IT 2073 - Income tax : application of full federal court judgment in F.C. of T. v. Rabinov & Anor

TAXATION RULING NO. IT 2073

INCOME TAX : APPLICATION OF FULL FEDERAL COURT JUDGMENT IN F.C. OF T. V. RABINOV & ANOR

F.O.I. EMBARGO: May be released

REF H.O. REF: J 196/5 DATE OF EFFECT:

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F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1082514	ADDITIONAL TAX INCURRED PENALTY RABINOV	226(2)

OTHER RULINGS ON TOPIC IT 2012, 2028, 2043

PREAMBLE This ruling provides guidelines as to the application of the judgment of the Full Court of the Federal Court of Australia in FCT v. Rabinov & Anor (83 ATC 4437 and 14 ATR 425) to other cases and particularly to currently outstanding objections, references and appeals where the imposition of additional tax under sub-section 226(2) of the Income Tax Assessment Act is disputed.

FACTS 2. On 11 November 1983 the High Court of Australia (Gibbs CJ, Murphy and Brennan JJ) refused the Commissioner's application for special leave to appeal against the Full Federal Court judgment in FCT v. Rabinov & Anor. As is customary on such applications, no reasons were given by the High Court.

3. The issue before the Federal Court in the Rabinov case was whether additional tax imposed by sub-section 226(2) of the Income Tax Assessment Act had been correctly included in assessments for the year ended 30 June 1978. The additional tax had been assessed because the taxpayers included in their returns claims for deductions (each $25,000) in respect of donations purportedly made to the Ezroh (Relief) Fund, a public fund within sub-paragraph 78(1)(a)(iii) of the Act, when in fact they had merely participated in a shallow tax avoidance scheme which lacked any significant element of benefaction. Non-deductibility of the "gift" had been conceded by the taxpayers before the Supreme Court of Victoria (Jenkinson J).

4. In a unanimous decision the Federal Court (Fox, Toohey and Lockhart JJ) affirmed the earlier decision of the Supreme Court reported at 82 ATC 4517, 13 ATR 496 that, although not a gift, each payment of $25,000 constituted expenditure actually incurred by the taxpayer and that there was therefore no liability for additional tax under sub-section 226(2).

5. Save for the difference in the identity of the charity,

the tax avoidance scheme under consideration in this case was identical to that struck down by the Federal Court in Leary v. F.C. of T. 80 ATC 4438, 11 ATR 145. In chronological order, the main steps in the taxpayers' participation in the scheme were as follows:-

(a) On 20 February 1978 each taxpayer purchased a bank cheque for $25,000 made payable to the Ezroh (Relief) Fund ("the Fund"). [For this purpose each taxpayer had withdrawn from his or her trading account the sum of $25,000. Prior to the withdrawal of the money the male taxpayer had in his account an amount of $16,636.70 and an overdraft facility to which he resorted for the balance of the $25,000. The female taxpayer had in her account an amount of $25,555.47 on which she drew.]

(b) The taxpayers on that day each entered into a written loan agreement with Baldon Investments Pty Ltd ("Baldon") to borrow $21,250, at an interest rate of 14 percent per annum.

(c) Pursuant to these loan agreements Baldon immediately delivered a bank cheque for $21,250 to each taxpayer.

(d) The taxpayers then delivered their bank cheques for $25,000 each to the Fund (cf Federal Court judgment).

(e) The "loan" bank cheques were deposited the same day to the credit of the taxpayers' individual accounts with their own trading bank.

(f) The taxpayers' bank cheques were deposited to the credit of the Fund.

(g) On 21 February 1978 $24,750 of each amount deposited was transferred from the Fund account to the account of Qualdike Nominees Pty Ltd ("Qualdike").

(h) On the same day $21,250 of each amount deposited in Qualdike's account was transferred to Baldon's account. The bank accounts of the Fund, Qualdike and Baldon were at the same branch of the relevant bank.

6. The terms of the loan agreement entered into by each taxpayer with Baldon permitted the taxpayer to collapse the loan for a nominal sum during the first five years (e.g. for $52 in the first year) provided the borrower had made a so-called "gift" to the Fund. Alternatively, the agreement allowed the loan to be repaid, together with 5% per annum simple interest at the expiration of 40 years, with no interest payment in the meantime. The loan in each case remained outstanding at the

time of the hearing of the appeals before the Federal Court.

7. In construing sub-section 226(2), the Federal Court held that the sub-section is concerned with three situations :

(a) the omission from a return of assessable income;

(b) the inclusion as a deduction of an amount in excess of expenditure actually incurred;

(c) the inclusion of false information in relation to a claim for a rebate.

Their Honours discerned a common characteristic in these situations, viz. that facts are withheld from or falsely stated to the Commissioner and went on to say that it is the failure to make a full and true disclosure of relevant information that attracts a liability to additional tax, not a failure to properly characterise an amount which has been disclosed.

8. The Federal Court proceeded to decide whether each payment of $25,000 to the Fund could be truly described as "expenditure actually incurred" by each taxpayer and concluded that it could be so described. The reason given for this view was that each amount was paid from the trading account of the taxpayer and from money in that account or, in one case, from resort to overdraft facilities.

9. The Federal Court accepted that the taxpayers did not use the loan money from Baldon in order to make payments to the Fund; the money paid by Baldon was paid into their accounts subsequent to the payment of money to the Fund and constituted a loan repayable in accordance with the terms of the agreement, with the borrowed sum still outstanding.

10. Their Honours also rejected the Commissioner's contention that the agreement each taxpayer made with Baldon operated to destroy the effect of what otherwise might have been expenditure actually incurred by each taxpayer. While the Federal Court acknowledged that this agreement was part of an overall contrived scheme that failed to achieve its purpose of making a tax free gift to the fund, their Honours said that it did not follow that amounts paid by the taxpayers were not expenditure actually incurred by them. Their Honours were clearly influenced by the evidence that, save for the loan agreement with Baldon, each taxpayer was not a party to and at all material times was unaware of the transactions constituting the scheme.

RULING

11. While it had been suggested in some quarters that the judgment of the Federal Court has a far reaching application, application of the decision should be restricted to cases where the essential facts are identical or very similar to those on which the decision in Rabinov's case was based; that is, where the expenditure has been accurately and not falsely described in

the return and has actually been incurred by the taxpayer, for example, by payment from money in a trading account or from resort to overdraft facilities. Of course, paragraph 226(2)(c) will apply in appropriate cases on and after 13 September 1982.

12. In tax avoidance scheme cases, there will be a need to examine closely the critical question of whether any expenditure has, in fact, been actually incurred. Because of the unusual financing arrangements used by the Rabinovs, the Federal Court decision that the expenditure was incurred may not necessarily apply to significant numbers of participants in other tax avoidance schemes.

13. The extent to which participants in avoidance schemes are covered by the Federal Court decision cannot be determined without careful consideration of the banking arrangements used in each case or, at least, in each scheme. It is considered that the decision would apply to the following:-

(a) to those participants in the Ezroh (Relief) Fund gift scheme who made similar financing arrangements to those made by the Rabinovs;

(b) to participants in other schemes with financing arrangements on all fours with those in the Rabinov case;

(c) in all cases where the expenditure claimed has been incurred and accurately described although it is not allowable.

14. Plainly, the decision of the Federal Court will not apply to alleged expenditure purportedly incurred as part of avoidance schemes which are held to be shams or fiscal nullities. Nor will it apply where the claimed expenditure was never intended to be borne and was not in fact borne by the taxpayer.

15. Any arrangement by which a taxpayer either has a power to recoup the expenditure or otherwise effectively obtains its recoupment will require careful analysis. It must be remembered that the Rabinovs, apart from entering into the loan agreement with Baldon, were not aware of any of the other transactions constituting the scheme and, even then, according to the Federal Court, the loan agreement with Baldon was entered into after each taxpayer had made payment of $25,000. Moreover, the money paid into the taxpayer's accounts by Baldon were regarded as constituting a loan repayable as agreed and outstanding at all material times. Cases may exist in which the recoupment has already occurred or the power of recoupment has already been exercised and other cases may arise where the taxpayer is well aware of the recoupment arrangements or the existence of a power of recoupment.

16. In implementing these guidelines, cases considered by Deputy Commissioners to be borderline are to be referred to Head Office for decision. In addition, where Deputy Commissioners

have any doubt as to the application of the Rabinov decision, Head Office approval is to be obtained before any decision is made.

COMMISSIONER OF TAXATION
20 February 1984