Commissioner of Taxation* (1971) 125 CLR 418 Gibbs J explained at 427-8 that the time of derivation of income is to be determined by application of ordinary business and commercial principles and depends, at least in part, upon which of the receipts (or cash) basis or the accruals (or earnings) basis of tax accounting gives the substantially correct reflex of the taxpayer’s true income:

The Act does not define the word “derived” and does not establish a method to be adopted as a general rule to determine the amount of income derived by a taxpayer, although particular situations not relevant to the present case are dealt with. The word “derived” is not necessarily equivalent in meaning to “earned”. “Derive” in its ordinary sense, according to the *Oxford English Dictionary*, means “to draw, fetch, get, gain, obtain (a thing from a source)”. It has become well established that unless the Act makes some specific provision on the point the amount of income derived is to be determined by the application of ordinary business and commercial principles and that the method of accounting to be adopted is that which “is calculated to give a substantially correct reflex of the taxpayer’s true income” (*Commissioner of Taxes (S.A.) v. Executor, Trustee and Agency Co. of South Australia Ltd. (Carden’s Case)*) (1938) 63 CLR 108 at 152-154’.

Income will ordinarily be derived when money has become due to a taxpayer if the accruals (or earnings) basis of tax accounting gives the substantially correct reflex of the true income of the particular taxpayer, but will ordinarily only be derived when received if the receipts (or cash) basis of tax accounting gives the substantially correct reflex of the true income of the taxpayer. The decision of whether a taxpayer is to account on an accruals or a cash basis is not arbitrary or discretionary although it may sometimes be difficult. The decision requires

consideration of the nature of the source of the income in question by reference to the activities of the taxpayer and to the nature of the income in question to determine which method of accounting best reflects the taxpayer's income.

4 Professor Parsons explained in *Income Taxation in Australia: principles of income, deductibility and tax accounting* (Law Book Company, 1985) at [11.46] that an amount will be derived when an item of income has become "due" to a taxpayer who accounts for income on an accruals basis. In contrast, a taxpayer who accounts on a cash (or receipts) basis is taken to have derived income when an amount is received. Professor Parsons also expressed the view at [11.43] that interest derived from investments "will generally be subject to accounting on a cash basis", although he went on to say that interest on loans would seem to be accounted for on an accruals basis where the lending of money was "an aspect" of a taxpayer's business. In the present case the applicant contended that SRC was not in the business of money lending and was to be assessed on its interest income upon a receipts basis. The Commissioner did not contend that SRC was in the business of money lending but submitted that lending money was part of the business of SRC and that SRC was to be assessed for interest derived on an accruals basis.

5 On 28 June 2010 SRC was owed US\$66,023,141 by News Limited pursuant to the terms of the News loan agreement. US\$65,168,676.49 interest (net of withholding tax) had accrued to SRC from News Limited to 28 June 2010 in the 2010 year but the net debt due to SRC from News Limited was recorded as US\$66,023,142 (A\$75,028,696) after taking into account foreign exchange fluctuation of US\$854,464.34. The general ledger for SRC recorded US\$65,168,676.49 interest earned from News Limited between 29 June 2009 and 27 June 2010. The general ledger also contained an entry for an unrealised foreign fluctuation of US\$854,464.34 resulting in the net amount of US\$66,023,141 (rounded up to the nearest dollar) recorded in the balance sheet of SRC for the year ended 30 June 2010 as net intercompany interest.

6 Section 6-5 includes as assessable income the ordinary income "derived" by an Australian resident. An amount may be derived before it is received (see *Commissioner of Taxes (SA) v The Executor Trustee and Agency Company of South Australia Limited* (1938) 63 CLR 108 ("*Carden's Case*")) and an amount may be received before it is derived (see *Arthur Murray (NSW) Pty Ltd v The Federal Commissioner of Taxation* (1965) 114 CLR 314). The inquiry into derivation is not into whether an entitlement to receive has arisen or whether an amount

has been received, although both entitlement and receipt may be relevant in determining whether there has been derivation. The inquiry is, rather, into when an item of ordinary income can be said to have come home to the taxpayer in a realised or immediately realisable form: see *Carden's Case* at [155]. That inquiry may, in respect of some items of income, be determined by the nature of the business, or of the other relevant income earning activities, of the taxpayer; but it may also be relevant to consider the nature of the receipt and the nature of the receipt in the context of the activities, or business, by which the taxpayer derives income. Professor Graeme S Cooper helpfully explained the concept of derivation in "Some Observations on Tax Accounting" in (1986) 15 *Australian Tax Review* 221 at 227 (omitting footnotes) saying:

The meaning of these words "derived" and "incurred" is sought to be determined primarily by the basis of accounting appropriate to the taxpayer. The choice is primarily between the cash basis of accounting, where a receipt or payment determines derivation or incurring, and the accruals basis, where an entitlement to a receipt or obligation to pay are determinative. It may also, however, be relevant to examine the nature of the receipt or payment in question if it is correct that for some receipts (such as dividends) even an accruals basis taxpayer need only account on a cash basis.

In considering which of the accruals or the receipts method of tax accounting applies to any given item for any given taxpayer it is important not to lose sight of the purpose for which the inquiry is undertaken. The inquiry in the present case is undertaken to determine whether entitlements have come home when accrued or only when received. In the present proceeding the applicant contended that the nature of the income as interest due to a taxpayer who was not a money lender determined the question of derivation as having occurred only upon its receipt (in the 2011 year) rather than upon the earlier accrual of the entitlement (in the 2010 year). The applicant also submitted that the Commissioner was in any event bound to assess the interest income on a receipts basis in accordance with Taxation Ruling 98/1.

- 7 The leading authority on the question of whether to apply the receipts or the accruals basis of tax accounting to a taxpayer in a particular year of income is *Carden's Case*. The decision is thought generally to stand for the proposition that a sole practitioner must account for tax on a cash basis although the issue in the case was not exactly that: see Justice DG Hill "The Interface between Tax Law and Accounting Concepts and Practice as seen by the Courts" (2005) 1(1) *Journal of the Australian Tax Teachers Association* 1. The questions in *Carden's Case*, however, included whether it was open to the Commissioner in the last year of a deceased taxpayer's medical practice to assess the executor up to the date of death of the

medical practitioner upon an earnings basis, and, if so, whether unpaid fees which had been rendered in the former period should have been brought to account. The High Court answered the first of these questions in the affirmative and the latter in the negative. There was also a related question of whether the Commissioner could reopen the assessment of the previous year to bring to account the book debts which had accrued in that period. In considering that question Dixon J (with whom Rich and McTiernan JJ agreed) considered that the proper basis to determine the income derived by Dr Carden from his medical practice was upon receipts rather than upon the accrual of fees because the receipts method in Dr Carden's circumstances better reflected his true income in the accounting period. At 154-156 his Honour explained:

In the present case we are concerned with rival methods of accounting directed to the same purpose, namely, the purpose of ascertaining the true income. Unless in the statute itself some definite direction is discoverable, I think that the admissibility of the method which in fact has been pursued must depend upon its actual appropriateness. In other words, the inquiry should be whether in the circumstances of the case it is calculated to give a substantially correct reflex of the taxpayer's true income. We are so accustomed to commercial accounts of manufacturing or trading operations, where the object is to show the gain upon a comparison of the respective positions at the beginning and end of a period of production or trading, that it is easy to forget the reasons which underlie the application of such a method of accounting to the purpose of ascertaining taxable income. Although the field of profit-making which it covers in practice is probably much greater than any other among the manifold forms of income or revenue, it is a system of accounting which does not represent the primary or basal position from which an investigation of income for taxation purposes begins. Speaking generally, in the assessment of income the object is to discover what gains have during the period of account come home to the taxpayer in a realized or immediately realizable form. Thus, in *Thorogood's Case*, where the question was whether, in a business of buying land and selling it in subdivision on instalment contracts, future instalments of purchase money should be taken into the account of taxable income derived during the accounting period, the court pronounced decisively against the inclusion of the present value of these future payments. *Isaacs J.* said: "Derived" is not necessarily actually received, but ordinarily that is the mode of derivation." Substantially the same thing is said in reference to the words "arising or accruing" by Sir *Houldsworth Shaw* and Mr. *Baker* in their work on the *Law of Income Tax*, and they place the distinction upon the difference between trading and other sources of income. They say:- "There is an important distinction between debts due to a trading company and unpaid in a particular year or period and other income which is not a trade receipt. Trading debts due but not yet paid must be included in arriving at the balance of profits or gains. With regard, however, to other income there must be something 'coming in'; that is, for income tax purposes, receivability without receipt is nothing" (*Law of Income Tax*, p. 111). Compare the article on Income Tax by the same authors in *Halsbury's Laws of England*, 2nd ed., vol. 17, p. 85; and cf. *St. Lucia Usines and Estates Co. Ltd. v. St. Lucia (Colonial Treasurer)*.

The reasons which underlie the practice of estimating for taxation purposes the income from trade or manufacture by means of a commercial profit and loss account consist in the impracticability of computing income in any other way and in the

adoption for fiscal purposes of recognized commercial principles. The computation of profits from manufacture and trading has always proceeded upon the principle that the profit may be contained in stock-in-trade and "outstandings." Whether this is to be explained on some view that the purpose is to ascertain what is the detachable increase in circulating capital, or more simply on the ground of common sense and the teachings of experience, the result for the purposes of taxation is the same. The result is that a tax upon the profits or income of such a business must be understood as a tax upon the profits or income computed according to the system, because, according to common understanding and commercial principles, that is the method of determining the profits. The basis of a trading account is stock on hand at the beginning and end of the period and sales and purchases. In such an account book debts represent what before sale was trading stock and it is almost inevitable that they should be taken into consideration upon an accrual and not a cash basis. But nearly all income tax legislation is against the practice which obtains commercially of making a reserve for bad debts or discounting the amount of book debts by a percentage for bad or doubtful debts. Specific provision is usually made for the deduction from the book debts accruing during the accounting period of such debts only as have proved to be bad during that period and have been written off. Usually the deduction is authorized also of book debts included in a previous accounting period which in the year under assessment prove to be bad and have been written off. Then book debts written off as bad which in a subsequent accounting period are nevertheless paid are to be brought in as receipts of that subsequent period: Cf. *Elder Smith & Co. Ltd. v. Commissioner of Taxation (N.S.W.)*.

(Footnotes omitted.)

It is clear from these passages that the fundamental inquiry into whether there has been derivation is "to discover what gains have during the period of accounting come home to the taxpayer in a realised or immediately realisable form". In some cases the entitlements accrued, rather than the amounts only when received, will better reflect the income derived by a taxpayer in an accounting period. That may be so, for example, in the case of a taxpayer conducting a business of manufacture and sales where its receivables upon invoice will reflect its gains in an accounting period according to common understanding and commercial principles. It may not be so in the case of other taxpayers, such as may be the case with professional sole practitioners, where fees rendered may not reflect actual gains in an accounting period if, for instance, the taxpayer's fees are frequently unpaid or remain unpaid for significant periods of time.

- 8 His Honour in *Carden's Case* went on at 156-9 to consider why the accruals system of accounting did not substantially reflect Dr Carden's true income. His Honour explained at 157 that the accruals system of accounting was plainly "not applicable to every pursuit by which income is earned". The considerations affecting the basis of accounting for Dr Carden's professional income were said by his Honour at 157 "to be found in the nature of the profession concerned and, indeed, in the actual mode in which it is practiced in a given

case”. His Honour observed at 158 that the activities of Dr Carden involved “nothing analogous to a stock of vendible articles to be acquired or produced and carried by him; outstandings on Dr Carden’s expenditure side [did] not correspond to, and were not naturally connected with, the outstandings on his earnings; and that there was no fund of circulating capital from which income or profit must be detached for actual enjoyment”. At 159 Dixon J expressed the view that the receipts basis of accounting would alone truly reflect the income of a medical practice if “there [was] but little certainty about the payment of fees”. In that context his Honour concluded at 159 that “to a great degree the question whether income of a particular kind can be properly calculated on one basis alone or upon either, must depend upon the nature of the *source* of income.” (Emphasis added.)

- 9 Counsel for the applicant in this case emphasised and relied upon the reference by Dixon J to the nature of the “source” of the income and upon passages in other cases suggesting that interest income was derived only upon receipt unless the taxpayer was in the business of money lending. In *Permanent Trustee Co v Federal Commissioner of Taxation* 2 (AITR) 109 it had been said at 11 that income had not been derived by the receipt of a valueless cheque. In *Saint Lucia Usines and Estates Company Limited v Colonial Treasurer of Saint Lucia* [1924] AC 508 the Privy Council had held that interest on an unpaid debt from an investment which failed to pay interest due was not income which had arisen or accrued in that year. Their Lordships said at 512-3:

There must be a coming in to satisfy the word “income.” This is a sense which is assisted or confirmed by the word “received” in the proviso at the end of section 4(1). If the taxpayer be the holder of stock of a foreign Government carrying say 5 per cent interest, and the Government is that of a defaulting State which does not pay the interest, the taxpayer has neither received nor has there accrued to him any income in respect of that stock. A debt has accrued to him but income has not. It does not follow that Income is confined to that which the taxpayer actually receives. Where Income Tax is deducted at the source the taxpayer never receives the sum deducted but it accrues to him. It is said, and truly, that a commercial company, in preparing its balance sheet and profit and loss account, does not confine itself to its actual receipts – does not prepare a mere cash account – but values its book debts and its stock in trade and so on and calculates its profits accordingly. From the practice of commerce and of accountants and from the necessity of the case this is so. But this is far from establishing that Income arises or accrues from (as above instanced) an investment which fails to pay the interest due.

In *Leigh v Inland Revenue Commissioner* [1927] 1 KB 73 Rowlatt J said at [77] that before “a good debt is paid there is no such thing as income tax upon it”.

- 10 The application of the accruals method of accounting for interest was, however, considered to be appropriate by the Full Court in *Federal Commissioner of Taxation v Ashwick (Qld) No*

127 Pty Ltd (2011) 192 FCR 325. One of the issues in that case concerned an entitlement to a bad debt deduction for interest which had been returned as assessable income in a prior year on an accruals basis but which had not been received. The primary judge (Ryan J) had found that each company had been carrying on a business and, on appeal, Edmonds J (with whom Bennett and Middleton JJ agreed) held that each of the three companies had properly returned the interest in prior years on an accruals basis. How the taxpayers accounted for the amounts was considered relevant and significant in determining whether the income had been derived upon accrual. At [66]-[68] Edmonds J said:

- 66 The treatment of amounts in a taxpayer's financial statements and accounting records, even if not determinative, are both relevant and significant in determining whether its assessable interest income is to be recognised on receipt or on accrual of the entitlement and are evidence of the test that ought to be applied: *Arthur Murray (NSW) Pty Ltd v Federal Commissioner of Taxation* (1965) 114 CLR 314 at 318 per Barwick CJ, Kitto and Taylor JJ; *International Nickel Australia Ltd v Federal Commissioner of Taxation* (1977) 137 CLR 347 at 367 per Mason J; *Federal Commissioner of Taxation v Citibank Ltd* (1993) 44 FCR 434 at 443 per Hill J with whom Jenkinson and Einfeld JJ agreed; *BHP Billiton Petroleum (Bass Strait) Pty Ltd v Federal Commissioner of Taxation* (2002) 126 FCR 119 at [50], [67]-[68] per Hill and Heerey JJ.
- 67 EFGT, FGL and Amayana (and EFGA) included their relevant interest entitlements in the reported income in their accounts on an accruals basis and those accounts were audited.
- 68 The taxation treatment which EFGT, FGL and Amayana (and EFGA) afforded to their interest entitlements was appropriate having regard to both their circumstances and the structure of the Assessment Acts:
 - (1) The circumstances of Amayana and EFGT (and EFGA) were that they had borrowings that related directly to the loans which they had made on which interest accrued (Reasons [51], [52], [118], [119], [123], [145], [160]). The accruing liability for interest on their borrowings was the cost to them of using loan funds to earn income by lending at interest. In circumstances where a legal or jurisprudential approach is required to determine whether a liability has been incurred to found a deduction (*Coles Myer Finance Ltd v Federal Commissioner of Taxation* (1993) 176 CLR 640 at 662-663 per Mason CJ, Brennan, Dawson, Toohey and Gaudron JJ), and where a pecuniary obligation must become due in the sense of a presently existing liability to have been incurred (*Nilsen Development Laboratories Pty Ltd v Federal Commissioner of Taxation* (1981) 144 CLR 616 at 623 per Barwick CJ and at 627 per Gibbs J), bringing amounts of interest to account as and when they accrue gives a more reliable reflex of the lending companies' assessable income — both the lending companies' liabilities for interest and their entitlements to interest would be brought to account in the same period to which they relate: cf *J Rowe & Son Pty Ltd v Federal Commissioner of Taxation* (1971) 124 CLR 421 at 448 per Menzies J.

- (2) Further, these companies and FGL had interest entitlements accrue in recoverable form — interest was ordinarily calculated on a daily basis and capitalised monthly — which allowed further interest to be charged on any accrued but unpaid amounts (Reasons [19], [20]). Accruals in such circumstances have sufficiently come home to be regarded as derived.
- (3) The structure of the Assessment Acts is such that a deduction arises upon the writing off of a bad debt that has previously been included in assessable income. The Assessment Acts do not call for consideration of the debtor's capacity to pay a debt as a condition of and before its inclusion in assessable income of the creditor. To the contrary, the Assessment Acts contemplate inclusion in assessable income and the allowance of a subsequent deduction if and when it is ascertained that the debt is bad and is written off: *National Bank of New Zealand* at 303 per Cooke J; *National Commercial Banking Corporation of Australia* at 24-26; 325-326.

Counsel for the applicant in this case submitted that none of the features found to be determinative by the Court in *Ashwick* were present in the interest income accruing to SRC on its loan to News Limited. However, the decision in *Ashwick* is an illustration that the task in each case, as had been explained in *Carden's Case* at 157, is to discover, from the facts, the basis of accounting which substantially reflects the taxpayer's true income.

- 11 The authorities establish that interest income may be derived when accrued and that the taxpayer's business and income earning activities, and the place of interest income in that business or activities, are relevant considerations to whether interest has been derived, in the sense of having come home, when accrued or only when received. In each case the "object is to discover what gains have during the period of account come home to the taxpayer in a realized or immediately realizable form": *Carden's Case* at 155. The mere fact that the income in question is from interest does not prevent its derivation upon accrual if the circumstances of the business or other income earning activity are such that what accrued has relevantly come in when accrued, albeit that the interest remained unpaid. The observation by Dixon J in *Carden's Case* at 159 that to a great degree the question depended upon "the nature of the source of income" calls for a consideration of the business or other income earning activity in which the interest income is derived and not only the consideration of the nature of the income as interest. The source of the income in question in *Carden's Case* was the conduct of a doctor's medical practice through which fees were received from patients. The nature of the source of income in *Carden's Case* was the professional skill and personal work of Dr Carden which, as Dixon J explained at 157-8, was unlike income from businesses with vendible stock or a fund of circulating capital:

Where there is nothing analogous to a stock of vendible articles to be acquired or produced and carried by the taxpayer, where outstandings on the expenditure side do not correspond to, and are not naturally connected with, the outstandings on the earnings side, and where there is no fund of circulating capital from which income or profit must be detached for actual enjoyment, but where, on the contrary, the receipts represent in substance a reward for professional skill and personal work to which the expenditure on the other side of the account contributes only in a subsidiary or minor degree, then I think according to ordinary conceptions the receipts basis forms a fair and appropriate foundation for estimating professional income.

In SRC's case it is necessary to consider the context of the business or income producing activities in which it derived the interest income and to consider the role within that business, or those income producing activities, of the interest earned from the use of its funds. In that context it is relevant that the interest accrued to SRC from its use of funds within a group of companies of which its borrower was its parent company. It is also relevant in this case that SRC accounted for the interest on the accruals method and that it had accounted for an unrealised foreign exchange gain on the basis of its accrued interest entitlements notwithstanding that the interest which had accrued had not been received.

- 12 SRC was incorporated under the laws of the Cayman Islands on 21 September 2000 as a wholly owned subsidiary of Newscorp Cayman Islands Ltd. SRC was incorporated as News Cayman China Holdings Ltd but changed its name to SRC Holdings Limited by special resolution dated 28 November 2000. It became a wholly owned subsidiary of News Ltd from 20 June 2003 and remained a subsidiary of News Ltd until News Ltd disposed of its interests in SRC to News Securities BV on 30 June 2011. It had no employees and its financial statements for the years ending 30 June 2004 to 30 June 2011 recorded no operating expenses. Its assets during that period were essentially cash and receivables, intracompany debts and shares in its subsidiaries.
- 13 Certain assets of the News Group were reorganised into two groups at about the time of SRC's incorporation. One group comprised those assets forming part of a group known as "Sky Global" which were held in anticipation of a public offering that ultimately did not proceed. The second group of assets were those held by SRC. In December 2000 SRC acquired a direct interest in a Cayman Island Limited partnership which from February 2001 held shares in China Netcom Corporation (Hong Kong) Limited ("China Netcom") which was listed on the Hong Kong Stock Exchange. On 29 June 2001 SRC acquired the shares in Star China Investment (No 1) Limited ("Star China") which held a direct investment in the Cayman Island limited partnership holding shares in China Netcom.

- 14 On 20 June 2003 SRC became a wholly owned subsidiary of News Limited as part of a pre-planned series of transactions for the reorganisation of the News Group's Cayman Island companies and acquired all of the shares in a number of companies, namely, Asia Productions Ltd ("Asia Productions"), News Finance (HK) Limited ("News Finance Hong Kong"), News Data Security Products Limited ("News Data"), News Printing Limited ("News Printing"), and News Corp Overseas Limited ("News Corp Overseas"). In July 2003 SRC disposed of its interest in the Cayman Island limited partnership and in the following years it disposed of the interest it had acquired in the corporate reorganisation of June 2003. On 18 July 2003 SRC assigned its interest in the Cayman Island limited partnership to Star China and on 17 November 2005 SRC subsequently disposed of its interest in Star China. SRC disposed of Asia Productions on 28 June 2007. The asset of Asia Productions had been an investment in Zee Telefilms Limited and on 28 June 2007 SRC transferred its interest in Asia Productions Limited to Star US Holdings Subsidiary LLC in consideration for an amount of US\$34,412,492 being equivalent to the amount of SRC's liability to Asia Productions Limited on intercompany account. During the 2006 year SRC's investment in News Data was written down to zero and SRC subsequently disposed of its shares in News Data on 19 August 2009 for the nominal consideration of US\$1. During the 2009 year SRC's shares in News Printing and News Finance Hong Kong were written down to nil but they remained subsidiaries of SRC until SRC was acquired by News Securities BV on 30 June 2011.
- 15 The application by SRC of its fund of capital by loans and financial accommodations were part of SRC's business activities since its incorporation and were recorded, and were relied upon in its dealings, by SRC upon accrual in accordance with generally accepted accounting principles consistent with the accounting policies of its ultimate parent.
- 16 On 22 December 2003 it participated in a series of pre-planned steps which were taken in relation to closing down the News Group's acquisition of a satellite television business in the United States known as "Direct TV". On 22 December 2003 News Limited subscribed for redeemable preference shares in SRC with an obligation to pay the subscription money of A\$2,723,284,314 which was satisfied by News Limited endorsing to SRC a non-interest bearing demand note having a face value of US\$2 billion issued by News Publishing Australia Limited ("the NPAL Note 1 Promissory Note"). SRC exchanged the NPAL Note 1 Promissory Note with News Publishing Australia Limited for another promissory note issued by News Publishing Australia Limited ("the NPAL Note 3 Promissory Note") in favour of

SRC for the same amount (namely, US\$2 billion) which bore interest at the rate of 8% per annum and had a maturity date of 19 June 2004. On 18 June 2004 (the day before maturity of the NPAL Note 3 Promissory Note) a pre-planned series of steps were taken by which News Publishing Pty Ltd satisfied the NPAL Note 3 Promissory Note by issuing another promissory note to SRC with a face value of US\$2,078,688,525 which did not bear interest ("the New Promissory Note"). SRC declared a dividend to News Limited on 18 June 2004, as part of the series of pre-planned steps, of A\$2,952,698,640 and US\$40.70. The dividend of A\$2,952,698,640 was payable on the redeemable preference shares held by News Limited and the dividend of US\$40.70 was payable on the ordinary shares held by News Limited. The total dividend amount was satisfied by SRC endorsing the New Promissory Note to News Limited which left a balance outstanding of US\$61,109,504 owing to SRC by News Limited on intercompany account. News Limited then presented the New Promissory Note to News Publishing Australia Limited in payment for the subscription amount for the new shares in News Publishing Australia Limited. The accounts for SRC for the year ended 30 June 2004 following the transactions entered into on 18 June 2004, disclosed that its only significant assets in that year were intercompany receivables of US\$63,740,983 and shares in subsidiaries of US\$97,995,667. The receivables comprised an amount of US\$1,334,703 owing by News Cayman Holdings Limited and the outstanding amount due to SRC by News Limited referred to above of US\$61,109,504 which, adjusted for movements in foreign exchange, was recorded as US\$62,406,208. The receivables of US\$1,334,703 had been assigned to SRC when it had acquired the companies mentioned above on 20 June 2003 and the receivables had remained outstanding at the end of the 2005 year. The only income of SRC recorded in the financial statements to 30 June 2004 was net intercompany interest of US\$78,804,343.

- 17 SRC declared a dividend in the following year on 8 September 2004 in the amount of A\$90,675,858 on its redeemable shares held by News Limited. SRC's liability to pay the dividend was satisfied by setting off the amount of the dividend against News Limited's indebtedness to SRC. Its accounts for the year ended 30 June 2005 disclosed that its only assets were intercompany receivables and shares in subsidiaries. The intercompany receivables had reduced to US\$1,334,703 but the amount recorded as shares in investment corporations remained the same as in the previous year at US\$97,995,667. The only significant income of the company for the year ended 30 June 2005 was net intercompany interest of US\$914,317.

- 18 SRC disposed of its investment in Star China, as mentioned above, during the year ending 30 June 2006. On 28 June 2002 Newscorp Cayman Islands Limited had assigned to SRC part of a debt in the amount of US\$29,829,127 which it had been owed by News Cayman Holdings Limited. SRC agreed on the same day to assign that debt to Star China to satisfy its obligation to pay the subscription price for the future issue to SRC by Star China of ordinary A class shares. On 25 June 2004 Star China issued 298 ordinary shares to SRC for a subscription price of US\$29,829,127 which was treated as having been satisfied by completion of the assignment of the debt. In July 2005 Star China disposed of its investment in China Netcom in consideration for US\$112 million. On 28 September 2005 Star China made a loan to SRC of approximately US\$112 million being the amount received on the sale of its shares in China Netcom. SRC deposited the amount lent to it by Star China in an interest bearing account with the HSBC bank. The loan to SRC by Star China was made by intercompany account and did not bear interest. Steps were taken in October and November 2005 to discharge Star China's liabilities and to redeem certain shares. SRC's ordinary shares in Star China were redeemed on 25 October 2005 and on 17 November 2005 the loan to SRC by Star China was repaid by set off against the redemption amount for the shares in Star China. On 17 November 2005 SRC also transferred its remaining interest in Star China to Star US Holdings Subsidiary LLC (another News Group entity) in consideration for US\$1.
- 19 SRC made two loan advances to News Limited in the 2006 year with funds from its subsidiaries. In February 2006 SRC made a loan to News Limited of A\$151,483,216 (being the Australian dollar equivalent of US\$114,172,900) as part of a step in a pre-planned series of steps to make repayments under a financing structure. At the time SRC owed News Limited A\$157,887 with the result that News Limited owed SRC A\$151,325,329 after the loan made in February 2006.
- 20 The loan by SRC to News Limited was governed by the News loan agreement which provided for the payment of interest at the rate of 7.5% per annum (or 7% if prepaid) and had a maturity date of 31 May 2011. The News loan agreement recited that News Limited (the borrower) and SRC (the lender) had maintained a running intercompany account on which at the time the borrower owed the lender A\$151,483,216 and the lender owed the borrower A\$157,887. The News loan agreement also recited that the borrower and the lender had agreed that the liability of each to the other on the running intercompany account was to be set off with the resultant liability of the borrower to the lender of A\$151,325,329 being satisfied by the borrower and the lender entering into the News loan agreement. The loan

was denominated in Australian dollars and provided for interest to become due and payable as at 28 June in each year in which the loan remained outstanding. Clause 3.1 provided:

3.1 Period of Accrual; Rate

Subject to clause 3.3 the Principal Sum accrues interest on a daily basis at the rate of 7.5% per annum from (and including) 2 February 2006 and ceases to accrue interest from (but excluding) the date on which the Principal Sum is repaid in full in accordance with clause 4 unless payment is improperly withheld or refused in which case the Principal Sum will continue to bear interest in accordance with this clause 3 (both before and after judgment) and until (but excluding) the day on which all sums due in respect of this Agreement up to that day are received by or on behalf of the lender.

Clause 3.2 provided that the borrower would “pay accrued interest on each Interest Payment Date” which was defined in clause 1.1 to mean the “28th day of each June and the Maturity Date”. Clause 3.3 provided for the prepayment of interest and gave the borrower the ability to prepay interest at a lower rate. Clause 3.4 provided for the capitalisation of unpaid interest at the election of the lender as follows:

3.4 Annual Capitalisation

On each Interest Payment Date, either or both of the following amounts will be capitalised if the Lender requires by notice to the Borrower:

- (a) Unpaid Loan Interest Amounts (if any) which have not previously been capitalised; and
- (b) Any increased amounts payable by the Borrower pursuant to clause 5.3 and which the Borrower has not paid to the Lender.

The term “Unpaid Loan Interest Amount” in clause 3.4(a) was defined in clause 1.1 to mean “an amount of accrued interest which is due and payable but is unpaid”.

- 21 The second loan advance made by SRC to News Limited in the 2006 year was made in June 2006 when SRC lent A\$339,941,195 to News Limited on the terms of the News loan agreement. The funds for that loan were sourced from borrowings by SRC in United States currency totalling US\$248,174,350 as part of the initial steps in a pre-planned series of transactions from SRC’s direct and indirect subsidiaries, namely US\$31,647,048 from Asia Productions Limited, US\$212,239,284 from Eastrise Profits Limited (“Eastrise”) (a subsidiary of News Finance Hong Kong), and US\$4,288,018 from News Printing. The amount borrowed by SRC from Asia Productions was subsequently repaid by SRC in June 2007 following the transfer on 28 June 2007 of its investment in Asia Productions to Star US Holdings Subsidiary LLC in consideration for an amount of US\$34,412,494 (being the amount equal to SRC’s liability to Asia Productions on intercompany account). The amount

borrowed by SRC from Eastrise was subsequently repaid by SRC in June 2008. As at 27 June 2008 SRC had been indebted to Eastrise in the amount of US\$245,582,082 which SRC satisfied by the issue of a promissory note to Eastrise. Eastrise declared a dividend of an amount of US\$245,582,082 to its shareholder, News Finance Hong Kong, and endorsed SRC's promissory note to News Finance Hong Kong in satisfaction of the obligation to pay the dividend. News Finance Hong Kong then declared a dividend in an amount equivalent to US\$244,300,983 and satisfied its obligation to pay that amount by endorsing SRC's promissory note to SRC, being News Finance Hong Kong's sole shareholder, with the excess of the face value of SRC's promissory note being left outstanding on intercompany account. News Finance Hong Kong subsequently disposed of its shares in Eastrise to Star US Holdings Subsidiary LLC for US\$1. The amount of US\$4,288,018 which SRC had obtained from News Printing in June 2006 was written off in 2009.

- 22 On 30 June 2006 News Limited prepaid interest pursuant to the terms of the News loan agreement by delivery of a demand promissory note in the amount of A\$37,152,259 ("the News Note"). On the same day News (NAPI) Pty Ltd ("NAPI") agreed to acquire the News Note in consideration for the face value of the News Note, and SRC agreed to allow the consideration payable to remain outstanding on intercompany account on the terms of a loan agreement entered into on the same day ("the NAPI loan agreement") upon the same terms as the News loan agreement which had been entered into between SRC and News Limited on 28 April 2006. It was submitted for the applicant that the financial accommodation reached in this way between SRC and NAPI was not a loan but the "provision of financial accommodation in the sense of a vendor providing credit to the purchaser, or a party forbearing to demand payment for a period": see *Prime Wheat Australia Ltd v CCSD* (1997) 42 NSWLR 505, 511-512 per Gleeson CJ. The Commissioner disputed that submission but for present purposes it is not necessary to determine whether the financial accommodation between SRC and NAPI amounted to a loan and it can be accepted that the arrangement between the parties was treated between them as a financial accommodation on terms that did not create a loan between them.
- 23 SRC accounted for the investment it earned as it accrued. SRC's financial accounts for the year ended 30 June 2006 disclosed intercompany receivables of US\$397,671,168 and shares in subsidiaries at US\$34,562,539. The total non-recurrent liabilities recorded for intercompany payables and loans was US\$250,286,369. SRC's income for that year was

recorded as a dividend of US\$52,718,572, interest on the HSBC bank account comprising US\$1,522,646, and net intercompany interest income of US\$3,410,905.

- 24 SRC closed its account with HSBC in February 2007 and transferred the closing balance in that account of US\$185,650 to News Limited. The indebtedness of News Limited to SRC as governed by the News loan agreement was thereby increased by the amount of US\$185,650.01 which was transferred by SRC from its HSBC account to News Limited. SRC thereafter did not maintain a bank account as was reflected by its balance sheet for that year and for subsequent years which recorded a nil value for cash and equivalents.
- 25 On 28 June 2007, as mentioned above, SRC sold its shares in Asia Productions to Star US Holdings Subsidiary LLC for an amount equivalent to the debt owed by SRC to Asia Productions of US\$34,412,494. On 29 June 2007 News Limited prepaid interest for the following twelve month period pursuant to the terms of the News loan agreement by delivery of a demand promissory note in the amount of A\$34,502,693 to SRC. NAPI agreed to acquire the note in consideration for its face value and SRC agreed to allow the consideration payable to remain outstanding on intercompany account on the terms of the NAPI loan agreement. The agreement by SRC to allow the consideration for the face value of the News Note to remain outstanding on intercompany account was also not treated as a loan but as the provision of financial accommodation in the sense of a vendor providing credit to the purchaser or a party forbearing to demand payment for a period.
- 26 SRC's financial accounts for the year ended 30 June 2007 disclosed intercompany receivables owing to SRC in the amount of US\$486,392,882 and shares in subsidiary corporations at US\$7,645,355. US\$234,532,084 was recorded as owing by SRC on intercompany account. SRC's interest income (on the HSBC account) was US\$2,018 and its net intercompany interest income was US\$10,572,826.
- 27 On 27 June 2008 SRC satisfied its liability on intercompany account to Eastrise in the amount of US\$245,582,082 by the issue of an on demand promissory note for that amount which was ultimately endorsed back to SRC as payment of a dividend by News Finance Hong Kong to SRC of US\$244,300,983. That left a balance of US\$1,281,099 which was treated as an advance by News Finance Hong Kong to SRC on intercompany account that was subsequently written off in the 2009 year. On 27 June 2008 News Finance Hong Kong sold its shares in Eastrise to Star US Holdings Subsidiary LLC for US\$1.00.

- 28 The balance sheet for SRC for the year ended 30 June 2008 recorded the intercompany receivables owing to SRC having decreased to US\$552,615,983. The amount owing by SRC on intercompany account had decreased to US\$7,580,379 and the investment in its subsidiaries was recorded to have remained unchanged at US\$7,645,355. Its income statement for the 2008 financial year recorded net intercompany interest income of US\$18,505,637 and dividends received of US\$244,300,983.
- 29 In November 2008 NAPI repaid its outstanding indebtedness to SRC of A\$82,573,199 by delivering a promissory note for that amount to SRC as part of a pre-planned series of transactions. News Limited then agreed to acquire the note for its face value and SRC agreed to allow the consideration for the acquisition to remain outstanding on intercompany account on the terms of the News loan agreement. That transaction was similarly treated as a financial accommodation in the sense previously explained rather than as a loan. News Limited then endorsed the note back to NAPI in reduction of its outstanding indebtedness to NAPI and cancelled the note. On 24 June 2009 SRC disposed of its shares in Newscorp Overseas to Star US Holdings Subsidiary LLC for no consideration as the company had no assets and SRC thereby incurred an accounting loss of US\$2,208,702. SRC wrote down its investment in News Publishing to zero during the 2009 year and thereby incurred an accounting loss of US\$5,436,640.
- 30 SRC's balance sheet for the year ended 30 June 2009 recorded that the intercompany account receivables owing to SRC had decreased to US\$501,773,609 and almost all of that debt was owed by its parent News Limited. The amount owing by SRC on intercompany payables and loans had reduced to US\$1,334,773 and its investment in subsidiaries was recorded as zero. This reflected the disposal of some of the subsidiaries and the write down to nil of SRC's investments in the remainder of its subsidiaries. The profit and loss statement for the 2009 year recorded a loss to SRC on disposal of investments of US\$7,645,351 and net intercompany interest income of US\$31,333,252.
- 31 SRC disposed of its shares in News Data, as mentioned above, on 19 August 2009 for the nominal consideration of US\$1, the investment having been written down to zero in the 2006 year. Subsequently, on 27 August 2009, SRC was assigned two promissory notes issued by News Limited for a total amount of A\$460 million, being a demand promissory note in favour of NAPI Pty Limited, having a face value of A\$440 million, and a demand promissory note in favour of News Asia Pacific Holdings Partnership, having a face value of

A\$20 million. As consideration, SRC issued demand promissory notes of identical face value to those issued by News Limited to each of NAPI and News Asia Pacific Holdings Partnership respectively. On the same day SRC presented the notes issued by News Limited for payment and the obligation of News Limited to pay SRC was satisfied by the total indebtedness of News Limited under the News loan agreement being increased by the additional amounts owing to SRC by SRC's presentation of the promissory notes. On the same day, News Limited made a cash payment of A\$440 million to NAPI Pty Limited and a further cash payment of A\$20 million to News Asia Pacific Holdings Partnership in exchange for becoming the holder of the promissory notes issued by SRC in favour of NAPI and News Asia Pacific Holdings Partnership. News Limited on that day also entered into a subscription agreement for News Limited to subscribe for 4,600,000 fully paid redeemable shares in SRC at \$1.00 each. The obligation of News Limited to pay the subscription amount of A\$460 million to SRC was offset against SRC's obligation to News Limited, as issuer of the promissory notes in favour of NAPI and News Asia Pacific Holdings then held by News Limited as a result of the cash payments it made to each of those entities, to pay the face value of those notes, being A\$460 million, to News Limited when News Limited presented them for payment. The shares under the subscription agreement were issued to News Limited when News Limited presented the promissory notes issued by SRC for payment on 27 August 2009 and the SRC promissory notes were then cancelled. This transaction had the effect of refinancing the indebtedness previously owing by the group to other members of the News Worldwide Group. It was treated as financial accommodation rather than a loan, but it resulted in, and was recorded as, an increase in the overall indebtedness of News Limited to SRC on intercompany account.

- 32 The financial accounts for SRC for the year ended 30 June 2010 disclosed that the amount owing to SRC on intercompany account was US\$942,608,056 (almost all of which was owed to SRC by its parent News Limited). The amount owing by SRC on intercompany account was US\$1,334,773. Its investment in subsidiaries remained at zero and the net interest income on the intercompany receivables from News Limited was US\$66,023,141. On 30 June 2011 SRC redeemed all of its preference shares which were held by News Limited, and News Limited transferred the remaining share capital in SRC of two ordinary shares to News Securities BV.
- 33 In those circumstances an accruals basis of accounting for the interest accruing to SRC provided the correct reflex of SRC's true income and the applicant is to be assessed on SRC's

interest income which accrued in the 2010 year. That the interest income had been derived upon accrual, in the sense that the interest income had come home when due, is not denied by the fact that, as was submitted, “SRC made only 2 loan advances in 10 years, and occasionally provided other financial accommodation in other forms”. SRC’s undertaking was substantial and the derivation of interest income was significant and was a means by which it employed a fund of capital from which to derive income or profit. SRC performed within the group a function involving broad and complex arrangements and transactions, including financial arrangements and transactions, for which it received and employed substantial capital funds, and the interest income it derived was sourced from the fund of circulating capital from which interest income was to be detached for enjoyment: see *Carden’s Case* at 158. SRC also accounted for its interest income on an accruals basis and used and relied upon its funds upon accrual. There was no suggestion on the evidence that payment of the accrued interest income from its parent was uncertain. SRC’s activities included unhedged foreign exchange risks producing a substantial profit over several years, but the lending of money and the provision of financial accommodation for reward to its parent company was part of its business or income earning activities. It may be accepted, without deciding, that SRC did not carry on a business of investment or of lending money, but its income earning activities included the lending of money to, amongst others, its parent on commercial terms for reward and the interest income had come home to SRC in a realised or immediately realisable form upon its accrual.

- 34 SRC’s contemporaneous books recorded accrued interest income due and payable as at 28 June 2010. Its general ledger and the unaudited balance sheet recognised a debit for interest of US\$65,168,676 and a related credit of US\$66,023,141 as at 27 June 2010. Both amounts were not subject to any contingency or likelihood of being unpaid. The figure of US\$66,023,141 was affected by the unrealised foreign exchange fluctuation of US\$854,464.34 as at 27 June 2010, producing the net amount of US\$65,168,676.49. That figure was recognised both as at 27 June 2010 and also as at 2 July 2010 when the interest due was capitalised pursuant to the terms of the News Limited loan agreement. Recognition of unrealised foreign exchange fluctuations were recorded in previous years in the general ledger, in the trial balance, and in income statements of SRC, and that recognition affected its profit or loss and retained earnings. SRC’s income statements recorded a foreign exchange gain of US\$58,446,003 for the year ended 30 June 2007, US\$59,533,177 for the year ended 30 June 2008, a loss of US\$85,288,957 in the year of income ended 30 June 2009,

a gain of US\$51,969,021 in the year ended 30 June 2010 and a gain of US\$210,328,346 in the year ended 30 June 2011.

- 35 In the 2011 financial year, SRC assumed a liability totalling A\$1,237,792,233 (US\$1,294,040,124.47) by the issue of three promissory notes to News Limited. The notes were issued as part of a series of pre-planned steps which included the repurchase by SRC on 30 June 2011 of certain of its issued shares and the execution on the same day of an agreement by which SRC agreed to assign to News Australia Holdings Partnership on 1 July 2011 the entire debt owing by News Limited to SRC. The assignment occurred on 1 July 2011 with the consideration payable to SRC being offset against SRC's liability under the three promissory notes issued by SRC to News Limited on 30 June 2011, but the dividend declared and the notes issued were supported at the time of the declaration and issue of the promissory notes, in part, by the unrealised gains. SRC's balance sheet as at 30 June 2011 disclosed total assets of US\$1,333,101,771 (including US\$1,332,836,488 intercompany receivables and loans) and total liabilities of US\$1,333,109,567, leaving a net deficiency of US\$7,796.00. The offset effected by these transactions required taking into account an unrealised gain to SRC of some US\$204 million. The trial balance recorded the unrealised intercompany amount for SRC at US\$204,951,154.94 and was recorded in the general ledger at US\$204,530,041.23. SRC's articles of association authorised it to make distributions from unrealised profits and the assumption of the liabilities by the issue of promissory notes and the declarations of a dividend were consistent with SRC's accrued interest being treated by SRC as having come home as it accrued.
- 36 The applicant also submitted that the Commissioner was in any event bound, but had failed, to apply Taxation Ruling 98/1 to assess SRC's interest income on a receipts basis rather than on an accruals basis. Section 357-60 of Schedule 1 to the *Taxation Administration Act 1953* (Cth) provided that a ruling bound the Commissioner in relation to a taxpayer if the ruling applied to the taxpayer and the taxpayer relied upon the ruling by acting or omitting to act in accordance with the ruling. In *CTC Resources NL v Federal Commissioner of Taxation* (1994) 48 FCR 397 Gummow J explained at 402 that when a ruling applies it is "treated as the factum upon which the legislation" operates thereby modifying the operation of the general law to the taxpayer.
- 37 The applicant contended that ruling TR 98/1 applied to it and that it, through its agent, had relied upon it by acting in accordance with it. Mr Michael Whyte gave evidence by affidavit

of being the partner of the applicant's tax agent for the 2010 year who had advised the applicant in relation to the issues arising in its tax return for that year. Mr Whyte was aware of TR 98/1 and of the issues concerning the appropriate treatment of the attribution of SRC's interest income to the applicant under the controlled foreign corporation provisions. Mr Whyte's unchallenged evidence was also that he had formed the view that SRC's interest income was to be treated as derived on a cash, rather than an accruals, basis having regard to the facts and law. It is not clear that what SRC did, whether through Mr Whyte or otherwise, satisfied the requirement of reliance in s 357-60(1)(b) by action or omission in accordance with the ruling, but the Commissioner's submission was directed to the broader proposition that the ruling did not by its terms bind the Commissioner in the way submitted by the applicant rather than by whether what was done amounted to relevant reliance.

38 The particular passages relied upon by the applicants in this regard were those in paragraphs [17], [19], [47] and [48] of ruling TR98/1 which stated:

17. When accounting for income in respect of a year of income, a taxpayer must adopt the method that, in the circumstances of the case, is the most appropriate. A method of accounting is appropriate if it gives a substantially correct reflex of income. Whether a particular method is appropriate to account for the income derived is a conclusion to be made from all the circumstances relevant to the taxpayer and the income.

[...]

19. As a general rule, the receipts method is appropriate to determine income derived from investments. However, there are exceptions to the general rule (refer paragraphs 47 and 48).

[...]

Investment income

Interest

47. The general principle is that interest is only derived, or arises, when it is received or credited. This general rule is subject to the overall principle that the appropriate method is that giving a substantially correct reflex of income. So exceptions to the general rule include (but are not limited to):

- interest from a business of money lending carried on by the taxpayer;
- interest derived by a financial institution (Taxation Ruling TR 93/27); unless from a 'non-accrual loan' (Taxation Ruling TR 94/32);
- interest from the everyday provision of credit as part of business activities (Taxation Ruling IT 2227);
- interest derived by taxpayers, whose other income is calculated on an accruals basis, who invest in fixed or variable interest securities cum interest (Taxation Ruling TR 93/28); and

- interest from deposits made in the ordinary course of carrying on a business, where the business income is properly assessable on the earnings basis, may be derived on a due and receivable basis. An example of this would be a large trading business that actively manages its funds on deposits.

Rent and royalties

48. Rent and royalties are generally assessable when received or applied at the taxpayer's direction. However, where rent or royalties are business income, a substantially correct reflex of that income may be given by use of the earnings basis.

To those paragraphs there needs also to be added what appeared in paragraphs [2] and [3] in which it was stated that the ruling discussed “the factors that are relevant” in determining the correct method to bring to account income for tax purposes and that the ruling was “not intended to be prescriptive”.

- 39 A fair reading of the ruling does not state the way in which the Commissioner considered a relevant provision applied or would apply to entities so as to bind the Commissioner to treat SRC's interest income as derived only when it was received. Paragraph [19] was expressly stated as a general rule from which there were exceptions. The general rule as stated in paragraph [47] was itself expressed to be subject to the overall principle that the appropriate method of tax accounting was that which gave a substantially correct reflex of income in the case of a particular taxpayer. It followed from this that the application of the ruling depended upon the particular circumstances of the taxpayer and that the ruling was not intended to apply other than in accordance with adoption of that method that gave the correct reflex by reference to the specific facts of each case. Paragraph [17] made clear the importance of the principle that the appropriate method to adopt was that which gave a substantially correct reflex of a taxpayer's income without adopting a rule that interest income was always derived only on receipt. The exceptions in paragraph [47] were not stated to be exhaustive of the exceptions that might apply when considering the application of the ruling but were expressly said to include those mentioned in the paragraph without being limited to them. The ruling was directed to giving general guidance concerning the application, in the context of interest income, of the general principle that the correct method of tax accounting to adopt was that which gave a substantially correct reflex of income. The terms of the ruling do not apply to bind the Commissioner on the facts of SRC.

40 Accordingly, the application will be dismissed.

I certify that the preceding forty (40) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justice Pagone.

Associate:



Dated: 8 June 2017