Cases and Comments

Commissioner of Taxation v Stone (2005) 215 ALR 61: Its Implications for the Role of Intention in Assessing Business Receipts, and the Treatment of Gains Made by Athletes

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In the decision of *Commissioner of Taxation v Stone*[1] the High Court unanimously ruled that the taxpayer, an elite athlete, was in the business of throwing javelins for financial reward. Accordingly, prize money and government grants received by the taxpayer constituted income according to ordinary concepts. Although profit-making was not her primary purpose, the taxpayer was aware that sporting success would bring financial reward, and her acceptance of sponsorship indicated that she had turned her talent to account for money. In making this finding, the judgment of the late Hill J was partially restored, furthering his status as a 'tax titan'. This article will consider the judicial discussion of profit-making purpose, and the contributions made by Hill J to this field. Such a discussion inevitably leads to an examination of the meaning of income, and how well judicial pronouncements on the matter accord with economic and accounting concepts of income.

1. Case Summary

Joanna Stone was one Australia's leading javelin throwers. Between 1987–2000, Stone represented Australia in various international competitions, including the 2000 Sydney Olympic Games. She was also employed by the Queensland Police Force. Stone has now retired from javelin throwing due to injuries and is concentrating on her career as a policewoman. Throughout her sporting years, Stone received money in a variety of forms such as prize monies, government grants, scholarships and appearance fees. Before 1999, these types of receipts were relatively few and far between, and were not treated as taxable income.

A. Stone's Receipts

For the year ending June 1999, Joanna Stone reported an assessable income of $39 832, being her salary as a police officer. Also included in her tax return were receipts totaling $136 448, which arose from her javelin throwing. These amounts were not reported as assessable income. The 'sporting receipts' included prize money of $93 429, grants from the Australian Olympic Committee ('AOC') and

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1 *Commissioner of Taxation v Stone* (2005) 215 ALR 61 (hereafter *Stone HC)* (26 April 2005).

Queensland Academy of Sport ('QAS') of $27 900, sponsorship worth $12 419, and $2 700 in appearance fees. The Commissioner treated all these amounts as assessable income and Ms Stone's objection was disallowed. However both parties agreed that if the sporting receipts were income, Stone would be entitled to deductions of $19 739. The dispute was run as part of the Australian Tax Office ('ATO') test case program, in order to clarify the treatment of receipts attained by professional sports people.[2]

B. Hill J's Decision in the Federal Court

At first instance, Hill J found that Stone had turned her sporting talent to the pursuit of money, and was hence carrying on a business as a professional athlete.[3] The sporting receipts were rewards arising from this business, and consequently income according to ordinary concepts.[4]

Hill J also sought to clarify what the outcome would be if Stone's activities were not a business, by determining whether the sporting receipts had their source in other forms of earning activity. Stone had conceded that the sponsorship receipts were assessable, on the basis that they were income for services. Hill J also found the appearance fees to be income for the provision of service, for instance, by giving a speech or attending a function.[5] In addition, $22 500 of the grant money awarded through the AOC Medal Incentive Scheme, was ordinary income, due to its periodicity, and purpose to compensate athletes for income forgone as a result of their sporting activities. Yet the other grants did not exhibit the same characteristics. With respect to prize money, although it is undoubtedly a product of any business carried on by a professional athlete, Hill J said it did not follow that money won by an amateur athlete would be income. The question instead turns on the 'nature of the activity which the athlete pursues, not the fact that it is a prize as such'.[6]

C. Reversal of the Decision in the Full Federal Court

Stone appealed to the Full Federal Court where it was decided that she was not carrying on a business.[7] Particular attention was paid to Stone's criteria for choosing which contests and competitions to compete in. The evidence showed that these decisions were made on the basis of acquiring competitive experience, rather than the likelihood of maximising prize winnings.[8] The Full Court found that Stone lacked profit-making intention, she 'sought sponsorship to further her aims as a sportswoman' — she did not throw javelins in order to derive income from sponsorship.[9] The Full Court concluded that Stone was primarily a career

2 Annamaria Carey, 'Athlete's Income all Taxable – Commissioner Wins Again in High Court' (2005) 34 *AT Rev* 118 at 118. See Australian Taxation Office, *Annual Report 2002–3* (2003): <http://www.ato.gov.au/corporate/content.asp?doc=/content/39007.htm&page=223&H10_2_5_1_2> (14 Sept 2005).

3 *Stone v Commissioner of Taxation* (2002) 196 ALR 221 (hereafter *Stone FC*).

4 Id at 238.

5 Id at 242.

6 Ibid.

7 *Stone v Commissioner of Taxation* [2003] 130 FCR 299 (hereafter *Stone FFC*).

8 Id at 312.

policewoman,[10] whose athletic pursuits were merely that, not a business activity. The only assessable receipts were the appearance fees, being rewards for services. The Full Court found that the grants were for the additional costs of competing, and not compensation for income and also rejected the Commissioner's contention that prize money was a reward for services provided.

The Commissioner appealed to the High Court and Stone cross-appealed from the ruling that appearance fees were assessable income. The Commissioner submitted that Stone had engaged in business activity by turning her talent as an athlete to account for money. According to the Commissioner, an athlete was to be identified as having turned his or her talent to account for money when others recognised them as a celebrity or personality having marketable value.[11] It was contended that the sponsorship agreements and appearance fees were indicative of this. Stone argued that she was not conducting a business, as her motivation was to excel in her chosen sport, represent Australia and win medals, not make money.[12]

D. Partial Restoration of Hill J's Judgment in the High Court

The High Court reached a unanimous finding that all of Stone's receipts were assessable.

The majority judgment found that Stone was in the business of deriving financial reward from competing and winning in the athletics arena.[13] This finding was based on the fact that Stone had been paid to endorse companies and their products, hence establishing that she had turned her athletic ability to account for money.[14] Once she had accepted that the sums paid by sponsors were assessable income, this conclusion was 'inevitable'. The majority stated:

> The sponsorship agreements cannot be put into a separate category marked business, with other receipts being put into a category marked sport. Nor can some receipts be distinguished from others on the basis that the activity producing a receipt was not an activity in the course of carrying on what otherwise was to be identified as a business.[15]

The majority acknowledged that the sponsorship agreements, and perhaps the appearance fees, could be characterised as rewards for services. Yet when set in context of Stone's other activities, it was evident that the sponsorship agreements were commercial arrangements made in pursuit of her athletic activities.[16]

It followed that the grants were also assessable, being rewards for the conduct of Stone's business in competing and winning in athletic tournaments. The majority emphasised that the Medal Incentive Scheme payments were not necessarily gratuitous, as Stone agreed to commercial inhibitions on her future

9 Id at 314.
10 Id at 315.
11 Outlined in *Stone HC*, above n1 at 70.
12 Id at 71.
13 Id at 74.
14 Ibid.
15 Id at 71.
16 Ibid.

sporting conduct and commercial exploitation of her sporting success.[17] Likewise, they assumed that the prizes she had won were paid pursuant to contractual obligations of the event organisers.[18] The majority concluded that even if these receipts were gratuitous, (and it was accepted that the QAS grants were gratuitous) such payments might still form part of a taxpayer's assessable income. The QAS grant 'was as much a financial product of her athletic activities as her winning a prize in a competition, or a sponsor agreeing to pay her to have her endorse the sponsor's product'.[19]

Therefore, taken as a whole, Stone's athletic activities constituted the conduct of a business.[20] Stone wanted to compete at the highest level, and to defray the costs of competing, she sought sponsorship and accepted grants. This was sufficient to establish a business, despite the fact that money was not her primary goal.

This raises the issue of profit making intention. The majority accepted Stone's evidence that she did not throw javelins for money. Yet they pointed out that this did not mean that Stone failed to realise that success in her sport could bring financial reward. This, for instance, was drawn to her attention by the AOC:[21]

> Although she did not seek to maximise her receipts from prize money, preferring to seek out the best rather than the most lucrative competitions, her pursuit of excellence, if successful, necessarily entailed the receipt of prizes, increased grants, and the opportunity to obtain more generous sponsorship arrangements.[22]

The majority reiterated that the state of mind or intention with which a taxpayer undertakes activities giving rise to receipts, though relevant, is only one factor to be taken into account in deciding whether the receipts are properly classed as income. Referring to *Graham v Commissioner of Inland Revenue,*[23] the majority held that a taxpayer might still be conducting a business, even if their motives are idealistic rather than mercenary.[24]

In his minority judgment, Kirby J expressed hesitation at the majority's approach, particularly the 'interposition' of the term *business* into the definition of income and pointed out that the word 'business' does not appear in s6–5(1) of the 1997 Act. Hence to superimpose an intermediate question of whether the taxpayer is carrying on a business, and then to ask whether the various receipts can be aggregated in such a way so to be regarded as income of that business undermines the 'primacy of the statutory command in s6–5(1)'.[25] According to Kirby J, this interposition of the term *business* glosses the provisions of the *Income Tax*

17 Id at 72.
18 Id at 71–72: 'Perhaps there was an express contract to that effect; perhaps the principles in *Carlill v Carbolic Smoke Ball Company* [1983] 1 QB 256 applied; it matters not for present purposes'.
19 *Stone HC*, above n1 at 74.
20 Id at 72.
21 Ibid.
22 Ibid.
23 *Graham v Commissioner of Inland Revenue* [1961] NZLR 994.
24 *Stone HC*, above n1 at 72.
25 Id at 80 (Kirby J).

Assessment Act 1997 (Cth), so that they are disadvantageous to taxpayers and unduly favourable to the Commissioner, as the Commissioner is not obliged to show that each individual receipt is income according to ordinary concepts.[26]

Kirby J concluded that this 'gloss' must be accepted[27] finding that there existed considerable judicial authority in favour of the business income category, and the taxpayer had not challenged the 'business income' accumulation approach Kirby. J stated:

> it is the interposition of the postulate of the taxpayer's "business" that affords that additional ingredient that helps to link the several receipts and to colour them — each of them reinforcing the conclusion of the character of "income" that might not otherwise have been drawn reviewing them individually.[28]

As to profit making intention, Kirby J noted that motivation for most human activity is 'complex and multifarious'.[29] That Stone was primarily motivated by her desire for sporting excellence did not negate the conclusion that before the year of income, she had also decided to turn her sporting talents also to her economic advantage.[30] Kirby J stated:

> … once the view of profit became a real feature of the taxpayer's sporting endeavours it had a dual consequence. It gave a logical and factual unity to most of the receipts connected with her sport and unconnected with her employment as a police officer. Moreover, it warranted the Commissioner's conclusion that the receipts that individually might not have been regarded as "income" took on that character.[31]

E. Implications of the Decision

Although the case has been met with significant media interest, it is unclear to what extent it will influence taxation law. The decision was quite factually based, and for this reason its precedential value may be limited. In addition, commentators have noted that it is difficult to ascertain whether the majority intended that their judgment be a redefinition of what will constitute a business for the purposes of income tax.[32] For instance, it is possible that the majority intended to propose a new test of whether the taxpayer has 'turned talent to account to money'. However it is the author's view that the majority did not seek to redefine business in this way, but instead employed the principle as it was appropriate to the specific facts at hand. This is consistent with Hill J's explanation of the principle:

> A business which consists of selling a product turns that product to account for money. Athletes do not have a tangible product to turn to account. What the professional athlete who carries on a business does is turn the athlete's talent to

26 Id at 76.
27 Id at 81.
28 Id at 85.
29 Id at 84.
30 Ibid.
31 Ibid.
32 Mark Burton, 'Stone's Left Unturned in Stone's Case' (2005) 19 *CCH Tax Week* 293 at 295.

account for money rather than turn a tangible product to account.[33]

It is likely that the implications of the minority judgment in *Stone* are more subtle. For instance, the court's failure to consider other indicia of business and emphasis on the question of profit making intent may signal a shift in focus of the business test to intention.

The late Hill J's role in this development is of interest. Referred to as a 'tax titan',[34] Hill J's decisions are among the most widely quoted in contemporary taxation literature.[35] It is not unusual for the High Court to restore, or partially restore Hill J's judgments. This paper will explore the role of profit making intent and the concept of income with a particular focus on Hill J's contributions to taxation law.

2. The Role of Intention in Assessing Business Receipts

The judicial concept of income requires that a receipt have its source in an earning activity. The main sources of income include those receipts derived from services, property or business.[36] The last source is the focus of this paper.

To assist in the determination of whether a taxpayer is carrying on a business, the courts have enumerated certain characteristics as being indicia of a business. For instance, when a taxpayer conducts activities with a profit-making purpose, showing repetition and regularity, on a large scale, in a systematic and business-like way, he or she is likely to be conducting a business.[37] Hill J has stated that identifying a business is a factual, holistic task and there is no one decisive factor.[38] Hence it is worthwhile to consider whether Stone's sporting activities exhibited indicia of business, other than profit-making purpose.

A. Analysis of Stone's Activities against the Other Indicia

The courts have stated that if the taxpayer's activities are better described as the pursuit of a hobby or an addiction to a sport, they will not be held to be carrying on a business.[39] It is possible that stronger evidence of business-like system and organisation is required than that expected of 'more conventionally "commercial" activities'.[40] In determining the level of system and organisation, the courts consider whether their methods are characteristic of ordinary trading in their field,[41] whether the taxpayer keeps records, or employs managers or experts.[42]

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33 *Stone FC*, above n3 at 237.

34 Richard Vann quoted in Fiona Buffini, 'Tax Titan Was No Heir but Had all the Grace' *Australian Financial Review* (26 August 2005) at 29.

35 David Evans, 'Profile of Hill J' (1995) 30 *Taxation in Australia* 19 at 19.

36 Graeme Cooper, Richard Krever, Richard Vann & Cameron Rider, *Income Taxation*: Commentary and Materials (5th ed, 2005) at 45.

37 *Ferguson v FCT* (1979) 37 FLR 310 at 314 (Bowen CJ & Franki J).

38 *Evans v FCT* (1989) ATC 4540 at 4554–4555 (Hill J).

39 *Ferguson*, above n37; *Martin v FCT* (1953) 90 CLR 470.

40 *Brajkovich v FCT* (1989) ATC 5227 at 5234; *Ferguson*, above n37.

41 *IRC v Livingston and Ors* (1927) 11 TC 538 at 542.

42 *FCT v Walker* (1985) 16 ATR 331.

Throughout her sporting career, Stone appointed a manager, used a coach and entered into contractual sponsorship arrangements. However, Stone's employment of a manager was short-lived and unfruitful, and although she sent out a sponsorship proposal, it was a crude document which did not lead to endorsements. The bulk of Stone's sponsorship was a result of personal connections. Stone also did not keep records or have an identifiable system of organising her sporting activities and receipts. Although courts have recognised businesses with inefficient record keeping and organization,[43] considering that Stone's activities were not 'conventionally commercial', the general impression[44] suggests her operations were not sufficiently business-like.

It is also arguable that Stone's sporting activities were too infrequent for her to reach the level of a professional athlete. In the year of income, she did not compete in international circuits due to injuries and only won two prizes. Yet 'business is not confined to being busy'.[45] This is pertinent as Stone chose not to compete in these circuits on account of her injuries and not a lack of commitment. Also, it appears that Stone maintained sufficient regularity in her training activities as she only worked two office days a week at the Police Academy in order to better train for javelin.

The analysis of Stone's activities is ultimately inconclusive. Stone pursued javelin with a profit making purpose, (though it is highly arguable that profit making was incidental to Stone's main purpose to achieve sporting excellence), but her activities were not systematic or business-like. Yet the total of her receipts in 1999 were of such a scale that she seems to have moved into the realm of professional athleticism. Stone's activities also exhibited a fair degree of regularity and repetition. Perhaps this is why the courts placed such emphasis on profit making intention. Hill J explained the reason for his emphasis on purpose:

> Although it has been said that it is the extent of the activity … and not the state of mind or intention of a taxpayer which determines whether the taxpayer carries on a business: *Inglis v Federal Commissioner of Taxation* (1980) 80 ATC 4,001, that is not to say that the state of mind is irrelevant. Two different taxpayers may carry on the same activity … yet the one may be carrying on a business and the other merely selling the product of a hobby. What must differentiate the two cases is the purpose for which the activity is carried on. Generally … the profit motive is important in leading to the conclusion that the activity undertaken is a business …. That is particularly the case here … The question whether the athlete is carrying on a business will not be resolved in these cases by considering the activity he or she engages in, but rather by a consideration of the motive or purpose for doing so. That motive may often, however, be gleaned from the activities which the athlete undertakes.[46]

B. Profit-Making Purpose

The meaning of intention is a necessary precursor to an analysis of profit-making purpose.[47] Intent can be seen as what a taxpayer wants to have happen when

43 *Thomas v FCT* (1972) 3 ATR 165.

44 *Martin*, above n39.

45 *Inland Revenue Commissioners v Westleigh Co Ltd, South Behar Railway Co and Eccentric Club Ltd* (1923) 12 TC 657.

46 *Stone FC*, above n3 at 234–235.

conducting their activities. Motive is why the taxpayer wants a transaction to occur.[48] In *Magna Alloys*, Brennan J stated:

> Purpose may be either a subjective purpose — the taxpayer's purpose where it means the object which the taxpayer intends to achieve by incurring the expenditure; or it may be an objective purpose, meaning the object which the incurring of the expenditure is apt to achieve …[49]

However, it appears that courts use the terms purpose, motive and intention interchangeably. In *Henry Jones (IXL) Ltd v FCT*,[50] Hill J observed in relation to 'profit making purpose' that (when applying the *Myer Emporium*[51] doctrine) the concepts of 'intention' and 'purpose' are interchangeable. Hart and Coleman espouse this view.[52] This is because in many cases the terms are in fact interchangeable, and in most cases they have considerable overlap.

> Generally where a taxpayer has a profit-making intention or purpose, that taxpayer will also but not invariably have a motive of profit-making.[53]

This paper will proceed upon the assumption that profit, motive and intention are indeed interchangeable.

A related issue is whether the inquiry is directed to the taxpayer's objective or subjective purpose. Judicial authority leans towards subjective intention.[54] However, ascertaining subjective intention may lead to an inquiry which considers the taxpayer's acts rather than their actual state of mind. Issacs J stated in his dissent in *Ruhumah Property Co Ltd v The Federal Commissioner of Taxation* that 'the character of a taxpayer's profits is determined by his acts, and not by the intention or motive with which he does the acts'.[55] In determining the taxpayer's intention,

> the real thing that has to be decided is what were the acts that were done in connection with this business and whether they amounted to trading which would cause the profits that accrued to be profits arising from trade or business.[56]

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47 I am indebted to Geoffrey Hart for his contributions in relation to the meaning and role of intention in taxation law.

48 Jeffrey Waincymer, *Australian Income Tax Principles and Policy* (2nd ed, 1993) at 187.

49 *Magna Alloys & Research Pty Ltd v FCT* (1980) 11 ATR 276 at 279

50 *Henry Jones (IXL) Ltd v FCT* (1991) 31 FCR 64.

51 *FCT v Myer Emporium Ltd* (1987) 163 CLR 199.

52 Geoffrey Hart & Cynthia Coleman, 'Intention, Purpose and Motive in Income Tax Law', paper presented at ATTA Conference in Wellington, January 2005 at 6.

53 Id at 6.

54 In the context of profit making schemes: *Myer Emporium*; *Westfield Ltd v FCT* (1991) 21 ATR 1398. The Commissioner stated in Ruling TR 92/3 that a profit from an isolated transaction was generally assessable income if certain criteria were fulfilled. One criterion was that the objective intention or purpose of the taxpayer in entering into the transaction was to make a profit. This was rejected by Hill J in *Westfield*, id at 3–4.

55 *Ruhumah Property Co Ltd v FCT* (1928) 41 CLR 148 at 160.

56 *J & R O'Kane & Co v Commissioner of Inland Revenue* (1922) 12 TC 303 at 347; citation in id at 161 (Isaacs J); cited in Hart & Coleman, above n52 at 2.

Hart and Coleman state that the modern extrapolation as espoused in *Myer Emporium* produces the same result as Issacs J, 'but instead of saying that subjective intention or motive is irrelevant, the modern view is that it may be assumed from the circumstances of what has been done'.[57] Indeed Hill J expressed this notion subsequent to *Myer Emporium*, that 'generally speaking a person will be said to intend the natural and probable consequences of his acts and likewise his purpose may be inferred from them'.[58]

C. Profit-Making Intent: An Essential Criterion?

There is considerable judicial authority supporting the notion that the subjective intention of the taxpayer is an important, but not decisive factor when deciding whether a business is being carried on, or whether there is an isolated profit-making scheme.[59] However the more problematic question is whether profit-making purpose is an essential pre-condition in order to find that a business is being carried on.[60]

In *FCT v Walker*[61] a taxpayer in possession of an Angora goat was found to be in the business of primary production as he had profit-making intent coupled with repetition and regularity in his activities. This finding was made despite there being no actual profit. Cassidy notes that 'a realistic potential for the activities to make a profit is not necessary as long as the taxpayer intends to make a profit and diligently pursues that object'.[62] This highlights the significance of intention as indicia. Also, Hill J commented in *Babka v FCT,* (in the particular context of gambling) that 'the motive of making a profit generally forms an essential element in the factual matrix which leads to the conclusion that a particular activity is a business'.[63]

On the other hand, the court in *Ferguson v FCT,* whilst stating that 'the nature of activities, particularly whether they have a profit-making purpose, may be important',[64] went on to declare that an immediate purpose of profit making in a particular income year is not essential. This statement was made in *obiter* as the taxpayer had intended to make profit in the long run. It appeared that profit motive was also not essential in *Brajkovich v FCT*,[65] where the Full Federal Court held

57 Hart & Coleman, id at 3.

58 *Raymor Contractors Ptd Ltd v Commissioner of Taxation (Cth)* (1991) 91 ATC 4259 at 4270; cited in *Henry Jones (IXL) Ltd*, above n50 at 71.

59 *Smith v Anderson* (1880) 15 Ch D 247 at 258; *FCT v Pepper* (1985) 85 ATC 4518 at 4531; *Babka v FCT* (1989) 89 ATC 4963 at 4969; *FCT v Radnor Pty Ltd* (1991) 91 ATC 4689 at 4700; *Case 47/96* (1996) 96 ATC 463 at 468; *Case 75/96* (1996) ATC 677 at 682; *Daff v FCT* (1998) 98 ATC 2129 at 2134. Also see above discussion on indicia of business.

60 Hart & Coleman, above n52 at 2.

61 *Walker*, above n42.

62 Julie Cassidy, *Concise Income Tax* (3rd ed, 2004) at 201. See also *Tweddle v FCT* (1942) 7 ATD 186; *Thomas* above n43; *Case H11* (1976) 76 ATC 59; *Case M67* (1980) 80 ATC 479; *Daff v FCT* (1998) 98 ATC 2129 at 2135; *Glennan v FCT* (1999) ATC 4467 at 4481; *Vincent v FCT* (2002) ATC 4490 at 4513.

63 *Babka v FCT*, above n59 at 4969.

64 *Ferguson v FCT* (1979) 9 ATR 873 at 876.

that the taxpayer was not in the business of gambling, even though the taxpayer strongly desired to make a substantial financial success of gambling. Moreover, in *Investment and Merchant Finance Corporation Limited v FCT*[66] it was held that a subjective profit making purpose might be irrelevant if there is sufficient repetition of business activities. In such scenarios, the fact that a particular transaction was entered into without the subjective intention of making profit will not prevent that transaction from forming part of that business. Nonetheless, these cases have fairly specific *ratios* and do not necessarily stand for the proposition that profit making purpose is not essential for the carrying on of a business.

English courts appear willing to recognise a business in the absence of a subjective intention of profit making.[67] For instance in *Incorporated Council of Law Reporting for England and Wales,*[68] it was found that in publishing judicial decisions and digests, the taxpayer was not motivated by profit. Nevertheless a business was being carried on. Similarly a business was found to exist in *Royal Agricultural Society of England v Wilson*[69] despite the fact that the taxpayer chose towns for shows not on the grounds of profit but out of a duty to give all regions within England a turn.

In contrast, in New Zealand subjective intention is essential in establishing a business. However, profit making need not be the dominant intention.[70] In *Graham v IRC*[71] an evangelist was found to be conducting a business. Although the evangelist's main purpose was charitable, he performed his activities with the intention of acquiring donations. McCarthy J agreed with *Gunn's Commonwealth Income Tax Law and Practice*[72] that the essential test as to whether a business exists is the intention of the taxpayer as evidenced by his conduct.[73] The business indicia referred to in the cases are merely aimed at determining that intent. Waincymer points out that many commentators would disagree with this view in the Australian context, as there are many cases that have been thought to support the view that profitable intent need not even be present for an activity to constitute a business.[74]

More controversially, Waincymer argues that the development of case law in relation to isolated, or extraordinary transactions has downgraded and subordinated the traditional requirements of judicial income to an inquiry as to purpose.[75] The leading case, *Myer Emporium*, held that extraordinary transactions

65 *Brajkovich*, above n40 at 5233-4.
66 *Investment and Merchant Finance Corporation Limited v FCT* (1971) 125 CLR 249.
67 See discussion in Hart & Coleman, above n52 at 13.
68 *Incorporated Council of Law Reporting for England and Wales* (1888) XXIL QBD 279.
69 *Royal Agricultural Society of England v Wilson* 9 TC 62 at 67–68.
70 See discussion in Hart & Coleman, above n52 at 13.
71 *Graham v Commissioner of Inland Revenue,* above n23.
72 John Gunn in collaboration with Otto Berger, James Greenwood & Richard O'Neil, *Gunn's Commonwealth Income Tax Law and Practice* (6th ed, 1951) at para 69.
73 Also referred to by Waincymer, above n48 at 177; *Commissioner of Taxation v Stone* [2004] HCATrans 368 at [3925] (Mr Pagone QC).
74 Waincymer, above n48 at 117.
75 Id at 113.

may be classified as within the scope or ordinary course of business when the gain was stamped with subjective profit making intention:

> Generally speaking … 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.[76]

While it is inconceivable that the High Court was purporting to fundamentally change the income concept in Australian tax law, according to Waincymer, any change in the balance of competing facts and in the way facts are viewed can be nearly as far reaching.[77] However Hart and Coleman[78] point out that the High Court in *Myer Emporium* did not accept the 'simple proposition that the existence of an intention or purpose of making a profit or gain is enough in itself to stamp the receipt with the character of income'.[79]

Waincymer complains that the uncertainty in determining what constitutes a business or commercial activity is one of the problems pervading the definition of income. Characterisation often requires consideration of the taxpayer's motivation and purpose, which are both troublesome concepts.[80]

> The cases examining the relevance of profit-motive are excellent examples of the dangerous effects of illogical inverse propositions and misreading of precedents. A number of unassailable propositions were made by the courts. There need be no actual profit. An unprofitable business is still a business. There is no need for an immediate hope of profit. Many businesses are expected to lose money in their early years. The mere presence of a profit-motive does not ensure that the activity is a business. Everyone who buys a lottery ticket wants to win.[81]

Commentators had hoped that the High Court in *Stone* would address some of these issues, particularly as the reversal in the Full Federal Court of Hill J's decision was primarily driven by the view that Stone was insufficiently driven by profit.[82] With respect to the issue of whether profit-making purpose need be the sole purpose of the business activity, Hill J stated that the profit motive need not be the sole or dominant motive, but it must be a substantial motive before the conclusion could be drawn that Stone was carrying on a business.[83] Although the majority did not explicitly approve this statement, they adopted a similar approach to Hill J in finding that although Stone was primarily motivated by notions of

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76 *Myer Emporium*, above n51 at 209-210. Also of interest is the argument made Mr Pagone, QC in *Stone HC*. Using the words of *Myer* (Mason ACJ, Wilson, Brennan, Deane & Dawson JJ) he contended that what 'stamped' her receipts with the character of income was the commercial exploitation of talent: see HCA Transcript, above n73 at [255]–[270].

77 Waincymer, above n48 at 113.

78 Hart & Coleman, above n52 at 1.

79 *Myer Emporium*, above n51 at 211.

80 Waincymer, above n48 at 174.

81 Id at 186.

82 Cooper, et al, above n36 at 250.

83 *Stone FC*, above n3 at 235.

athletic glory, she recognised that sporting success would bring financial reward. Unfortunately, the question as to whether profit-making intention is essential in establishing a business remains unanswered.

3. The Utility of the Intent Criterion in Assessing Receipts

If a substantial profit-making intention on the part of the taxpayer was an essential pre-condition for a business, greater consistency would be had in this area. For instance, judicial balancing of the various business criteria would no longer be as unpredictable. Indeed it has been suggested that it makes little sense to consider anything other than profit intent as the primary consideration, as this is the only factor which could lead to an isolated transaction that satisfied none of the other criteria to still give rise to income on ordinary concepts.[84]

However it is arguable such changes would be merely superficial. The views of Isaacs and McCarthy JJ discussed above[85] indicate that business indicia, such as system-like behaviour, are to be considered when determining (or even *inferring*) intent. Thus in practice the inquiry may stay the same, assessing intention would still remain a question of 'fact and degree' and a purposive test may actually raise more complex issues of fact. Often there will be a number of purposes and motivations, meaning that no simple conclusions are possible,[86] and when courts consider the motivation behind transactions, there is a need to both identify the facts and ask why they appeared in the way that they did.[87] Hence findings of fact dominate the outcome. As a result, a particular transaction can be taxed differently to two people because of the difference in intent or purpose. This downgrades the role of precedent, increases uncertainty, and makes judicial decision making more difficult.[88] This problem is demonstrated by *Stone*, with Hill J in fact stating that two athletes carrying on similar activities can reach different tax outcomes depending on their purpose.[89] There has also been criticism of the decision for its uncertainty as it provides little guidance to athletes in determining whether they have crossed the threshold of turning their talent to account for money.[90] The majority stated:

> Whether there may be other ways of showing that an athlete is engaged in the business of turning athletic talent to account for money is a question that need not be decided. Nor is it necessary to decide whether the bare receipt of sporting equipment or clothing from a seller or manufacturer of those items, coupled with an undertaking or an obligation to use or wear it would reveal that the athlete has turned talent to account for money. Such cases may present difficult questions of fact and degree.[91]

84 Waincymer, above n48 at 205.

85 Above under 'Profit Making Purpose' of this paper.

86 Waincymer, above n48 at 188.

87 Id at 85.

88 Ibid.

89 See *Stone FC*, above n3 at 234–235 and the 'Analysis of Stone against the other Business Indicia' of this paper.

90 See Karen Barlow, 'Athletes Confused by Tax Ruling on Sponsorship' (Radio report) *PM* (26 April, 2005); Burton, above n32 at 295 (Gleeson CJ, Gummow, Hayne & Heydon JJ).

The former head solicitor at Athletics Australia, Dave Culbert, says small sporting organisations and councils may now think twice about giving grants to young athletes.[92] It also has been suggested that as councils may be less willing to hand over grants to athletes if they think that a significant percentage of that will go directly to the taxman. A shift in the allocation of resources may occur, with councils spending money on developing local sporting facilities instead.[93] Distortion of resource allocation due to uncertainty is clearly undesirable.

The subjective nature of the inquiry can also be difficult. The court must decide whether to accept the taxpayer's assertions, and assess their credibility.[94] As for more external evidence, Waincymer notes that 'objective evidence is not direct evidence of the truth of the subjective assertions' and may end up being irrelevant to the question of what a particular taxpayer intended.[95] According to Waincymer, the main problem is to reconcile the suggested importance of the profit intent criterion in *Myer Emporium* and other recent cases, with the views in some older cases that seemed to play down the importance of profit intent.[96] Unfortunately, the High Court's decision in *Stone* did not bring the law much closer to such reconciliation.

Finally, a purposive test is arguably unjustified in economic theory. The Haig-Simons school defines income as the sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question.[97] The existence of gain is essential to income and the source of the gain, its form and how it is used, is irrelevant. The analysis of Stone's case reveals the appeal of the gain concept. The fact that Stone financially gained from her sporting talents is fairly clear. Yet to be income, her sporting activities must fit into the perhaps inappropriate rubric of a 'business'.

The suite of lease incentive cases, such *FCT v Whitfords Beach Pty Ltd*[98] and *Myer Emporium* were heralded as signs of the increasing judicial recognition of the gain concept of income.[99] Dabner also argues that Hill J's statement in *Warner Music Australia Pty Ltd v FCT* provides support for the view that the gains analysis is infiltrating the application of the traditional principles of income determination:[100]

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91 *Stone HC*, above n1 at 63.

92 See Barlow, above n90.

93 Ibid.

94 Waincymer, above n48 at 188. See *Case 41* (1983) 27 CTBR (NS); *Case 23* (1983) 27 CTBR (NS).

95 Waincymer, id at 85.

96 Id at 186–187.

97 Henry Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (1983) at 49–57 in Cooper et al, above n36 at 19.

98 *FCT v Whitfords Beach Pty Ltd* (1982) 150 CLR 355.

99 Robin Woellner, Stephen Barkoczy, Shirley Murphy & Chris Evans, *Australian Taxation Law* (14th ed, 2004); Justin Dabner, 'Lease Incentives and the Gain Theory of Income' (1998) 1 *Journal of Australian Taxation* 136.

100 Dabner, id at 141.

> It is now too late to argue in the case of a taxpayer carrying on a continuing business and thus required to account on an accruals basis, that income is confined to that which comes in. Gains, at least if they are capable of being converted into money in a practical and commercial sense, may clearly constitute assessable income.[101]

Likewise, gain concepts have permeated legislative reform through the introduction of the fringe benefits tax and capital gains tax.[102] Yet the High Court majority in *FCT v Montgomery* said that the flow concept of income was too entrenched to be replaced with concepts of gain.[103] It appears from this, and abandonment of the Tax Value Method in 2002, that the definition of income remains far from the economic ideal.

However it is possible that that the personal taxation system cannot be fixed by simply altering the definition of income to reflect gain theory or taxpayer intention. Prebble believes the concept of income suffers from displacement, or 'ectopia', which is pathological and incurable due to the unavoidable separation of law from its subject matter. As it is impossible for the law to tax economic movements directly, the results of legal transactions are taxed rather than their underlying effect. This means that tax law's concept of income is not income itself but a legalistic simulacrum of transactions, which is inherently artificial.[104] Prebble's thesis suggests that 'inherent in any income tax is a concept of income that cannot avoid being flawed'.[105] Whether analysis is directed towards intention, gain or other indicia, we are still taxing a legal simulacrum, not actual economic activity. Although the conceptual framework of gain theory appears simplistic, as for all income tax laws, the devil inevitably lies in the detail and reform may have little impact on the law's complexity, equity or efficiency.[106]

4. Conclusion: Between a Rock and a Hard Place

This paper has exposed some cracks in the *Stone* decision: its uncertainty; possibly limited precedential value; and its failure to address issues concerning the role of intention and meaning of income. However these cracks appear somewhat unavoidable, particularly considering the peculiar, highly factual nature of the case. The problems apparent in re-defining business to accord solely with profit-making intention also indicate why the High Court may have been reluctant to stray too far from existing authorities. As to whether the delineation of 'carrying on a business', or the meaning of income should be reformed, such issues are better reserved for a more extensive paper — and ultimately — Parliament. Yet even then, the 'ectopic nature of the income concept' may hinder its ability to improve the situation. Who knew that throwing javelins could be this complicated?

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101 *Warner Music Australia Pty Ltd v FCT* (1996) 70 FCR 197 at 205.
102 Woellner, et al, above n99 at 272–73.
103 *FCT v Montgomery* (1999) 198 CLR 639.
104 John Prebble, 'Income Taxation: A Structure Built on Sand' (2002) 24 *Syd LR* 301 at 305–309.
105 Id at 318.
106 Taxation Board Report, *Evaluation of the Tax Method* (2002) at 16.