FEDERAL COURT OF AUSTRALIA

Watson as trustee for the Murrindindi Bushfire Class Action Settlement Fund v Commissioner of Taxation [2020] FCAFC 92

Appeal from:	*Watson as trustee for the Murrindindi Bushfire Class Action Settlement Fund v Commissioner of Taxation* [2019] FCA 228
File number:	VID 243 of 2019
Judges:	**KENNY, DAVIES AND THAWLEY JJ**
Date of judgment:	27 May 2020
Catchwords:	**TAXATION** – allowable deductions – where the taxpayer is the scheme administrator of the Murrindindi Bushfire Class Action Settlement Scheme – whether the costs and expenses incurred by the taxpayer in administering the Scheme are deductible under s 8-1 of the *Income Tax Assessment Act 1997* (Cth) – whether the costs were incurred in gaining or producing assessable income – whether the costs were incurred in carrying on a business – whether the costs were an outgoing of capital or of a capital nature – appeal dismissed
Legislation:	*Corporations Act 2001* (Cth) s 477 *Income Tax Administration Act 1936* (Cth) s 95 *Income Tax Assessment Act 1997* (Cth) ss 8-1, 995-1 *Supreme Court Act 1986* (Vic) Part 4A, ss 33V, 33ZF
Cases cited:	*Charles v Commissioner of Taxation* (1954) 90 CLR 598 *Charles Moore & Co (WA) Pty Ltd v Commissioner of Taxation* (1956) 95 CLR 344 at 351 *Colonial Mutual Life Assurance Society Limited v Commissioner of Taxation* (1953) 89 CLR 428 *Commissioner of Taxation v Anstis* [2010] HCA 40; 241 CLR 443 *Commissioner of Taxation v Citylink Melbourne Limited* [2006] HCA 35; 228 CLR 1 *Commissioner of Taxation v Day* [2008] HCA 53; 236 CLR 163 *Commissioner of Taxation v Montgomery* [1999] HCA 34; 198 CLR 639 *Commissioner of Taxation v Payne* [2001] HCA 3; 202

CLR 93

Commissioner of Taxation v Radnor Pty Ltd (1991) 102 ALR 187

Commissioner of Taxation v Sharpcan Pty Ltd [2019] HCA 36; 373 ALR 414

Commissioner of Taxation v Smith (1981) 147 CLR 578

Commissioner of Taxation v Stone [2005] HCA 21; 222 CLR 289

GP International Pipecoaters Pty Ltd v Commissioner of Taxation (1990) 170 CLR 124

Hallstroms Pty Ltd v Commissioner of Taxation (1946) 72 CLR 634

Handley v Federal Commissioner of Taxation (1981) 148 CLR 182

Ronpibon Tin NL v Commissioner of Taxation (1949) 78 CLR 47

Rowe v AusNet Electricity Services Pty Ltd [2015] VSC 232

Spriggs v Commissioner of Taxation [2009] HCA 22; 239 CLR 1

St George Bank Limited v Commissioner of Taxation [2008] FCA 453

Steele v Commissioner of Taxation [1999] HCA 7; 197 CLR 459

Sun Newspapers Limited v Commissioner of Taxation (1938) 61 CLR 337

Trustees of the Estate Mortgage Fighting Fund Trust v Commissioner of Taxation [2000] FCA 981; 102 FCR 15

W Nevill & Co Ltd v Commissioner of Taxation (1937) 56 CLR 290

Watson as trustee for the Murrindindi Bushfire Class Action Settlement Fund v Commissioner of Taxation [2019] FCA 228

Western Gold Mines NL v Commissioner of Taxation (WA) (1938) 59 CLR 729

Date of hearing:	22 August 2019
Registry:	Victoria
Division:	General Division
National Practice Area:	Taxation

Category:	Catchwords
Number of paragraphs:	49
Counsel for the Appellant:	Mr D H Bloom QC with Mr D J McInerney and Ms C Horan
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Solicitor for the Respondent:	Australian Government Solicitor

ORDERS

VID 243 of 2019

BETWEEN:	**ANDREW WATSON AS TRUSTEE FOR THE MURRINDINDI BUSHFIRE CLASS ACTION SETTLEMENT FUND** Appellant
AND:	**COMMISSIONER OF TAXATION** Respondent

JUDGES:	**KENNY, DAVIES AND THAWLEY JJ**
DATE OF ORDER:	**27 MAY 2020**

THE COURT ORDERS THAT:

1. The appeal be dismissed.

2. The appellant pay the respondent's costs, as agreed or assessed.

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

REASONS FOR JUDGMENT

THE COURT:

OVERVIEW

1 The appellant (**the taxpayer**) is the scheme administrator of the Murrindindi Bushfire Class Action Settlement **Distribution Scheme**. The Distribution Scheme was implemented following the approval by the Supreme Court of Victoria of a settlement of a class action relating to the 7 February 2009 Murrindindi bushfire under which the defendants to that action agreed to pay the sum of $300 million in settlement of the claims of the plaintiff and group members. In issue in this appeal is whether costs and expenses incurred by the taxpayer in the administration of the Distribution Scheme are deductible pursuant to s 8-1 of the *Income Tax Assessment Act 1997* (Cth) (***ITAA 1997***). For the reasons that follow, the primary judge was correct to hold that the administration costs are not deductible: see *Watson as trustee for the Murrindindi Bushfire Class Action Settlement Fund v Commissioner of Taxation* [2019] FCA 228.

BACKGROUND FACTS

2 The bushfire known as the Murrindindi Bushfire killed 40 people, destroyed over 500 homes and caused substantial property damage in an area covering Murrindindi, Narbethong, Marysville, Buxton and Taggerty.

3 A class action, or "group proceeding" under Part 4A of the ***Supreme Court Act*** *1986* (Vic), was commenced in the Supreme Court of Victoria against parties including AusNet Electricity Services Pty Ltd. The representative plaintiff claimed damages in negligence for losses caused by the bushfire. Maurice Blackburn acted for the representative plaintiff, ultimately Dr Katherine Rowe. The class action was settled on the day the trial was due to commence, the parties entering into a "Settlement Deed" on 6 February 2015.

4 In substance, the proceedings settled for $300 million, inclusive of costs. After approximately $20 million in costs and reimbursements were deducted, approximately $280 million (**Distribution Sum**) was to be paid into an interest-bearing bank account opened by Maurice Blackburn (Settlement Distribution **Fund**). The Fund was to be distributed to members of the group after assessment of the various claims of group members. It was intended and expected that the interest earned on the Fund whilst the assessment procedure was undertaken would cover the costs of assessing the claims and otherwise administering the Fund.

5 The settlement of the proceedings was conditional upon the making by the Supreme Court of the "Approval Orders": cl 7(a) of the Settlement Deed. The Settlement Deed provided for Maurice Blackburn to prepare a "Settlement **Distribution Scheme**" which, subject to any orders of the Court, would provide for the Distribution Sum to be administered by a principal of Maurice Blackburn as a Court appointed fund administrator: cl 7(d)(1). "Settlement Distribution Scheme" was relevantly defined in cl 1.2 of the Deed of Settlement, as meaning "a Scheme for the distribution of the Distribution Sum to Participating Group Members …".

6 On 27 May 2015, Emerton J made orders under ss 33V and 33ZF of the *Supreme Court Act*, including an order approving the settlement in accordance with the Settlement Deed (Order 2), and an order approving the terms of the Settlement Distribution Scheme prepared by Maurice Blackburn and dated 6 May 2015 "as the procedure for distributing among the plaintiff and group members the settlement sum payable by the defendants pursuant to the Deed" (Order 3). Her Honour delivered reasons in connection with the orders she made: *Rowe v AusNet Electricity Services Pty Ltd* [2015] VSC 232.

7 Order 5 provided for the payment from the Fund of the Scheme Administrator's "costs of and incidental to the implementation of the Scheme". It provided:

> Pursuant to s 33ZF of the Act, alternatively the inherent jurisdiction of the Court:
>
> a. the Scheme Administrator at such times as he or she considers appropriate shall file with the Court his or her claims for payment of costs of and incidental to the implementation of the Scheme, in a form to be approved by the supervising judge; and
>
> b. subject to any further orders made by the supervising judge, the Scheme Administrator's costs of and incidental to the implementation of the Scheme are to be paid from the Settlement Distribution Sum according to the procedure set out in the Scheme.

8 The orders were fashioned with a view to bringing the proceedings to an end once the Fund had been distributed. Order 11 was:

> Upon completion of distributions pursuant to the Scheme, the proceeding, including any counterclaim and contribution notices, be dismissed with no order as to costs.

9 The appellant was appointed as the "Scheme Administrator" and trustee of the Fund in accordance with cl A3.1 of the Scheme. Clause A3.2 provided that the discharge of functions and exercise of discretions by the appellant (and staff) was done "as lawyers required by the Court" to administer the Scheme and "as a duty owed to the Court" in priority to any obligation owed to any individual group member. Clause A3.2 was in these terms:

> The Scheme Administrator and the Administrator Staff in discharging any function or exercising any discretion conferred by this Scheme:
>
> (a) shall do so as lawyers required by the Court to administer this Scheme fairly according to its terms, as a duty owed to the Court in priority to any obligation to any individual Claimant; and
>
> (b) shall have the same immunities from suit as attach to the office of a judge of the Supreme Court of Victoria.

10 As required by the terms of the Settlement Deed, the Distribution Scheme provided for $34 million of the settlement sum to be allocated to an "I-D Claims Fund" and applied to the payment of claims for personal injury and/or dependency (**I-D claims**), with the balance to be allocated to an "ELPD Claims Fund" and applied to the payment of claims for economic loss or property damage (**ELPD claims**). A cap of 80% of the final assessed value was imposed for I-D claims, with any balance remaining in the I-D Claims Fund to be transferred into the ELPD Claims Fund.

11 The Distribution Scheme set out the claims assessment procedure to be followed for establishing the proportional entitlement of each group member to a share of the Fund. The assessment procedure varied depending on whether the claim was an I-D claim or an ELPD claim, and provided for the numerous assessments to be done by independent assessors, engaged by the scheme administrator for that purpose, who were required to determine the claims in accordance with uniform criteria.

12 As permitted by the Distribution Scheme, the taxpayer, as Scheme Administrator, established a team of Maurice Blackburn staff members to assist him in administering the scheme, defined in the Distribution Scheme as the "Administrator Staff". The size of the team fluctuated over the course of the administration but, at its largest, the team had approximately 50 members comprised of lawyers, paralegals and administrative staff performing a variety of legal and administrative tasks. As noted, the taxpayer and his staff were to administer the scheme fairly and in accordance with its terms as a duty owed to the Court in priority to any obligation to any individual claimant and, in administering the scheme, had the same immunities from suit that attach to the office of a judge of the Supreme Court of Victoria: cl A3.2. In *Rowe* at [34] Emerton J noted that the immunities from suit were said to be appropriate because they were administering a court-approved scheme. The independent assessors who undertook the actual assessments were also given immunities from suit in the discharge of their office that attach to the office of a judge of the Supreme Court of Victoria: cll C3.1, E3.1. The administration of the scheme was also subject to the overall supervision of the Supreme Court of Victoria: cl J1.

13 The taxpayer performed a wide range of duties pursuant to the Distribution Scheme, including:

(1) ongoing development, implementation and monitoring of internal processes for assessing claims, including the development of IT system requirements and infrastructure and the recruitment, training and supervision of Administrator Staff;

(2) delegating to Administrator staff the responsibilities to perform the functions necessary and convenient for the efficient implementation of the Distribution Scheme;

(3) engaging barristers, medical practitioners and professional loss assessors or adjustors to assist in the assessment of claims;

(4) managing and administering the Fund, including estimating costs and the process for distribution;

(5) liaising with organisations regarding workflow and assessment rates, and taxation of interest accrued on the Distribution Sum;

(6) implementing practices to monitor and estimate the costs of administering the Fund; and

(7) investing the Distribution Sum while the assessment of claims proceeded.

14 The Distribution Sum was to be paid into an interest-bearing bank account held by the Scheme Administrator with an Australian deposit-taking institution on the basis that the accrued interest would become part of the Fund available for costs and disbursements and for distribution to claimants: see definitions of 'I-D Claims Fund' and 'ELPD Claims Fund', particularly cll A1.1(i)(iv) and (j)(vi), B1.2, B2.1, and I1. There was no obligation on the part of the Scheme Administrator to derive a return on the Distribution Sum. The Scheme Administrator could take no decision other than one to deposit the Distribution Sum with an Australian deposit-taking institution.

15 The investment of the Distribution Sum was addressed by the primary judge, in his Honour's reasons (hereafter "J") at [12]–[13], as follows:

> After assessing the funding needs of the Fund over the short and long term, the Taxpayer invested the Distribution Sum in a series of term deposits and other interest-bearing bank accounts across a number of different 'Big 4' Australian banks which, in the Taxpayer's view, would provide the highest level of security. As part of this process, the Taxpayer consulted with Maurice Blackburn's in-house finance team regarding different investment options and requested that they obtain and negotiate rates with various banks to see which could provide the best rate for the relevant term. The Taxpayer considered available interest rates, deposit terms, and the present and future liquidity needs of the Fund and concluded that because interest rates were expected to fall, it would be prudent to deposit a large portion of the moneys in a long

> term deposit (even though the rates on long term deposits were lower than on shorter term deposits). Accordingly, at the outset the Taxpayer deposited $240 million into a 12-month term deposit, $35 million into a 3-month term deposit, and the remainder (approximately $6 million) into a controlled money account in order to meet the ongoing expenses of the administration of the SDS.
>
> As the administration progressed and the term deposits matured, the Taxpayer made further decisions regarding the reinvestment of the Distribution Sum at least every three months. When making these decisions, the Taxpayer re-evaluated available interest rates and reassessed the liquidity needs of the Fund.

16 The Distribution Scheme provided for the costs incurred in the administration of the scheme to be paid in the first instance from the interest accruing on the settlement sum before reducing the principal compensation sums payable to the claimants: cl A4.2. All fees and disbursements payable to any person pursuant to the Distribution Scheme had to be approved by the Court: cl I1. It was submitted by the taxpayer that it was central to the overall operation of the Distribution Scheme that the Distribution Sum be invested so as to generate sufficient interest income to cover the administration costs of the Scheme. The taxpayer's evidence was that it was his "fundamental obligation as scheme administrator to control the costs of the administration, to the extent that this was consistent with [his] obligations to ensure that the process was fair and appropriately conducted". The taxpayer also gave evidence that, as he had reported to the Supreme Court in the approval hearing, it was anticipated that the administration costs would be wholly or substantially covered by the interest earned on the settlement funds and "[he] was vitally concerned throughout the administration process to monitor whether this was likely to be achieved".

17 In the income year ended 30 June 2016, the interest amount of $8,355,722 accrued on the bank deposits and the taxpayer (as Scheme Administrator) incurred $4,341,327 in costs and expenses in administering the Distribution Scheme. The overwhelming majority of the work carried out by the appellant taxpayer as Scheme Administrator was to oversee the assessment of claims made by group members: J[14], J[17]. The costs were, accordingly, almost entirely constituted by the legal and other fees of the appellant taxpayer's staff and fees or disbursements paid to those engaged to assist in assessing the claims of the various group members. As one would expect, the costs related to the derivation of interest income were minimal. The appellant did not argue an alternative case that it should be entitled to deduct those de minimis costs: cf ***Ronpibon*** *Tin NL v Commissioner of Taxation* (1949) 78 CLR 47 at 58–59.

THE DECISION BELOW

18 The issue before the primary judge was whether the administration costs were deductible from the interest income under s 8-1 of the *ITAA 1997*.

19 Sections 8-1(1) and (2)(a) of the *ITAA 1997* provide:

> (1) You can ***deduct*** from your assessable income any loss or outgoing to the extent that:
>
> (a) it is incurred in gaining or producing your assessable income; or
>
> (b) it is necessarily incurred in carrying on a *business for the purpose of gaining or producing your assessable income.
>
> …
>
> (2) However, you cannot deduct a loss or outgoing under this section to the extent that:
>
> (a) it is a loss or outgoing of capital, or of a capital nature; …

20 Section 995-1(1) of the *ITAA 1997* relevantly provides:

> ***business*** includes any profession, trade, employment, vocation or calling, but does not include occupation as an employee.

21 In arguing that the administration costs were deductible, the taxpayer relied on both positive limbs of s 8-1(1) and further submitted that the first negative limb of s 8-1(2)(a) did not apply because the costs were not an outgoing of capital or of a capital nature. The primary judge rejected each of these contentions.

22 As to the first positive limb, the primary judge concluded that the administration costs did not bear a sufficient connection with the interest income, or the activities which more directly gained or produced the interest income, such as to be said to be "incurred in gaining or producing the assessable income" of the Fund. The primary judge reasoned that such costs related to the distribution of the settlement moneys, not to the "incidental task" of deriving income from bank deposits.

23 As to the second positive limb, the primary judge did not accept that the activities engaged in by the taxpayer as Scheme Administrator constituted the carrying on of a business. The primary judge reasoned that the production of assessable income by the taxpayer was "a mere incident of the Taxpayer's pursuit of his overarching purpose or motivation to dutifully

discharge his obligations under the [Distribution Scheme], principally being the administration of the [Distribution Scheme] according to its terms".

24 As to the negative limb contained in s 8-1(2)(a), the primary judge concluded that the administration costs were, in any event, of a capital nature, reasoning that "the regular incurring of costs and expenses [were] mere steps on the path towards the ultimate destination being the completed settlement of the litigation relating to the Murrindindi Bushfire".

THE APPEAL

25 It was not in dispute that the taxpayer, as Scheme Administrator, is, for income tax purposes, the trustee of a trust estate, namely the Fund: see definition of "trustee" in s 995-1(1) of the *ITAA 1997*. It was also not in dispute that the taxpayer is liable to pay tax on the net income of the Fund for the 2016 income year. The "net income" of a trust estate is defined by s 95 of the *Income Tax Administration Act 1936* (Cth) (***ITAA 1936***) as:

> … the total assessable income of the trust estate calculated under this Act as if the trustee were a taxpayer in respect of that income and were a resident, less all allowable deductions …

26 Further, there was no dispute between the parties that in calculating the net income of the trust estate, the interest income was assessable income of the Fund.

27 The taxpayer submitted that the primary issue for determination was whether the taxpayer was carrying on a business as Scheme Administrator. It was submitted that the primary judge erred in concluding that the administration costs were not deductible under the second positive limb of s 8-1(1)(b) in circumstances where it was not in dispute that: (1) the taxpayer's activities, as Scheme Administrator, were systematic, organised, repetitive and of a significant scale, as the primary judge accepted at J[81]–[83], [89]; and (2) the taxpayer's activities, as Scheme Administrator, were intended to, and did, generate assessable income in the form of the interest on the Distribution Sum invested in the Fund. It was submitted that the primary judge fell into error in reasoning that the taxpayer's activities lacked a "commercial character" (at J[84]–[88]) and that his "profit-making purpose" was not one in the "ordinary, commercial sense" (at J[92]). It was submitted that the taxpayer's activities, which included the engagement of the Administrator Staff and independent assessors, on commercial terms, as well as the investment of the Fund on arm's-length terms were "indisputably activities of a commercial character". It was further submitted that the primary judge placed too much weight and significance on the fact that the taxpayer was carrying on those activities as Scheme Administrator and subject to

the supervision of the Supreme Court of Victoria. It was submitted that his position as Scheme Administrator did not preclude a conclusion that he was carrying on a business in that capacity and the fact of regulation by the Court said nothing as to whether or not the activities amounted to a business.

28 The taxpayer also challenged the primary judge's conclusion that the taxpayer did not have a profit-making purpose, arguing that the evidence demonstrated that the taxpayer's objective was to derive an excess of income over costs and, thus, he had a profit-making purpose. At [93]–[94], the primary judge reasoned:

> In this case, the Taxpayer's 'purpose' in respect of the Interest Income extends no higher than the intention to derive as much interest as possible having regard to the need to maintain the highest levels of financial security. As was put by the Commissioner in the course of oral submissions, this is not a profit making purpose in the ordinary, commercial sense of that phrase because the other side of the ledger – the costs – are driven by completely separate considerations. In that sense, the Taxpayer was not in a position where he was weighing up the earning or derivation of interest income on one side of the equation with the costs of administering the Fund on the other, and actively either seeking to maximise the income and minimise the costs in the manner that a businessperson might ordinarily do in a typical commercial operation. Rather, in my view, the Taxpayer had different considerations in mind:
>
> (1) in respect of the income, Mr Watson attested to the fact that in investing the Distribution Sum, he considered it his 'principal duty' to 'ensure the security of the funds'; and
>
> (2) in respect of the costs, Mr Watson attested to the fact that in administering the [Distribution Scheme] he needed to control the costs of the administration but, critically, only to the extent that doing so was consistent with his 'obligations to ensure that the process was fair and appropriately conducted'.
>
> Put another way, the production of assessable income by the Taxpayer was a mere incident of the Taxpayer's pursuit of his overarching purpose or motivation to dutifully discharge his obligations under the [Distribution Scheme] principally being the administration of the [Distribution Scheme] according to its terms.

It was argued that the primary judge's conclusion at J[93] that the taxpayer did not actively seek to maximise the income and minimise the costs misconstrued the evidence. Reference was made to the taxpayer's evidence that he sought to maximise the interest that could be earned on the Fund. It was submitted that the fact that the taxpayer also ensured the security of the funds did not derogate from his profit-making purpose. Reference was also made to the taxpayer's evidence that he had a "fundamental obligation" to control costs and that he sought to do so whilst ensuring the process for assessing claims was fair and appropriate. It was submitted that the control of those costs was not just prudent, but entirely consistent with ordinary business practices.

29 The respondent did not agree that the primary issue was whether the appellant was carrying on a business, noting that s 8-1(1)(b) required that the outgoing be "incurred in carrying on a business *for the purpose of gaining or producing your assessable income*". The respondent also contended that the appellant had to establish that the outgoing was not one of a capital nature (s 8-1(2)(a)), submitting that that question is not subsidiary or necessarily separate to whether the positive limbs are satisfied.

30 As to s 8-1(1)(a), the taxpayer contended that what was productive of the income was the "bundle of tasks to be performed" by the taxpayer as Scheme Administrator, which included, but was not limited to, the investment of the Fund as part of the administration of the Distribution Scheme. It was submitted that taking into account the "whole of the operations" of the taxpayer, the "occasion of the outgoings" may be found in the taxpayer's production of assessable income and therefore the administration costs were deductible under the first positive limb of s 8-1(1)(a). The relationship between the activities of the taxpayer was said to be reinforced by the fact that the costs of administering the Fund were intended to be paid from the interest derived from it. The taxpayer argued that the primary judge erred in concluding that the administration costs did not satisfy the first positive limb because his Honour erroneously segregated the activities giving rise to the production of assessable income from the remainder of the activities undertaken by the taxpayer: at J[73]. It was submitted that this segregation was contrary to the approach endorsed by the High Court in *Commissioner of Taxation v* ***Day*** [2008] HCA 53; 236 CLR 163 at [33]:

> That no narrow approach should be taken to the question of what is productive of a taxpayer's income is confirmed by cases which acknowledge that account should be taken of the whole of the operations of the business concerned in determining questions of deductibility. A similar approach should be taken to what is productive of a salary-earner's income, whether it be described as employment or by reference to a bundle of tasks to be performed and duties to be observed. …
>
> (Citations omitted.)

31 It was also submitted that the concept of "gaining or producing" assessable income is wider than simply the activities that may be said to earn income (citing in support *Commissioner of Taxation v* ***Anstis*** [2010] HCA 40; 241 CLR 443 at [29]) and is concerned with whether "the occasion of the outgoings [is] found in whatever is productive of actual or expected income": *Day* at [30].

Section 8-1(1)(a): whether costs "incurred in gaining or producing … assessable income"

32 The meaning of the phrase "incurred in gaining or producing" assessable income, as it appeared in s 51(1) of the *ITAA 1936*, was considered by the High Court in *Commissioner of Taxation v* ***Payne*** [2001] HCA 3; 202 CLR 93. Gleeson CJ, Kirby and Hayne JJ observed at [9]:

> The connection which must be demonstrated between an outgoing and the assessable income, in order to fall within the first limb of s 51(1), is that the outgoing is "incurred in gaining or producing" that income. The subsection does not speak of outgoings incurred "in connection with" the derivation of assessable income or outgoings incurred "for the purpose of" deriving assessable income. It has long been established that "incurred in gaining or producing" is to be understood as meaning incurred "in the course of" gaining or producing. What is meant by being incurred "in the course of" gaining or producing income was amplified in *Ronpibon Tin NL and Tongkah Compound NL v Federal Commissioner of Taxation* [(1949) 78 CLR 47] where it was said that:
>
> > "to come within the initial part of [s 51 (1)] it is both sufficient and necessary that the occasion of the loss or outgoing should be found in whatever is productive of the assessable income or, if none be produced, would be expected to produce assessable income."
>
> (Citations omitted.)

See also: *Day* at [30]; ***Spriggs*** *v Commissioner of Taxation* [2009] HCA 22; 239 CLR 1 at [55]; *Anstis* at [27].

33 The taxpayer's reliance on *Anstis* does not assist his case. While the connection with activities which more directly gained or produced the assessable income need not be direct (*Day* at [21]), the occasion of the outgoing must be found in what is productive of the assessable income; there must be a sufficient nexus between the outgoing and "the activities which more directly gain or produce the assessable income": *Trustees of the Estate* ***Mortgage Fighting Fund Trust*** *v Commissioner of Taxation* [2000] FCA 981; 102 FCR 15 at [16]; ***Charles Moore*** *& Co (WA) Pty Ltd v Commissioner of Taxation* (1956) 95 CLR 344 at 351; *Commissioner of Taxation v Smith* (1981) 147 CLR 578 at 585–586. Here, the occasion of the administration costs did not lie in what the taxpayer did to produce the interest income earned on the bank deposits, but in giving effect to the terms of the Distribution Scheme for the distribution of the money paid under the settlement scheme to eligible claimants. The costs were incurred by the taxpayer in performing his duty to distribute the settlement sum to eligible claimants in accordance with the terms of the Distribution Scheme. The occasion of the outgoings is to be found in the appellant's task, as an appointee of the Court, in the assessment of claims and distribution of the settlement funds. Those activities were not productive of interest income and they were

not incurred "in" gaining or producing interest income. Those expenses had a loose, but ultimately insufficient, connection with the derivation of interest income: see *Payne* at [9].

34 Nor could the outgoings incurred in the assessment of claims and the distribution of the Fund be described as incidental and relevant to the limited activity which produced interest income: *W Nevill & Co Ltd v Commissioner of Taxation* (1937) 56 CLR 290 at 305; *Ronpibon* at 56; *Charles Moore* at 350; *Handley v Federal Commissioner of Taxation* (1981) 148 CLR 182 at 189; *Mortgage Fighting Fund Trust* at [18].

35 The occasion of the outgoings of $8,355,722 related to the assessment of claims and the distribution of the Fund were not in any real practical or business sense to be found in the task of deriving the interest income of $4,341,327 or of choosing which Australian deposit-taking institution the funds should be deposited with. Any connection between the occasion of the expenditure and the earning of interest on the bank deposits was insufficient and too indirect to qualify the costs as deductions under s 8-1(1)(a).

Section 8-1(1)(b): whether costs "incurred in carrying on a business"

36 The determination of whether a business is carried on is a matter of fact and degree, requiring "both a wide survey and an exact scrutiny of the taxpayer's activities": *Commissioner of Taxation v Montgomery* [1999] HCA 34; 198 CLR 639 at [69], citing *Western Gold Mines NL v Commissioner of Taxation (WA)* (1938) 59 CLR 729 at 740 per Dixon and Evatt JJ; *Commissioner of Taxation v* ***Stone*** [2005] HCA 21; 222 CLR 289 at [19]. The taxpayer's activities must be looked at overall. Whether those activities are to be characterised as a business will depend on a number of indicia, which are to be considered in combination and as a whole: *Spriggs* at [59]. Relevant factors to consider include the existence of a profit-making purpose, the scale of the activities, the commercial character of the transactions and whether the activities are systematic and organised, but, as the High Court in *Spriggs* stated at [59], no one factor is necessarily determinative. Nor is it necessarily determinative that the activities are not conducted by a taxpayer with a view to making a profit. A profit motive is not necessary for the activities to be characterised as a business: *Stone* at [55].

37 The taxpayer's position as Scheme Administrator is not determinative of the conclusion that the taxpayer was not carrying on a business. As Hill J said in *Commissioner of Taxation v Radnor Pty Ltd* (1991) 102 ALR 187 at 200: "[i]t could never be conclusive of the question whether a business is carried on by a taxpayer that the taxpayer is a trustee". Likewise, the fact that the taxpayer owed duties to the Court and was subject to the supervision of the Court in

discharging his duties as Scheme Administrator does not compel a finding that the taxpayer was not carrying on a business. A person can carry on a business, even if the carrying on of the business is subject to court supervision. An obvious example relates to a court-appointed liquidator, whose powers include the power to carry on the business of the company in liquidation: s 477(1)(a) of the *Corporations Act 2001* (Cth).

38 However, that is not to say that it is irrelevant to the question of characterisation that the activities conducted by the taxpayer were undertaken pursuant to the Distribution Scheme: see *Charles v Commissioner of Taxation* (1954) 90 CLR 598; *Radnor* at 190 (Gummow J) and 200-201 (Hill J). Nor is the capacity of the taxpayer as Scheme Administrator irrelevant to the question of characterisation because, as submitted by the taxpayer, the effect of s 95 of the *ITAA 1936* is that the net income of the Fund is to be calculated on the footing that the income was derived by a hypothetical taxpayer. Section 95 has nothing to do with the question of the characterisation of the activities of the taxpayer under the Distribution Scheme and whether such activities amounted to a business. The question of whether the taxpayer was carrying on a business in performing his functions and duties as Scheme Administrator cannot be considered without regard to the purpose and terms of the Distribution Scheme and the primary judge did not err in taking those considerations into account.

39 The primary judge was correct to conclude that the taxpayer's activities did not amount to the carrying on of a business. First, it is important to bear in mind the purpose for which the Distribution Scheme was established, namely to provide the procedure for the distribution of the money paid by the defendants under the settlement of the class action. The activities conducted by the taxpayer pursuant to the Distribution Scheme were conducted by him in implementing and administering the Distribution Scheme. Such activities lacked the character of activities conducted as a business. The fact that some of those activities were commercial in nature, such as engaging staff and third party contractors, and the investment of the Fund, does not imbue the activities with a business character when looked at overall. Nor does the fact that Mr Watson had considerable experience in the administration of settlement schemes of this kind lead to a different answer. Mr Watson had earlier been appointed as scheme administrator of the materially identical Kilmore East/Kinglake Bushfire Settlement Distribution Scheme and had previously managed or supervised more than 20 other settlement distribution schemes administered by Maurice Blackburn. It can be accepted that he turned his experience to account in discharging his functions and responsibilities under the Distribution Scheme, but he was doing so in the context of administering the Distribution Scheme in

accordance with its terms. As the primary judge observed, at J[87], it is "important not to confuse Mr Watson's role as a principal of Maurice Blackburn and Mr Watson's other role as scheme administrator".

40 Secondly, the primary judge was correct to conclude that the investment activities conducted by the taxpayer did not stamp the activities of the taxpayer taken as a whole as the conduct of a business. Undoubtedly the purpose of the investment was to accrue sufficient interest out of which to pay the administration costs, but even if done systematically and skilfully, it does not follow that, without something more, the activity can properly be described as a business. In the present case, it may be accepted that the intention was to maximise the interest income from the deposits having regard, as the primary judge said, at J[93], "to the need to maintain the highest levels of financial security". The payment of funds into interest-bearing accounts occurred because of the requirement under the Distribution Scheme to hold those funds in such an account or accounts. Considered as a whole, the taxpayer's investment activities were therefore an incident of the performance of his duties under the Distribution Scheme.

41 Thirdly, the scale of activities does not have the consequence that the activities are properly to be characterised as the carrying on of a business. The scale and nature of the activities undertaken by the taxpayer was a function of the number of group members and the complex nature of the process required to assess the various claims. It does not lead to a conclusion that a business was being carried on.

42 Cases such as *Stone* and *Spriggs* do not assist the taxpayer. In issue in *Stone* was whether prizes, appearance fees and sponsorships that the taxpayer received from her activities as an athlete were assessable as income. It was held that taken as a whole, the athletic activities of the taxpayer in the relevant years constituted the conduct of a business of turning those activities to account for money. In *Spriggs*, the issue was whether management fees paid by a professional footballer to a manager for negotiating a contract with a new football club were deductible under s 8-1. It was held that looking at his activities as a whole, the taxpayer was engaged in the business of commercially exploiting his sporting prowess and associated celebrity and the management fees were "reasonably capable of being seen as desirable or appropriate from the point of view of the pursuit of the business ends of the business" and thus were deductible under s 8-1(1)(b). Here, the taxpayer, in administering the Fund, was not turning his talent to account for money but was administering a court-approved scheme for the distribution of a settlement sum agreed upon by parties to a class action.

43 The activities undertaken by the taxpayer pursuant to the Distribution Scheme do not have the character of a business.

Section 8-1(2): whether costs an "outgoing of capital, or of a capital nature"

44 As noted at [29] above, the respondent contended that the question of whether the outgoing was on capital account was not subsidiary or necessarily separate to the question of whether the positive limbs were satisfied. It may be accepted that, because the occasion of the outgoing is to be found in the activity of ascertaining the group members' rights in respect of the distribution of the Fund and not the generation of interest income, this points to the positive limbs not being satisfied and to the outgoing as being one of capital. We did not understand the submission to suggest that the negative limb in s 8-1(2)(a) was not a true exception, as to which see *Steele v Commissioner of Taxation* [1999] HCA 7; 197 CLR 459 at [24]; *St George Bank Limited v Commissioner of Taxation* [2008] FCA 453 at [53].

45 The task of characterisation required to determine whether an outgoing is on revenue or capital account involves consideration of the character of the advantage sought by the taxpayer by making the payments: *Sun Newspapers Limited v Commissioner of Taxation* (1938) 61 CLR 337 at 363; ***GP International Pipecoaters*** *Pty Ltd v Commissioner of Taxation* (1990) 170 CLR 124 at 137-138; *Commissioner of Taxation v Citylink Melbourne Limited* [2006] HCA 35; 228 CLR 1 at [148] per Crennan J (Gleeson CJ, Gummow, Callinan and Heydon JJ agreeing at [1], [3], [76] and [77]). As the authorities make clear, the analysis requires the determination of what the outgoing was calculated to effect from a practical or business point of view: *Colonial Mutual Life Assurance Society Limited v Commissioner of Taxation* (1953) 89 CLR 428 at 454; *Hallstroms Pty Ltd v Commissioner of Taxation* (1946) 72 CLR 634 at 648; *Commissioner of Taxation v* ***Sharpcan*** *Pty Ltd* [2019] HCA 36; 373 ALR 414 at [33]. But, as the authorities also make clear, that is not to say that the legal rights and obligations are to be ignored (*GP International Pipecoaters* at 137; *Sharpcan* at [27]) and, in the present case, the analysis of what the administration costs were calculated to effect from a practical and business point of view requires taking into account the purpose and terms of the Distribution Scheme. The primary judge was correct to hold that the administration costs were of a capital nature.

46 The character of the administration costs is not determined by the source of the funds out of which those costs were to be paid. The fact that the scheme provided for the administration costs to be paid out of the interest that accrued on the settlement sum from the investments made by the taxpayer does not give the expenditure the character of expenditure on revenue

account: *Sharpcan* at [26] and the cases there cited. As the High Court in *Sharpcan* at [26] made clear, the nature of the expense is determined by the character of the advantage sought to be achieved.

47 The primary judge's reliance on *Mortgage Fighting Fund Trust* was, with respect, correct. In that case Hill J held that expenses incurred by a trustee in mailing out leaflets to solicit capital contributions to the trust were not deductible, reasoning that the expenses did not have a sufficient connection to the interest income of the trust, notwithstanding that without those funds interest would not have been earned. As in that case, there is, in the present case, a "fundamental relationship" between the outgoings in question and the capital of the trust: *Mortgage Fighting Fund Trust* at [25].

48 Properly analysed, the costs of administering the scheme were costs incurred in the course of effecting the distribution of the settlement sum to claimants entitled to share in the settlement sum, and thus costs incurred on capital account. The requirement that the settlement sum be held in interest-bearing accounts pending distribution as part of the Distribution Scheme does not give the costs of administering the scheme the character of revenue outgoings.

CONCLUSION

49 The appeal should be dismissed, with costs.

I certify that the preceding forty-nine (49) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justices Kenny, Davies and Thawley.

Associate: 

Dated: 27 May 2020