FEDERAL COURT OF AUSTRALIA

Academy Cleaning & Security Pty Ltd v Deputy Commissioner of Taxation

[2017] FCA 875

File number:	NSD 1073 of 2014
Judge:	**RARES J**
Date of judgment:	3 August 2017
Catchwords:	**INCOME TAX** – assessable income – appeal against objection decision to disallow taxpayer's objection to notice of amended assessment – where taxpayer paid non-refundable deposit of $63,000 and claimed deduction of $420,000 from assessable income after entering into agreement to pay balance of $357,000 purchase price at uncertain future time when notice given that future property then deliverable – where Deputy Commissioner conceded deposit outgoing incurred in year of income – deductibility of balance of purchase price under s 8-1(1)(a) of *Income Tax Assessment Act 1997* (Cth) – whether balance outgoing "incurred" in gaining or producing taxpayer's assessable income – whether liability to pay balance defeasible **INCOME TAX** – assessable income – deductibility of outgoing under s 8-1(1)(b) of *Income Tax Assessment Act 1997* (Cth) – whether whole, or part, of $420,000 outgoing necessarily incurred in carrying on taxpayer's business for purpose of gaining or producing assessable income – where outgoing made to acquire future property to be created in commercially speculative and unspecified projects – where taxpayer used outgoing as promotional tool – whether whole, or part, of outgoing appropriate and adapted for ends of taxpayer's business – whether sufficient connection between outgoing and taxpayer's business **INCOME TAX** – whether taxpayer obtained tax benefit under s 8-1(1) of *Income Tax Assessment Act 1997* (Cth) in connection with scheme to which Pt IVA of *Income Tax Assessment Act 1936* (Cth) applied – whether "dominant purpose" of taxpayer, through its director or his professional advisors, entering into agreement was to obtain tax benefit of deduction of $420,000, or $63,000 – where subject matter of agreement priced at well above market price – where agreement lacked clarity and did not oblige vendor ever to deliver any property or complete transaction to trigger taxpayer's obligation to pay balance of purchase

price – where agreement entered into shortly before end of tax year – where no evidence of taxpayer investigating other investment options

Legislation:

Evidence Act 1995 (Cth) s 63

Income Tax Assessment Act 1936 (Cth) Pt IVA, ss 177A, 177C, 177D, 177F

Income Tax Assessment Act 1997 (Cth) s 8-1

Taxation Administration Act 1953 (Cth) s 14ZZ

Carbon Pollution Reduction Scheme Bill 2009 (Cth)

Cases cited:

Australian Securities and Investments Commission v Hellicar (2012) 247 CLR 345

Cecil Bros Pty Ltd v Federal Commissioner of Taxation (1964) 111 CLR 430

Commissioner of Taxation v Gwynvill Properties Pty Ltd (1986) 13 FCR 138

Commonwealth Aluminium Corporation Ltd v Federal Commissioner of Taxation (1977) 77 ATC 4151

Ecosse Property Holdings Pty Ltd v Gee Dee Nominees Pty Ltd (2017) 343 ALR 58

Electricity Generation Corporation v Woodside Energy Ltd (2014) 251 CLR 640

Ex parte Professional Engineers' Association (1959) 107 CLR 208

Federal Commissioner of Taxation v Consolidated Press Holdings Ltd (2001) 207 CLR 235

Federal Commissioner of Taxation v Forsyth (1981) 148 CLR 203

Federal Commissioner of Taxation v James Flood Pty Ltd (1953) 88 CLR 492

Federal Commissioner of Taxation v Spotless Services Ltd (1996) 186 CLR 404

Federal Commissioner of Taxation v Trail Bros Steel & Plastics Pty Ltd (2010) 186 FCR 410

Fitzgerald v Masters (1956) 95 CLR 420

Glenfield Estates Pty Ltd v Federal Commissioner of Taxation (1988) 80 ALR 671

Handley v Federal Commissioner of Taxation (1981) 148 CLR 182

Jones v Dunkel (1959) 101 CLR 298

L Schuler AG v Wickman Machine Tool Sales Ltd [1974] AC 235

Magna Alloys and Research Pty Ltd v Federal Commissioner for Taxation (1980) 49 FLR 183; 11 ATR

	276 *New Zealand Flax Investments Ltd v Federal Commissioner of Taxation* (1938) 61 CLR 179 *Nilsen Development Laboratories Pty Ltd v Federal Commissioner of Taxation* (1981) 144 CLR 616 *Ronpibon Tin NL v Federal Commissioner of Taxation* (1949) 78 CLR 47 *Spriggs v Federal Commissioner of Taxation* (2009) 239 CLR 1 *Zhu v Treasurer of New South Wales* (2004) 218 CLR 530
Date of hearing:	6-8 June 2017
Registry:	New South Wales
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National Practice Area:	Taxation
Category:	Catchwords
Number of paragraphs:	137
Counsel for the Applicant:	Mr IS Young
Solicitor for the Applicant:	Dom Velcic & Co Solicitors
Counsel for the Respondent:	Ms KJ Deards with Mr GJ O'Mahoney and Mr MA Cosgrove
Solicitor for the Respondent:	Australian Government Solicitor

ORDERS

NSD 1073 of 2014

BETWEEN:	**ACADEMY CLEANING & SECURITY PTY LIMITED** Applicant
AND:	**DEPUTY COMMISSIONER OF TAXATION** Respondent

JUDGE: **RARES J**

DATE OF ORDER: **3 AUGUST 2017**

THE COURT ORDERS THAT:

1. The appeal be dismissed with costs.

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

REASONS FOR JUDGMENT

RARES J:

1 **Academy** Cleaning & Security Pty Ltd (or **the taxpayer**) has appealed to the Court under s 14ZZ of the *Taxation Administration Act 1953* (Cth) against the decision of the Deputy **Commissioner** of Taxation to disallow its objection to the Commissioner's **assessment** of income tax and shortfall penalty for the year of income ended 30 June 2009. In substance, the fate of Academy's objection turns on whether the Commissioner should have disallowed its claim to deduct $420,000 from its assessable income under s 8-1 of the *Income Tax Assessment Act 1997* (Cth) (**ITAA 1997**). Academy claimed that deduction because it contended that it was an outgoing that it:

- incurred in gaining or producing its assessable income, within the meaning of s 8-1(1)(a) of the ITAA 1997 (**the incurred issue**); or
- necessarily incurred in carrying on a business for the purpose of gaining or producing its assessable income, within the meaning of s 8-1(1)(b) (**the business purpose issue**).

2 Academy also contended that the Commissioner erred in determining that any tax benefit that it would obtain, if the whole or part of the outgoing were properly deductible under either limb of s 8-1(1) of the ITAA 1997, was not allowable because it was, or would have been, so obtained in connection with a scheme to which **Pt IVA** of the *Income Tax Assessment Act 1936* (Cth) (**ITAA 1936**) applied within the meaning of s 177F(1)(b) (**the scheme issue**).

Background

3 On 29 June 2009, the taxpayer entered into an emissions reduction purchase **agreement**, as buyer, with **BR Redd** Ltd, a Malaysian company, as seller. BR Redd later changed its name to **Voluntary Credits** Ltd. Under the agreement, Academy agreed to acquire three contract lots, each of 5,000 tonnes of "sequestered carbon", at a price of "AUD 28.00 per tonne of carbon". By entering into the agreement and paying a non-refundable deposit of $63,000 or 15% of the total price of $420,000 for the three contract lots, the taxpayer contended that it had incurred, on 29 June 2009, a total outgoing of $420,000.

4 I will set out the details of the agreement shortly, but before doing so, it is necessary to provide a context. On 14 May 2009, the Government introduced and read for a first time in

the House of Representatives, the *Carbon Pollution Reduction Scheme* ***Bill*** *2009* (Cth). The Bill was read a third time on 4 June 2009 and was then transmitted to the Senate.

5 The Bill had not been read a second time in the Senate before 29 June 2009. Although not relevant for the purposes of these reasons, the second reading in the Senate was later defeated on 13 August 2009. Thus, at the time the agreement was entered into, the precise form of any Commonwealth legislation that would, or might, provide for carbon reduction schemes was uncertain, as indeed was the question whether legislation would be enacted in the form, or to the effect, of the Bill or at all. Subsequently in late April 2010, the then Prime Minister, the Hon Kevin Rudd MP, announced that the Bill, and cognate Bills, would not be pursued until sometime in the subsequent Parliament.

6 Academy was incorporated on 6 February 2001. Warren **Hughes** was Academy's sole director. It was part of a group of companies that Mr Hughes had founded in 1991, known as the ACS Integrated Service Provider **Group**. Mr Hughes was the controlling mind of the Group and each of its members, including Academy. He made the decision to enter into the agreement and he signed it on Academy's behalf. The Group had about 600 full and part time employees and contractors in August 2015 when Mr Hughes affirmed his affidavit on behalf of the taxpayer on 13 August 2015.

7 Academy's business included undertaking responsibilities for providing security and cleaning services under contracts with a number of corporations including Westfield, Lend Lease, Stockland, Lederer & Lederer, Terrace Towers and Coles, as well as New South Wales State and local government entities such as Workcover and Wyong, Gosford and Penrith Councils.

8 The Group engaged in a wide range of business activities providing services to clients for security, cleaning, infrastructure management in the mining resources sector, building and site maintenance, housekeeping for serviced apartments, traffic control management plans, retail cleaning and security. Mr Hughes said that Group members, including Academy, had to win their security and cleaning contracts in tender processes. The Group submitted tenders "under the banner name ACS". Mr Hughes said that if the Group won a tender, the contract was allocated to the appropriate Group member to perform.

9 Mr Hughes said that, based on his knowledge and experience gained over 25 years in running and growing his business and the Group, he understood that the success of his companies (including Academy) in winning tender bids involved a number of factors. He said that those

factors included cost, competitiveness, previous experience and a prior working relationship with the particular client, the expected or perceived future financial capability and viability of the Group, innovation and a factor, that he said had particular importance in winning public sector tenders, including with local governments, namely, "environmental sustainability and social responsibility".

10 Mr Hughes ascribed percentage weightings to those factors. He understood that, in determining the winning bid, those who considered the tenders used a 20% weighting for the environmental sustainability and social responsibility factor of each bid. He said that the effort that the Group put into its tenders reflected his understanding of those weightings and he understood that the Group's environmental policies were "therefore significant in the winning of tenders".

11 Mr Hughes relied on his long time accountant and tax agent, Ian **Figtree**, to look after the Group's taxation and accounting work. By 2009, their relationship had existed for about 20 years. Mr Figtree, who did not give evidence, prepared tax returns and accounts for the Group. He suggested to Mr Hughes that he might consider dealing with BR Redd which was selling **REDD Credits**. (REDD is an acronym for "reducing emissions from deforestation and forest degradation".)

12 After Mr Figtree referred him to BR Redd, Mr Hughes spoke to Bruce **Rowntree**, a solicitor. From the date of its incorporation on 11 May 2009 to at least 30 June 2009, Mr Rowntree was a director of BR Redd and he was also a director and secretary of its sole shareholder, BR Redd Holdings Ltd.

The agreement

13 The agreement comprised five pages, the final one of which was a schedule and signature page. The agreement was clumsily prepared and contained numerous and obvious errors and some ambiguities, as will appear below.

14 The recitals recorded that:

- BR Redd had entered into an agreement to acquire "**Emission Units**" (being defined in cl 1.1.1 as having "the same meaning ... as it bears in the Applicable Rules") from **Carbon Strategic** Pte Ltd;

- Carbon Strategic had entered into contracts to develop **projects** in the Independent State of Papua New Guinea, Indonesia and the Solomon Islands that "will yield REDD Credits sufficient to meet the requirements of [Academy] under this Agreement';
- BR Redd had agreed to acquire REDD Credits "on completion of the projects by "[Carbon Strategic]".

15 The definitions clause (cl 1.1) provided that:

- the "Applicable Rules" were both "any International Rules referred to in [the Bill] and any law passed by any Sovereign nation providing for the registration of, and trading in, carbon credits" and the Bill, together with any regulations made "under that legislation".
- "Buyer's Registry Account" meant "an account specified or nominated in the Agreement [sic] by the Buyer in the National Registry of Emission Units maintained under the Applicable Rules". (No such account was specified or nominated in the agreement and there was no evidence that any account meeting that definition ever existed.)
- "**Contract Lots**" meant "Emission Units equal to 2,000 [sic] tonnes of sequestered carbon". (The number of tonnes in this definition was inconsistent with the provision in the schedule of "Quantity per Contract Lot ... 5,000 [sic] tonnes of sequestered carbon" and there was no definition of what "sequestered carbon" signified.)
- "Delivery Date" meant the date that BR Redd specified in a Delivery Notice to the taxpayer.
- "**Delivery**" means the posting by the Seller of documentation that shall allow the crediting of the Buyer's Registry Account with the Contract Quantity in accordance with the Applicable Rules or such other similar mechanism as prescribed by the Applicable Rules.
- "**Delivery Notice**" means a notice given by the Seller to the Buyer that it is ready *to post the Seller* [sic] the documentation that shall allow the crediting of the Buyer's Registry Account with the Contract Quantity in accordance with the Applicable Rules. The Delivery Notice shall include a copy of such documentation to allow the Buyer to verify that the documents comply with the Applicable Rules. (The part of the definition of "Delivery Notice" that I have italicised above seems to be an error for a requirement to post such a notice to the buyer.)

...

- "**Termination Date**" means the date the Agreement is terminated either by payment of the Purchase Price in full or by the Buyer giving notice of Termination in accordance with Paragraph 5.1 of this Agreement.

  ...

- "**Unit**" means the Emission Units, expressed **as a tonne of carbon sequestered by the projects**.

  ...

- "**Unit Price**" means the price per tonne of Contract Quantity Emission Unit [sic] specified in the Schedule. (emphasis added)

16 In cl 2.1, BR Redd agreed to sell and Academy agreed to purchase, the total number of contract lots specified in the schedule. The schedule provided that there were three contract lots, each of 5,000 tonnes of sequestered carbon (which as noted above was a different quantity per lot from the 2,000 tonnes in the definition of "Contract Lots" in cl 1.1.1). However, the schedule also provided that the unit price was "AUD 28.00 per tonne of carbon" and the purchase price was AUD420,000 (being the product of multiplying $28 by 15,000).

17 Clause 2.1 continued:

> **Upon completion of the projects referred to in the Recitals** the Seller shall post to the Buyer a Delivery Notice. The Delivery Notice shall give the Buyer twenty (20) Banking Days notice of the Delivery. The Buyer must within ten (10) Banking Days of receipt of the Delivery Notice pay the balance of the Purchase Price to the Seller as the Seller directs in its notice under this Clause. Upon receipt of the balance of the Purchase Price the Seller will complete Delivery. (emphasis added)

18 Academy had to pay the purchase price in two instalments under cl 3.1, the first instalment being 15% of the total (here $63,000) payable on execution of the agreement, and the balance of 85% in accordance with cl 2.1.

19 In addition, cl 5.1 provided that, *first*, Academy had a right to terminate the agreement if it had not received a delivery notice within three years of the date of execution of the agreement and, *secondly*, if Academy elected to terminate, it had no right to a refund of any part of the purchase price paid beforehand.

20 The agreement was governed by the law of Malaysia (cl 6.1), but, as there was no evidence of any relevant difference to Australian law, that is of no consequence for this appeal. The parties had to send notices to the addresses in the schedule (cl 7.5), namely to the attention of Mr Rowntree for a notice to BR Redd and to the attention of Mr Figtree for a notice to

Academy. David **Bonnell**, Mr Rowntree's partner in his solicitors firm, executed the agreement on behalf of BR Redd.

21 The Bill contemplated the establishment of a register, to be known as the Australian National Registry of Emissions Units (cl 145). It provided that a person could open a registry account, identified by a unique account number in that register (cll 146, 147). It provided, in Div 14 of Pt 10, for carbon sequestration and forestry rights, each of which related, however, to land in Australia (cll 239A-241).

The put option

22 Also on 29 June 2009, Mr Hughes signed, on behalf of Academy, an emissions reduction **put option** with Carbon Strategic in respect of emissions units the subject of the agreement. Mr Bonnell signed the put option as agent on behalf of Carbon Strategic. Under the put option, Academy would have had to pay Carbon Strategic an option fee of 2% of the purchase price (i.e. $8,400) in consideration of which it would have obtained the right to require Carbon Strategic to acquire, for AUD23 each, any emission units that Academy was obliged to take under the agreement (at a price of AUD28 each), after BR Redd served Academy with a delivery notice. However, there was no evidence that Academy paid the option fee and Academy's appeal statement acknowledged that it had not paid that fee "such that this agreement was rendered void *ab initio*". Accordingly, I have not treated the put option as ever having been in force.

23 The put option provided that the terms defined in the agreement had the same meanings in it (cl 1.2.2). If Academy exercised the put, settlement would occur contemporaneously with settlement under the agreement (cl 3.2) and cl 3.3 irrevocably directed Academy (scil: Carbon Strategic) to pay BR Redd the purchase price for the put "in [part] satisfaction of [Academy's] obligations under the [agreement]". (This was a further example of the lack of care in the drafting of the transactional documents.) The governing law was that of Singapore (cl 6.1).

24 The next effect, if the put option were in force and exercised, was that Academy would incur a loss of AUD5 per unit as well as its initial outlay of the option fee. The put option provided in cl 5.1 that it terminated on the termination date of the agreement. Thus, if Academy had entered into, and then exercised, the put option in respect of all 15,000 units, it would have been able to limit its risk (if the market had fallen by the time of settlement) to a total outlay as follows:

Item	Total Unit Cost	Payment due by Academy
Deposit 15%		$ 63,000
Option fee 2%		$ 8,400
85% balance purchase price	357,000	
Less: 15,000 units @ AUD23 ea	345,000	
Net:	12,000	$ 12,000
Total:		$ 83,400

The factual context

25 Mr Hughes said that, at the time that he caused Academy to enter into the agreement, the introduction of a REDD trading scheme was a topical issue and that "a scheme was imminent". He said, in his affidavit, that his recollection was that his Group's clients were also particularly concerned with both the introduction of a carbon tax and the ability of their contractors to be in a position to offset their carbon footprint.

26 Mr Hughes said, in his affidavit, that he met with Mr Rowntree who gave him marketing or explanatory material for REDD carbon credits. Mr Hughes added that he was not presently able to locate that material. Mr Hughes explained in his oral evidence that in April 2013, a fire at the Group's premises had destroyed all its records. That was why, he said, he had no documents to annex to his affidavit or produce as evidence of the original marketing or other material that he had considered in connection with his decision to enter into the agreement with BR Redd or the use that Academy, or the Group, had made of the agreement subsequently in tender documents or marketing material prior to 2014. However, he had not asked either of Mr Figtree or Mr Rowntree for copies of any documents that they had provided him in 2009 or which he had given them, or if they had retained any of that material. He did not ask Mr Figtree to give evidence and Mr Rowntree was Academy's solicitor on the record in this proceeding until 4 May 2015.

27 Instead, Mr Hughes annexed to his affidavit copies of material "that I have been provided [subsequently] with including a CD with photos and videos". That material related to activities that the rebranded BR Redd, in its new name of Voluntary Credits, appeared to

have undertaken in Vietnam, that had nothing to do with any project referred to in the recitals to the agreement (being projects in Papua New Guinea, Indonesia and the Solomon Islands), some of which included newspaper articles that antedated the fire. Mr Hughes said that those (irrelevant) documents "would have come through Bruce Rowntree". When I asked Mr Hughes why he had annexed to his affidavit that material, that consisted of over 250 pages, he said, "that's probably a question that Ian Figtree and Bruce Rowntree have to answer".

28 Mr Hughes said that both Mr Figtree and Mr Rowntree assisted him to work out how many contract lots the taxpayer should purchase. He said that "we" made a strategic decision:

> as a group to invest up to [$]200,000. It may have been [$]50,000. But [$]200,000 in the sustainability practices that were going to gel in and obviously make our business more viable than the others. **So when I told them that amount of money that I was investing, then they worked and then they told me what was available then.** (emphasis added)

29 Mr Hughes attached to his affidavit an extract of the response to an invitation to tender for "provision of street scape cleaning and promotion" to Burwood Council that "ACS Integrated Service Provider" (being a business name that the Group used) had made in July 2015 and before 13 August 2015, when Mr Hughes affirmed that affidavit (**the Burwood tender**). The Council required the tenderer to address 15 matters, one of which was "Ecologically Sustainable Development". The tenderer's response included two pages under the heading "Environment". The pages had the appearance of being professionally designed and printed and displayed a logo of the image of a green frog that bisected both the expressions "forest friendly" and "carbon reduced". On the first of those pages the following text also appeared above a logo of a human footprint that appeared over the name "Voluntary Credits Pty Ltd" and five photographs that predominately depicted trees:

> ACS has entered into a contract with **BR Redd Limited** for the purchase of **5,000 tonnes of carbon credits. The credits will be generated as a result of projects being conducted by Carbon Strategic Pty Limited** in the Independent State of Papua New Guinea, Indonesia and the Solomon Islands.
>
> **These projects will result in ACS acquiring Reduced Emissions from Deforestation and Degradation (REDD) credits which are carbon credits generated by the highest quality projects run by the world's largest REDD developers resulting in;**
>
> - The world's most effective response to climate change so far;
> - The protection of our last remaining rainforests;

- Preservation of our valuable biodiversity;
- Empowerment of some of the most impoverished people on the planet; and a product with real environmental integrity from which you can build your brand.

ACS has invested into the environment $1.5m in the purchase of the Carbon Credits which is considered an excessive purchase for the size of the company, industry expectation **and the minimal claim we will have against the credits**. We do this as our business philosophy embraces environmental protection and allows us to assist our business partners in leveraging off our credits. (emphasis added)

30 Mr Hughes said that this printed material in the Burwood tender comprised some extracts from earlier tenders. He could not explain why the extract referred to a purchase of 5,000 tonnes, rather than 15,000 tonnes, or the use of $1.5 million as the size of that "investment" which he said was a "good question". It remained unanswered. He said that in 2009 and 2010 the Group had offered carbon credits for sale, but despite expressions of interest, none of the Group's clients took up those offers. Once the Government changed, Mr Hughes said, "carbon credits went to sleep" and in "the last five or six years it hasn't been a topic of conversation". He knew that the taxpayer had not received any REDD credits but he said that it "remains committed to the purchase of the credits as soon as a REDD trading scheme is introduced". However, Mr Hughes was not aware, until his cross-examination, that Carbon Strategic had been dissolved following its voluntary winding up in Singapore on 20 July 2015.

31 Mr Hughes' understanding of the importance of his Group's environmental policies to securing contracts was corroborated by Deborah **Warwick**, the Centre manager of the Imperial Shopping **Centre** at Gosford, New South Wales. She had been in her position, employed by A&A Lederer Pty Ltd, for 15 years. Ms Warwick affirmed her affidavit on 10 February 2016, but was unable to give evidence at the trial because the roof of the Centre had collapsed over a major tenant (namely Woolworths) as a result of severe storms immediately before she was to be called and she had to remain on site. I was satisfied that in those circumstances Ms Warwick was not available to give evidence, within the meaning of s 63 of the *Evidence Act 1995* (Cth), about the admissible facts asserted in her affidavit. Accordingly, I admitted the admissible representations in Ms Warwick's affidavit as evidence under s 63.

32 Ms Warwick said that ACS Pty Ltd (which was one of the companies in the Group) was the current cleaning and security service provider for the Centre and had been so for the previous

22 years. Ms Warwick said that all such contracts for the Centre were put to tender every three to five years. She stated that the fact that companies in the Group participated in the REDD program was "a significant factor in the Centre awarding them past and present cleaning and security services contracts".

33 I formed the view that Mr Hughes was an honest witness, who relied on his tax advisors, Mr Figtree and Mr Rowntree, to deal with the detail once he had made the decision to invest in the agreement. In his words, "the due diligence I performed was with Ian Figtree and Bruce Rowntree". Mr Hughes said that Mr Figtree "plays a major role in all of our business, all marketing strategies, particularly if it relates to money". Mr Hughes did not seek any advice from anyone else than Mr Figtree and Mr Rowntree in respect of Academy's entry into the agreement.

34 I accept that Mr Hughes genuinely saw an advantage for Academy, and through it, the Group, investing in a project with "green, clean credentials", as he understood was the purpose of having Academy enter into the agreement to buy REDD credits. That transaction would allow Academy and its related companies in the Group to promote to their existing and potential clients its commitment to carbon reduction and the protection of the environment. This made commercial sense for both the Group's business interests and those corresponding interests of its actual and potential clients, all of whom, in the then commercial and political environment, could portray themselves as contributing to the socially desirable goal of reducing carbon emissions.

35 Equally, Mr Hughes was astute enough to understand that, by entering into the agreement and paying $63,000 immediately, the taxpayer would obtain a much more substantial tax deduction in the 2009 year of income, leaving fulfilment of the obligation to pay the balance of the price for the contract lots, of $357,000, to occur, if at all, sometime in the future. Mr Hughes exhibited no subsequent interest, after his initial decision to enter into it, in the performance of the agreement or in when, if at all, the taxpayer would have to meet its obligation to pay for the balance that might become due on each of the three contract lots.

36 Academy recorded an item "Carbon Credits Loan $357,000" as a non-current liability in its statements of financial position for the 2009, 2010 and 2011 years. There was no evidence of any such loan having been made.

The expert evidence

37 The Commissioner led expert evidence from Robert **Fowler**, a climate change and finance consultant about the position in Australia and internationally in relation to the existence and nature of both governmental and voluntary carbon credit trading schemes at the time that the agreement was made in June 2009.

38 Mr Fowler also gave evidence as to the understanding of persons familiar with the market for such schemes as to the existence of primary and secondary markets for trading in carbon credits and the units in which any such trading occurred. Mr Fowler explained the distinction between the primary and secondary markets for carbon credits as follows.

39 **The primary market** dealt with transactions by project developers for the creation of carbon credits and their registration on a governmental or other recognised register. Once the carbon credits had been entered onto such a register, then they could be traded on **the secondary market**. Mr Fowler opined that at the time of entry into the agreement, the taxpayer and BR Redd were transacting in the primary market because the carbon credits that the taxpayer was agreeing to purchase did not then exist. The carbon credits would be capable of being traded on the secondary market only once they came into existence (i.e. they could be traded as registered carbon credits vendible to third parties who could be registered as purchaser on the governmental or other register). Carbon Strategic or BR Redd (or the person who created them) would register them and at that point, BR Redd could issue a delivery notice to Academy.

40 Essentially, the primary market operated in respect of projects in which there were inherent development risks associated with completing a project that was intended to result in the creation of carbon credits that, in the future, would be registered on a governmental or other recognised register. The registration of such carbon credits would then enable persons to trade, in the secondary market, the registered carbon credits as an existing product which was not affected by the risks that operated in the primary market.

41 The agreement used concepts, namely "tonnes of sequestered carbon", "tonne of carbon", "REDD credits", "carbon" and "carbon credits", without it providing any internal definition or mechanism by reference to which one could calculate equivalence or conversion rates between those concepts. A conversion mechanism for those concepts is necessary in order to assess objectively whether the price of "AUD28.00 per tonne of carbon" bore a relationship

to market prices for any unit of measurement of a traded emission reduction product in either the primary or secondary market.

42 Mr Fowler said that there was only one mandatory carbon credit trading scheme operating in Australia as at June 2009, namely the NSW Greenhouse Gas Abatement Scheme (**GGAS**) established by the State of New South Wales. He said that project developers could participate in the GGAS voluntarily by generating carbon credits, called NSW Greenhouse Abatement Certificates (that were measures of **tonnes of carbon dioxide equivalent** (**tCO_2-e**)). These certificates could be registered with the GGAS Administrator and then sold to one or more of the 18 electricity retailers in the State that were bound by the GGAS. He said that there were also four mandatory schemes operating internationally as at June 2009, being the European Union Emissions Trading Scheme (**EUETS**) and smaller schemes in Switzerland, New Zealand and north-eastern States of the United States of America, but that none of those schemes allowed Australian businesses to participate in them voluntarily.

43 Mr Fowler referred to data produced by the **World Bank** in its **report**, *State and Trends of the Carbon Market 2009*, that included a **chart** included in his report titled, "Carbon Prices Respond to the Recession". That chart reflected what he described as "rapid price declines" in both the compliance (or primary) and voluntary (or secondary) carbon markets that had occurred as a result of the global financial crisis. The chart showed that the price of a high quality CER (a measure of tCO_2-e) in the secondary (or voluntary market) (called a SCER, in contrast to PCERs which were CERs that were transferable on a primary market where mandatory compliance operated), had fallen from about €20 per tonne in October 2008 to about €10 in April 2009. The PCER (or primary market) prices on the chart were always below the SCER (or secondary market prices).

44 Mr Fowler said that the expression "sequestered carbon" was often used in the industry as a shorthand for "carbon dioxide equivalent" but that neither of those expressions referred to a commodity. Rather, the commodity that could be traded was a carbon credit issued or registered by a government. Mr Fowler said that one tonne of elemental carbon (i.e. the element of pure carbon) equated to 3.7 tonnes of carbon dioxide equivalent. He assumed that the price of "AUD28 per tonne of carbon" in the schedule to the agreement referred to one tonne of carbon dioxide equivalent.

45 Based on this assumption, he opined that the price of AUD28 (or about €18) per tonne of carbon dioxide equivalent (tCO_2-e) was very high in comparison to the price of between

AUD8 and 12 or €5 and 7 per tCO_2-e in the secondary market as at June 2009. Mr Fowler said that the markets all operated in respect of a tonne of carbon dioxide equivalent and that no government carbon credit market operated on the basis of a price per tonne of elemental carbon.

46 Mr Fowler also considered that the non-refundable deposit of 15% of the total price was an unusual provision in a voluntary or secondary market transaction, particularly where the vendor (here BR Redd) kept the deposit even if it did not, or could not, provide any carbon credits under the agreement. Assuming in the taxpayer's favour that the AUD28 per tonne was for a tonne of (elemental) carbon (i.e. about AUD7.60 per tonne of carbon dioxide equivalent), that contract price reflected the absence of any risk that Academy might not be supplied with what it had contracted to purchase.

47 However, the agreement had real risks, *first*, BR Redd had no obligation to deliver anything unless and until Carbon Strategic completed the projects that it was developing, and *secondly*, cl 5.1 enabled Academy to terminate the agreement after three years if it had not received a delivery notice, in which case it would forfeit 15% of the price and receive nothing in return. In that context (based on the assumption in [44]), the total price that Academy had to pay (if it did not terminate) was a market price for a carbon credit sale transaction that did not have any risk of non-delivery. Mr Fowler opined that the risk of non-delivery should have been reflected in the agreement in a lower price.

48 Moreover, Mr Fowler said that the market prices in the World Bank report chart did not include any forestry or REDD carbon credit prices. He said that the European Commission had decided not to include any forestry credits in its scheme because "[i]t was just too risky". In his report Mr Fowler had explained that the Clean Development Mechanism under the Kyoto Protocol permitted industrialised countries to meet, in part, their emissions targets by sponsoring greenhouse gas reducing projects in developing countries. However, Mr Fowler explained, the level of carbon in forests and landscapes was impermanent because, *first*, forests could burn or be destroyed and, *secondly*, the carbon level in landscapes could "be dramatically altered by seasonal or other forces". He said that none of the four then existing international schemes had accepted Clean Development Mechanism credits. As I have mentioned at [21], the Bill envisaged that both carbon sequestration and forestry rights in respect of land in Australia (but not overseas) would form part of the Australian carbon

trading scheme, if it were enacted. Nonetheless, the REDD credits the subject of the agreement were in respect of forestry projects outside Australia.

49 Accordingly, the REDD credits the subject of the agreement were, *first*, not commodities that were then in existence and involved the risk that they may never exist, *secondly*, not marketable or then available in any market and, *thirdly*, priced as if they were existing commodities currently tradeable in a market without any discount for risk. In that regard, the agreement allowed BR Redd scope to deliver units tradeable under any international or domestic Australian scheme and did not fix any time for performance by it.

50 Mr Fowler opined that the agreement was a primary market transaction because, in essence, its subject matter did not exist at 29 June 2009. He considered that since the emissions units (whatever they were) that the buyer (Academy) had contracted to purchase did not then exist, it had an exposure to "a much higher level of risk on non-delivery of the [carbon] credits compared to a secondary market transaction". I accept that evidence. And, of course, if the price of AUD28 were for a tonne of carbon dioxide equivalent, that price was well above any market price and necessarily reflected no risk at all.

51 The recitals to the agreement merely recorded that BR Redd had entered into an agreement to buy the emissions units from Carbon Strategic, that in turn had entered into contracts with unspecified persons in three countries to develop, again unspecified, projects there, that "will yield REDD credits sufficient to meet the requirements of [BR Redd] under this Agreement", and that BR Redd had contracted to "acquire REDD credits on completion of the projects by [Carbon Strategic]". There was no evidence that any of those three countries had or was then planning to develop a mechanism to register any REDD or other carbon credits. In other words, the projects were still in the developmental stage and no REDD credits then existed that were capable of delivery under the agreement.

52 In my opinion, that scenario provided a sound foundation for Mr Fowler's opinion that there was a much higher risk of non-delivery of the emissions units under the agreement than in a transaction in the secondary market where, necessarily, the registered emissions units already existed and could be traded immediately in the current market environment.

The taxation history

53 Academy included the amount of $420,000 in the "all other expenses" item in its 2009 tax return. After making allowance for that deduction the Commissioner issued an assessment

that the taxpayer had a taxable income of $33,683 on its total income of $5,179,066 for that year.

54 In January 2013, the Commissioner commenced an audit of Academy's income tax affairs for the four years ended 30 June 2009 to 2012. On 21 November 2013, the Commissioner notified Academy of the outcome of the audit.

55 On 9 December 2013, the Commissioner issued a notice of amended assessment, in respect of the year ended 30 June 2009, that disallowed the deduction of $420,000. The amended assessment increased Academy's taxable income to $453,683 and its tax payable to $136,104.90. A notice of assessment of shortfall penalty also imposed a 75% penalty of $94,500 on Academy.

56 On 18 December 2013, Academy objected to the notices of amended assessment and assessment of shortfall penalty.

57 On 10 October 2014, the Commissioner, *first*, issued a notice of **objection decision** and provided reasons for disallowing the taxpayer's objection and, *secondly*, made a determination under s 177F(1)(b) of ITAA 1936 that the whole of the amount of $420,000 was a tax benefit that was not allowable to the taxpayer for the 2009 year.

58 The objection decision, *first*, decided that the purchase price payable under the agreement, of $420,000, was not deductible under either limb of s 8-1 of ITAA 1997 and, *secondly*, if it were, Pt IVA of ITAA 1936 applied to it. The objection decision reasoned that entry into the agreement was not a normal aspect of the taxpayer's income producing activities.

59 The Commissioner considered that the agreement was void for uncertainty because of the lack of an objective means to identify both what the projects referred to in the recitals were or involved or when they would be completed and what "emissions unit" meant. He reasoned that the agreement was an extraordinary and artificial transaction. If the agreement were not void for uncertainty, the Commissioner reasoned that the only expenditure that the taxpayer "incurred", within the meaning of s 8-1(1)(a), was the deposit of $63,000. That was because the balance would not become due until settlement at an uncertain time contingent on the subsequent successful creation of emission units. The Commissioner found that, consequently, Academy was not definitely committed to paying that balance when it entered into the agreement.

60 Next, the Commissioner considered that the agreement was one for the purchase of a capital asset, namely the enduring benefit of both, *first*, an asset that could be sold to others for valuable consideration which was not part of Academy's ordinary trading activity and, *secondly*, a marketing credential that Academy had used to represent itself "as green on the back of it having merely entered [into] the [agreement] for nearly five years". The Commissioner found that the carbon credits, when acquired, would not form part of Academy's circulating capital and that the agreement did not provide for it to acquire them to meet some ongoing requirement of its business. Rather, he found, the acquisition was capital in nature.

61 Last, the Commissioner found that, if his earlier view were wrong, the purchase price was part of a scheme within the meaning of Pt IVA of ITAA 1936 and that, accordingly, the taxpayer was not entitled to a deduction for any of the purchase price. He found that Academy would not have done anything in the absence of the tax benefit of the deduction it claimed.

This appeal

62 The taxpayer commenced this appeal on 24 October 2014. At the hearing, the Commissioner did not press any contention that the agreement was void for uncertainty or that the amount of the purchase price was an outgoing of a capital nature. For its part, the taxpayer no longer challenged the Commissioner's decision to impose a shortfall penalty and not to remit the administrative penalty, if the taxpayer failed to establish its entitlement to deduct the purchase price under the agreement.

The incurred and business purpose issues – the legislation

63 Relevantly, to the incurred and business purpose issues, s 8-1(1) of ITAA 1997 provided:

> **8-1 General deductions**
>
> (1) You can ***deduct*** from your assessable income any loss or outgoing to the extent that:
>
> (a) it is incurred in gaining or producing your assessable income; or
>
> (b) it is necessarily incurred in carrying on a *business for the purpose of gaining or producing your assessable income. (emphasis in original)

Construction of the agreement

64 The agreement was a commercial contract. Its terms must be construed as a reasonable businessperson in the position of the parties to it would have understood them to mean. This requires consideration of the language used in the agreement, the surrounding circumstances known to both parties and the commercial purpose or objects to be secured by it, having regard to the genesis of the transaction, the background, the context and the market in which the parties are operating: *Electricity Generation Corporation v Woodside Energy Ltd* (2014) 251 CLR 640 at 656-657 [35] per French CJ, Hayne, Crennan and Kiefel JJ; *Ecosse Property Holdings Pty Ltd v Gee Dee Nominees Pty Ltd* (2017) 343 ALR 58 at 63 [16]-[17] per Kiefel, Bell and Gordon JJ..

65 Here, the parties were aware that they were entering the agreement in the context that the Parliament was considering, but had not passed, the Bill (as the definition of "Applicable Rules" in cl 1.1.1 contemplated). The definitions in cl 1.1.1 of "Emissions Units", "Unit" and "Contract Lots" appeared to deal with a concept that operated with the definitions of "Applicable Rules" and "International Rules" in the context of the Bill (that appeared to have been misnamed as "the *Carbon Pollution Reduction Bill*" in the definition of "International Rules").

66 However, the projects that the recitals asserted that Carbon Strategic was pursuing would not qualify for registration under the then version of the Bill because those projects did not involve land or forests in Australia. Thus, the parties had left open the identity and location of the secondary market register on which the emission units could be traded that BR Redd one day might include in a delivery notice. There was confusion in the agreement between, *first*, the definition in cl 1.1.1 of a "Contract Lot" as comprising Emission Units equal to 2,000 tonnes of sequestered carbon and the statement in the schedule that a contract lot comprised 5,000 tonnes of sequestered carbon and, *secondly*, the use of a price of AUD28 "per tonne of carbon".

67 I am of opinion that a reasonable person in the position of the parties at the time of entry into the agreement would have understood the definition's use of 2,000 tonnes to be a mistake and to refer, in fact, to the 5,000 tonnes used in the schedule. Generally, words or other expressions, in an instrument may be supplied, omitted or corrected where it is necessary in order to avoid absurdity or inconsistency: *Fitzgerald v Masters* (1956) 95 CLR 420 at 426-427 per Dixon CJ and Fullagar J, at 437 per McTiernan, Webb and Taylor JJ. Here, the

provisions of the schedule demonstrated that a contract lot had to comprise 5,000 tonnes in order for the pricing mechanism of AUD28 per tonne to work. The price of AUD420,000 was for three contract lots, one of which therefore would cost $140,000.

68 The unit price per tonne of AUD28 in the schedule had to be a reference to the price of emission units equal to 5,000 tonnes for each of the three contract lots so as to equate to the purchase price of $420,000. Thus, the reference to "AUD28.00 per tonne of carbon" in the unit price field in the schedule must be to a tonne of sequestered carbon or carbon dioxide equivalent. That is because the pricing mechanism in the schedule would not work if the price of AUD28 was for a tonne of pure or elemental carbon, being equivalent to 3.7 tonnes of carbon dioxide equivalent. Each contract lot comprised emission units equal to 5,000 tonnes of sequestered carbon. No other provision of the agreement referred to elemental carbon and the agreement gave it no role to play.

69 I reject Academy's argument, as it suggested during cross-examination of Mr Fowler, that the unit price of AUD28 was for a tonne of elemental carbon, so that the price of a tonne of sequestered carbon would equate to around AUD7.60. The latter price, of course, would have been closer to the prevailing prices for a tonne of sequestered carbon in the secondary market identified in the World Bank report (see at [43]-[44] above).

70 The agreement was bereft of any indicium that the parties had intended to contract on the basis that the unit price reflected a price for elemental carbon, a measure that no actual or proposed emissions, or carbon trading, scheme in the local or international markets used. It is easy and natural to read "carbon" in the unit price box in the schedule as a shorthand or mistake for sequestered carbon. But if the price per unit were based on elemental carbon, Academy was unable to offer any commercial or other reason why the parties did not simply multiply AUD28 by 3.7 to specify the unit price of $103.60 as being the price for the measure of sequestered carbon that the parties otherwise used consistently throughout the balance of the agreement. In my opinion, that would be an absurd construction since the purpose of the agreement was for the taxpayer to purchase emission units, not of elemental carbon, but of tCO_2-e, that could be traded in a secondary market: *Zhu v Treasurer of New South Wales* (2004) 218 CLR 530 at 559 [82] per Gleeson CJ, Gummow, Kirby, Callinan and Heydon JJ; *L Schuler AG v Wickman Machine Tool Sales Ltd* [1974] AC 235 at 251E per Lord Reid. A reasonable person in the position of the parties would have understood that. The emission

units and unit price referred to throughout the agreement were of, or for, sequestered carbon, not elemental carbon.

The incurred issue –Academy's submissions

71 Academy argued that by entering into the agreement it had completely subjected itself to the liability to pay the whole of the purchase price. It contended that, in the alternative, the deposit of $63,000 had been paid and was an outgoing incurred in gaining or producing its assessable income. The Commissioner did not dispute that the $63,000 had been incurred because Academy had paid it, but, he argued the balance, of $357,000, had not been incurred.

72 Academy's principal submission in respect of s 8-1(1)(a) was that the whole of the purchase price was incurred on its entry into the agreement and thus it could deduct the whole. It contended that the liability to pay the balance of the purchase price was not conditional, contingent or defeasible. Academy argued that its liability to pay the purchase price amounted to an entire outgoing that it had incurred within the test in *New Zealand Flax Investments Ltd v Federal Commissioner of Taxation* (1938) 61 CLR 179 at 207; *Federal Commissioner of Taxation v James Flood Pty Ltd* (1953) 88 CLR 492 at 507-508 and *Nilsen Development Laboratories Pty Ltd v Federal Commissioner of Taxation* (1981) 144 CLR 616 at 623-624.

73 Academy also argued that, if it so wished, BR Redd could obtain emissions units elsewhere than from Carbon Strategic and issue a delivery notice for them triggering the obligation to pay the balance of the purchase price. It submitted that if, in the future, the agreement were terminated, adjustments could be made in the year of income when that occurred, relying on *Commonwealth Aluminium Corporation Ltd v Federal Commissioner of Taxation* (1977) 77 ATC 4151 at 4161.

The incurred issue – consideration

74 I am of opinion that Academy did not incur a loss or outgoing, within the meaning of s 8-1(1)(a), to pay the balance of the purchase price of $357,000 when it entered into the agreement. The agreement provided that the balance would become payable for a subject matter, namely emissions units, that did not then exist, after Academy had received a delivery notice that BR Redd could issue only at an uncertain time in the future. That subject matter was, at most, property that was expected, but by no means certain, to come into existence at some time in the future. If it did not come into existence within three years, Academy could

terminate the agreement under cl 5.1 and, thus, extinguish any liability to pay BR Redd any more than the deposit paid on 29 June 2009, or it could keep the agreement on foot indefinitely, without BR Redd performing or being compellable to perform any obligation to give a delivery notice and, in those circumstances, without Academy having any immediate obligation to pay any sum to BR Redd.

75 Moreover, there were at least two conditions that had to be met before BR Redd could be in the position to issue a delivery notice. *First*, Carbon Strategic would have had to bring one or more of its unspecified projects to the point where sufficient REDD Credits had been brought into existence to create one, two or three "contract lots" of emission units equal to 5,000 tonnes of sequestered carbon within the meaning of the agreement. *Secondly*, those emission units had to be both registerable and registered in a government or other emissions or carbon credits trading scheme so that they would be immediately capable of being sold or traded by Academy when it paid the balance of the price due on the one or more contract lots in the delivery notice.

76 I reject Academy's argument that BR Redd could substitute other carbon credits for those that Carbon Strategic had to create. That is because cl 1.1.1 contained a definition of "Unit" as meaning "the Emissions Units, expressed as a tonne of **carbon sequestered by the projects**". The "projects" were those that the recitals defined as projects that Carbon Strategic was pursuing in Papua New Guinea, Indonesia and the Solomon Islands. There was no evidence of what those projects involved, how long (as at 29 June 2009) it would take to bring any of them to fruition or the steps that had to be undertaken to create emissions units from any of those projects that could be converted into a contract lot that BR Redd could include in a delivery notice.

77 The word "incurred" in s 8-1 and its analogues describes the character of the outgoing in question as having occurred during, or existing at the end of, the year of income. It is not necessary that the taxpayer make an actual disbursement for an outgoing in order that it be characterised as incurred in the year of income as Dixon CJ, Webb, Fullagar, Kitto and Taylor JJ held in *James Flood* 88 CLR at 506-508. They said that it is sufficient that the outgoing be one that amounts to an expenditure to which the taxpayer was definitively committed in the year of income.

78 The Court held that if an outgoing (in that case, the obligation to pay employees holiday pay under an industrial award) is imposed, or must be paid, or continues to accrue an increasing

quantum as an obligation to be satisfied by payment only in a subsequent tax year, it is not "incurred" in the earlier year of income. They held that the correct characterisation of outgoings or losses as "incurred" in the relevant year of income depended on whether or not the taxpayer had "completely subjected himself to them". Their Honours approved (88 CLR at 507) Dixon J's explanation of an analogue of s 8-1 in *New Zealand Flax* 61 CLR at 207, namely:

> To come within that provision there must be a loss or outgoing actually incurred. 'Incurred' does not mean only defrayed, discharged, or borne, but rather it includes encountered, run into, or fallen upon. It is unsafe to attempt exhaustive definitions of a conception intended to have such a various or multifarious application. **But it does not include a loss or expenditure which is no more than impending, threatened, or expected.** (emphasis added)

79 Dixon CJ, Webb, Fullagar, Kitto and Taylor JJ held that an employer did not incur a loss or outgoing for sums that it had accrued for holiday pay in the relevant tax year when its legal obligation was to pay holiday pay to only those employees who remained in its employment in December of the next tax year. That was because (88 CLR at 507-508):

> In respect of those employees there was no *debitum in praesenti solvendum in futuro*. There was not an accrued obligation, whether absolute or defeasible. There was at best **an inchoate liability in process of accrual but subject to a variety of contingencies** ... the source of the accruing liability, the award, imposes it as an obligation to pay wages for a period of time in the future during which the employee must be given leave. That means that **it is imposed in the form of a liability associated with the operations of the taxpayer for the ensuing year**. (emphasis added)

80 Here, the first recital in the agreement contemplated that the REDD credits generated by one or more of Carbon Strategic's projects would create sufficient emission units to enable BR Redd to meet its obligations under cl 2.1 to sell to Academy the three contract lots, or 15,000 tonnes of sequestered carbon. The first and second recitals were couched in prospective language. They envisaged that the emission units for those three contract lots did not then exist but, rather, that they would be created after the passage of time or happening of an event or both. Indeed, the second recital expressly recorded that BR Redd had yet to acquire the REDD credits and that this would occur only "on the completion of the projects by" Carbon Strategic.

81 I am of opinion that the agreement did not contemplate that Academy would purchase, or become liable to pay the balance of the purchase price for, any of the three contract lots on 29 June 2009. The subject matter of any liability of Academy to pay for one or more contract

lots was contingent on property coming into existence at an uncertain future time. That property (being the converted value of the REDD credits that Carbon Strategic might supply to BR Redd at an unspecified future date) did not then, and might never, exist. Indeed, cll 2.1, 3.1 and 5.1 provided that 85% of the purchase price would become due and payable if, and only if, *first*, Carbon Strategic completed its projects (cl 2.1) and BR Redd then posted a delivery notice to Academy, being a document that would entitle Academy to obtain some form of official recognition, under the Applicable Rules, that it had valuable rights to some kind of existing carbon credits, and, *secondly*, Academy had not exercised any right to terminate the agreement under cl 5.1, if the delivery notice were posted to it after 29 June 2012.

82 The recitals identified the projects that Carbon Strategic had contracted to undertake that were the source from which BR Redd had contractual rights to purchase REDD Credits on completion of Carbon Strategic's projects. And, cl 2.1 provided that BR Redd's obligation to post a delivery notice to Academy would arise upon completion of one or more of the projects referred to in the recitals. BR Redd could not compel Academy to pay for any part of the second instalment unless and until a third party, Carbon Strategic, *first*, completed its projects and, *secondly*, fulfilled its contractual obligations to BR Redd to deliver sufficient REDD credits to enable BR Redd to post a delivery notice in respect of those REDD credits to Academy under cl 2.1 of the agreement.

83 The source of any obligation of Academy to pay the 85% second instalment was necessarily contingent upon the coming into existence, at an uncertain future date, of future property, the fulfilment of which was uncertain: *James Flood* 88 CLR at 507-508. The parties to the agreement expressly acknowledged, in the recitals and the provisions of cll 2.1, 3.1 and 5.1, the uncertainty of whether the REDD credits would ever come into existence. Academy could elect to prolong its potential liability to acquire and pay for the contract lots if they had not come into existence before the termination date of three years after entry into the agreement. But Academy could never be compelled to pay for any contract lot, unless and until Carbon Strategic had completed sufficient of its projects and BR Redd had acquired from it the, or some of the, subject matter, namely one or more of the three contract lots of 5,000 tonnes of sequestered carbon and that, before this time, Academy had not exercised any right to terminate the agreement.

84 As at the end of the 2009 year of income, Academy had at best an inchoate liability that may have been in the process of accrual (if, by then, Carbon Strategic had commenced all or any of its projects, of which there was no evidence), but which was subject to a variety of contingencies. No reasonable businessperson in the position of the parties would have understood that on 29 June 2009, by entering into the agreement, Academy had completely subjected itself to pay the, or any part of the, second instalment totalling $357,000: *James Flood* 88 CLR at 506, 507-508.

85 It follows that Academy had not incurred an outgoing of $357,000, in respect of the second instalment, in the 2009 year of income within the meaning of s 8-1(1)(a) of the Act.

The business purpose issue – Academy's submissions

86 Academy argued that the outgoings, totalling $420,000 (being each of the deposit of $63,000, the liability to pay the balance of the purchase price and its assumption of the obligation to pay those sums by entering to the agreement), were necessarily incurred in carrying on its business. It contended that the outgoings were clearly appropriate or adapted for carrying on that business. It submitted that Mr Hughes, as Academy's controlling mind, considered that it was appropriate to incur the outgoings because it was in the taxpayer's business interest to be in a position where it could represent its consciousness of its carbon footprint and that it had taken steps to acquire offsetting carbon credits. Academy argued that it had exploited its entry into the agreement in growing its business and demonstrating to its clientele, particularly those in the public sector, its environmental credentials and attempts to reduce its carbon footprint.

The business purpose issue – consideration

87 The question is whether the whole, or part, of the deduction claimed of $420,000 was necessarily incurred in carrying on a business for the purpose of gaining or producing Academy's assessable income within the meaning of s 8-1(1)(b). There is no dispute that Academy was carrying on a business.

88 The Group's company profile, prepared in July or August 2015, shortly before Mr Hughes affirmed his affidavit on 13 August 2015, stated:

> ACS has invested into the environment $1.5m in the purchase of the Carbon Credits **which is considered an excessive purchase for the size of company, industry expectation and the minimal claim we will have against the credits**. We do this as our business philosophy embraces environmental protection and allows us to assist our business partners in leveraging off our credits. (emphasis added)

89 The emphasised portion of that statement reflects the true position of Academy even though there was no evidence of any investment by the Group beyond the $420,000 the subject of the agreement. In my opinion, the last sentence of that quotation did not reflect Mr Hughes' state of mind. Rather, his state of mind was reflected in the following evidence:

> Well, here we are seven years after the agreement has been signed, and no credits have been issued to Academy, have they? --- The whole carbon credits went to sleep when – change of government, and, in a sense, everything was put on the backburner. **The clients then didn't show as much interest in carbon then because the tax didn't come to reality, and, yes, so, in a sense, yes, the last five or six years, it hasn't been a topic of conversation as much as other environmentally strategic plans.**
>
> ... and Academy has not actually received any REDD credits as a result of the agreement that it entered into, has it? --- Not to my knowledge.
>
> Would someone else know about that? --- **Ian Figtree would be the only fellow that would know about Academy.** (emphasis added)

90 That evidence indicated that Mr Hughes had done nothing more to pursue any "business philosophy [that] embraces environmental protection". He had done nothing in seven years to ascertain what, if anything, BR Redd had done to pursue the realisation of its obligation to obtain any REDD credits the subject of the agreement. He was unaware of the winding up of Carbon Strategic in 2015. Nor did Mr Hughes know whether Academy had made any provision in its accounts to pay the $357,000 balance of the purchase price. In fact, in its 2009, 2010 and 2011 financial statements it had recorded that amount as a non-current liability for "Carbon Credits Loan". As he said, "it's probably outside my comfort zone, so I would probably have to go back to Mr Figtree".

91 Mr Hughes, like many self-made persons, was astute to seize on commercial opportunities to promote his businesses without finding it necessary to explore the fiscal intricacies that this involved. He left fiscal or taxation matters to his accountant, Mr Figtree. I am satisfied that Mr Hughes genuinely believed that investing in the agreement would yield good commercial value for Academy and that this would enable Academy, and his other companies, to demonstrate to actual and potential customers that it, and the Group, was environmentally concerned and could meet environmental criteria that clients and potential clients perceived or had set as desirable. Indeed, Academy and other Group companies continued to use, to the time of the trial, logos like those in the 2015 company profile and their agreement to purchase

the contract lots as marketing tools. Academy made provision in its financial statements for the 2009, 2010 and 2011 years of income for the future liability of $357,000.

92 Mr Fowler said that in mid-2009 there were many voluntary carbon credit trading schemes in Australia and internationally in which persons could participate. He said that there were then:

> so many options and choices for carbon credits available to Australian businesses ... that governments and industry groups were actively trying to introduce quality standards and codes of best practice into the voluntary carbon market.

93 A reasonable businessperson in the taxpayer's position could consider it appropriate and desirable to have its business associated with an investment in activities to generate carbon credits. Moreover, the taxpayer subsequently used the logos of BR Redd and the fact of its acquisition of rights under the agreement to promote its environmental credentials to its actual and potential customers. The extract from the Burwood tender included a statement that the Council was:

> committed to the principles of Ecological Sustainable Development (ESD) as defined in the *Local Government Act 1993* [NSW] and therefore competitiveness through environmental, as well as social and economic aspects.

94 The statement went on to warn that if a tenderer had been involved in activity contrary to those principles at any time in the preceding 12 months "a tender may be rejected". Thus, the Parliament of New South Wales regarded ecologically sustainable development business activity of persons with which it, and local government bodies, proposed to contract as relevant to their selection.

95 The parties accepted that the test for ascertaining the business purpose of a claimed deduction was to enquire, as Deane and Fisher JJ discerned for an analogue of s 8-1(1)(b) in *Magna Alloys and Research Pty Ltd v Federal Commissioner for Taxation* (1980) 49 FLR 183 at 205, 208; 11 ATR 276 at 293, 295, whether the relevant expenditure was "appropriate and adapted for the ends of the business carried on for the purpose of earning assessable income". That involved a subjective purpose for, and an objective character of, the outgoing in question. Their Honours recognised that the authorities had held that, in considering the taxpayer's subjective purpose, for practical purposes and within the limits of reasonable human conduct, the person who is carrying on the business must be the judge of what outgoings are necessarily to be incurred. In addition, Deane and Fisher JJ acknowledged that

taxpayers were free to decide both in what business they should engage and how to run their businesses profitably or economically (49 FLR at 205; 11 ATR at 293).

96 Their Honours explained when a voluntary outgoing would have the objective character to be deductible under an analogue of s 8-1(1)(b). They said that when "viewed objectively, the outgoing must, in the circumstances, be reasonably capable of being seen as desirable or appropriate from the point of view of the pursuit of the business ends of the business being carried on for the purpose of earning assessable income" (49 FLR at 208; 11 ATR at 295). That test was applied in *Commissioner of Taxation v Gwynvill Properties Pty Ltd* (1986) 13 FCR 138 at 150 per Neaves J, at 155 per Jackson J.

97 In *Spriggs v Federal Commissioner of Taxation* (2009) 239 CLR 1 at 24 [75] French CJ, Gummow, Heydon, Crennan, Kiefel and Bell JJ adapted the test under s 51(1) of ITAA 1936 stated by Latham CJ, Rich, Dixon, McTiernan and Webb JJ in *Ronpibon Tin NL v Federal Commissioner of Taxation* (1949) 78 CLR 47 at 56 and in *Magna Alloys* 49 FLR at 208; 11 ATR at 295-296, to s 8-1(1)(b) as follows:

> ... a loss or outgoing will be "necessarily incurred in carrying on" a business **if it is "clearly appropriate" or "adapted" for the carrying on of the business** ... Restating the test another way, the loss or outgoing will be "necessarily incurred" if it is "reasonably capable of being seen as desirable or appropriate from the point of view of the pursuit of the business ends of the business". (footnotes omitted) (emphasis added)

98 In *Glenfield Estates Pty Ltd v Federal Commissioner of Taxation* (1988) 80 ALR 671 at 683-684, Lockhart J, with whom Wilcox and French JJ agreed, considered numerous authorities on both limbs of s 51(1) of ITAA 1936, the analogue of s 8-1(1). As Lockhart explained, the word "necessarily", as used in the second limb (now found in s 8-1(1)(b)), meant "clearly appropriate or adapted for" and so placed a qualification upon the degree of connection between the expenditure and the carrying on of the business (80 ALR at 684). Lockhart J held that the absence of a sufficient connection between a transaction and a taxpayer's business would result in an outgoing under the transaction not being deductible. He found that, because of the absence of any relationship between the outgoings and the business, in that case, the transactions were "explicable only as measures intended to reduce Glenfield's liability to tax" (80 ALR at 684).

99 Here, the nature of the outgoings (in respect of the deposit, the liability to pay the balance and the transaction as a whole) was unusual. There is an absence of any evidence as to

Academy's contemporaneous rationale for its choice of such a large outgoing, as opposed to, for example, a more modest one. Mr Hughes simply said that Mr Figtree had assisted him to work out an investment of $200,000 (see [28] above) but he did not know if Mr Figtree did so by reference to the tax profile of Academy. Since Mr Figtree did not give evidence, it follows that the rationale is unexplained.

100 The liability to pay $357,000 represented about 10 times the taxable profit that Academy would have made in the 2009 year of income, had it not entered into the agreement. The size, and potential impact on its business (if and when it ever had to meet it), of that liability entailed a need for Academy to make financial provision to meet that expense, and to monitor the progress of the projects being pursued by Carbon Strategic, especially if Mr Hughes were as philosophically concerned about environmental protection as the 2015 company profile asserted.

101 Yet, the only actions that Mr Hughes took after entering the agreement, paying the $63,000 deposit and claiming the $126,000 deduction in Academy's 2009 tax return, were to promote the Group's environmental credentials to its existing and potential clientele. The promotional activity was consistent with Academy characterising the $420,000 outgoing as "marketing" in its statement of financial performance for the 2009 year of income, in contrast to recording no marketing expenditure in the 2010 and 2011 years.

102 The 2015 company profile also asserted that the Group had entered into a contract with BR Redd for the purchase of 5,000 tonnes of carbon credits. Mr Hughes could not explain how the 5,000 tonnes or the $1.5 million (see [88] above) referred to there related to the 15,000 tonnes or price of $420,000 the subject of the agreement.

103 As Wilson J, with whom Mason J agreed (and see too *Handley v Federal Commissioner of Taxation* (1981) 148 CLR 182 at 197 per Murphy J), said in *Federal Commissioner of Taxation v Forsyth* (1981) 148 CLR 203 at 213 (and see too at 215):

> In every case it is clearly a question of fact and degree whether the outgoing has the necessary relation to the gaining of assessable income.

104 In *Magna Alloys* 49 FLR at 203; 11 ATR at 295 Deane and Fisher JJ said that the:

> controlling factor is that, viewed objectively, the outgoing must, in the circumstances, be reasonably capable of being seen as desirable or appropriate from the point of view of the pursuit of the business ends of the business being carried on for the purpose of earning assessable income.

105 I accept that, in June 2009, Mr Hughes considered that Academy should invest in a form of creation of carbon credits to enhance the Group's environmental credentials and as a basis for marketing those credentials. However, the investment in the agreement was so out of the nature and character of the business carried on by Academy and so excessive that I am of opinion that its purpose can only reasonably have been to gain the significant tax advantage that it appeared to provide. The scale of the outgoing of $420,000 was out of all proportion to the carrying on of any business that Academy conducted that could justify an inference that that outgoing was truly incidental to that business.

106 The agreement was in reality an investment in speculative and unspecific projects that BR Redd was pursuing, though its own asserted dealing with Carbon Strategic, in three foreign countries in the hope of generating, at an uncertain time in the future, something that might be able to be realised on the primary market as, or in, REDD or carbon credits and then converted into property that could be sold on one or more secondary markets. This commercially speculative venture had no real or sufficient connection to Academy's business. Moreover, it was so detached from that business that, apart from using its entry into the agreement as a promotional tool, Mr Hughes and Academy never thought of, or inquired about, when the projects that Carbon Strategic was supposed to be pursuing would be brought to fruition.

107 Here, Academy claimed a deduction of $126,000, twice the amount of the $63,000 that it paid for the 15% deposit, for what at best was a speculative investment in which it might never be required to pay the balance of 85% of the purchase price (a circumstance that actually occurred). This outgoing appeared to have the dominant, if not only, purpose of obtaining a tax advantage for Academy and was not clearly appropriate or adapted for the carrying on of its business: *Spriggs* 239 CLR at 24 [75]; *Glenfield* 80 ALR at 684.

108 Objectively, the entry into the agreement was the sole involvement that Academy had in relation to the purchase and sale of carbon credits. And, the entry into the agreement did not give Academy any legal or equitable interest in any existing carbon credits. Academy had not before, and did not after, entering into the agreement, transacted any dealing in carbon credits. The scale of the potential commitment to pay the balance of the purchase price was out of all proportion to Academy's ordinary advertising or promotional expenditure. While Mr Hughes said that some of the Group's customers (which I infer included those of Academy) expressed "interest" in the possible purchase of carbon credits during the time that

the Bill and the general political debate on carbon credits were topical, Academy, at that time (and later), had nothing to sell. That would remain the case unless and until BR Redd provided a delivery certificate to Academy, triggering its obligation to pay the, or a part of the, balance of the purchase price for the up to three contract lots to be delivered.

109 Accepting that the New South Wales Government and its local governments placed importance on ecologically sustainable development, as did Ms Warwick's employer and others to which the Group provided or tendered to provide services, and that this was a factor of importance in the Group's (and Academy's) tendering credentials, the reality is that, as the Group's 2015 profile stated, the investment in the agreement to purchase carbon credits "is considered an excessive purchase for the size of company, industry expectation and the minimal claim we will have against the credits".

110 Mr Hughes did not investigate, or inform himself about, what BR Redd and Carbon Strategic were to do in order to deliver contract lots to Academy under the agreement. Nor did he explore any other possible alternatives for Academy in the available market for carbon credits. His interest in exploring the investment appears to have been to listen to advice from one of its promoters, his accountant, Mr Figtree. Mr Hughes showed no interest in the progress, or, on the evidence, lack of progress, in (the now liquidated) Carbon Strategic pursuing projects in the three countries nominated in the agreement in very general terms. Indeed, such was Mr Hughes' lack of any interest in pursuing or following up on this "excessive purchase" that he attached to his affidavit a large volume of irrelevant material of other projects that BR Redd, in its new name, Voluntary Credits, was pursuing in countries other than the three nations from which Carbon Strategic had to source the contract lots.

111 Mr Hughes was unaware of the liquidation of Carbon Strategic, Academy's right to terminate the agreement and the failure of BR Redd to do anything under the agreement except take the deposit. These factors suggest that, subjectively, too, Mr Hughes did not consider that the outgoing (both the deposit and balance of the purchase price) was clearly appropriate or adapted for carrying on Academy's business.

112 Accordingly, I am not satisfied that the outgoing claimed, of $420,000, was necessarily incurred in carrying on a business of Academy for the purpose of gaining or producing its assessable income within the meaning of s 8-1(1)(b). Nor do I consider that the $63,000 deposit is capable of being treated as severable from the balance. That is because I am of

opinion that Academy's purpose for its payment in 2009 was inseverable from its purpose for entering the agreement as a whole.

The scheme issue – the legislative provisions

113 A taxpayer can obtain a tax benefit in connection with a scheme including, as provided in s 177C(1)(b) of ITAA 1936, if a deduction would be allowable in relation to a year of income "where the whole or a part of that deduction would not have been allowable, or might reasonably be expected not to have been allowable, to the taxpayer in relation to that year of income if the scheme had not been entered into or carried out". Relevantly, s 177D, as in force in June 2009, provided:

> **177D Schemes to which Part applies**
>
> This Part applies to any scheme that has been or is entered into after 27 May 1981, and to any scheme that has been or is carried out or commenced to be carried out after that date (other than a scheme that was entered into on or before that date), whether the scheme has been or is entered into or carried out in Australia or outside Australia or partly in Australia and partly outside Australia, where:
>
> (a) a taxpayer (in this section referred to as the ***relevant taxpayer***) has obtained, or would but for section 177F obtain, a tax benefit in connection with the scheme; and
>
> (b) having regard to:
>
> (i) the manner in which the scheme was entered into or carried out;
>
> (ii) the form and substance of the scheme;
>
> (iii) the time at which the scheme was entered into and the length of the period during which the scheme was carried out;
>
> (iv) the result in relation to the operation of this Act that, but for this Part, would be achieved by the scheme;
>
> (v) any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme;
>
> (vi) any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant taxpayer, being a change that has resulted, will result or may reasonably be expected to result, from the scheme;
>
> (vii) any other consequence for the relevant taxpayer, or for any person referred to in subparagraph (vi), of the scheme having been entered into or carried out; and

> (viii) the nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in subparagraph (vi);
>
> it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for the purpose of enabling the relevant taxpayer to obtain a tax benefit in connection with the scheme or of enabling the relevant taxpayer and another taxpayer or other taxpayers each to obtain a tax benefit in connection with the scheme (whether or not that person who entered into or carried out the scheme or any part of the scheme is the relevant taxpayer or is the other taxpayer or one of the other taxpayers).

114 The Commissioner had power (as occurred here), under s 177F(1)(b), to determine not to allow the whole or a part of a deduction comprising a tax benefit that had been, or but for s 177F would have been, obtained by the taxpayer in connection with a scheme.

The scheme issue – Academy's submissions

115 Academy argued that Pt IVA of ITAA 1936 was a provision of last resort. It contended that if it had succeeded in satisfying either limb of s 8-1(1) of ITAA 1997, then, to that extent, the outgoing of either the $63,000 deposit or the total $420,000 price payable under the agreement had been necessarily incurred by it carrying on its business. It submitted that axiomatically, for the purposes of ss 177D and 177A(5) of ITTA 1936, the outgoing must have been an ordinary commercial dealing and, consequentially, Academy's dominant purpose in incurring that outgoing cannot have been the obtaining of a tax benefit. Academy called in aid what Dixon CJ, Taylor J, Kitto J and Windeyer J each agreeing, observed in *Cecil Bros Pty Ltd v Federal Commissioner of Taxation* (1964) 111 CLR 430 at 438, 442, that the repealed s 260 could not apply to defeat or reduce any deduction otherwise truly allowable under the repealed s 51.

116 Academy contended that, as at June 2009, in the context of the political debate as to climate change and carbon credits, including the Parliament's consideration of the Bill, even if Mr Hughes had been muddled in his reasoning, he was genuinely concerned to position his business favourably as one having environmentally sound credentials. It submitted that Academy, and the Group, used the investment in carbon credits under the agreement as part of its sales and marketing effort. That, Academy contended, was Mr Hughes' and its real or motivating purpose. It argued that the Commissioner had not asserted that the $357,000 was an outgoing of a capital nature. Academy contended that Mr Hughes' evidence was that in June 2009 he was looking to invest $200,000 in "the sustainability practices that were going

to gel in and obviously make our business more viable than the others". Academy argued that the counterfactual position would have been that had Academy not invested $420,000 in the agreement, it would have invested money in other programs.

The scheme issue – consideration

117 A taxpayer bears the onus of establishing that there is no tax benefit in connection with a scheme: *Federal Commissioner of Taxation v Trail Bros Steel & Plastics Pty Ltd* (2010) 186 FCR 410 at 420 [35] per Dowsett and Gordon JJ, Edmonds J agreeing at 426 [62].

118 It is not necessary to refer specifically to each of the eight matters in s 177D(b) individually when making "a global assessment" of the dominant purpose of the person or persons who entered into or carried out the scheme: *Federal Commissioner of Taxation v Consolidated Press Holdings Ltd* (2001) 207 CLR 235 at 263 [94] per Gleeson CJ, Gaudron, Gummow, Hayne and Callinan JJ. They said that the decision maker can attribute to that party the (objectively discernible) purpose of a professional adviser for a party to the scheme (207 CLR at 264 [95]). They also observed that a taxpayer's dominant purpose of obtaining a tax benefit can be consistent with the pursuit of commercial gain in carrying on a business and said (207 CLR at 264 [96]):

> The fact that the overall transaction was aimed at a profit making does not make it artificial and inappropriate to observe that **part of the structure of the transaction is to be explained by reference to a s 177D purpose**. Nor is there any inconsistency involved, as was submitted, in looking to the wider transaction in order to understand and explain the scheme, and the eight matters listed in s 177D. (emphasis added)

119 The eight matters to which s 177D(b) required a decision maker to have regard enable the drawing of an objective, not subjective, conclusion as to the existence or not of the dominant purpose of the person or persons who entered into, or carried out, the scheme, to enable the taxpayer to obtain the relevant tax benefit. Here, the question is whether the dominant purpose of Academy, through one or more of Mr Hughes, Mr Figtree and Mr Rowntree, was to obtain the tax benefit of the deduction of $420,000, or the deposit of $63,000, by causing Academy to enter into the agreement and pay the deposit.

120 However, a particular course of action that a taxpayer takes can be both "tax driven" and bear the character of a rational commercial decision as Brennan CJ, Dawson, Toohey, Gaudron, Gummow and Kirby JJ observed in *Federal Commissioner of Taxation v Spotless Services Ltd* (1996) 186 CLR 404 at 416. Nonetheless, as they held, the mere presence of a rational

commercial basis does not determine whether, within the meaning of Pt IVA, a taxpayer entered into or carried out a "scheme" for the "dominant purpose" of enabling the taxpayer to obtain a "tax benefit". A dominant purpose, their Honours said, is one that is "ruling, prevailing, or most influential". It is the presence of such a dominant purpose that is determinative of the question whether the result achieved was to obtain a tax benefit. Their Honours also held that Pt IVA must "be construed and applied according to its terms, not under the influence of 'muffled echoes of old arguments' concerning other legislation" (186 CLR at 414 citing *Ex parte Professional Engineers' Association* (1959) 107 CLR 208 at 276). Accordingly, Academy's reliance on *Cecil Bros* 111 CLR 430 was misplaced.

121 Mr Hughes' evidence that he had decided to invest up to $200,000 in sustainability practices did not sit comfortably with his actual decision to invest a little more than double that sum and the apparent lack of any examination by him of what else was available for his asserted purpose, especially in his nominated lower price range. Mr Hughes assumed that Academy would get a tax deduction. Moreover, he said that Mr Figtree helped him work out the figure of $200,000, but he was unaware of whether Mr Figtree took into account Academy's tax profile in doing so. He also said that both Mr Figtree and Mr Rowntree assisted him to work out how many contract lots Academy should purchase. He had not asked either professional to give evidence in this appeal. I infer that their evidence would not have assisted Academy's case on any issue in this appeal: *Jones v Dunkel* (1959) 101 CLR 298; *Australian Securities and Investments Commission v Hellicar* (2012) 247 CLR 345 at 412-413 [167] per French CJ, Gummow, Hayne, Crennan, Kiefel and Bell JJ.

122 Here, the agreement held out the prospect of Academy obtaining an immediate deduction of $420,000 for the payment of a non-refundable deposit of $63,000 or 15% of the total price. The agreement allowed the taxpayer to terminate after three years if, by then, it had not received any delivery notice. The recitals to the agreement described the projects that Carbon Strategic proposed to pursue in the vaguest of terms. The agreement did not require BR Redd to deliver or do anything at all for the $63,000 deposit. BR Redd appeared to be a reseller of whatever it was supposed to buy from Carbon Strategic's unspecified projects that it was developing in Papua New Guinea, Indonesia and the Solomon Islands. The register and market for any emission units that might be delivered to Academy in a contract lot were uncertain.

123 There was no evidence of any investigation by anyone involved (Mr Hughes, Mr Figtree or Mr Rowntree) of whether the price payable under the agreement was a market price. Mr Fowler's evidence highlighted the inherently uncertain nature of what Academy was agreeing to buy, if it ever received a delivery notice.

124 In essence, the agreement involved Academy investing in a hybrid between the primary and secondary markets; that is, in REDD credits that were yet to come into existence with all the risks associated with their development and subsequent registrability on one or more unspecified registers in order to render them transferable in the secondary market. Yet, Academy had no control over the performance of any obligation by BR Redd to deliver anything for its non-refundable outgoing of $63,000 and was at risk of receiving, or not receiving, something under a delivery notice for a price that was well above a market price for tCO_2-e carbon credits. The price of AUD28 in the agreement for one tonne of carbon dioxide equivalent was between over twice and nearly four times (AUD8 to 12) the secondary market price of that commodity as an existing, immediately deliverable product at about June 2009 (see [45] above) (s 177D(b)(i)). Moreover, the secondary market prices, being higher than those in the risker primary market, did not reflect that increased transactional risk. Accordingly, the price of AUD28 per tonne was not a market price but was well above the market value of the subject matter that Academy was agreeing to purchase.

125 The terms of the agreement bore the signs of the drafters' and parties' unfamiliarity with the markets and concepts with which it dealt. As I have set out above, there was a lack of clarity of what Academy was buying (sequestered carbon, REDD credits, contract lots (of 2,000 or 5,000 tonnes), emissions units), the market or register on which that purchase would be transferable and, indeed, the precise project or projects that would be the source of the carbon credits. Mr Rowntree was a director of BR Redd, the vendor under the agreement and a solicitor to which Mr Figtree introduced Mr Hughes when suggesting that Academy enter the agreement.

126 The discussions leading up to Academy's decision to enter into the agreement occurred shortly before the end of the 2009 year of income. The effect of the purchase of three contract lots produced a net tax refund of $37,896.10 for Academy (which previously had paid $48,001 in PAYG instalments in the 2009 year of income). The following table shows the consequences for Academy of doing nothing or buying one, two or three contract lots.

No of contract lots	Total Price $	Taxable Income $	Tax payable (at 30%) $	Net position Tax payable (credit) $
0	0	453,683	136,104.90	88,103.90
1	140,000	313,683	94,104.90	46,103.90
2	280,000	173,683	52,104.90	4,103.90
3	420,000	33,683	10,104.90	(37,896.10)

127 As is apparent, the consequence of Academy entering into the agreement was that its tax payable reduced by $126,000 (being 30% of $420,000) (s 177D(b)(ii) and (iii)).

128 The agreement was open ended as to when, if at all, BR Redd would render performance. Academy could choose to terminate if no delivery notice had been given after three years, but it could not enforce any delivery and it could, as it did, leave the agreement on foot even after Carbon Strategic was wound up. Thus, under the scheme, Academy could keep the full benefit of the total deduction of $420,000 even though it might, and, once Carbon Strategic was wound up, could, never be given a delivery notice. Unless Academy exercised its right to terminate the agreement, or Carbon Strategic's winding up came to light, Academy could have kept the tax benefit of the full deduction of $420,000 for an outlay of only $63,000 without ever receiving a delivery notice or paying BR Redd the $357,000 balance of the purchase price.

129 There was no evidence of the capacity of Carbon Strategic to carry out any of the projects or the time that they would take or of any information that Academy had or sought about that capacity or timing or, after the agreement was made, Carbon Strategic's performance. Nor did Mr Hughes give any evidence of investigating any other environmentally sustainable investment. Thus, I am not satisfied that Academy would have made any other investment before 30 June 2009, had it not entered into the agreement.

130 The agreement structured the timing of Academy's payment obligations in a way designed to attract a full deduction (unsuccessfully, as I have held) while paying only 15% of the price to generate a large tax benefit (s 177D(b)(iii)). But for the operation of Pt IVA, Academy would have been able to deduct the $63,000 deposit under s 8-1(1)(a) of ITAA 1997 (and, if I

were wrong about the deductibility of the balance under s 8-1(1)(a)) or alternatively, the whole $420,000 (if I were wrong about the application of s 8-1(1)(b)) (s 177D(b)(iv)).

131 Academy's financial position, that resulted from its implementation of the scheme, was that it achieved a tax refund of $37,896.10 instead of being liable to an assessment under which it would have had to pay a further $88,103.90 in tax (s 177D(b)(v)). There is no evidence about any of the matters in s 177D(b)(vi), (vii) or (viii) other than the benefit received by BR Redd of $63,000.

132 The Commissioner argued that the $63,000 deposit that Academy paid to BR Redd had the appearance of a fee and Mr Rowntree was a tax solicitor, each of which suggested a dominant tax purpose. Mr Rowntree's professional speciality does point to that dominant purpose as I have found above, especially in connection with his involvement in advising and acting on Academy's entry into the agreement. However, the Commissioner's characterisation of the $63,000 payment as a fee is speculative. I am mindful of Mr Hughes' evidence of the loss of the Group's records in the 2013 fire, albeit that this did not explain Academy's failure to call evidence from Mr Figtree or Mr Rowntree. That failure left to speculation the true character of the deposit and whatever material was taken into account by Academy in deciding to enter the agreement. In the end, all that I can take from this absence of evidence is that whatever Mr Figtree or Mr Rowntree might have said or produced in documentary form, as the contemporaneous material available before the agreement was entered into, would not have assisted Academy's case: *Jones v Dunkel* 101 CLR 298.

133 These matters point objectively to the conclusion that I have formed, namely that the dominant purpose of each of Academy, Mr Hughes, Mr Figtree and Mr Rowntree when they entered into or carried out the scheme (being, advising or causing Academy to enter into the agreement pay the deposit of $63,000 and claim the full purchase price of $420,000 as a deductible outgoing in the 2009 year of income) was to enable Academy to obtain a tax benefit in connection with that scheme within the meaning of s 177D. Objectively, the dominant purpose of Academy's entry into the agreement was for it to obtain the tax benefit of being able to deduct the $420,000 (or at least the deposit).

134 The agreement had every appearance of an artifice that Academy's professional advisers contrived to achieve an immediate tax deduction of twice the value of the deposit payable using a grossly inflated price of AUD28 per tonne of carbon dioxide equivalent in contract

lots that did not reflect any reasonable or commercial relationship to any market in which carbon credits were then being traded.

135 As I have explained, Academy paid the deposit without even receiving an enforceable obligation against BR Redd to give it a delivery notice for any carbon credits at all. BR Redd's performance of any part of the agreement was optional and if, after three years, Academy saw itself at risk of having to pay all or part of $357,000 in respect of the imminent service on it of a delivery notice it could terminate the agreement and bring to account in that income year the reversal of its earlier deduction of that sum at a cost of 30% or $107,100. Once again, this bears a distinct character of a scheme with the dominant purpose of Academy obtaining a tax benefit.

136 Accordingly, for these reasons I am not satisfied that Academy has established any error or excessiveness in the Commissioner's determination, under s 177F(1)(b), not to allow the whole, or any part, of the deduction of $420,000 from Academy's taxable income for the 2009 year of income. Indeed, the Commissioner's determination was correct and inevitable on the evidence.

Conclusion

137 For these reasons, the appeal must be dismissed with costs.

I certify that the preceding one hundred and thirty-seven (137) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justice Rares.

Associate:

Dated: 3 August 2017