FEDERAL COURT OF AUSTRALIA

Bywater Investments Limited v Commissioner of Taxation [2015] FCAFC 176

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| Citation: | Bywater Investments Limited v Commissioner of Taxation [2015] FCAFC 176 |
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| Appeal from: | Hua Wang Bank Berhad v Commissioner of Taxation [2014] FCA 1392  Hua Wang Bank Berhad v Commissioner of Taxation (No 19) [2015] FCA 454 |
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| Parties: | **BYWATER INVESTMENTS LIMITED, CHEMICAL TRUSTEE LIMITED and DERRIN BROTHERS PROPERTIES LIMITED v COMMISSIONER OF TAXATION**  **HUA WANG BANK BERHAD v COMMISSIONER OF TAXATION** |
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| File numbers: | NSD 71 of 2015  NSD 76 of 2015 |
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| Judges: | **ROBERTSON, PAGONE AND DAVIES JJ** |
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| Date of judgment: | 11 December 2015 |
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| Catchwords: | **INCOME TAX** – whether companies residents of Australia – place of central management and control – relevant principles  **INCOME TAX** – profits from sale of shares – whether on revenue or capital account – where shares agreed to be trading stock  **INCOME TAX –** trading stock – construction of s 70-40(2) of the *Income Tax Assessment Act 1997* (Cth) – whether items taken into account for purposes of Division 70 – relevant principles  **INCOME TAX –** shares – whether proved to be held beneficially |
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| Legislation: | *Income Tax Assessment Act 1936* (Cth) s 6  *Income Tax Assessment Act 1997* (Cth) ss 70-5, 70-35, 70-40, 70-45, 70-80  *Agreement between Australia and Switzerland for the Avoidance of Double Taxation with respect to Taxes on Income* [1981] ATS 5, arts 3(1)(f), 4(1)(a) (entered into force 13 February 1981)  *Agreement between the Government of the Commonwealth of Australia and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains* [1968] ATS 9, arts 3(1)(a)(ii), 3(5), 5 (entered into force 8 May 1968)  *Convention between the Government of Australia and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital Gains* [2003] ATS 22, arts 4.1(b), 7 (entered into force 17 December 2003) |
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| Cases cited: | *Commissioners for Her Majesty’s Revenue and Customs v Smallwood* [2010] EWCA Civ 778  *Commissioner of Taxation v Energy Resources of Australia Ltd* (2003) 135 FCR 346; [2003] FCAFC 314  *De Beers Consolidated Mines Limited v Howe* [1906] AC 455  *Esquire Nominees Limited v The Commissioner of Taxation of the Commonwealth of Australia* (1973) 129 CLR 177; [1973] HCA 67  *Koitaki Para Rubber Estates Limited v The Federal Commissioner of Taxation* (1940) 64 CLR 15; [1940] HCA 33  *Koitaki Para Rubber Estates Limited v The Federal Commissioner of Taxation* (1941) 64 CLR 241; [1941] HCA 13  *Metwally v University of Wollongong* (1985) 60 ALR 68;[1985] HCA 28  *Re Mendonca; Ex parte Commissioner of Taxation* (1969) 15 FLR 256  *Unit Construction Co. Ltd v Bullock* [1960] AC 351  *Wood v Holden* [2006] 1 WLR 1393; [2006] EWCA Civ 26 |
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| Date of hearing: | 9–11 November 2015 |
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| Place: |  |
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| Division: | GENERAL DIVISION |
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| Category: | Catchwords |
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| Number of paragraphs: | 36 |
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| Counsel for the Appellants in NSD 71 of 2015: | Mr A J Myers AO QC with Mr F D O’Loughlin and Mr T Bagley |
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| Counsel for the Respondent in NSD 71 of 2015 and NSD 76 of 2015: | Ms K Stern SC with Dr J Jaques |
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| Solicitor for the Respondent in NSD 71 of 2015 and NSD 76 of 2015: | Australian Government Solicitor |

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| IN THE FEDERAL COURT OF AUSTRALIA |  |
| NEW SOUTH WALES DISTRICT REGISTRY |  |
| GENERAL DIVISION | NSD 71 of 2015 |

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| ON APPEAL FROM THE FEDERAL COURT OF AUSTRALIA |

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| BETWEEN: | BYWATER INVESTMENTS LIMITED  First Appellant  CHEMICAL TRUSTEE LIMITED  Second Appellant  DERRIN BROTHERS PROPERTIES LIMITED  Third Appellant |
| AND: | COMMISSIONER OF TAXATION  Respondent |

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| JUDGES: | ROBERTSON, PAGONE AND DAVIES JJ |
| DATE OF ORDER: | 11 DECEMBER 2015 |
| WHERE MADE: | SYDNEY |

THE COURT ORDERS THAT:

1. The appeal be dismissed.
2. Order 1 made on 15 May 2015 in NSD 652 of 2011, NSD 654 of 2011 and NSD 656 of 2011 be set aside and the following substituted:

Declare that s 70-40(2) of the *Income Tax Assessment Act 1997* (Cth) requires the value of the taxpayers’ shares in each year to be valued at nil unless an assessment has been made for the preceding income year or, in the case of years prior to the 2004-05 year of income, no assessment has been made for the preceding year because the Commissioner has ascertained or is deemed to have ascertained under the *Income Tax Assessment Act 1936* (Cth) that the taxpayer has no taxable income and/or no tax payable for that preceding year.

1. The appellants pay the respondent’s costs of the appeal.
2. If any further orders are necessary to give effect to these reasons, the parties are to file an agreed form of orders or, failing agreement, their competing form of orders, by 8 February 2016.

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

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| IN THE FEDERAL COURT OF AUSTRALIA |  |
| NEW SOUTH WALES DISTRICT REGISTRY |  |
| GENERAL DIVISION | NSD 76 of 2015 |

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| ON APPEAL FROM THE FEDERAL COURT OF AUSTRALIA |

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| BETWEEN: | HUA WANG BANK BERHAD  Appellant |
| AND: | COMMISSIONER OF TAXATION  Respondent |

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| JUDGES: | ROBERTSON, PAGONE AND DAVIES JJ |
| DATE OF ORDER: | 11 DECEMBER 2015 |
| WHERE MADE: | SYDNEY |

THE COURT ORDERS THAT:

1. The appellant have leave to amend the Notice of Appeal in the form of the Further Amended Notice of Appeal dated 22 October 2015, save for grounds 13 and 14–22.
2. The respondent’s application to file a Notice of Contention dated 26 October 2015 be dismissed.
3. The respondent’s application to rely on further evidence dated 6 November 2015 be dismissed.
4. The appeal be dismissed.
5. Order 1 made on 15 May 2015 in NSD 653 of 2011 be set aside and the following substituted:

Declare that s 70-40(2) of the *Income Tax Assessment Act 1997* (Cth) requires the value of the taxpayers’ shares in each year in dispute to be valued at nil unless an assessment has been made for the preceding income year or, in the case of years prior to the 2004-05 year of income, no assessment has been made for the preceding year because the Commissioner has ascertained or is deemed to have ascertained under the *Income Tax Assessment Act 1936* (Cth) that the taxpayer has no taxable income and/or no tax payable for that preceding year.

1. The appellant pay the respondent’s costs of the appeal.
2. If any further orders are necessary to give effect to these reasons, the parties are to file an agreed form of orders or, failing agreement, their competing form of orders, by 8 February 2016.

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

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| IN THE FEDERAL COURT OF AUSTRALIA |  |
| NEW SOUTH WALES DISTRICT REGISTRY |  |
| GENERAL DIVISION | NSD 71 of 2015 |

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| ON APPEAL FROM THE FEDERAL COURT OF AUSTRALIA |

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| BETWEEN: | BYWATER INVESTMENTS LIMITED  First Appellant  CHEMICAL TRUSTEE LIMITED  Second Appellant  DERRIN BROTHERS PROPERTIES LIMITED  Third Appellant |
| AND: | COMMISSIONER OF TAXATION  Respondent |

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| IN THE FEDERAL COURT OF AUSTRALIA |  |
| NEW SOUTH WALES DISTRICT REGISTRY |  |
| GENERAL DIVISION | NSD 76 of 2015 |

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| ON APPEAL FROM THE FEDERAL COURT OF AUSTRALIA |

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| BETWEEN: | HUA WANG BANK BERHAD  Appellant |
| AND: | COMMISSIONER OF TAXATION  Respondent |

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| JUDGES: | ROBERTSON, PAGONE AND DAVIES JJ |
| DATE: | 11 DECEMBER 2015 |
| PLACE: | SYDNEY |

**REASONS FOR JUDGMENT**

# THE COURT

1. These appeals were heard together and raise three common issues for determination:
2. Whether the primary judge erred in finding that the central management and control of each appellant was in Australia during the relevant years and that each appellant was, accordingly, a resident of Australia for tax purposes.
3. Whether the primary judge erred in concluding that profits that the appellants derived from share sales were on revenue account.
4. Having found that the shares were trading stock, whether the primary judge erred in holding that s 70-40(2) of the *Income Tax Assessment Act 1997* (Cth) (**“the 1997 Act”**) required the appellants’ shares to be valued at nil at the start of an income year if no assessment was issued for the preceding income year.
5. There were seven proceedings involving five companies (collectively **“the taxpayers”**) before his Honour. All of the proceedings were heard together and all of the taxpayers were represented by the same solicitors and counsel. One of the taxpayers subsequently settled with the Commissioner and its appeal was disposed of by consent. Bywater Investments Limited (**“Bywater”**), Chemical Trustee Limited (**“Chemical Trustee”)** and Derrin Brothers Properties Limited (**“Derrin Brothers”**) are the appellants in NSD 71 of 2015 and were represented by different counsel from those who had appeared for them at first instance. Hua Wang Bank Berhad (**“Hua Wang”**) is the appellant in NSD 76 of 2015 and was represented by different counsel from the other appellants and by different senior counsel from senior counsel who had appeared at first instance.

# issue (1): Central management and control

1. His Honour concluded that each taxpayer was a resident of Australia for tax purposes on the basis that each company’s central management and control was located in Sydney: *Hua Wang Bank Berhad v Commissioner of Taxation* [2014] FCA 1392.
2. The terms “resident” and “resident of Australia” are defined in s 6 of the *Income Tax Assessment Act 1936* (Cth) (**“the 1936 Act”**), and, relevantly, mean:

a company which is incorporated in Australia, or which, not being incorporated in Australia, carries on business in Australia, and has either its central management and control in Australia, or its voting power controlled by shareholders who are residents of Australia.

The taxpayers conceded at first instance that each of them carried on business in Australia but they contended that their “central management and control” was not in Australia. Bywater, Chemical Trustee and Derrin Brothers contended that their place of central management and control was in London in the United Kingdom or Neuchâtel in Switzerland because that was where their directors met and made decisions about the share transactions in question. Hua Wang contended that its place of central management was in Apia in Samoa for a similar reason.

1. The agreement between Australia and Switzerland relating to double taxation in force at the relevant time relevantly provided that the profits of an enterprise were taxable in the country of residence. Article 7 in Chapter III dealt with the taxation of income and provided:

The profits of an enterprise of one of the Contracting States shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State, but only so much of them as is attributable to that permanent establishment.

The issues before his Honour, and on appeal, did not raise any question about whether the taxpayers were conducting business in Australia through a permanent establishment but, relevantly, only whether the profits made by them were profits of an enterprise of Australia. The definition in Article 3(1)(f) of “enterprise of one of the Contracting States” and “enterprise of the other Contracting State” defined the terms to mean an enterprise carried on by “a resident of Australia” or a “resident of Switzerland” as the context requires. Article 4(1)(a) provided that, for the purposes of the agreement, a person was a resident of Australia if the person was a resident “for the purposes of Australian tax law”.

1. The relevant UK treaty altered during the years in question but not in effect. The UK treaty in force until 17 December 2003 relevantly provided in Article 5 that the commercial profits of an enterprise were taxable by the country of residence of the enterprise. The definition of “Australian enterprise” in Article 3(5) provided that the term meant an industrial or commercial enterprise or undertaking carried on “by an Australian resident”. Article 3(1)(a)(ii) defined “Australian company” to mean a company being a resident of Australia which “is managed and controlled in Australia”. The subsequent treaty with the United Kingdom was to the same effect by operation of Article 7 and the definition of residence in Article 4.1(b) which provided that a person is a resident of Australia if the person is a resident for the purposes of Australian tax. In each case, therefore, as was common ground between the parties, it is necessary to determine the place of central management and control of the appellants.

## Relevant principles

1. On appeal, each of the appellants contended that his Honour erred by misapplying the relevant test to determine the central management and control of a corporation for the purposes of determining its residence and, in particular, that in doing so his Honour placed inappropriate emphasis upon the ultimate ownership of the taxpayers by a Mr Vanda Gould. In *De Beers Consolidated Mines Limited v Howe* [1906] AC 455 Lord Loreburn LC said at 458:

In applying the conception of residence to a company, we ought, I think, to proceed as nearly as we can upon the analogy of an individual. A company cannot eat or sleep, but it can keep house and do business. We ought, therefore, to see where it really keeps house and does business. An individual may be of foreign nationality, and yet reside in the United Kingdom. So may a company. Otherwise it might have its chief seat of management and its centre of trading in England under the protection of English law, and yet escape the appropriate taxation by the simple expedient of being registered abroad and distributing its dividends abroad. The decision of Kelly C.B. and Huddleston B. in the *Calcutta Jute Mills* *v Nicholson* and the *Cesena Sulphur Co. v Nicholson* [cases]…involved the principle that a company resides for purposes of income tax where its real business is carried on…I regard that as the true rule, and the real business is carried on where the central management and control actually abides.

It remains to be considered whether the present case falls within that rule. This is a pure question of fact to be determined, not according to the construction of this or that regulation or bye-law, but on a scrutiny of the course of business and trading.

(Citations omitted.)

In *Koitaki Para Rubber Estates Limited v The Federal Commissioner of Taxation* (1940) 64 CLR 15; [1940] HCA 33 at 19 (CLR), Dixon J observed that finding the residence of a company must always be a matter of degree constituted by a combination of various factors of which one was the place of the “superior or directing authority by means of which the affairs of the company are controlled”. On appeal, Williams J (with whom the other members of the Court relevantly agreed) said at (1941) 64 CLR 241; [1941] HCA 13, 248–9 (CLR):

The registration of a company, which brings it into existence, corresponds to the birth of an individual. The place of registration and the situation of the registered office are therefore strong circumstances to be taken into account in determining its residence. But the crucial test is to ascertain where the real business of the company is carried on, not in the sense of where it trades but in the sense of from where its operations are controlled and directed. It is the place of the personal control over and not of the physical operations of the business which counts.

The focus of the inquiry to determine the residence of a corporation, therefore, is where its activities are controlled from, rather than, for instance, where the company was incorporated, where its activities may occur or, it may be added, merely the location of its ultimate owner.

1. The test of residence has been applied in circumstances where the decisions of those in control of the company have been heavily influenced by others. In *Esquire Nominees Limited v The Federal Commissioner of Taxation of the Commonwealth of Australia* (1973) 129 CLR 177; [1973] HCA 67, Gibbs J said at 189–191 (CLR):

It is now well settled that, for the purposes of income tax, a company is resident where its real business is carried on, and its real business is carried on where the central management and control actually abides: *Koitaki Para Rubber Estates Ltd. v. Federal Commissioner of Taxation* and on appeal; *North Australian Pastoral Co. Ltd. v. Federal Commissioner of Taxation*; *Unit Construction Co. Ltd. v. Bullock (Inspector of Taxes)*. For the purposes of the definition of "resident" in s. 6 of the Act, the fact of incorporation in Australia is made conclusive; that definition does not have any direct application to s. 7(1), but the place of incorporation is a factor to be considered: *Koitaki Para Rubber Estates Ltd. v. Federal Commissioner of Taxation*; *North Australian Pastoral Co. Ltd. v. Federal Commissioner of Taxation*. The question where a company is resident is one of fact and degree.

In the present case the appellant was incorporated in Norfolk Island and had its office there. All the directors resided in Norfolk Island. All the A class shareholders who were natural persons were residents of Norfolk Island and it seems proper to conclude that the other A class shareholder, Myee Ltd., was also a resident. All meetings of the company and of the directors were held in Norfolk Island. The business of the company was to act as trustee on Norfolk Island. These facts strongly support the conclusion that the appellant was a resident of Norfolk Island. However, the Commissioner, relying particularly on the decision in *Unit Construction Co. Ltd. v. Bullock (Inspector of Taxes)*, that it is the actual place of management of a company and not the place where it ought to be managed which fixes its residence, submitted that the directors of the appellant merely carried out directions given to them by Messrs. Wilson, Bishop, Bowes and Craig, and that the actual management and control of the appellant company was in Australia. It was said that at all relevant times the activities of the appellant were confined to acting as trustee of a number of settlements all of which had been set up on similar lines as a result of instructions received from Messrs. Wilson, Bishop, Bowes and Craig, and that the administration of the trusts of the settlements followed a general pattern which had been laid down in advance by that firm. The extent of the influence of the accountants was shown by the fact that they would not infrequently prepare in detail the agenda of a meeting of the directors of the appellant or of the company itself. These facts, according to the Commissioner, showed that in reality the activities of the appellant were directed from Australia. I am unable to accept this argument. As I have already indicated, it is obvious that what the appellant did in relation to the Manolas Trust was done in the course of carrying out a scheme formulated in Australia and that Messrs. Wilson, Bishop, Bowes and Craig not only communicated to the appellant particulars of the scheme but advised the appellant in detail of the manner in which it should be carried out. But if it be accepted that the appellant did what Messrs. Wilson, Bishop, Bowes and Craig told it to do in the administration of the various trusts, it does not follow that the control and management of the appellant lay with Messrs. Wilson, Bishop, Bowes and Craig. That firm had no power to control the directors of the appellant in the exercise of their powers or the A class shareholders in the exercise of their voting rights. Although it is doubtless true that steps could have been taken to remove the appellant from its position as trustee of one or more of the trust estates, Messrs. Wilson, Bishop, Bowes and Craig could not control the appellant in the conduct of its business of a trustee company. The firm had power to exert influence, and perhaps strong influence, on the appellant, but that is all. The directors in fact complied with the wishes of Messrs. Wilson, Bishop, Bowes and Craig because they accepted that it was in the interest of the beneficiaries, having regard to the tax position, that they should give effect to the scheme. If, on the other hand, Messrs. Wilson, Bishop, Bowes and Craig had instructed the directors to do something which they considered improper or inadvisable, I do not believe that they would have acted on the instruction. It was apparent that it was intended that the appellant should carry on its business of trustee company on Norfolk Island. It was in my opinion managed and controlled there, none the less because the control was exercised in a manner which accorded with the wishes of the interests in Australia. The appellant was, in my opinion, a resident of Norfolk Island.

(Citations omitted.)

His Honour’s decision on residence was not the subject of appeal but was accepted by the Full Court: see Barwick CJat 209 and 212, Menzies J at 220–1, 222–3, and Stephen J at 225–6. Critical to the outcome in that case, however, was that those exerting influence, albeit strong influence, were not those making the decisions of the company. As observed by Gibbs J at first instance, the compliance of the directors with the wishes of others was because the directors accepted those wishes to be in the interest of the beneficiaries to give effect to the scheme.

1. A similar result can be seen in *Wood v Holden* [2006] 1 WLR 1393; [2006] EWCA Civ 26 and *Commissioners for Her Majesty’s Revenue and Customs v Smallwood* [2010] EWCA Civ 778. In *Unit Construction Co Ltd v Bullock* [1960] AC 351 distinctions were drawn between those with an ability to influence others who make the decisions of the company and those who may be usurping that function or who are directing those appearing to act for the company: see *Unit Construction* at 364–6; *Wood v Holden* [2006] 1 WLR 1393 at [24]–[27]; *Smallwood* [2010] EWCA Civ 778 at [61]. In *Wood v Holden* the critical finding of the trial judge was that the effective decisions had been made by the directors and the trial judge specifically rejected the suggestion that their participation was “merely going through the motions of passing and signing documents”: see [36], [40]–[43].
2. His Honour below applied these principles. At [3(a)] his Honour identified the issue in terms of identifying the place where each taxpayer had its “central management and control”. The Commissioner had contended that the place of the taxpayers’ central management and control was in Australia because each was said by the Commissioner to be “completely controlled by Mr Vanda Gould, an accountant”. In that regard his Honour noted the Commissioner’s submission that the structures which had been put in place were “entirely formal and that, in truth, it was Mr Gould who was pulling all of the strings from Sydney”. The taxpayers, in contrast, denied that Mr Gould had the role of a decision-maker.
3. His Honour referred to the authorities bearing upon the issue in question, including the decision in *Esquire Nominees*,and correctly identified at [403] the question to be “where was the real business of each of the taxpayers”. His Honour found that the real business of each taxpayer was conducted from Sydney by Mr Gould. His Honour did that by considering the evidence which had been relied upon by the taxpayers in support of their respective contentions that their places of central management and control were at places other than Australia. His Honour had regard to such factors as the place of incorporation of each of the companies, the shareholding of each company, and where relevant, the place of incorporation of shareholders, the location of the directors, the minutes of meetings of the board of directors, the place at which the meetings were held, and the place at which the transactions were entered into constituting the businesses of each of the taxpayers. His Honour concluded, however, at [60]:

The question of central management and control is a factual one. For the reasons which follow I am satisfied that the directors of the taxpayers exercised no independent judgment in the discharge of their offices but instead merely carried into effect Mr Gould’s wishes in a mechanical fashion. The taxpayers’ places of central management and control were in Sydney.

In the case of each taxpayer, his Honour concluded that he could not accept the evidence relied upon by them in support of their contention that their place of management and control was located other than in Sydney.

1. His Honour’s rejection of the evidence relied upon by the taxpayers, and the significance of that rejection in the application of the relevant test, needs to be understood in the context of the way in which the case was conducted at first instance. A factual dispute in the proceeding was about the ultimate ownership of the taxpayers. The significance of that fact, and of the evidence concerning that fact, to the disposition of the proceeding was that the taxpayers had each asserted that a Mr Peter Borgas was the ultimate owner. Each had asserted that fact in support of their contention that he, and the other directors, rather than Mr Gould, were conducting their respective businesses. The taxpayers did not advance a case, nor lead evidence, that the directors had been engaged to perform, for example, corporate services as directors on behalf of others but, rather, led evidence that Mr Borgas was their ultimate owner in support of the fundamental issue to be decided, namely, that their central management and control was where the directors performed their acts and not Australia where Mr Gould was located. The Commissioner contended, in contrast, that all five taxpayers were managed and controlled by Mr Gould from Sydney, Australia.
2. Mr Borgas was the primary witness called on behalf of the taxpayers. He was a director of Bywater, Derrin Brothers and Chemical Trustee and he gave evidence that he was the ultimate beneficial owner of those companies through JA Investments Ltd (**“JA Investments”**) and MH Investments Limited (**“MH Investments”**) which he claimed to control as sole shareholder. His Honour found that evidence to be false and that it was Mr Gould who was the true owner of JA Investments and MH Investments. His Honour also found that Hua Wang was controlled and owned by Mr Gould through JA Investments.
3. The evidence in chief of Mr Borgas, in response to questions by senior counsel appearing for the taxpayers, was that Mr Gould’s role was that of an advisor to the taxpayers, chosen by Mr Borgas to occupy such positions as “the Appointor” of JA Investments because of years of trust as an advisor, rather than being the true owner and controller of the taxpayers. Other evidence led for the taxpayers was to the same effect. Thus, a Mr Vara had described Mr Gould as merely a consultant and advisor to Mr Borgas. The taxpayers’ case depended upon the evidence of Mr Borgas and his evidence was found by his Honour to be dishonest. Part of his evidence had been directed to establish that he, and the other directors where relevant, were making the decisions and not simply implementing those decisions which had been made by Mr Gould. His Honour’s rejection of the evidence of Mr Borgas about ownership, which he found to be false, led his Honour to have doubt about the veracity of the other evidence given by Mr Borgas about the control and management of the taxpayers. Mr Borgas’s asserted ownership became central in an evidentiary sense because it called into question the veracity and reliability of the whole of the evidence that Mr Borgas had given.
4. His Honour concluded that Mr Borgas was “quite willing to lie to the Court about his ownership of JA Investments” such that his evidence was considered to be unreliable “in areas of any controversy”. His Honour went on to analyse the balance of the evidence and to conclude from it that it was Mr Gould in Sydney who was truly in control of all the taxpayers. Mr Borgas’s evidence was that he made the decisions for the three taxpayers of which he was a director, namely Bywater, Chemical Trustee and Derrin Brothers. His evidence was said to be corroborated by other witnesses. His Honour considered that evidence at [118]–[143] but rejected it as corroboration. As for Mr Vara, critical aspects of his evidence were found by the primary judge to be false. Mr Codd had given evidence that on occasion Mr Borgas would give instructions “on the spot (although sometimes it would take a week or so)”. In that context his Honour observed that the evidence of Mr Codd was insufficient to enable his Honour to conclude that instructions being given by Mr Borgas were relevant evidence of decision-making by him on behalf of the taxpayers without knowing whether Mr Gould (who was not called to give evidence) had prompted Mr Borgas before the latter’s discussions with Mr Codd. Mr Yunus gave evidence of receiving instructions and appearing to take advice from Mr Borgas. His Honour, however, analysed that evidence, including email correspondence between Mr Yunus and Mr Gould, which, in his Honour’s view, suggested that it was Mr Gould who was in charge of Chemical Trustee, rather than Mr Borgas. As for the other witnesses, namely Mr Gibbs, Mr Watson, Mr Facey and Mr Saba, His Honour found that their evidence was not inconsistent with the Commissioner’s case.
5. Hua Wang’s case similarly depended on the veracity of Mr Borgas’s evidence about ownership. Mr Borgas was not a director of Hua Wang but his Honour found that Hua Wang was controlled by JA Investments, and rejected as false Mr Borgas’s evidence that he was the beneficial owner of JA Investments. Hua Wang also relied on the evidence of four other witnesses which his Honour considered at [354]–[358]. Those witnesses were directors or former directors of Hua Wang, each of whom gave evidence that they transacted the decisions of the company, doing so on every occasion at the direction of Mr Gould. His Honour observed that none suggested that they had any commercial input into the decisions and it was clear that their roles were that of a “back-office” nature. Senior counsel for Hua Wang referred to a number of the communications from Mr Gould to the directors of that company, submitting that those communications could not be described as instructions to the directors on which they were compelled to act. That was not the evidence of the witnesses, however, and whatever the form of the communications, the evidence of those directors was that they had acted at Mr Gould’s direction. Senior counsel for Hua Wang also stressed that each of those witnesses had also given evidence that they would not have done anything improper and were cognisant of their duties as directors to act in the best interests of the company. That submission was dealt with below by his Honour at [358] where his Honour referred to that evidence and concluded that such evidence should be given little weight, given that none of them knew anything of the affairs of the company.
6. There is no reason to reject his Honour’s findings on the evidence or to reject his Honour’s reasons for his findings. No error has been demonstrated in his Honour’s conclusion that each of the appellants failed to discharge their burden of proof to establish that each was not a resident of Australia for tax purposes.

# ISSUE (2): capital or revenue

1. An issue before the primary judge was whether profits made on the sale of shares held as long term investments were on revenue or capital account. In the Court below, the taxpayers argued that the profits were on capital account and, in the alternative, if on revenue account, that the shares were trading stock. The primary judge found that the profits were on revenue account because the profits had been made as part of the ordinary course of the taxpayers’ businesses and with the intention of making a profit. His Honour also found that the shares were trading stock because the taxpayers were in the business of making profits by buying and selling shares. The appellants have challenged the finding that the profits were on revenue account but not the finding that the shares were trading stock. The Commissioner, who at first instance had argued that the shares were not trading stock even if the profits were on revenue account, also did not seek to challenge the trading stock finding. As none of the parties have sought to disturb the finding of the primary judge that the shares were trading stock of the appellants, it would be inappropriate for this Court on appeal to consider whether the primary judge was correct to find that the profits were on revenue account. The unchallenged finding that the shares were trading stock was predicated on the finding that the profits from the sale of those shares were made in the ordinary course of the taxpayers’ businesses. Given that finding, s 70-80 of the 1997 Act applies to include the proceeds from the sale of trading stock in assessable income and the question of whether the shares were held on capital or revenue account does not arise.

# ISSUE (3): section 70-40 of the 1997 Act

1. His Honour was asked to construe and apply s 70-40(2) of the 1997 Act upon the basis of a finding that the shares were trading stock. Section 70-40(2) is concerned with trading stock and provides that the opening value of an item of trading stock is a nil amount “if the item was not taken into account under [Division 70]…at the end of the last income year”. The question of construction arose for determination in the context that none of the appellants had lodged tax returns, or had been assessed, in relation to the income years that had preceded the income years in dispute with the Commissioner. The Commissioner submitted, therefore, that s 70-40(2) required the trading stock at the start of the income years in dispute to be valued at nil because an item of trading stock would only be “taken into account” as contemplated by the section if the item had been an item in the issuing of an assessment. On appeal the Commissioner accepted, and it appeared to be common ground, that the taxpayers could still lodge returns for the preceding years showing amounts for trading stock.
2. The taxpayers had contended that the words “taken into account” in s 70-40(2) did not refer to the process of assessment but were to be understood to include the independent operation of the trading stock provisions by their own force. His Honour construed the words “taken into account under [Division 70]” to mean “taken into account as part of a process of assessment carried out by the Commissioner”. His Honour therefore made a declaration that:

[Section] 70-40(2) of the *Income Tax Assessment Act 1997* (Cth) requires the value of the taxpayers’ shares in each year in dispute to be valued at nil if no assessment has been issued for the preceding income year.

His Honour was correct to make such a declaration in relation to the taxpayers, although the Commissioner submitted that the form of the declaration requires some amendment to accommodate self-assessments and assessments where no tax is payable.

1. The general rules for the tax treatment of trading stock are contained in Division 70. Pursuant to that Division, the value of trading stock is taken into account in the calculation of taxable income. For that purpose, a taxpayer must compare the value of all trading stock on hand at the start of the income year with the value of all trading stock on hand at the end of the income year and must bring the difference between the values to account for tax purposes:   
   s 70-5; s 70-35(1). An increase in the value of the trading stock between the start of the income year and the end of the income year is assessable income: s 70-35(2). A decrease in value is an allowable deduction: s 70-35(3). Section 70-35 provides:

**You include the value of your trading stock in working out your assessable income and deductions**

1. If you carry on a \*business, you compare:

(a) the \*value of all your \*trading stock on hand at the start of the income year; and

(b) the \*value of all your trading stock on hand at the end of the income year.

Note: You may not need to do this stocktaking if you are a small business entity: see Division 328.

1. Your assessable income includes any excess of the \*value at the *end* of the income year over the value at the *start* of the income year.
2. On the other hand, you can deduct any excess of the \*value at the *start* of the income year over the value at the *end* of the income year.
3. Section 70-40 deals with the value of an item of trading stock at the start of the income year. Pursuant to s 70-40(1) the value of an item of trading stock at the start of the income year is the same amount “at which it was taken into account under this Division”. Pursuant to s 70-40(2) the value of the item is a nil amount “if the item was not taken into account under this Division” in the preceding income year. The full text of s 70-40 is as follows:

**Value of trading stock at start of income year**

1. The ***value*** of an item of \*trading stock on hand at the start of an income year is the same amount at which it was taken into account under this Division or Subdivision 328-E (about trading stock for small business entities) at the end of the last income year.
2. The ***value*** of the item is a nil amount if the item was not taken into account under this Division or Subdivision 328-E (about trading stock for small business entities) at the end of the last income year.
3. Section 70-45 deals with the value of trading stock at year end. Pursuant to s 70-45, the taxpayer must elect to value each item of trading stock at its cost, market selling value or replacement value.
4. His Honour considered this in *Hua Wang Bank Berhad v Commissioner of Taxation (No 19)* (2015) 231 FCR 371; [2015] FCA 454. His Honour accepted the Commissioner’s contention that when s 70-40(2) refers to a value being taken into account “under this Division”, it means taken into account as part of a process of assessment carried out by the Commissioner. His Honour held that unless an assessment had issued for the preceding income year, s 70-40(2) of the 1997 Actrequired the value of the taxpayers’ shares at the opening of the following year to be valued at nil. His Honour reasoned as follows, at [9] of that judgment:

The Commissioner’s construction is to be preferred. Sections 70-35 and 70-40 appear in the Act underneath the heading ‘General rules’. The provisions are clearly directed at the calculation of assessable income and deductible expenses. Section 70-35(1) requires a comparison between two quantities, viz. the value of trading stock on hand at the start of an income year and the value of trading stock on hand at the end of the income year. If the value at the end of a given year exceeds the value at the beginning, then the difference is to be accounted for by inclusion in the taxpayer’s assessable income: s 70-35(2). If the value at the beginning exceeds the value at the end, then the taxpayer is entitled to claim a deduction against its assessable income: s 70-35(3). The purpose of these provisions is to facilitate the calculation of assessable income. Section 70-40 is an input into the calculus required by s 70-35. It has no role apart from supplying an integer to s 70-35, and the only point of s 70-35 is to calculate what must either be added to or taken away from assessable income. Section 70-40 is, therefore, a provision concerned with the assessment of tax liabilities. When it refers to a value being taken into account ‘under this division’ it means taken into account as part of a process of assessment carried out by the Commissioner.

On appeal, the appellants argued that his Honour wrongly held that being taken into account “under this Division” means taken into account as part of the assessment process. It was argued that the amount that represents the value of closing stock for any year will exist by force of s 70-40 independently of any process of assessment, citing *Re Mendonca; Ex parte Commissioner of Taxation* (1969) 15 FLR 256 at 259 in support. It was alternatively argued that it was sufficient for an item to be taken into account under Division 70 if a calculation had been made by the appellants of the value of the trading stock worked out using one of the methods prescribed in s 70-45, and as long as the appellants elected a valuation method as required by s 70-45 and worked out the value of their trading stock, the value of the shares was taken into account within the terms of s 70-40(2). We do not agree.

1. Section 70-40 must be read together with s 70-35, which is the operative provision in Division 70. An item is “taken into account under [Division 70]” if it is taken into account in ascertaining the amount which is included in the assessable income of a taxpayer (if the value of trading stock at year end exceeds the value at the start of the year) or the amount that is allowable as a deduction (if the value of trading stock at the start of the year exceeds the value at year end) for an income year in relation to the value of the trading stock which a taxpayer must bring to account in taxable income. His Honour correctly stated that the provisions are directed at the calculation of assessable income and allowable deductions as it is the difference in the value of the trading stock at the start and end of the income year that is brought to account for tax purposes. The effect of s 70-40(1) is to link the opening value of trading stock with its closing value in the preceding income year, so that if the previous year’s closing value is amended, the next year’s opening value is also amended by force of the section. If the value of an item of trading stock has not been brought to account at year end it has a nil opening value in the next income year by virtue of s 70-40(2). The Explanatory Memorandum to the 1997 Act makes it clear that s 70-40 was intended to have that operation, and that it was enacted to avoid the potential problem under the predecessor provision in s 29 of the 1936 Act, which referred to the value of trading stock as at the beginning of a year of income as being “its value as ascertained under this or the previous Actat the end of the year immediately preceding”. That section had been construed by the Taxation Board of Review to mean that the value must be determined in accordance with one of the three prescribed methods so that the opening value must be that value, irrespective of the value actually attributed in the previous year, with the potential consequence of either a windfall gain or an unexpected loss for the taxpayer. The Explanatory Memorandum stated that:

The rewrite avoids the possible problem. If one year’s closing value is amended, then the next year’s opening value will change to reflect that amendment. If the closing value cannot be amended, the next year’s opening value will still be what was recorded as the closing value. Subsection 70-40(2) supports this by ensuring that an item’s opening value is nil if the item’s closing value in the previous year was not taken into account at all.

In *Commissioner of Taxation v Energy Resources of Australia Ltd* (2003) 135 FCR 346; [2003] FCAFC 314 the statutory object of s 70-40 to reverse the position under s 29 of the 1936 Act was referred to and relied on by the Full Court in considering the proper construction of s 29 of the 1936 Act.

1. Accordingly, for the value of an item of trading stock to be taken into account under   
   Division 70, there must be an election by the taxpayer under s 70-45 in relation to the method of valuation of that item for Division 70 purposes, and that value then included in the comparison required by s 70-35(1), and the difference in values brought to account by the taxpayer in taxable income for that year of income. An amount is brought to account in taxable income through the assessment process. The construction given to s 70-40 by his Honour does not give rise to any unfairness or unjust result in the circumstances where the appellants themselves have not taken any steps to bring the shares to account as trading stock for tax purposes. Nor does the appellants’ reliance on *Re Mendonca; Ex parte Commissioner of Taxation* (1969) 15 FLR 256 advance their argument. Whilst the appellants’ tax liabilities arise by force of statute, Division 70 does not operate of its own force to include an amount in assessable income or allow it as a deduction independently of the assessment process. Unless the relevant item is part of the computation for s 70-35(2) and (3) purposes in relation to the preceding income year, s 70-40(2) requires the opening value of the trading stock in the next income year to be valued at nil.
2. The terms of the declaration made by his Honour on the facts of the case before him were apt and sufficient to dispose of the issue. The Commissioner submitted an alternative form of declaration to be made by the Court which was said, however, to be more accurate. The proposed substitute declaration which the Commissioner seeks is:

Declare that s 70-40(2) of the *Income Tax Assessment Act 1997* (Cth) requires the value of the taxpayers’ shares in each year in dispute to be valued at nil unless an assessment has been made for the preceding income year or, in the case of years prior to the 2004-05 year of income, no assessment has been made for the preceding year because the Commissioner has ascertained or is deemed to have ascertained under the *Income Tax Assessment Act 1936* (Cth) that the taxpayer has no taxable income and/or no tax payable for that preceding year.

It was explained that the substitution of “made an assessment” for “issued” adopted the terminology of Part IV of the 1936 Act and that deemed assessments would thus be covered. The Commissioner also accepted, in relation to income years prior to the 2004-5 income year in respect of which a nil assessment was not an assessment within the meaning of s 6(1) of the 1936 Act, that the relevant taking into account for Division 70 purposes would be satisfied by a determination from the Commissioner that the taxpayer has no taxable income and/or no tax payable for that preceding year. The appellants did not challenge the amended form of declaration and this declaration should be made in lieu.

# additional huA wang grounds

1. Hua Wang has raised two further grounds of appeal which apply only to it.

## (1) Beneficial ownership issue

1. The first issue relates to the beneficial ownership of the shares which Hua Wang sold.

### (i) Sunland Group Limited

1. Hua Wang’s case below was that 122,146 of the Sunland Group Limited (**“Sunland”**) shares it sold in 2004 had in fact been held on trust for the Phillips River Superannuation Fund. On appeal, Hua Wang contended that his Honour had erred in holding that Hua Wang had not proven that it was not the beneficial owner of all of the shares that it held in Sunland. His Honour’s consideration of the evidence appears at [465]–[468]. The only evidence relied on by Hua Wang before his Honour was two letters. The first letter was from Mr Gould to the directors of Hua Wang in January 1995 requesting that the directors approve an investment of $400,000 into the shares of Sunland and stating “in addition $50,000 will be required from the Phillips River Superannuation Fund in relation to an investment on behalf of one of the funds members into shares in Sunland”. The second letter was from Hua Wang to a Mr Saba of “Wilson HTM” in August 2004 advising that Mr Saba had incorrectly sold 122,146 shares in Sunland which were subsequently bought back and the proceeds returned to his trust account. His Honour had regard to that evidence but was “unable to deduce” from those documents that Hua Wang was holding any of its Sunland shares for the Phillips River Superannuation Fund. His Honour stated that the first letter may suggest that the Phillips River Superannuation Fund was to invest $50,000 in Sunland shares but his Honour was “hard pressed to see” that this was the same as the 122,146 shares referred to in the second letter. His Honour also stated that the first letter suggested that applications were to be made both by the Phillips River Superannuation Fund and Hua Wang which his Honour stated was “inconsistent with the suggested nominee arrangement under which only [Hua Wang] would be buying the shares”. His Honour concluded that neither letter specifically supported the contention that 122,146 of the Sunland shares were held by Hua Wang for the Phillips River Superannuation Fund. No appealable error appears in his Honour’s conclusion.

### (ii) Cyclopharm Limited

1. Hua Wang also challenged his Honour’s conclusion that it had not proven that it was not the beneficial owner of all the shares that it held in Cyclopharm Limited. His Honour’s consideration of the evidence appears at paragraphs [469]–[473]. His Honour pointed to inconsistencies between the documents relied on in support and the contentions of Hua Wang that all of its shares in Cyclopharm were held for “clients of Normandy Finance and Investments Asia Ltd”. His Honour concluded that the documents “may tend to prove that the shares were held by [Hua Wang] for Normandy Finance itself – indeed it appears to say that – but that was not what the taxpayers allege”. Senior counsel accepted that his Honour had fairly set out the argument that had been advanced in the Court below but submitted that the “real issue” was not the identity of the precise ultimate beneficial owner but whether Hua Wang owned the shares beneficially or not. However, the submission advanced below was not that the shares were held by Hua Wang for Normandy Finance. The submission had been that the shares were held by Hua Wang for clients of Normandy Finance and the evidence relied on by Hua Wang had been furnished in support of establishing that fact. As his Honour stated at [470], the first letter was “immediately inconsistent with [Hua Wang’s] submission that all the shares were held for clients of Normandy Finance. No clients of Normandy Finance appear to be referred to in this letter…”. His Honour dealt with the case put by Hua Wang and, on appeal, Hua Wang is bound by the conduct of its case below: *Metwally* *v University of Wollongong* (1985) 60 ALR 68 at 71; [1985] HCA 28 at [7].

### (iii) CVC Limited

1. Hua Wang did not press ground 13 of its Further Amended Notice of Appeal in relation to the sale of the CVC Limited shares.

## (2) Whether the shares had the “necessary connection with Australia” for the purposes of Division 136 of the 1997 Act

1. The second issue only arose for determination if the appellants were held to be non-residents for Australian tax purposes and the profits from the sale of the shares were held to be on capital account. The issue would then have arisen as to whether the shares had the “necessary connection with Australia” and whether Division 136 of the 1997 Act (which has now been repealed) applied in respect of any capital gain made by Hua Wang from the sale of its shares. As the findings below on residency and the revenue nature of the profits have not been overturned on appeal, it is unnecessary to deal with this issue.

# Procedural matters

1. In proceeding NSD 76 of 2015 application was made by Hua Wang to amend the Notice of Appeal in the form of a Further Amended Notice of Appeal. The Commissioner consented to the grant of leave save for grounds 13 and 14 to 22. Leave to amend grounds 14 to 22 inclusive was opposed by the Commissioner on the basis that Hua Wang did not consent to the Commissioner filing a Notice of Contention. The Commissioner submitted that if his Notice of Contention was allowed then he would consent to the application to rely on grounds 14 to 22. If the application to amend to rely on grounds 14 to 22 was not allowed, the Commissioner did not seek to rely on his Notice of Contention.
2. Hua Wang should be given leave to amend the Notice of Appeal in the form of the Further Amended Notice of Appeal save for ground 13 which was not pressed and grounds 14 to 22 which raise the second issue referred to in paragraph [33] above, which the Court has not dealt with in light of its conclusion that the findings on residency and the revenue nature of the profits should not be overturned. The Commissioner’s application for leave to file a Notice of Contention raising an additional argument in relation to the matters raised in those grounds and to rely on further evidence in relation to this issue should accordingly also be refused.

# conclusion

1. The appeals will be dismissed.

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| I certify that the preceding thirty-six (36) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justices Robertson, Pagone and Davies. |

Associate:

Dated: 11 December 2015