FEDERAL COURT OF AUSTRALIA

Doutch v Commissioner of Taxation [2016] FCAFC 166

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| Appeal from: | *PFGG v Commissioner of Taxation* [2015] AATA 972 |
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| File number: | WAD 20 of 2016 |
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| Judges: | **GREENWOOD, MCKERRACHER AND MOSHINSKY JJ** |
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| Date of judgment: | 2 December 2016 |
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| Catchwords: | **TAXATION** – capital gains tax – small business concessions – 50% reduction for small business – whether aggregated turnover of relevant entity for previous year of income was less than $2,000,000 – whether receipts in respect of fuel disbursements were ordinary income that the entity derived “in the ordinary course of carrying on a business” |
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| Legislation: | *Administrative Appeals Tribunal Act 1975* (Cth), s 44  *Bankruptcy Act 1924* (Cth), s 95(2)(b)  *Income Tax Assessment Act 1936* (Cth), ss 63(1)(b), 118  *Income Tax Assessment Act 1997* (Cth), ss 152-1, 152-10, 152-35, 152-40, 152-205, 328-110, 328-115, 328-120, 328-125, 328-130  *Tax Laws Amendment (Small Business) Act 2007* (Cth)  *Tax Laws Amendment (2009 Measures No 2) Act 2009* (Cth) |
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| Cases cited: | *Commissioner of Taxation v Cooling* (1990) 22 FCR 42  *Commissioner of Taxation v Consolidated Media Holdings Ltd* (2012) 250 CLR 503  *Commissioner of Taxation v Montgomery* (1999) 198 CLR 639  *Commissioner of Taxation v The Myer Emporium Limited* (1987) 163 CLR 199  *Downs Distributing Co Pty Ltd v Associated Blue Star Stores Pty Ltd (in liq)* (1948) 76 CLR 463  *Haritos v Federal Commissioner of Taxation* (2015) 233 FCR 315  *Independent Commission Against Corruption v Cuneen* (2015) 256 CLR 1  *Tisdall v Webber* (2011) 193 FCR 260 |
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| Date of hearing: | 4 August 2016 |
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| Registry: |  |
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| Division: |  |
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| National Practice Area: |  |
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| Category: | Catchwords |
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| Number of paragraphs: | 86 |
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| Counsel for the Applicant: | Mr JW Fickling |
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| Solicitor for the Applicant: | Blackwall Legal |
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| Counsel for the First Respondent: | Ms F Vernon |
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| Solicitor for the First Respondent: | Australian Government Solicitor |
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| Counsel for the Second Respondent: | The Second Respondent filed a submitting notice, save as to costs |

ORDERS

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|  | | WAD 20 of 2016 |
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| BETWEEN: | JOHN DOUTCH  Applicant | |
| AND: | COMMISSIONER OF TAXATION  First Respondent  ADMINISTRATIVE APPEALS TRIBUNAL  Second Respondent | |

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| JUDGES: | GREENWOOD, MCKERRACHER AND MOSHINSKY JJ |
| DATE OF ORDER: | 2 DECEMBER 2016 |

THE COURT ORDERS THAT:

1. The appeal be dismissed.
2. The applicant pay the first respondent’s costs of the appeal, to be taxed if not agreed.

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

REASONS FOR JUDGMENT

THE COURT:

## Introduction

1. On 17 July 2008, the applicant (**Mr Doutch**) sold certain mining tenements to Golden West Resources Pty Ltd (**GWR**). Mr Doutch received $5,000,000 cash and 5,000,000 ordinary shares in GWR as consideration for the tenements. The value of the sale was $11,680,000 (GST exclusive).
2. In his tax return for the year of income ended 30 June 2009, Mr Doutch declared the capital gain he made on the sale of the tenements. He claimed in his tax return a 50% capital gains tax (**CGT**) discount under the applicable provisions of the *Income Tax Assessment Act 1997* (Cth) (**ITAA 1997**). The capital gain, after application of that discount, was $5,443,900. A notice of assessment for that year was issued on 14 September 2010, showing Mr Doutch’s taxable income to be $5,612,632 (**2009 Assessment**).
3. Some years later, on 19 December 2013, Mr Doutch objected to the 2009 Assessment on the basis that the small business 50% reduction in Subdivision 152-C of the ITAA 1997 should also apply to the capital gain. If applicable, this would reduce the capital gain by an amount of $2,877,364. In order to establish that the concession was available, Mr Doutch contended in his objection, and subsequent correspondence in relation to the objection, that the “aggregated turnover” (a defined expression) of an associated entity, Denarda Holdings Pty Ltd (**Denarda**), which carried out exploration activities on the land the subject of the tenements, for the previous year (that is, the year ended 30 June 2008), was less than $2,000,000.
4. The Commissioner disallowed the objection. In the course of his decision, he concluded that the aggregated turnover of Denarda for the year ended 30 June 2008 was more than $2,000,000.
5. Mr Doutch applied to the Administrative Appeals Tribunal (the **Tribunal**) for review of the Commissioner’s decision on the objection. The principal issue before the Tribunal was whether the aggregated turnover of Denarda for the year ended 30 June 2008 was less than $2,000,000. This turned on whether receipts totalling $55,106 in respect of fuel disbursements formed part of Denarda’s “annual turnover” (a defined expression) for the year ended 30 June 2008. The expression “annual turnover” was relevantly defined in s 328-120(1) as meaning:

An entity’s ***annual turnover*** for an income year is the total \*ordinary income that the entity **\***derives in the income year in the ordinary course of carrying on a \*business.

The Tribunal concluded that the receipts in respect of fuel disbursements were ordinary income that Denarda derived in the year ended 30 June 2008 in the ordinary course of carrying on a business. As a consequence, the Tribunal affirmed the decision under review.

1. Mr Doutch has appealed to this Court on a question of law pursuant to s 44 of the *Administrative Appeals Tribunal Act 1975* (Cth) (**AAT Act**). As one of the members of the Tribunal who decided the application was a judge, the jurisdiction of this Court is to be exercised by a Full Court: AAT Act, s 44(3)(c).
2. Mr Doutch contends, in summary, that the Tribunal erred in adopting a construction of the phrase “in the ordinary course of carrying on a business” from the explanatory memorandum for the *Tax Laws Amendment (Small Business) Bill 2007* (Cth); the Tribunal should have adopted the meaning given to the phrase in case law, in particular *Commissioner of Taxation v The Myer Emporium Limited* (1987) 163 CLR 199 (***Myer Emporium***) at 209-201; and the Tribunal should have ascertained whether the receipts were derived “in the ordinary course of carrying on a business” by reference to whether they were “extraordinary” judged by reference to the ordinary course of the taxpayer’s business. Mr Doutch also contends that a particular factual finding made by the Tribunal was not open on the evidence.
3. In our view, Mr Doutch has not established any error by the Tribunal. Our reasons, in summary, are as follows.
   1. The Tribunal was correct to hold that the words “in the ordinary course of carrying on a business” in s 328-120(1) bear their ordinary meaning
   2. It was open to the Tribunal to conclude (as it essentially did conclude) that the transactions in question took place in the ordinary course of the business carried on by Denarda. Although it may be accepted that Denarda’s customers usually purchased and provided fuel for Denarda’s drilling operations, the transactions in question, namely the provision of drilling services by Denarda to two customers, were part of the ordinary and common flow of transactions of Denarda’s business.
   3. We reject Mr Doutch’s contention that income may be both “incidental to” the normal day-to-day activities of a business and also “extraordinary” judged by reference to the ordinary course of the taxpayer’s business.
   4. In respect of the factual finding challenged on appeal, it was open to the Tribunal to make that finding.
4. It follows that the appeal is to be dismissed.

## Legislation

1. The issues raised by the appeal concern Division 152 (small business relief) and Division 328 (small business entities) as applicable for the year of income ended 30 June 2009.
2. As noted in the objection decision, s 152-10(1) was amended by the *Tax Laws Amendment (2009 Measures No 2) Act 2009* (Cth). These changes were effective 23 June 2009 (the date of Royal Assent) but applied retrospectively to the 2007-2008 income year and later income years. In setting out the relevant provisions below, we set out the provisions as applicable for the year ended 30 June 2009 including these amendments.
3. Division 152 comprised a number of tax concessions relating to CGT designed to “help small business” (s 152-1). The basic conditions for relief were set out in Subdivision 152-A. Of the four available small business concessions, only the 50% reduction (in Subdivision 152-C) is relevant for present purposes.
4. Section 152-10 (located in Subdivision 152-A) relevantly provided as follows:

**152-10 Basic conditions for relief**

(1) A \*capital gain (except a capital gain from \*CGT event K7) you make may be reduced or disregarded under this Division if the following basic conditions are satisfied for the gain:

(a) a \*CGT event happens in relation to a \*CGT asset of yours in an income year;

Note: This condition does not apply in the case of CGT event D1: see section 152-12.

(b) the event would (apart from this Division) have resulted in the gain;

(c) at least one of the following applies:

(i) you are a \*small business entity for the income year;

(ii) you satisfy the maximum net asset value test (see section 152-15);

(iii) you are a partner in a partnership that is a small business entity for the income year and the CGT asset is an interest in an asset of the partnership;

(iv) the conditions mentioned in subsection (1A) or (1B) are satisfied in relation to the CGT asset in the income year;

Note: For determining whether an entity is a ***small business entity***, see Subdivision 328-C (as affected by section 152-48).

(d) the CGT asset satisfies the active asset test (see section 152-35).

Note: This condition does not apply in the case of CGT event D1: see section 152-12.

*Passively held assets—affiliates and entities connected with you*

(1A) The conditions in this subsection are satisfied in relation to the \*CGT asset in the income year if:

(a) your \*affiliate, or an entity that is \*connected with you, is a \*small business entity for the income year; and

(b) you do not carry on a \*business in the income year (other than in partnership); and

(c) if you carry on a business in partnership—the CGT asset is not an interest in an asset of the partnership; and

(d) in any case—the small business entity referred to in paragraph (a) is the entity that, at a time in the income year, carries on the business (as referred to in subparagraph 152-40(1)(a)(ii) or (iii) or paragraph 152-40(1)(b)) in relation to the CGT asset.

Note 1: For determining whether an entity is a ***small business entity***, see Subdivision 328-C (as affected by section 152-48).

Note 2: For businesses that are winding up, see section 152-49 and subsection 328-110(5).

…

1. Sections 152-35 and 152-40 dealt with the active asset test and were relevantly in the following terms:

**152-35 Active asset test**

(1) A \*CGT asset satisfies the active asset test if:

(a) you have owned the asset for 15 years or less and the asset was an \*active asset of yours for a total of at least half of the period specified in subsection (2); or

(b) you have owned the asset for more than 15 years and the asset was an active asset of yours for a total of at least 7½ years during the period specified in subsection (2).

(2) The period:

(a) begins when you \*acquired the asset; and

(b) ends at the earlier of:

(i) the \*CGT event; and

(ii) if the relevant business ceased to be carried on in the 12 months before that time or any longer period that the Commissioner allows—the cessation of the business.

**152-40 Meaning of *active asset***

(1) A \*CGT asset is an ***active asset*** at a time if, at that time:

(a) you own the asset (whether the asset is tangible or intangible) and it is used, or held ready for use, in the course of carrying on a \*business that is carried on (whether alone or in partnership) by:

(i) you; or

(ii) your \*affiliate; or

(iii) another entity that is \*connected with you; or

(b) if the asset is an intangible asset—you own it and it is inherently connected with a business that is carried on (whether alone or in partnership) by you, your affiliate, or another entity that is connected with you.

Note 1: An intangible asset need satisfy only paragraph (a) or paragraph (b).

Note 2: The meaning of ***connected with*** in subparagraph (1)(a)(iii) and paragraph (b) is affected by section 152-42.

Note 3: An example of an asset that is inherently connected with a business is goodwill or the benefit of a restrictive covenant.

Note 4: For businesses that are winding up, see section 152-49 and subsection 328-110(5).

…

1. As noted above, Subdivision 152-C related to the small business 50% reduction. Section 152-205, located in that subdivision, provided:

**152-205 You get the small business 50% reduction**

The amount of a \*capital gain remaining after applying step 3 of the method statement in subsection 102-5(1) is reduced by 50%, if the basic conditions in Subdivision 152-A are satisfied for the gain.

Example: For an individual (other than one who opts to claim indexation instead of the discount), the discount percentage that applies under step 3 of the method statement is 50%. Therefore, the combined effect of the discount percentage and this section would be to reduce the original capital gain by a total of 75%.

For an individual who opts to claim indexation, or a company, there is no discount percentage, so the individual or company would simply get the 50% reduction under this section.

1. Division 328 dealt with small business entities. Subdivision 328-C explained the meaning of the terms “small business entity”, “annual turnover” and “aggregated turnover”. Section 328-110 relevantly provided:

**328-110 Meaning of *small business entity***

*General rule: based on aggregated turnover worked out as at the beginning of the current income year*

(1) You are a ***small business entity*** for an income year (the ***current year***) if:

(a) you carry on a \*business in the current year; and

(b) one or both of the following applies:

(i) you carried on a business in the income year (the ***previous year***) before the current year and your \*aggregated turnover for the previous year was less than $2 million;

(ii) your aggregated turnover for the current year is likely to be less than $2 million.

Note: Section 328-110 of the *Income Tax (Transitional Provisions) Act 1997* affects the operation of this subsection in relation to the 2007-08 and 2008-09 income years.

…

1. The term “aggregated turnover” was defined in s 328-115 as follows:

**328-115 Meaning of *aggregated turnover***

(1) Your ***aggregated turnover*** for an income year is the sum of the relevant annual turnovers (see subsection (2)) excluding any amounts covered by subsection (3).

Note: For small business relief purposes, additional entities may be treated as being connected with you or your affiliate under section 152-48.

(2) The ***relevant annual turnovers*** are:

(a) your \*annual turnover for the income year; and

(b) the annual turnover for the income year of any entity (a ***relevant entity***) that is \*connected with you at any time during the income year; and

(c) the annual turnover for the income year of any entity (a ***relevant entity***) that is an \*affiliate of yours at any time during the income year.

(3) Your ***aggregated turnover*** for an income year does not include the following amounts:

(a) amounts \*derived in the income year by you or a relevant entity from dealings between you and the relevant entity while the relevant entity is \*connected with you or is your \*affiliate;

(b) amounts derived in the income year by a relevant entity from dealings between the relevant entity and another relevant entity while each relevant entity is connected with you or is your affiliate;

(c) amounts derived in the income year by a relevant entity while the relevant entity is not connected with you and is not your affiliate.

1. The term “annual turnover” was relevantly defined in s 328-120 as set out in [5] above.
2. Section 328-125 dealt with the meaning of “connected with” an entity and s 328-130 dealt with the meaning of “affiliate”. It is not necessary to set out these provisions for the purposes of the issues on appeal.

## Background facts

1. The following summary of the background facts is based on the reasons of the Tribunal (the **Reasons**).
2. On 6 November 1997, Mr Doutch’s sister transferred WA gold mining leases to him for no consideration.
3. In December 2001, the WA gold mining leases expired and were reissued to Mr Doutch (the **Tenements**).
4. On 17 July 2008, Mr Doutch entered into a Sale and Purchase Agreement with GWR (referred to as “Mining Co” in the Reasons) to sell the Tenements for a consideration of $5,000,000 in cash plus 5,000,000 ordinary shares in GWR, valued at their closing price on the Australian Stock Exchange on that day. This disposal resulted in a capital gain.
5. During the period 1 July 2007 to 30 June 2009, Mr Doutch was one of two directors of Denarda (referred to as “Drilling Co” in the Reasons). Denarda’s issued capital consisted at the material time of two ordinary shares, one B class share and one C class share. At all material times, Mr Doutch beneficially owned one ordinary share and one B class share in the company.
6. Denarda is an oil and gas drilling business based in Western Australia and carrying on business in that State.
7. Denarda owns a drilling rig which it uses in the conduct of its business. The drilling rig usually operates continually, namely seven days a week, weather dependent.
8. The drilling rig moves from drilling site to drilling site on a float (a low loader truck). This is because when the drilling rods are on board the rig, the drilling rig exceeds the permissible weight for use on public roads.
9. Once on site the drilling rig will be tasked with drilling holes at the direction of the mining or exploration site owner. This will involve a geologist employed by the mining or exploration site owner directing the drilling rig where to place itself prior to commencing drilling. Generally a “pad” will have been prepared. A “pad” is a flat area of around 15 to 20 metres by 15 to 20 metres where the drill rig will operate. The depth of the holes drilled and the angle drilled are at the direction of the mining or exploration site owner’s geologist.
10. The drilling rig operates mainly on mining sites and each job can last for up to six months.
11. During the course of carrying out the drilling operations, the drilling rig uses diesel fuel. It also uses other products which are consumed in the course of drilling operations. These include drill bits and hammers.
12. The drilling rig takes 1,000 litres of fuel (stored in 2 x 500 litre tanks). The drilling rig uses approximately 1,000 of litres of fuel a day. On the basis that the drilling rig was operating to capacity, it can be inferred that the drilling rig used in excess of 300,000 litres of fuel in the year ended 30 June 2008.
13. Before undertaking a drilling operation for a client, Denarda enters into a contract with the company which has engaged Denarda to carry out the drilling operations. The contract usually contains terms which deal with the charging of consumables and fuel.
14. During the four years ended 30 June 2006 to 30 June 2009, Denarda performed the majority of its drilling services for (and derived the vast majority of its income from) GWR, and less frequently performed drilling services for (and derived income from) Magellan, on mine sites in or near West Wiluna. Magellan’s mine site was approximately 20 kilometres away from GWR’s West Wiluna site. The provision of drilling services to GWR accounted for 65% of Denarda’s revenue during the year ended 30 June 2008 and 79% during the years ended 30 June 2006 to 30 June 2009.
15. Annexure A to the “Wiluna West Project Drilling Contract” between GWR and Denarda, dated 5 June 2009 (**GWR Contract**), titled “Tender for RC Drilling”, provides (at clause 1.3(C)) that the “Contractor” (i.e. Denarda) would provide “all fuel required” and if fuel is supplied by GWR it would be “noted as part of the overall drilling cost”.
16. However, that term did not represent what actually occurred in relation to the fuel charges in respect of the drilling services provided by Denarda to GWR and Magellan. In each of those cases during the period 2006 to 2009, GWR and Magellan provided the fuel used by Denarda on site and Denarda did not invoice each of those companies for the cost of the fuel used by the drilling rig in carrying out the drilling functions.
17. The unchallenged evidence of Mr Doutch and the Exploration Director of GWR was that the GWR Contract (which provided that Denarda was to provide the fuel and would charge the client for the fuel consumed by the drilling rig) most likely arose as a result of a temporary CEO seeking to change practices, almost a year after the year ended 30 June 2008, but that the changes were never implemented.
18. In about October 2007, the drill was located near Wiluna. Mr Doutch was asked by Mr DC (adopting the anonymised reference used in the Reasons), with whom he had a good relationship, to provide drilling services at an exploration site of Pioneer Nickel Limited (**Nickel Limited**) near Ravensthorpe. Mr Doutch agreed and the rig was relocated from Wiluna to near Ravensthorpe.
19. Denarda sent Nickel Limited a letter dated 30 October 2007, attaching a document titled “Price Schedule at 30th October 2007” (the copy before the Tribunal was unexecuted) which stated, under the heading “Client Responsibility”:

The client [i.e. Nickel Limited] will be responsible for provision of fuel for all drilling associated equipment and vehicles.

1. Nickel Limited did not, however, provide fuel for the operation of the rig during the time that it was at its exploration site. The fuel needed to operate the rig was purchased by employees of Denarda from a commercial outlet in Ravensthorpe and taken to the site where it was then used by the drilling rig in its operations. The fuel charges were then included in invoices which were furnished by Denarda to Nickel Limited (see further below).
2. While the drilling rig was operating at Nickel Limited’s site, Mr Doutch was asked by Tectonic Resources NL (**Resources NL**) if Denarda could also carry out drilling services at its site. Mr Doutch agreed.
3. Denarda sent a letter to Resources NL, dated 14 November 2007, which attached a document titled “Price Schedule at 14th November 2007” (the copy before the Tribunal was executed) which stated, under the heading “Client Responsibility”:

The client [i.e. Resources NL] will be responsible for [the] full cost of all drilling associated equipment and vehicles.

1. However, as in the case of Nickel Limited, the fuel that was used by the drilling rig in performing the contract for Resources NL was purchased by Denarda from a commercial outlet in Ravensthorpe and the fuel charges incurred by Denarda were then included in the total amount invoiced to Resources NL.
2. At [56] of the Reasons, the Tribunal made the following finding, which is challenged on appeal:

Despite the fact that the terms of the Price Schedule provided otherwise, [Mr Doutch] knew in advance of the supply of the drilling services under [the] contracts with Nickel Limited and Resources NL that neither would be supplying the fuel for the provision of the drilling services.

1. An amount comprising a fuel disbursement was included in each of five separate invoices that Denarda issued to Nickel Limited and Resources NL in the year ended 30 June 2008. Each invoice shows that Denarda invoiced Nickel Limited and Resources NL “at cost” for diesel fuel (totalling $55,106) purchased by it in the year ended 30 June 2008 and consumed by the drilling rig whilst Denarda was performing its contracted drilling services for Nickel Limited and Resources NL (**Fuel Disbursements**). As well as including the charges for fuel, the invoices also included charges for various other expenses incurred by Denarda necessary to perform its contracted drilling services for Nickel Limited and Resources NL, including hammers, hammer oil, drill foam, drill bits, truck tyres and so on. The five invoices together charged a total of $476,129 (the **Invoices)**.
2. Details of the Invoices, which included the Fuel Disbursements, are set out in the table below.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Date of Invoice** | **Client** | **Period work done** | **Total amount of invoice (GST exclusive)** | **Fuel Disbursements (included in amounts in fourth column)** |
| 29/01/08 | Resources NL | 10 to 22 Jan 08 | $104,978 | $8,919 |
| 19/12/07 | Resources NL | 10 to 17 Dec 07 | $75,358 | $10,858 |
| 10/12/07 | Resources NL | 3 to 9 Dec 07 | $77,377 | $8,001 |
| 3/12/07 | Nickel Limited | 17 Nov to 1 Dec 07 | $103,962 | $11,550 |
| 20/11/07 | Nickel Limited | 8 to 19 Nov 07 | $114,456 | $15,779 |
|  |  |  | $476,129 | **$55,106** |

1. The Office Manager of Denarda, who was responsible for issuing invoices, remembered the Invoices because it was unusual for Denarda to charge for fuel. The Office Manager said, however, that she took no action as a consequence of this and issued the Invoices in the usual way.
2. In the experience of the Exploration Director of GWR it was usual for the clients of Denarda to supply the fuel consumed by the drilling rig in providing drilling services under a contract. However, he accepted there were occasions when the client did not provide the fuel and when the fuel was provided by Denarda and the client was invoiced for the fuel.
3. In the experience of the Exploration Director it was “industry practice” for mining companies to supply fuel for contractors (including drillers), especially for large drilling contractors. He accepted, however, that there would be cases where the mining company did not supply fuel.
4. The provision of drilling services to Nickel Limited and Resources NL was a not insignificant part of Denarda’s overall business in the year ended 30 June 2008. At a total of $476,129, the Invoices account for approximately 23% of the amount of the claimed “annual turnover” for that year of $2,032,829 (including the Fuel Disbursements). The time period covered by the Invoices, being 54 working days, also constitutes a not insignificant portion of the relevant year.
5. Denarda’s income tax return for the year ended 30 June 2008 disclosed total gross income of $2,545,010, comprising:

|  |  |
| --- | --- |
| Drilling Receipts | $2,466,753 |
| Lease/Hire of Motor Vehicle Income | $72,978 |
| Miscellaneous Income | $3,963 |
| Interest | $1,316 |
| **Denarda’s Gross Income** | **$2,545,010** |

1. However, Mr Doutch contended prior to the hearing in the Tribunal that the “annual turnover” (as defined in s 328-120 of the ITAA 1997) of Denarda for the year ended 30 June 2008 was $1,974,323, calculated as follows:

|  |  |  |
| --- | --- | --- |
| **Taxable income returned** |  | **$2,545,010** |
| Less: |  |  |
| Lease/Hire of Motor Vehicle | $72,978 |  |
| Miscellaneous Income | $3,963 |  |
| Interest | $1,316 | $78,257 |
| **Drilling Receipts** |  | **$2,466,753** |
| Less: |  |  |
| Advance Payments | $205,000 |  |
| Loan from N Metals | $50,000 | $255,000 |
|  |  | $2,211,753 |
| Less: |  |  |
| Amounts invoiced for reimbursement of “irregular disbursements” incurred in providing access to the Tenements for purposes of inspection | $135,714 |  |
| Fuel disbursements charged | $55,106 |  |
| GWR drilling charges accrued in 2007 financial year | $46,610 | $237,430 |
| **Adjusted Annual Turnover** |  | **$1,974,323** |

1. There were concessions made prior to the hearing before the Tribunal so that Mr Doutch’s position at the time of the Tribunal hearing was that Denarda’s “annual turnover” for the year ended 30 June 2008 for the purposes of s 328-120 of the ITAA 1997 was $1,977,723, calculated as set out in the following table:

|  |  |
| --- | --- |
| Adjusted Annual Turnover per above table | $1,974,323 |
| Add: Amount conceded by applicant re loan from [N] Metals | $50,000 |
|  | $2,024,323 |
| Less: Irregular disbursements paid to Mr BM on behalf of GWR | $46,600 |
| Further Adjusted Annual Turnover | **$1,977,723** |

## The tax return, objection and objection decision

1. On 6 September 2010, Mr Doutch lodged his income tax return for the year ended 30 June 2009.
2. The 2009 tax return disclosed a taxable income of $5,612,632, calculated as follows:

|  |  |  |
| --- | --- | --- |
| Salary and Wages |  | $152,300 |
| Interest |  | $33,575 |
| Add: Capital Gain | $11,680,000 |  |
| Less: CGT cost base (sale costs) | $170,544 |  |
| Gross capital gain | $11,509,456 |  |
| Less: Capital losses | $621,656 |  |
|  | $10,887,800 |  |
| Less: 50% discount | $5,443,900 | $5,443,900 |
|  |  | $5,629,775 |
| Less: Cost of managing tax affairs |  | $17,143 |
| **Mr Doutch’s Taxable Income** |  | **$5,612,632** |

1. On 14 September 2010, Mr Doutch was issued with the 2009 Assessment, by which Mr Doutch’s taxable income was assessed in accordance with his 2009 tax return.
2. On 19 December 2013, Mr Doutch objected to the 2009 Assessment on the basis that the 50% reduction in Subdivision 152-C of the ITAA 1997 should apply to the capital gain amount of $5,443,900 (as disclosed in the 2009 tax return), reducing that capital gain amount by $2,877,364.
3. In a memorandum dated 19 December 2013 in support of the objection, MKT Taxation Advisers, on behalf of Mr Doutch, contended:
   1. from 1999 through to 2003, exploration activities were undertaken on the land the subject of the Tenements by Deep Mining Pty Ltd and Linden Gold Mining Pty Ltd (companies controlled by Mr Doutch);
   2. from 2003, another company controlled by Mr Doutch, Lingchip Pty Ltd, carried out exploration activities;
   3. exploration and drilling activities continued to be undertaken throughout the period up to 2008;
   4. at the time of the Sale and Purchase Agreement dated 17 July 2008, the Tenements were still held by the Doutch family as part of their ongoing exploration business;
   5. over the course of the ownership of the Tenements, Mr Doutch together with four companies controlled by him (namely, Deep Mining Pty Ltd, Linden Gold Mining Pty Ltd, Lingchip Pty Ltd and Denarda) carried out exploration and small mining activities, which continued through to the sale of the Tenements;
   6. Mr Doutch relied on the small business entity test; under this test, where a taxpayer that does not carry on a business owns a CGT asset that is used in a business by an affiliate or an entity connected with the taxpayer, he or she can also access the small business CGT concessions; accordingly, the small business entity test can apply to Mr Doutch where the Tenements are used in the business carried on by an entity that is connected with Mr Doutch;
   7. from 2003/2004 to the date of sale, the Tenements were used in a business conducted by Lingchip Pty Ltd and Mr Doutch;
   8. in the year ended 30 June 2008, none of Mr Doutch, Lingchip Pty Ltd, Linden Gold Mining Pty Ltd and Deep Mining Pty Ltd had business turnover in excess of $2 million; however, Mr Doutch held a 50% interest in Denarda, and it carried on business as a drilling contractor in that year;
   9. while the gross sales derived by Denarda in the year ended 30 June 2008 were in excess of $2 million, its “annual turnover” (as defined) was less than $2 million.
4. In a further memorandum, dated 4 April 2014, MKT Taxation Advisers contended as follows:
   1. contrary to the earlier memorandum, from the 2005 year, Denarda (rather than the other companies) incurred the costs and carried out the exploration activities on the land the subject of the Tenements, and bore responsibility for the marketing and eventual sale of the Tenements through to July 2008;
   2. in the year ended 30 June 2008, Lingchip Pty Ltd was not carrying on a business, and neither were the other associated entities of Mr Doutch, being Deep Mining Pty Ltd and Linden Gold Mining Pty Ltd;
   3. Denarda was, however, carrying on a business (a detailed breakdown of Denarda’s receipts for the year ended 30 June 2008 was provided, with adjustments for receipts that, it was contended, did not constitute annual turnover pursuant to s 328-120).
5. On 30 June 2014, the Commissioner disallowed the objection in full as he was not satisfied that Denarda’s “annual turnover” for the year ended 30 June 2008, for the purposes of s 328-120 of the ITAA 97, was less than $2 million (**Objection Decision)**. We note the following in relation to the Objection Decision:
   1. It was concluded that Mr Doutch did not himself carry on a business.
   2. However, it was accepted that Mr Doutch could still claim the 50% reduction where the Tenements were used in a business carried on by an entity connected with Mr Doutch. Thus it was stated that Mr Doutch could satisfy the requirements of a small business entity if the aggregated income of Denarda did not exceed the $2 million threshold.
   3. The Objection Decision considered the conditions in s 152-10(1A). This involved consideration of whether Denarda was a small business entity within the meaning of s 328-110(1), which required consideration of whether the “aggregated turnover” of Denarda for the previous year (that is, the year ended 30 June 2008) was less than $2 million. This in turn required consideration of the “annual turnover” of Denarda for that year. It was concluded that the aggregated turnover of Denarda for the year ended 30 June 2008 exceeded the small business threshold of $2 million.
   4. In relation to whether the CGT asset satisfied the active asset test (s 152-35), it was concluded that this was satisfied in circumstances where Mr Doutch owned the Tenements but allowed Denarda to carry on the business of mining in relation to the Tenements.

## The Tribunal’s decision

1. On 29 August 2014, Mr Doutch applied to the Tribunal for a review of the Objection Decision.
2. It was accepted before the Tribunal that Denarda is, and at all relevant times was, a company “connected with” Mr Doutch for the purposes of s 328-125 of the ITAA 1997. It was also accepted that in assessing the sum of the “relevant annual turnovers” for the purpose of determining the “aggregated turnover” for the year ended 30 June 2008 regard was to be had only to the “annual turnover” of Denarda.
3. It followed, therefore, that the question to be determined by the Tribunal depended on whether the “annual turnover” of Denarda for the previous year, namely, the year ended 30 June 2008, was less than $2 million.
4. As a result of certain concessions, the only issue was whether, in assessing Denarda’s “annual turnover” for the year ended 30 June 2008, Denarda was entitled to deduct the total sum of $55,106 in respect of the monies received for the Fuel Disbursements.
5. Before the Tribunal, there were two bases upon which Mr Doutch contended that he was entitled to deduct the sum of $55,106 which Denarda charged in respect of the fuel it had purchased:
   1. First, Mr Doutch contended that the monies received from the two customers in respect of the invoicing of the amounts it expended on the fuel was not ordinary income derived by Denarda in the year ended 30 June 2008 “in the ordinary course of carrying on” its drilling business for the purposes of s 328-120(1) of the ITAA 1997.
   2. Secondly, he contended that the amount derived from the payment of the amounts invoiced in respect of the Fuel Disbursements must be excluded from Denarda’s “annual turnover” for the year ended 30 June 2008 because the monies were derived from “sales of retail fuel” for the purpose of s 328-120(3) of the ITAA 97.
6. The second of these contentions is not pursued on appeal and can be put to one side.
7. The Tribunal considered Mr Doutch’s first contention at [68]-[78] of the Reasons. We set out this passage of the Reasons in full:

68 It is convenient to set out again the terms of s 328-120(1) of the ITAA 1997:

**328-120(1)** *An entity’s* ***annual turnover*** *for an income year is the total* ***\*ordinary income*** *that the entity \*derives in the income year in the* ***ordinary*** *course of carrying on a business.* [Emphasis added.]

69 The expression “ordinary income”, as it appears in s 328-120(1) of the ITAA 1997, is defined in s 995-1 and s 6-5 of the ITAA as “income according to ordinary concepts”. A substantial body of case law has evolved to identify various factors that indicate whether an amount is “income according to ordinary concepts”. As has already been mentioned, in *Myer Emporium* the High Court observed that the term “ordinary income” can include income derived from a transaction which was “extraordinary when judged by reference to the ordinary course of the taxpayers business”.

70 The phrase “in the ordinary course of carrying on a business”, as it appears in s 328-120(1) of the ITAA 1997, is not defined in the ITAA 1997 and it is necessary to construe those words. In engaging in the exercise of statutory construction, the Court is to consider the text of the statute in context. The High Court in *Commissioner of Taxation v Consolidated Media Holdings Ltd* (2012) 250 CLR 503 observed as follows at [39]:

*“This Court has stated on many occasions that the task of statutory construction must begin with a consideration of the [statutory] text” [Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue [2009] HCA 41; (2009) 239 CLR 27 at 46 [47]]. So must the task of statutory construction end. The statutory text must be considered in its context. That context includes legislative history and extrinsic materials. Understanding context has utility if, and in so far as, it assists in fixing the meaning of the statutory text. Legislative history and extrinsic materials cannot displace the meaning of the statutory text. Nor is their examination an end in itself.*

71 The extrinsic materials to which the High Court referred includes an explanatory memorandum.

72 The definition of “annual turnover” in s 328-120(1) of the ITAA 1997 was inserted into the ITAA 1997 by *Tax Laws Amendment (Small Business) Act 2007* (**TLASBA 2007**). The “Explanatory Memorandum” to the *Tax Laws Amendment (Small Business) Bill 2007* (**EM**), which Bill was ultimately enacted as the TSLABA 2007, commencing from the 2008 income year, states:

***What does ‘in the ordinary course of carrying on a business’ mean?***

*……..*

*2.15 In general, income is derived in the ordinary course of carrying on a business if the income is of a kind that is regularly or customarily derived by the entity in the course of carrying on its business, arising out of no special circumstance or event. Similarly,* ***the income is derived in the ordinary course of carrying on a business if the income although not regularly derived, is a direct result of the normal activities of the business****.*

*2.16 Ordinary* ***income may be derived in the ordinary course of carrying on a business even if it is not the main type of ordinary income derived by the entity.*** *Similarly,* ***the income does not need to account for a significant part of the entity's overall receipts.*** *It is sufficient that the ordinary income is of a kind derived regularly or customarily in the carrying on of a business. [Emphasis added.]*

73 In the Tribunal’s view, the EM provides assistance in the construction of s 328-120(1) because it does not displace, but rather confirms the ordinary meaning of the words “income….derived….in the ordinary course of carrying on a business” as to refer to income which is an incident of, or directly related to, the carrying on of the normal day to day activities of the business in question, even if that income is not regularly derived in that way.

74 In this case, the business of [Denarda] was the carrying out of drilling services by means of a drilling rig. The use of fuel and hammers were, and are, essential to the operation of the drilling rig and, therefore, to the carrying out of the normal day to day activities of the business. The income in this case was derived by [Denarda] charging the two companies for the supply of fuel to the drilling rig and so the income was [an] incident of, or directly related to, the carrying on of the normal day to day activities of its drilling business, and, therefore, income derived in the ordinary course of carrying on a business for the purposes of s 328-120(1).

75 The fact [Denarda] did not derive income in that way in respect of every contract for drilling services that it entered, does not alter that characterisation of the income in those circumstances when it did derive income from that source, namely, by charging for the supply of fuel to the rig. The income derived from the payment of the Fuel Disbursements is no less income in the ordinary course of [Denarda’s] business than the income derived from any of the other charges levied in the Invoices, such as the charge for hammers.

76 In the Tribunal’s view, [Mr Doutch’s] reference to *Myer Emporium* does not assist his case. In *Myer Emporium*, the High Court was concerned with the scope of the expression “ordinary income” (or “income according to ordinary concepts”) and not of the phrase “in the ordinary course of carrying on a business”. Further, the High Court was concerned with a transaction, namely, the consideration received from an assignment to a finance company of the taxpayer’s right to receive interest under a $80 million loan to a subsidiary, which was a transaction which the Commissioner conceded was outside of the ordinary business of the taxpayer as a retailer and property developer. By contrast, in this case the transactions in question, namely, the charging for the supply of fuel used by the drilling rig, were charges which were incidental to, and directly related to, the carrying out of the day to day trading activities of [Denarda], namely, the operation of a drilling rig.

77 Further, no assistance to the construction of s 328-120(1) [comes] from a consideration of the cases of *Downs* [*Distributing Co Pty Ltd v Associated Blue Star Stores Pty Ltd (in liq)* (1948) 76 CLR 463] and *Taylor* [*v White* (1964) 110 CLR 129]. Both of those cases [are] concerned with s 95(1) of the *Bankruptcy Act 1924-1960* (**Bankruptcy Act**) which gave rise to the question of whether a payment to a creditor was made “in the ordinary course of business” for the purpose of determining whether the payment constituted a preference. The phrase under consideration in those cases was “ordinary course of business” rather than in “the ordinary course of carrying on a business”. Further, the bankruptcy statutory context in which the words “ordinary course of business” occur is very different to the statutory context in which words “the ordinary course of carrying on a business” occur in s 328-120(1) of the ITAA 1997. Under the Bankruptcy Act what is considered is whether the relevant payments were payments commonly occurring within the course of the business generally, as opposed to a business which might be suffering from financial pressure. This is very different to the context … in which the words “the ordinary course of carrying on a business” in s 328-120(1) fall for construction.

78 It follows that the Tribunal finds that the income derived by [Denarda] was ordinary income derived in the ordinary course of carrying on a business and that, therefore, the annual turnover of [Denarda] for the year ended 30 June 2008 exceeded $2 million.

## The appeal on a question of law

1. Mr Doutch’s amended notice of appeal contains 10 questions of law and 10 related grounds of appeal. At the hearing of the appeal, counsel for Mr Doutch indicated that he did not press grounds 9 and 10 (which relate to the expression “sales of retail fuel” in s 328-120(3)). In relation to grounds 1 to 3 (which relate to the expression “ordinary income”), at the hearing of the appeal counsel for Mr Doutch said that the way the Tribunal “answered what is in the ordinary course of business by including what is incidental to the ordinary course of business, probably gets [the Tribunal] to the right answer on ‘ordinary income’”. He accepted that, subject to the challenge to the finding of fact raised by ground 8, the Tribunal’s conclusion as to ordinary income “must stand”. He therefore said that it made sense not to press grounds 1 to 3. In these circumstances, and in light of our conclusion, below, in relation to ground 8, it is unnecessary to consider grounds 1 to 3.
2. Questions of law numbered 4 to 8 and the associated grounds in the amended notice of appeal are as follows:

**Questions of law**

…

4. **Further to 1.**, did the Tribunal err in the proper construction of the words “*in the ordinary course of carrying on a business*” as used in sub-section 328-120(1) of the *1997 Act*?

5. **Further to 1. and 4.**, did the Tribunal err in adopting a construction of the words “*in the ordinary course of carrying on a business*” as used in sub-section s 328-120(1) of the *1997 Act* that gave the words “*in the ordinary course of carrying on a business*” a superfluous meaning such that the Tribunal’s construction effectively struck the words from s 328-120(1) of the 1997 Act?

6. **Further to 1., 4. and 5.**, did the Tribunal err in adopting a construction of the words “*in the ordinary course of carrying on a business*” as used in s 328-120(1) of the *1997 Act* that gave the words “*ordinary income*” and in that context, the words “*in the ordinary course*” a construction or constructions inconsistent to constructions adopted in decisions of appellate courts in respect of income tax legislation and other legislation?

7. **Further to 1., 4., 5. and 6.**, did the Tribunal err in the application of the facts as found, in finding that the Fuel Disbursements constituted, on the term’s proper construction, as used in s 328-120(1) of the *1997 Act*, “*ordinary income that [Drilling Co] derive[d] in the income year in the ordinary course of carrying on [its] business*”?

8. **Further to 1., 2., 3., 4., 5., 6. and 7.**, and to the extent relevant in resolving the above questions, was the Tribunal’s finding at paragraph 56 (a finding that Drilling Co knew in advance that its clients Nickel Limited and Resources NL would not be supplying fuel) not open to the Tribunal on the evidence before the Tribunal?

…

**Grounds of appeal**

…

4. **Pertaining to Question [4]**, the Tribunal erred in the proper construction of the words “*in the ordinary course of carrying on a business*” as used in s 328-120(1) of the *1997 Act* as set out below.

5. **Pertaining to Question [5]**, the Tribunal erred in adopting a construction of the words “*in the ordinary course of carrying on a business*” as used in sub-section s 328-120(1) of the 1997 Act that gave the words “*in the ordinary course of carrying on a business*” a superfluous meaning such that the Tribunal’s construction effectively struck the words from sub-section s 328-120(1) of the 1997 Act:

a. The principles of statutory construction require that every word in the legislation be given meaning; and

b. The construction of s 328-120(1) of the *1997 Act* adopted by the Tribunal, in purported reliance upon the explanation contained at paragraphs 2.15 to 2.16 of the *“Explanatory Memorandum” to the Tax Laws Amendment (Small Business) Bill 2007* (“EM”) gives no real meaning to the words “*in the ordinary course of carrying on a business*”, where the consequence is that on the Tribunal’s construction there could be no ascertainable Ordinary Income that is excluded from being “*in the ordinary course of carrying on a business*”.

6. **Pertaining to Question [6]**, the Tribunal erred in adopting a construction of the words “*in the ordinary course of carrying on a business*” as used in sub-section s 328-120(1) of the 1997 Act that gave the words “*ordinary income*” and in that context, the words “*in the ordinary course*”, a construction or constructions inconsistent to constructions adopted in decisions of appellate courts in respect of income tax legislation and other legislation:

a. The concepts of “ordinary income” and “in the ordinary course” are linked and have been used by appellate Courts in the interpretation of the statutory expression “ordinary income” for in excess of 70 years;

b. Where a term is used in tax legislation that has previously been used in tax legislation or by the appellate Courts in interpreting tax legislation, that term should be appropriately considered as giving meaning and context to the words of the legislation;

c. The term “in the course of the taxpayer’s business” was used by the High Court in *FCT v Myer Emporium [1987] HCA 18; (1987) 163 CLR 199 at [14]* wherein the High Court, observed the term required determination of whether a transaction was “*extraordinary judged by reference to the ordinary course of the taxpayer’s business*”; and

d. The Tribunal did not adopt a construction of the term “*in the ordinary course of carrying on a business*” that gave consideration to what was “*extraordinary judged by reference to the ordinary course of the taxpayer’s business*”; and

e. Further, the Tribunal did not adopt a construction of the term “*in the ordinary course of carrying on a business*” by reference to the similar term “*ordinary course of business*” used in previous enactments of the *Bankruptcy Act 1966 (Cth)* and considered by the High Court.

7. **Pertaining to Question [7]**, the Tribunal erred in the application of the facts, as found, in finding that the Fuel Disbursements constituted, on the term’s proper construction as used in sub-section 328-120(1) of the *1997 Act*, “*ordinary income that [Drilling Co] derive[d] in the income year in the ordinary course of carrying on [its] business*”:

a. The Tribunal, on the facts found that the Fuel Disbursements were recharged “*at cost”* and thereafter found as a matter of mixed fact and law that the Fuel Disbursements constituted Ordinary Income of Drilling Co; however the Tribunal failed to turn its mind to whether the Fuel Disbursements constituted Ordinary Income; and

b. The Tribunal did not determine, on the facts found by the Tribunal, whether the Fuel Disbursements (if the Fuel Disbursements so constituted Ordinary Income of Drilling Co) were “*extraordinary judged by reference to the ordinary course of the taxpayer’s business*”;

c. Having regard to [the] proper construction of “*ordinary income that [Drilling Co] derive[d] in the income year in the ordinary course of carrying on [its] business*” requiring the Tribunal to determine whether the Fuel Disbursements recharged “*at cost*” were first *“ordinary income” and second “extraordinary”*, the Tribunal did not apply the facts as found by the Tribunal, being the “*circumstances of the case*”, to the proper construction of sub-section 328-120(1), specifically noting that at paragraphs [46]-[49] of the Decision findings of fact as to the ordinary mode of operation of Drilling Co not purchasing or recharging for fuel for at least “79%” of its business during the period 30 June 2006 to 30 June 2009 (in relation to its work for Mining Co) and further specifically noting at paragraph [60] of the Decision that the Tribunal found that “*it was ‘industry practice’ for mining companies to supply fuel for contractors (including drillers), especially for large drilling contractors*”, of which Drilling Co was [one]; and

d. Further, if it was appropriate for the Tribunal to adopt a meaning of “*in the ordinary course of carrying on a business*” as set out in the EM which is denied, the Tribunal did not consider whether the Fuel Disbursements were such that the Fuel Disbursements were “*arising out of no special circumstance or event*”.

8. **Pertaining to Question [8]**, the Tribunal’s finding at paragraph 56 (a finding that “*PFGG [sic] knew in advance of the supply of the drilling services under its contracts with Nickel Limited and Resources NL that neither would be supplying the fuel for the provision of the drilling services*”) was not open to the Tribunal on the evidence before the Tribunal:

a. At paragraph [51] of the Decision, the Tribunal found that the engagement documentation dated 30 October 2007 for Resources NL provided that, “*The client [i.e. Nickel Limited] will be responsible for provision of fuel for all drilling associated equipment and vehicles.*”

b. At paragraph [30] of the Decision, the Tribunal found the work for Nickel Limited commenced on 8 November 2007;

c. At [the] hearing before the Tribunal the Applicant gave evidence under cross examination by the Respondent: “*Did you know before you went that there wouldn’t be fuel on site? --- No. // But you were prepared to pay the cost of fuel in order to do the work, isn’t that right? --- Only once we got there and we knew that they didn’t have the fuel. I thought Dave was going to organise that for us*”;

d. The Tribunal did not make any adverse credit finding against any witness;

e. At paragraph [52] of the Decision, the Tribunal found that fuel for the Nickel Ltd job “*was purchased by employees of Drilling Co from a commercial outlet [near the site] in Ravensthorpe and taken to the site*”; and

f. At paragraph [53] of the Decision, the Tribunal found that Drilling Co was asked to do the Resources NL job only after the drilling rig was operating at Nickel Limited’s site.

(Footnotes omitted.)

## The taxpayer’s submissions on appeal

1. Mr Doutch’s submissions in relation to grounds 4-7 can be summarised as follows:

(a) The Tribunal erred by disregarding the way in which the expression “in the ordinary course of carrying on a business” was used by the High Court in *Myer Emporium* at 209-210. In that passage, Mason ACJ, Wilson, Brennan, Deane and Dawson JJ said:

Although it is well settled that a profit or gain made in the ordinary course of carrying on a business constitutes income, it does not follow that a profit or gain made in a transaction entered into otherwise than in the ordinary course of carrying on the taxpayer’s business is not income. Because a business is carried on with a view to profit, a gain made in the ordinary course of carrying on the business is invested with the profit-making purpose, thereby stamping the profit with the character of income. But a gain made otherwise than in the ordinary course of carrying on the business which nevertheless arises from a transaction entered into by the taxpayer with the intention or purpose of making a profit or gain may well constitute income. Whether it does depends very much on the circumstances of the case. Generally speaking, however, it may be said that if the circumstances are such as to give rise to the inference that the taxpayer’s intention or purpose in entering into the transaction was to make a profit or gain, the profit or gain will be income, notwithstanding that the transaction was extraordinary judged by reference to the ordinary course of the taxpayer’s business. Nor does the fact that a profit or gain is made as the result of an isolated venture or a “one-off” transaction preclude it from being properly characterized as income: *Federal Commissioner of Taxation v. Whitfords Beach Pty. Ltd*. [(1982) 150 CLR 355 at pp 366-367, 376]. The authorities establish that a profit or gain so made will constitute income if the property generating the profit or gain was acquired in a business operation or commercial transaction for the purpose of profit-making by the means giving rise to the profit.

(b) Instead of adopting a construction of the phrase “in the ordinary course of carrying on a business” reflecting the above passage, the Tribunal adopted the meaning given in the explanatory memorandum to the *Tax Laws Amendment (Small Business) Bill 2007* (Cth): see, in particular, [70]-[73] of the Reasons.

(c) The crux of the Tribunal’s error was its reliance on “context”; not context in the sense of the words within the legislation but “context” in the sense of the importation of words used in the explanatory memorandum over and above the words of the legislation.

(d) The correct approach, as acknowledged in the Tribunal’s quotation of *Commissioner of Taxation v Consolidated Media Holdings Ltd* (2012) 250 CLR 503, is that the words of the legislation are paramount. True it is that context is important, but the predominant task is the examination of the words in the legislation itself: see *Independent Commission Against Corruption v Cuneen* (2015) 256 CLR 1 at [57].

(e) Paragraphs 2.15 and 2.16 of the explanatory memorandum, quoted by the Tribunal, leave the reader wondering, if the explanatory memorandum meaning be adopted, what is the purpose of the words “in the ordinary course of carrying on a business”? The explanation appears to encompass almost every scenario such that the words “in the ordinary course of carrying on a business” could be deleted.

(f) Section 328-120(1) adopts two commonly understood case law defined concepts in tax law, the first being “ordinary income”, the second being “in the ordinary course of carrying on a business”. As with “ordinary income”, the words “ordinary course” have a meaning that has been built up over time. The phrase was used in ss 63(1)(b) and 118 of the *Income Tax Assessment Act 1936* (Cth). The Tribunal erred by preferring the explanatory memorandum over the jurisprudence in relation to those words.

(g) The High Court used the phrase in *Myer Emporium*, some 20 years before the enactment of s 328-120(1). Parliament was enacting a section using a well-known taxation concept that has been in the tax legislation since 1936, if not before.

(h) The expression as used in *Myer Emporium* requires ascertaining what was “in the ordinary course of carrying on a business” by reference to whether it is “extraordinary judged by reference to the ordinary course of the taxpayer’s business”. Notably, the point of comparison is “extraordinary” which has been expressed in dictionaries as an adjective that means “very unusual or remarkable” and as a noun, in the accounts context, as “an item in a company’s accounts not arising from its normal activities”.

(i) The plurality in *Myer Emporium* (at 215-216) expressed the same concept of the need to distinguish what was “in the ordinary course of business” from what was “extraordinary”, noting that “profit”, though of “telling significance”, does not detract from the ability of the transaction to be “extraordinary”.

(j) The Tribunal’s rejection of the relevance of *Myer Emporium* at [76] of the Reasons in favour of the explanatory memorandum was misplaced. The crux of the Tribunal’s task was to answer whether the Fuel Disbursements were “in the ordinary course of carrying on a business”, which is what *Myer Emporium* does, albeit for a different kind of transaction. The key task of the Tribunal was to work out whether the Fuel Disbursements, if ordinary income, were “extraordinary” judged by reference to the “ordinary course of carrying on a business”.

(k) The clear reading of [76] of the Reasons is that the Tribunal refused to answer the question whether the Fuel Disbursements were “extraordinary” judged by reference to the ordinary course of Denarda’s business, by instead saying that the Fuel Disbursements were “incidental”. But the Tribunal needed to answer whether the Fuel Disbursements were “extraordinary” because (a) the question of these disbursements being “incidental” is not raised by the words of the question; and (b) something may be “incidental” while still being extraordinary.

(l) The evidence before the Tribunal was that the charging of the Fuel Disbursements (as well as the sourcing of the fuel in the first place) by Denarda was extraordinary judged by reference to the ordinary course of Denarda’s business.

(m) Since *Myer Emporium*, the case law in relation to what is “extraordinary” has been applied in other cases, including *Commissioner of Taxation v Montgomery* (1999) 198 CLR 639 at [113].

(n) The cases establish that what is naturally incidental to an activity carried out in the ordinary course of a taxpayer’s business will also be ordinary income; but something being “naturally incidental” and by consequence being “ordinary income” does not also make it “in the ordinary course of carrying on a business” which is the relevant consideration here. That is, the key question is whether the Fuel Disbursements were “extraordinary”: the plurality in *Montgomery* states that something can be “an ordinary incident of” but at the same time be “extraordinary”.

(o) In any event, it was not open to the Tribunal to find that the Fuel Disbursement revenue was incidental.

(p) Denarda was philosophically opposed to providing fuel; in the period 30 June 2006 to 30 June 2009 it did that on just two jobs (amounting to less than 19% of its overall work); it did not intend to provide fuel but felt compelled to do so “as a favour” to get the job done (having already relocated the drilling rig to Ravensthorpe); and it did not provide the fuel at a profit.

(q) While the construction of “in the ordinary course of carrying on a business” is a question of law, the application of the correct construction to the facts is a mixed question of fact and law which is permissible in an appeal pursuant to s 44 of the AAT Act: *Haritos v Federal Commissioner of Taxation* (2015) 233 FCR 315.

1. Mr Doutch’s submissions in relation to ground 8 (which challenges the Tribunal’s finding of fact at [56] of the Reasons, set out in [43] above) can be summarised as follows:
   1. Mr Doutch testified under cross-examination he did not know, before he went to the relevant area, that there would not be fuel on the site. It was put to him that he was prepared to pay the cost of fuel in order to do the work. He said in response: “Only once we got there and we knew that they didn’t have the fuel. I thought Dave was going to organise that for us.”
   2. Mr Doutch’s testimony reflects the fact that Denarda’s contractual documentation for Nickel Limited, provided in advance of relocating the drilling rig, provided that “The client [i.e. Nickel Limited] will be responsible for provision of fuel for all drilling associated equipment and vehicles” (see Reasons at [51]). As the Tribunal also found, the subsequent work done for Resources NL was only done once the site work for Nickel Limited had commenced (see Reasons at [53]).
   3. As the Tribunal did not make any adverse credit finding against Mr Doutch (and there is no reason to suggest it had any reason to do so), Mr Doutch’s evidence must be accepted: see *Tisdall v Webber* (2011) 193 FCR 260 at [83], [134]. It clearly contradicts the Tribunal’s finding at [56] of the Reasons. On the authority of *Haritos*, the finding of fact amounted to an error of law.
   4. Further, the finding of fact at [56] goes to the core of determining whether the Fuel Disbursements were derived “in the ordinary course of carrying on a business” and therefore infects the entire decision.

## Disposition of the appeal

1. For the following reasons, Mr Doutch has not established any error by the Tribunal.
2. First, the passage from *Myer Emporium* upon which Mr Doutch relies (see [69](a) above) is concerned with income according to ordinary concepts. Although the High Court referred to a profit or gain made in the ordinary course of carrying on a business, the Court was not construing the phrase “in the ordinary course of carrying on a business”; nor did it provide a definition of that phrase. The point the High Court was making was that a gain made otherwise than in the ordinary course of carrying on a business may constitute income; whether it does or not will depend on the circumstances of the case. The focus of the passage is on what constitutes income, not on what constitutes the ordinary course of carrying on business.
3. Mr Doutch in oral submissions referred to a sentence from the judgment of Hill J in *Commissioner of Taxation v Cooling* (1990) 22 FCR 42. His Honour said at 51:

While the fact that a transaction is a normal incident of the business activity will be conclusive of the income character of the profit derived from that business, the converse is not the case and the profit arising from an unusual or indeed extraordinary transaction may be income at least where, as in *Commissioner of Taxation (Cth) v Myer Emporium Pty Ltd* the transaction was entered into by a taxpayer with the intention or purpose of making the profit.

Again, as with the passage from *Myer Emporium* set out above (to which Hill J made reference), his Honour was discussing the concept of “income” rather than the meaning of the phrase “in the ordinary course of carrying on a business”.

1. Secondly, the Tribunal was correct to hold that the words “in the ordinary course of carrying on a business” in s 328-120(1) of the ITAA 1997 bear their ordinary meaning. While the words have been used in other provisions, and discussed in cases in the context of those provisions, they do not have a technical legal meaning: cf Pearce, DC and Geddes, RS, *Statutory Interpretation in Australia* (8th ed, 2014), [4.13]-[4.14].
2. Thirdly, the Tribunal referred to the explanatory memorandum to the Bill which became the *Tax Laws Amendment (Small Business) Act 2007* (Cth) to confirm the ordinary meaning of the words used in s 328-120(1). The Tribunal did not adopt the words of the explanatory memorandum as providing a definition for the words used in the statute.
3. Fourthly, the meaning given to the expression “ordinary course of business” in the context of bankruptcy legislation is not wholly applicable. In the context of s 95(2)(b) of the *Bankruptcy Act 1924* (Cth), in *Downs Distributing Co Pty Ltd v Associated Blue Star Stores Pty Ltd (in liq)* (1948) 76 CLR 463, Rich J said at 476-477:

As was pointed out in *Burns v. McFarlane* [(1940) 64 CLR 108, at p 125] the issues in sub-s. 2(b) of s. 95 of the *Bankruptcy Act 1924-1933* are “(1) good faith; (2) valuable consideration; and (3) ordinary course of business.” This last expression it was said “does not require an investigation of the course pursued in any particular trade or vocation and it does not refer to what is normal or usual in the business of the debtor or that of the creditor.” It is an additional requirement and is cumulative upon good faith and valuable consideration. It is, therefore, not so much a question of fairness and absence of symptoms of bankruptcy as of the everyday usual or normal character of the transaction. The provision does not require that the transaction shall be in the course of any particular trade, vocation or business. It speaks of the course of business in general. But it does suppose that according to the ordinary and common flow of transactions in affairs of business there is a course, an ordinary course. It means that the transaction must fall into place as part of the undistinguished common flow of business done, that it should form part of the ordinary course of business as carried on, calling for no remark and arising out of no special or particular situation.

1. But in the context of s 328-120(1), it seems likely that it is the ordinary course of the *particular business* that is relevant. The provision is concerned with the “annual turnover” of a particular entity, and the reference to “business” is to the business of that entity. Nevertheless, the passage is of assistance in indicating that the expression “ordinary course of business” refers to the ordinary and common flow of transactions of a business.
2. Fifthly, in the present case, it was open to the Tribunal to conclude (as it essentially did conclude at [74] and [75] of the Reasons) that the transactions in question took place in the ordinary course of the business carried on by Denarda. Although it may be accepted that Denarda’s customers usually purchased and provided fuel for Denarda’s drilling operations, the transactions in question, namely the provision of drilling services by Denarda to Nickel Limited and Resources NL, were part of the ordinary and common flow of transactions of Denarda’s business.
3. Sixthly, we reject Mr Doutch’s contention that income may be both “incidental to” the normal day-to-day activities of a business and also “extraordinary” judged by reference to the ordinary course of the taxpayer’s business. In circumstances where the income is incidental to the normal day-to-day activities of a business, it is derived “in the ordinary course of carrying on a business” and is necessarily not “extraordinary” judged by reference to the ordinary course of the business. It may be accepted that, as Mr Doutch submitted, in some circumstances a receipt may be an incident of an extraordinary part of a business (see, eg, *Commissioner of Taxation v Montgomery* (1999) 198 CLR 639 at [113]). But in the present case, as the Tribunal found, the relevant receipts were an incident of an ordinary part of the relevant entity’s business.
4. Seventhly, we reject Mr Doutch’s contention that the Tribunal failed to address whether the relevant income was derived in the course of an extraordinary part of Denarda’s business. The Tribunal addressed whether the income was derived in the ordinary course of carrying on the business, and thus by implication addressed whether it was derived in the course of an extraordinary part of the business.
5. Eighthly, in relation to the submission referred to in [69](o) above, there does not appear to be a basis to challenge the Tribunal’s finding (at [74] of the Reasons) that the relevant income was an incident of, or directly related to, the carrying on of the normal day-to-day activities of Denarda’s drilling business. As the Tribunal said in that paragraph, the use of fuel was essential to the operation of the drilling rig and, therefore, to the carrying on of the normal day-to-day activities of the business.
6. For these reasons, Mr Doutch’s grounds relating to the phrase “in the ordinary course of carrying on a business” should be rejected.
7. In relation to the Tribunal’s finding at [56] of the Reasons (see [43] above), Mr Doutch’s challenge to the finding of fact is premised on reading that paragraph in a particular way. Mr Doutch’s submissions involve reading [56] of the Reasons as a finding to the effect that Mr Doutch knew before the drilling rig was relocated to Ravensthorpe that the customers would not be supplying the fuel. However, we do not think it is correct to read paragraph [56] of the Reasons in the way contended by Mr Doutch. We think the Tribunal was merely stating that Mr Doutch knew before the supply of the drilling services (that is, Denarda using the drilling rig to carry out drilling) under the contracts with Nickel Limited and Resources NL that neither would be supplying the fuel. This is the natural way to read the words the Tribunal used and is consistent with the evidence (suggesting that this meaning is more likely than Mr Doutch’s reading of the paragraph). It follows that the premise of Mr Doutch’s challenge to [56] of the Reasons is not established.
8. Read in the way we have indicated in the preceding paragraph, there is no basis to challenge the finding in [56] of the Reasons. It was open to the Tribunal to find that Mr Doutch knew, before the supply of the drilling services under the contracts with Nickel Limited and Resources NL, that neither would be supplying the fuel.
9. Further, we do not think that the finding in [56] of the Reasons, even if interpreted in the way contended for by Mr Doutch, had any material bearing on the core reasoning of the Tribunal as to whether the income received in respect of the Fuel Disbursements was derived “in the ordinary course of carrying on a business”. The Tribunal did not specifically refer to this finding in its core reasoning at [74]-[76] of the Reasons. Given the way the Tribunal expressed its reasons at [74]-[76] of the Reasons, the finding at [56] was not material.

## Conclusion

1. For these reasons, the appeal should be dismissed. There is no reason why costs should not follow the event. There will, therefore, also be an order that Mr Doutch pay the first respondent’s costs.

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| I certify that the preceding eighty-six (86) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justices Greenwood, McKerracher and Moshinsky. |

Associate:

Dated: 2 December 2016