

# client alert | explanatory memorandum

September 2006

## **FCT v. CityLink Melbourne Ltd — Commissioner's Appeal Dismissed**

On appeal from the Full Federal Court, it has been held in the High Court that the concession fees satisfy the test for deductibility in respect of each of the income years in which they were incurred. The CityLink project was also held not to be capital in nature as no capital advantage arose for CityLink as a result of the project.

### **Background**

Annual concession fees were payable by CityLink to the State of Victoria (the State), in return for the right to design, construct and maintain the 'city link' which was to be operated using tolls. In granting these rights to CityLink, the State was required to provide the relevant land and obtain approvals from the various state authorities required to undertake the project. Under the agreement CityLink was able to defer payment of the concession fees up until the year 2034.

By way of background the following events transpired:

- CityLink claimed a deduction in respect of the concession fees payable under the agreement for the 1996, 1997 and 1998 income years.
- The Commissioner disallowed these deductions and subsequently issued amended assessments in respect of the above income years.
- An objection was made by CityLink and later disallowed by the Commissioner in respect of the amended assessments. As a result, CityLink appealed to the Federal Court.
- The Federal Court found in favour of the Commissioner on the basis that the concession fees were capital in nature, but this decision was overturned by the Full Federal Court, hence the Commissioner's appeal to the High Court.
- The key issues for the High Court to consider in *Commissioner of Taxation v. CityLink Melbourne Limited* [2006] HCA 35 (20 July 2006) were:
  - whether the concession fees claimed to be deductible in the relevant years of income were incurred by CityLink and if so, whether the amounts were referable to the years of income in which they were claimed so as to be deductible in those years;
  - whether the concession fees were to be characterised as consideration paid for a monopoly or other anti-competitive right granted to CityLink by the State and thus on capital rather than revenue account. If not, whether the concession fees were a sharing of profit or akin to a dividend and so not allowable deductions; and
  - whether, otherwise, the concession fees were precluded from deduction because they were losses or outgoings of capital or of a capital nature.

The High Court held in favour of CityLink and dismissed the Commissioner's appeal against the judgment made by the Full Federal Court.

The Commissioner had argued that the Full Federal Court had mistakenly held that the fees were on revenue account, incurred in producing assessable income for CityLink. The Commissioner argued that the payments were of a capital nature due to their contingent nature, gave rise to an enduring benefit and brought into existence a profit-yielding structure.

In dismissing the appeal, the High Court held that CityLink had completely subjected and committed itself to paying the fees that accrued in the relevant income years and as such they were incurred in these respective years. In addition, the High Court held that:

- the concession fees were a periodical and recurrent expense and correctly claimed to be deductible in the relevant years of income by CityLink;
- the amounts were referable to the years of income in which they were claimed as they were held to be an annual liability, which were payable semi-annually;
- the concession fees were not consideration paid for a monopoly or other anti-competitive right;
- the concession fees were not a sharing of profit or akin to a dividend and so allowable as deductions; and
- the concession fees were not losses or outgoings of capital or of a capital nature as they only related to non-permanent rights attaching to infrastructure assets and akin to periodic licence fees.

It was interesting to note that in a dissenting judgment, Kirby J held that CityLink had indeed acquired a bundle of rights in the concession deed from the State of Victoria once and for all and the promise to make concession payments was in return for that bundle of rights.

To this end, CityLink acquired the right to establish a profit-yielding structure that was an important capital asset. The method by which the concession fees operated on a recurrent basis was merely a method agreed to by the two parties and as a result the payments were of a capital nature.

With regard to the concession fees being properly referable to the periods in question, Kirby J held that the expenditure was only owing in a notional sense and was not due for payment as a result of the contract. As a result, CityLink did not incur an obligation to pay the concession fees until the terms of the contract were satisfied and as such, until then, the obligation in respect of those fees remained contingent.

## **Barter Exchange Arrangements**

In a recent GST Determination GSTD 2006/5, the Commissioner provides the Tax Office's position on a recent Taxpayer Alert TA 2005/4, which looks at the creation of inflated or non-existent GST input tax credits arising from barter exchange arrangements.

Taxpayer Alert TA 2005/4 describes arrangements where a barter exchange buys and sells goods and services, effectively acting as a member with its own trading account. The barter exchange has access to unlimited 'trade dollars' to spend on the acquisition of goods and services from its members, which are often at commercially unrealistic prices. As a result of these transactions a large GST refund can be claimed by the barter exchange, as its acquisitions will continually exceed its supplies.

TA 2005/4 was released to highlight these barter exchange arrangements exhibiting the following common features:

- The barter exchange acts as a member with its own trading account, recording transactions with its members.
- The barter exchange debits or credits the account in trade dollars each and every time it undertakes a purchase or sale.
- The barter exchange acquires goods and services from its members at inflated prices, which would be reasonably considered to be above their market value. Furthermore, acquisitions of services from members, particularly advertising services, are disproportionately high relative to the activities of the barter exchange.
- Acquisitions by the barter exchange in trade dollars create a GST liability for the supplying member.

- The barter exchange lodges a Business Activity Statement (BAS) claiming GST refunds as purchases exceed sales.
- In some instances goods and services that are purchased do not exist.

The GST consequences of this arrangement have now been discussed in GST Determination GSTD 2006/5 providing the Commissioner's view on barter exchange arrangements and their inability to qualify for input tax credits.

Under the facts and circumstances of each case in question, the Commissioner will determine whether or not a barter exchange arrangement exists within the following general criteria.

### **No enterprise carried on**

A 'barter exchange' is defined as carrying on a business, an adventure or concern in the nature of trade where it satisfies the definition set out in section 9–20 of the *A New Tax System (Goods and Services Tax) Act 1999*. In the above barter exchange situations, it will be difficult to conclude that the enterprise is carrying on a business at all.

### **Consideration for supply**

The Commissioner will determine whether or not the use of trade dollars would be deemed to be consideration. For an acquisition to be creditable, consideration must be provided for the supply. Consideration will usually be in money or in kind, or a combination of both.

Trade dollars are not deemed to be consideration under this arrangement for the following reasons:

- The commercial value of the trade dollars is nil.
- The trade dollars cannot be traded or converted to trade dollars in another barter exchange.
- No member entitlement exists to convert the trade dollars into Australian dollars or redeem them for property.

In consideration of the above, where the Commissioner deems one of these arrangements to be in place, the general anti-avoidance provisions may apply, taking into consideration the facts and circumstances of each particular case.

For further information please review GSTD 2006/5 — Goods and Services Tax: what are the results for GST purposes of barter exchanges engaging in the arrangement described in Taxpayer Alert TA 2005/4, at: <http://law.ato.gov.au/atolaw/print.htm?DocID=GSD%2FGSTD20065%2FNAT%2FATO%2F00001>

## **FBT Rates and Thresholds**

For further information please refer to the ATO website:

<http://www.ato.gov.au/corporate/content.asp?doc=/content/76140.htm>

## **Remission of SIC and GIC**

The Tax Office has recently released Law Administration Practice Statement PS LA 2006/8 providing guidelines on the remission of the shortfall interest charge (SIC) and general interest charge (GIC) accrued during a shortfall period.

The practice statement applies to interest charges that are imposed on shortfall amounts and accrue during the shortfall period, which include:

- SIC;
- shortfall GIC — accrued during the shortfall period on the shortfall amount; and
- interest and GIC imposed under section 170AA of the *Income Tax Assessment Act 1936 (ITAA 1936)*.

The shortfall period begins on the day that the tax debt becomes due for payment or would have become due had the shortfall been correctly reported. The period ends where the Commissioner provides the taxpayer with an amended notice of assessment.

For the 2004/05 and later income years, the SIC was introduced as a lower interest rate charge than the GIC. This is to recognise taxpayers who were genuinely unaware of the shortfall and as a result may be unable to take any steps to reduce their exposure to GIC. The SIC is in place to neutralise the benefits that a taxpayer would otherwise receive from a shortfall of income tax, so that there is no advantage over taxpayers who pay tax at the appropriate time. As SIC is only payable on liabilities for the 2004/05 and later income years, all shortfalls that relate to earlier income tax liabilities will continue to attract GIC.

The shortfall GIC is payable in respect of:

- amended income tax liabilities for the 2000/01 to 2003/04 income years; and
- shortfalls raised for other tax-related liabilities.

GIC is applicable from the original due date of payment. To recognise that some taxpayers are still subject to the higher GIC rates, the Commissioner will reduce the GIC on income tax amendments to the lower SIC rate for the period after 1 July 2005.

The Commissioner, according to the guidelines set out in this practice statement, may remit all or part of the SIC or shortfall GIC where he considers it fair and reasonable to do so.

A taxpayer can make a written application for the remission of SIC or shortfall GIC at any time, outlining the reasons to which the remission may apply.

The most common circumstances where the Commissioner will deem a remission to be appropriate include:

- Tax Office delay — it may be reasonable to make a request to the Commissioner for remission for SIC or shortfall GIC where there is a delay in Tax Office activities regarding an amended assessment. The practice statement outlines the following situations where this may be the case:
  - delay in commencing a tax audit;
  - where the audit completion date has been exceeded;
  - delay in obtaining information from a third party;
  - longer resolution time due to the complexity of the issues at hand; and
  - where the delay is outside of the taxpayer's control.

There are some circumstances where the Commissioner will decide to remit SIC or the GIC shortfall on a case-by-case basis and this will include the following situations:

- Cases involving fraud or evasion will generally not be granted a remission, notwithstanding that there may have been some delay attributable to the Tax Office and the expected audit completion date has been exceeded.
- If a delay arises as a result of the taxpayer's agent or an associate of the taxpayer (not dealing at arm's length), remission will not be considered unless the delay is reasonable or beyond the taxpayer's control.

Where the delay is within the taxpayer's control, the Commissioner will not consider a remission of SIC or shortfall GIC appropriate including:

- where the taxpayer unreasonably delays or obstructs the progress of an audit and as a result of the delay, the audit is completed beyond the expected date of completion; and
- where the taxpayer requests further time or deferment of action during an audit.

Please note, the practice statement does not apply to GIC that is not in relation to a shortfall amount and guidelines for remission of GIC for late payment can be found in the Tax Office's receivables policy.

For further information please review PS LA 2006/8: Remission of shortfall interest charge and general interest charge for shortfall periods, at:

<http://law.at0.gov.au/atolaw/print.htm?DocID=PSR%2FPS20068%2FNAT%2FATO%2F00001>

## **Longer Period for Commissioner to Amend Tax Returns**

For further information, please refer to ATO website:

<http://www.comlaw.gov.au/ComLaw/Legislation/LegislativeInstrument1.nsf/all/search/501964488B7393B5CA25718D001CAA90?OpenDocument>

## **Other Key Issues**

For information regarding shortfall interest charge rates please refer to ATO website:

<http://www.ato.gov.au/taxprofessionals/content.asp?doc=/content/65367.htm>

For information regarding general interest charge rates please refer to ATO website:

<http://www.ato.gov.au/taxprofessionals/content.asp?doc=/Content/gic.htm>

For information on the Division 7A benchmark interest rate please refer to ATO website:

<http://www.ato.gov.au/businesses/content.asp?doc=/content/54660.htm>

For further information on problems lodging tax returns please refer to ATO website:

<http://www.ato.gov.au/taxprofessionals/content.asp?doc=/content/77168.htm>

For further information on Tax Office practice statement PS LA 2006/7 on alternative assessments, refer to:

<http://law.ato.gov.au/atolaw/view.htm?rank=find&criteria=AND~PS~basic~exact:::AND~LA~basic~exact:::AND~2006%2F7~basic~exact&target=ZD&style=html&sdoid=PSR/PS20067/NAT/ATO/00001&recStart=1&recnum=1&tot=9&pn=ALL:::ALL>

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