IT 198 - Gratuitous benefits, value of holidays - assessability

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TAXATION RULING NO. IT 198

GRATUITOUS BENEFITS, VALUE OF HOLIDAYS - ASSESSABILITY

F.O.I. EMBARGO: May be released

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I 1102332	GRATUITOUS BENEFITS - ASSESSABILITY VALUE OF HOLIDAYS FC OF T v COOKE AND SHERDEN 80 ATC 4140, 10 ATR 696	25(1) 26(e)

PREAMBLE The following comments emerged as a result of the decision of the Federal Court of Australia in FC of T v Cooke and Sherden reported at 80 ATC 4140, 10 ATR 696. The judgment confirmed earlier decisions of the Taxation Board of Review No.2 in 76 ATC Case H54; 21 CTBR(NS) Case 19 and the Supreme Court of Victoria, 78 ATC 4685, 9 ATR 310.

FACTS 2. In FC of T v Cook and Sherden, 80 ATC 4140; 10 ATR 969 husband-and-wife partnerships, separately carried on business as door-to-door distributors of soft drinks under franchise arrangements with the soft drink manufacturers. The manufacturers sponsored incentive schemes under which their distributors each year could win prizes in the form of holiday trips to local or overseas resorts. The trips were not transferable and could not be converted into cash or any other form of property. If the winners did not take the trips they were not entitled to any other reward. The taxpayers had each won holidays to various destinations in a number of years. Amounts equal to the cost of the trips had been treated by the Commissioner as assessable income of the relevant taxpayers. The court unanimously held that no part of the cost or value of the trips was assessable.

3. In support of the assessments, it was argued that the value of the holiday trips was assessable under section 25(1) of the Income Tax Assessment Act as income according to ordinary concepts. Alternatively, it was contended that the holiday benefits were given and received as a result of services rendered to the manufacturers by the distributor taxpayers and that section 26(e) operated to treat the value of the holidays as assessable.

RULING 4. In relation to section 25(1), the court held that gratuitous benefits of the kind in issue, which are not convertible into cash or other property, are not income according to ordinary concepts. In the court's view, a benefit or gift of this kind will only be assessable if it is received

in money or is capable of being converted into money or money's worth. Money's worth is not obtained where, as here, the goods or services received cannot be converted into money. The court also held that it was immaterial that the taxpayers were saved the expense that would have been incurred had they paid for the holidays themselves; such a saving not being income.

5. The court observed, however, (at p.4148, 80 ATC; p.704 10 ATR) that "it will not often occur that a benefit to be enjoyed by a taxpayer cannot be turned to pecuniary account if the benefit be given up, or if it be employed in the acquisition of some other right or commodity". It went on to say that it is not necessary that the pecuniary alternative be available by way of direct conversion of the benefit received.

6. These observations represent a significant qualification of the court's reasoning in relation to section 25(1). Where a benefit is claimed to be non-convertible into cash, careful examination should be made to determine whether there is any indirect way in which a benefit in money or money's worth can be obtained. In this regard the Federal Court, by way of illustration, discussed the option to purchase shares which was involved in Abbott v Philbin (1961) A.C. 352. Although the option was not assignable, the right to call for shares was held to be money's worth because it could be used as a means of security to borrow money. Similarly, in Heaton v Bell (1970) A.C. 728 it was held that the use of a car under a loan arrangement with the employer was a "perquisite" of the employment because the employee could have surrendered the car and become entitled to a higher monetary wage.

7. Dealing with section 26(e), the court held that no services, in the relevant sense, were rendered by the taxpayers to the manufacturers. The taxpayers, in distributing the soft drinks, were conducting their own businesses on their own behalf and for their own benefit. The fact that the successful operation of those businesses resulted in the holiday trips did not alter the basic relationship of buyer and seller, which the court held existed between the taxpayers and the manufacturers. Minor activities such as the maintenance of the round-books supplied by the manufacturers were merely ancilliary to that relationship.

8. On the facts as they were found, there was clearly no room for the application of section 26(e). The Federal Court judgment imposes no restraints on the section. Its application has really only been ruled out where the essence of the relationship between donor and donee is that of seller and buyer of goods and no services can be seen to be involved. Where the benefit is provided to a taxpayer conducting a business as part of the reward for work and labour done, application of the section must be considered. In addition, the section may have application where services are rendered gratuitously, in the hope of gratuitous reward for them (cf. Supreme Court judgment).

9. Because of the decision on the services point it was not necessary for the court to enter upon the important question

whether section 26(e) can extend to benefits which are not within the general conception of income. However, it has been suggested in several prior decisions that the section only covers receipts of an income nature - Hayes v FC of T (1956) 98 CLR 47 per Fullagar J. at p.54, Scott v FC of T (1966) 117 CLR 514 per Windeyer J. at p.525, Donaldson v FC of T 74 ATC 4192 at 4205, 4 ATR 530. Consequently, it may hereafter be necessary to meet claims that section 26(e) does not reach beyond the area covered by section 25. Taxpayers may argue that non-pecuniary benefits which cannot be converted into money (such as, for example, meals taken on the job, the use of a motor vehicle, subsidised housing provided to tenants who have no right to sublet) are not income and therefore not assessable. It is true that such items sometimes would either have to be accepted or relinquished and might not be suitable subjects for conversion. Very often, however, there may be some indirect means available of turning the benefit to pecuniary account, or it may be that a higher wage would otherwise be available. Furthermore, even where the benefits are not income because a pecuniary alternative does not exist, it may be argued very strongly that they remain assessable income by reason of the very clear legislative direction in such provisions as sections 26(e), 26(ea), 26AAAA and sub-sections (4) and (5) of section 221C. Taxation of such benefits given in the context of employment or the rendering of services is supported by a number of decided cases. Accordingly, no change is required to the existing practice of requiring employees to bring benefits received into assessable income.

10. Cases may be expected to arise where it is difficult to determine whether recipients of benefits are employees or independent contractors. Indeed, at an earlier stage in the present case, arguments were developed that the taxpayers were employees of the manufacturer or, at best, agents for sale or sellers on commission who were involved in rendering services to the manufacturer. In the particular circumstances of this case, it was recognised that these were somewhat doubtful propositions and, in the event, they found no favour. In other cases there may be greater scope to argue that the contract is one of service (an employment contract) rather than for services; for instance, where the work done is integrated with the business of the provider of the benefit or that person can order or require how the work shall be performed as distinct from merely specifying what work is to be done; or the contract may be substantially for work and labour, within the meaning of the definition of salary and wages in section 221A. The real nature of the relationship between the parties will need to be examined in each case.

COMMISSIONER OF TAXATION