

***Commissioner of Taxation v Wood -***

# Decision impact statement

## Commissioner of Taxation v Wood

<b>Court citation/s:</b>	[2023] FCA 574 [2022] AATA 4147
<b>Venue/s:</b>	Federal Court of Australia Administrative Appeals Tribunal
<b>Venue reference no/s:</b>	NSD 1162 of 2022 2020/0079
<b>Judge/AAT member name:</b>	Stewart J (Federal Court) Member Rob Reitano (Administrative Appeals Tribunal)
<b>Judgment date/s:</b>	2 June 2023 (Federal Court) 28 November 2022 (Administrative Appeals Tribunal)
<b>Appeals on foot:</b>	No
<b>Decision outcome:</b>	Unfavourable to the Commissioner

## Impacted advice



This decision has no impact on any related advice or guidance.

## Summary

This Decision impact statement outlines the ATO's response to this case, which concerns whether a payment made by the taxpayer to settle litigation after his relevant employment ended was deductible under section 8-1 of the *Income Tax Assessment Act 1997* because it was incurred in gaining or producing assessable income and not capital or of a capital nature.

All judgment paragraph references in this Decision impact statement are to the judgment of *Commissioner of Taxation v Wood* [2023] FCA 574.

All legislative references in this Decision impact statement are to the *Income Tax Assessment Act 1997*.

## Brief summary of facts

From 1998 to 2011, the taxpayer was employed by Carina Finance & Investments Pty Ltd (Carina). Carina was owned by the taxpayer and his wife. Carina provided consultancy services to Alleasing Pty Ltd (Alleasing) which paid fees to Carina which in turn paid a salary to the taxpayer.<sup>1</sup>

The consultancy arrangement between the taxpayer, Carina and Alleasing was governed by a consultancy agreement. The consultancy agreement provided that the consultancy services to be provided by Carina would be performed 'through' the taxpayer.<sup>2</sup>

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<sup>1</sup> At [2].

<sup>2</sup> At [3].

When the consultancy arrangement came to an end, Carina, the taxpayer, Alleasing and Alleasing's holding company, Headleasing Holdco Pty Ltd (Headleasing), entered a Separation Deed.

The taxpayer then took up new employment with an unrelated company.<sup>3</sup>

After the separation, Alleasing and Headleasing alleged that the taxpayer had negotiated unauthorised transactions when performing consultancy services for Alleasing in 2006 or 2007. Alleasing and Headleasing commenced proceedings against the taxpayer and Carina, seeking damages of some \$2.4 million (the Proceedings). The claims included that the taxpayer had engaged in misleading or deceptive conduct that breached the consultancy agreement.<sup>4</sup> The taxpayer and Carina defended the Proceedings and filed a cross claim against Alleasing and Headleasing for performance of the Separation Deed as well as a claim for statutory leave entitlements based on the contention that the taxpayer was Alleasing's employee.

Separately from the Proceedings, the taxpayer threatened a defamation claim against Alleasing on the basis that one of its officers had made defamatory statements about him to his new employer concerning the allegations about the unauthorised transactions.<sup>5</sup>

In April 2013, Carina went into liquidation and the Proceedings against it were stayed.<sup>6</sup>

On 6 December 2013, the remaining parties settled the Proceedings in a Settlement Deed on the basis that the taxpayer pay Alleasing \$200,000 (Settlement Sum). The settlement was expressed to be 'without admission of liability'.<sup>7</sup>

On the same day, the taxpayer and Alleasing entered into a Deed of Release concerning the threatened defamation proceeding. The terms included that Alleasing not publish or republish allegations concerning the taxpayer's conduct and character, and that Alleasing pay the taxpayer \$180,000 with mutual releases.<sup>8</sup>

On 29 January 2014, the taxpayer and Alleasing concluded an acknowledgment of settlement which provided for the set-off of the amounts payable under the Settlement Deed and the Deed of Release, resulting in an obligation on the taxpayer to pay Alleasing \$20,000.<sup>9</sup>

The taxpayer claimed a deduction in the 2013–14 tax year for the Settlement Sum. The Commissioner disallowed the deduction and issued a notice of assessment. The taxpayer objected to the Commissioner's notice of assessment. The Commissioner disallowed the taxpayer's objection, as a consequence of which the taxpayer brought a review in the Administrative Appeals Tribunal (AAT).

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<sup>3</sup> At [5].

<sup>4</sup> At [6].

<sup>5</sup> At [8].

<sup>6</sup> At [9].

<sup>7</sup> At [10].

<sup>8</sup> At [11].

<sup>9</sup> At [12].

## Issues decided by the Court

### Administrative Appeals Tribunal decision

The Federal Court referred to the decision of the AAT which held that section 8-1 operated to allow the taxpayer a deduction in respect of the Settlement Sum. The reasoning of the AAT as summarised by the Federal Court was along the following<sup>10</sup>:

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(2) From a “practical business point of view” the Settlement Sum bore the essential character of a payment related directly to the activities that the [taxpayer] performed in the work that he did for Alleasing, which work produced assessable income for him by reason of his position with Carina.

...

21 The Tribunal nevertheless held ... that the Settlement Sum does not have the feature of a capital payment in the sense that it was not made from the standpoint of producing some longer-term benefit that might endure. ...

### Appeal

The Federal Court’s decision, following the Commissioner’s appeal against the AAT’s decision, involved 2 issues.

#### ***Issue 1 – whether the Settlement Sum is deductible under paragraph 8-1(1)(a) as being a loss or outgoing incurred in gaining or producing the taxpayer’s assessable income***

Justice Stewart found that the Settlement Sum was properly characterised as having been incurred in gaining or producing the taxpayer’s assessable income under paragraph 8-1(1)(a).<sup>11</sup>

His Honour observed that the Settlement Sum and releases under the Settlement Deed were to bring to an end the litigation in which some \$2.4 million was claimed – avoiding the risk of a judgment, which would have amounted to a very considerable reduction in income gained in the 2006 and 2007 tax years.<sup>12</sup> It is also not to the point that at the time of the Settlement Sum the taxpayer was no longer employed by Carina or through Carina by Alleasing.<sup>13</sup> The outgoing was calculated to bring to an end a litigation risk which had as its source the taxpayer’s employment with Carina and the Consultancy Agreement with Alleasing – this is a closer and more immediate connection than mere factual causation on a ‘but for’ basis.<sup>14</sup>

#### ***Issue 2 – whether the Settlement Sum cannot be deducted under paragraph 8-1(2)(a) as being a loss or outgoing of capital, or of a capital nature***

Justice Stewart rejected the Commissioner’s characterisation of the Settlement Sum as a loss or outgoing of capital or of a capital nature contending that it was a payment to protect the taxpayer’s reputation in the finance industry.

His Honour observed that it was the Deed of Release ‘that was primarily aimed at protecting the [taxpayer’s] reputation in the future, and to compensate him for any defamation in the past’ rather than the Settlement Sum and releases under the

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<sup>10</sup> At [18] and [21].

<sup>11</sup> At [42].

<sup>12</sup> At [46].

<sup>13</sup> At [47].

<sup>14</sup> At [43].

Settlement Deed.<sup>15</sup> To otherwise characterise the Settlement Sum as capital or of a capital nature would 'elide the different nature and purposes behind the Settlement Deed and the Deed of Release' when '[t]hey were legitimately directed to different ends'.<sup>16</sup>

## ATO view of decision

The Commissioner accepts on the facts found by the AAT that this conclusion was available to the Court.

It is also the Commissioner's view that this decision has limited application beyond its own factual circumstances.

The decision does not represent a departure from established principles concerning section 8-1, and cases concerning the application of these principles always turn on the facts of the particular case.

## Implications for impacted advice or guidance

None.

## Comments

We invite you to advise us if you feel this decision has consequences we have not identified. Please forward your comments to the contact officer.

**Date issued:** 21 February 2024

**Due date:** 22 March 2024

Contact officer details have been removed as the comments period has expired.

### Legislative references

ITAA 1997 8-1

ITAA 1997 8-1(1)(a)

ITAA 1997 8-1(2)(a)

### Case references

Commissioner of Taxation v Wood [2023] FCA 574; 116 ATR 34

XPTC and Commissioner of Taxation [2022] AATA 4147; 2022 ATC 10-658; 115 ATR 419

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### ATO references

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<sup>15</sup> At [46] and [52].

<sup>16</sup> At [53].