FEDERAL COURT OF AUSTRALIA

Hua Wang Bank Berhad v Commissioner of Taxation (No 19) [2015] FCA 454

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| Citation: | Hua Wang Bank Berhad v Commissioner of Taxation (No 19) [2015] FCA 454 |
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| Parties: | **HUA WANG BANK BERHAD v COMMISSIONER OF TAXATION**  **BYWATER INVESTMENTS LIMITED v COMMISSIONER OF TAXATION**  **CHEMICAL TRUSTEE LIMITED v COMMISSIONER OF TAXATION**  **SOUTHGATE INVESTMENT FUNDS LIMITED v COMMISSIONER OF TAXATION**  **DERRIN BROTHERS PROPERTIES LIMITED v COMMISSIONER OF TAXATION**  **DEPUTY COMMISSIONER OF TAXATION v HUA WANG BANK BERHAD**  **DEPUTY COMMISSIONER OF TAXATION v CHEMICAL TRUSTEE LIMITED, DERRIN BROTHERS PROPERTIES LIMITED and BYWATER INVESTMENTS LIMITED** |
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| File numbers: | NSD 653 of 2011  NSD 652 of 2011  NSD 654 of 2011  NSD 655 of 2011  NSD 656 of 2011  VID 672 of 2010  VID 887 of 2010 |
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| Judge: | **PERRAM J** |
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| Date of judgment: | 15 May 2015 |
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| Catchwords: | **TAXATION** – Div 70 of the *Income Tax Assessment Act 1997* (Cth) – trading stock – what does it mean to take value into account in s 70-40 |
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| Legislation: | *Income Tax Assessment Act 1997* (Cth) ss 70-35, 70-40, 70-45 |
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| Cases cited: | *Commissioner of Taxation v Energy Resources of Australia Ltd* (2003) 135 FCR 346  *Hua Wang Bank Berhad v Commissioner of Taxation* [2014] FCA 1392 |
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| Date of hearing: | 4 May 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: | 19 |
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| Solicitor for the Respondent in NSD 652-656 of 2011 and the Applicant in VID 672 of 2010 and VID 887 of 2010: | Australian Government Solicitor |

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| IN THE FEDERAL COURT OF AUSTRALIA |  |
| NEW SOUTH WALES DISTRICT REGISTRY |  |
| GENERAL DIVISION | NSD 653 of 2011 |

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

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| JUDGE: | PERRAM J |
| DATE OF ORDER: | 15 May 2015 |
| WHERE MADE: | SYDNEY |

THE COURT ORDERS THAT:

1. 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 if no assessment has been issued for the preceding income year.
2. Direct the taxpayers to make elections under s 70-45 in respect of each item of trading stock on hand at the end of each financial year in dispute within 21 days hereof.
3. Remit to the Commissioner the objection decisions insofar as they relate to the trading stock issue, in conformity with this Court’s reasons.
4. The Applicants are to pay the Commissioner’s costs of the trading stock debate on 4 May 2015.

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 652 of 2011 |

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| BETWEEN: | BYWATER INVESTMENTS LIMITED  Applicant |
| AND: | COMMISSIONER OF TAXATION  Respondent |

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| JUDGE: | PERRAM J |
| DATE OF ORDER: | 15 May 2015 |
| WHERE MADE: | SYDNEY |

THE COURT ORDERS THAT:

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2. Direct the taxpayers to make elections under s 70-45 in respect of each item of trading stock on hand at the end of each financial year in dispute within 21 days hereof.
3. Remit to the Commissioner the objection decisions insofar as they relate to the trading stock issue, in conformity with this Court’s reasons.
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| IN THE FEDERAL COURT OF AUSTRALIA |  |
| NEW SOUTH WALES DISTRICT REGISTRY |  |
| GENERAL DIVISION | NSD 654 of 2011 |

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| BETWEEN: | CHEMICAL TRUSTEE LIMITED  Applicant |
| AND: | COMMISSIONER OF TAXATION  Respondent |

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| JUDGE: | PERRAM J |
| DATE OF ORDER: | 15 MAY 2015 |
| WHERE MADE: | SYDNEY |

THE COURT ORDERS THAT:

1. 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 if no assessment has been issued for the preceding income year.
2. Direct the taxpayers to make elections under s 70-45 in respect of each item of trading stock on hand at the end of each financial year in dispute within 21 days hereof.
3. Remit to the Commissioner the objection decisions insofar as they relate to the trading stock issue, in conformity with this Court’s reasons.
4. The Applicants are to pay the Commissioner’s costs of the trading stock debate on 4 May 2015.

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| IN THE FEDERAL COURT OF AUSTRALIA |  |
| NEW SOUTH WALES DISTRICT REGISTRY |  |
| GENERAL DIVISION | NSD 655 of 2011 |

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| BETWEEN: | SOUTHGATE INVESTMENT FUNDS LIMITED  Applicant |
| AND: | COMMISSIONER OF TAXATION  Respondent |

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| JUDGE: | PERRAM J |
| DATE OF ORDER: | 15 MAY 2015 |
| WHERE MADE: | SYDNEY |

THE COURT ORDERS THAT:

1. 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 if no assessment has been issued for the preceding income year.
2. Direct the taxpayers to make elections under s 70-45 in respect of each item of trading stock on hand at the end of each financial year in dispute within 21 days hereof.
3. Remit to the Commissioner the objection decisions insofar as they relate to the trading stock issue, in conformity with this Court’s reasons.
4. The Applicants are to pay the Commissioner’s costs of the trading stock debate on 4 May 2015.

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 656 of 2011 |

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| BETWEEN: | DERRIN BROTHERS PROPERTIES LIMITED  Applicant |
| AND: | COMMISSIONER OF TAXATION  Respondent |

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| JUDGE: | PERRAM J |
| DATE OF ORDER: | 15 MAY 2015 |
| WHERE MADE: | SYDNEY |

THE COURT ORDERS THAT:

1. 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 if no assessment has been issued for the preceding income year.
2. Direct the taxpayers to make elections under s 70-45 in respect of each item of trading stock on hand at the end of each financial year in dispute within 21 days hereof.
3. Remit to the Commissioner the objection decisions insofar as they relate to the trading stock issue, in conformity with this Court’s reasons.
4. The Applicants are to pay the Commissioner’s costs of the trading stock debate on 4 May 2015.

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 653 of 2011 |

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

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| IN THE FEDERAL COURT OF AUSTRALIA |  |
| NEW SOUTH WALES DISTRICT REGISTRY |  |
| GENERAL DIVISION | NSD 652 of 2011 |

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| BETWEEN: | BYWATER INVESTMENTS LIMITED  Applicant |
| AND: | COMMISSIONER OF TAXATION  Respondent |

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| IN THE FEDERAL COURT OF AUSTRALIA |  |
| NEW SOUTH WALES DISTRICT REGISTRY |  |
| GENERAL DIVISION | NSD 654 of 2011 |

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| BETWEEN: | CHEMICAL TRUSTEE LIMITED  Applicant |
| AND: | COMMISSIONER OF TAXATION  Respondent |

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| IN THE FEDERAL COURT OF AUSTRALIA |  |
| NEW SOUTH WALES DISTRICT REGISTRY |  |
| GENERAL DIVISION | NSD 655 of 2011 |

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| BETWEEN: | SOUTHGATE INVESTMENT FUNDS LIMITED  Applicant |
| AND: | COMMISSIONER OF TAXATION  Respondent |

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| IN THE FEDERAL COURT OF AUSTRALIA |  |
| NEW SOUTH WALES DISTRICT REGISTRY |  |
| GENERAL DIVISION | NSD 656 of 2011 |

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| BETWEEN: | DERRIN BROTHERS PROPERTIES LIMITED  Applicant |
| AND: | COMMISSIONER OF TAXATION  Respondent |

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| IN THE FEDERAL COURT OF AUSTRALIA |  |
| NEW SOUTH WALES DISTRICT REGISTRY |  |
| GENERAL DIVISION | VID 672 of 2010 |

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

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| IN THE FEDERAL COURT OF AUSTRALIA |  |
| NEW SOUTH WALES DISTRICT REGISTRY |  |
| GENERAL DIVISION | VID 887 of 2010 |

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| BETWEEN: | DEPUTY COMMISSIONER OF TAXATION  Applicant |
| AND: | CHEMICAL TRUSTEE LIMITED  First Respondent  DERRIN BROTHERS PROPERTIES LIMITED  Second Respondent  BYWATER INVESTMENTS LIMITED  Third Respondent |
| JUDGE: | PERRAM J |
| DATE: | 15 MAY 2015 |
| PLACE: | SYDNEY |

**REASONS FOR JUDGMENT**

1. On 19 December 2014 I delivered reasons for judgment in *Hua Wang Bank Berhad v Commissioner of Taxation* [2014] FCA 1392. I concluded that the taxpayers’ appeals should be dismissed, save in relation to the issue of trading stock. In the case of each taxpayer I concluded that the shares they held were trading stock in respect of which they were entitled to make elections under Division 70 of the *Income Tax Assessment Act 1997* (Cth) (‘the Act’). On 12 January 2015, I ordered that the taxpayers’ appeals should be allowed in relation to trading stock but otherwise dismissed.
2. Despite those findings, the parties remain divided by an issue of statutory interpretation. It relates to the operation of ss 70-35 and 70-40 of the Act. Those sections provide:

‘**70‑35 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.

(2) 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.

(3) 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.

**70‑40 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.’

(emphasis in original)

1. Shortly, the issue between the parties concerns the meaning of the words in s 70-40(2), ‘was not taken into account under this Division … at the end of the last income year’.
2. The position of the taxpayer Derrin Brothers Properties Limited (‘Derrin’) will illustrate the problem which arises. Derrin acquired its shares in the financial year ending 30 June 1999. Assessments were issued to it for the years ending 30 June 2002-2005, but *not* for the years ending 30 June 1999-2001 or those income years from 30 June 2006 onwards.
3. The Commissioner contends that, as there were no assessments issued to Derrin for the 2001 income year, the value of Derrin’s shares at the start of the 2002 income year is taken to be nil because the shares were ‘not taken into account under this Division … at the end of the last income year’ within the meaning of s 70-40(2).
4. If this contention is correct it will have a significant impact on the taxpayers’ liabilities to income tax because the comparison required by s 70-35(1) will result, if the beginning of year figure be nil, in the whole of the value of the trading stock on hand at year’s end being brought to tax.
5. The position of the taxpayers is that, so long as they elect a valuation method as required by s 70-45 *and* work out the value of their trading stock, it is not necessary for there to be an assessment by the Commissioner in order for the value of the shares to be taken into account for the purposes of s 70-40(2).
6. The question then is simply what meaning is to be ascribed to the expression ‘not taken into account under this Division … at the end of the last income year’. Does it refer to a taking into account by the Commissioner of the trading stock in the previous year as part of the process of assessment or does it mean the calculation by the taxpayers of the value of the trading stock in the preceding year, not necessarily attached to any process of return or assessment?
7. 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.
8. The taxpayers advanced six reasons why this conclusion should nevertheless not be reached.
9. First, it was said that in referring to taking into account the value at the end of the income year, s 70-40(1) must be referring to the making of trading stock elections under s 70-45. I accept that this is so. But the taxpayers submitted that s 70-40(1) was ‘not referring to a larger computation of the type postulated by the Respondent’. The Commissioner did not, however, contend for such a larger computation. His point was, simply, that if no assessment had been made under Division 70 in respect of the prior year then the effect of s 70-40(2) was to produce a nil figure to be fed into s 70-35.
10. Secondly, it was submitted that the test of s 70-40 was about the calculation of ‘amounts’ and this evidently could not be read as requiring a taxpayer to undertake the onerous process of working out its assessable income in a prior year. This might be plausible if one were to read s 70-40 in isolation. However, s 70-40 exists only to provide the information which is then input into s 70-35 and it is clear that that provision is precisely, and only, concerned with the calculation of assessable income. In any event, the taxpayer is not obliged to lodge a return. It is just that the year end figure is taken to be nil if this course is not taken. There is no legal compulsion arising from s 70-40.
11. Thirdly, it was submitted that it would be to strain the language of s 70-40 to say that trading stock was not taken into account when elections had, in fact, been made as at the end of that year. But the election contemplated by ss 70-40 and 70-45 is not some abstract process conducted in a manner detached from the balance of the statute. Section 70-40 calls for a valuation, it is true, but only for the purpose of providing an input into s 70-35(1), which in turn has only the purpose of adjusting assessable income under ss 70-35(2) and (3). To conduct a valuation which does not go down that path and, in that eccentric non-statutory process, to choose a method of valuation is not the making of an election under s 70-40(1). Such an election can only occur as part of the process under ss 70-35(2) and (3), and these are strictly about the calculation of assessable income. As such, taking trading stock into account necessarily entails assessment by the Commissioner.
12. Fourthly, it was submitted that the purpose for which s 70-40 had been inserted into the legislation was to prevent trading stock arbitrage, which s 70-40(1) was said to achieve by ensuring that the closing figure in one year was the same as the opening figure in the next. It was then argued that this purpose was not facilitated by reading s 70-40(2) as requiring a nil assessment of the value of trading stock on hand at the start of the income year if there was no extant assessment for the prior year.
13. The explanatory memorandum accompanying the insertion of s 70-45 says this about the provision:

‘**Section 70-40 Value of Opening stock**

This section specifies that the value of stock on hand at the start of a year (the opening stock) is the same amount that was taken into account as the previous year’s closing stock.

**Change**

This ensures that the opening value of each item of stock is always the same as the closing value it had in the previous year. If not taken into account at the end of a year, its opening value at the start of the next year will be nil.

**Explanation**

Section 29 of the 1936 Act says that an item’s opening value is *the value ascertained under the Act* at the end of the previous year. There are some Board of Review decisions concluding that those words mean that the opening value must be what the previous year’s closing value *should have been*. If the previous year’s assessment cannot be amended because of time limits, its closing value will be different from the next year’s opening value. This will produce either a windfall gain or an unexpected loss for the taxpayer.

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.’

(emphasis in original)

1. A thorough explanation of the problem appears in *Commissioner of Taxation v Energy Resources of Australia Ltd* (2003) 135 FCR 346 at 348-351 [2]-[11] per Ryan and Finkelstein JJ. The taxpayers are probably correct in their identification of the legislative purpose in enacting s 70-40(1). However whilst it is true that the Commissioner’s construction does not further that end, neither does it hinder it. In any event, this case is about the operation of s 70-40(2), not s 70-40(1).
2. Fifthly, it was submitted that the Commissioner’s construction of s 70-40(2) had the perverse effect that the applicants would be taxed upon the full value of trading stock at the end of the income year rather than merely on its increase. However, that is only how the Division operates when a taxpayer elects not to lodge a return in the preceding year. The source of any perverse operation of the Division is the taxpayers’ actions in failing to lodge returns.
3. Finally, the taxpayers submitted that the Commissioner’s construction created the absurd situation that, in order to enliven the election provisions in s 70-45, a taxpayer would need to file returns in all the years in which the trading stock had been held. Of course, a taxpayer is not bound to do that, it is just that if that is not done then the value at the start of the year will be taken to be nil. In any event, I do not accept the result is absurd.
4. The orders I will make in matters NSD 652-656 of 2011 are:
5. 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 if no assessment has been issued for the preceding income year.
6. Direct the taxpayers to make elections under s 70-45 in respect of each item of trading stock on hand at the end of each financial year in dispute within 21 days hereof.
7. Remit to the Commissioner the objection decisions insofar as they relate to the trading stock issue, in conformity with this Court’s reasons.
8. The Applicants are to pay the Commissioner’s costs of the trading stock debate on 4 May 2015.

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| I certify that the preceding nineteen (19) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justice Perram. |

Associate:

Dated: 15 May 2015