

***Denmark Community Windfarm Ltd v Commissioner
of Taxation -***

Decision Impact Statement


Case Name *Denmark Community Windfarm Ltd v. Commissioner of Taxation*

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| Court citation(s): | [2017] FCA 478 |
| Venue: | Federal Court |
| Venue reference no: | WAD 113 of 2016 |
| Judge: | McKerracher J |
| Judgment date: | 10 May 2017 |
| Court citation(s): | [2018] FCAFC 11 |
| Venue: | Full Federal Court |
| Venue reference no: | WAD 239 of 2017 |
| Judge: | Gilmour, Jagot, Moshinsky JJ |
| Judgment date: | 5 February 2018 |
| Appeals on foot: | No |
| Decision outcome: | Favourable to the Commissioner |

Impacted Public Rulings, Determinations and Law Administration Practice Statements

Impacted Rulings/Determinations:

TD 2006/31

 The ATO is reviewing the impact of this decision on related advice and guidance products.

Précis

Outlines the ATO's response to these cases which concern whether a Commonwealth Grant (Grant) received by the taxpayer under the Renewable Remote Power Generation Program (RRPGP) constitutes an assessable recoupment under subsections 20-20(2) and 20-20(3) of the *Income Tax Assessment Act 1997* (ITAA 1997).

Brief Summary of Facts:

At all relevant times, the taxpayer was a small business entity.

In the 2011 year of income, the Western Australian Coordinator of Energy agreed to provide the taxpayer with a Grant under the RRPGP. The Grant was provided to the taxpayer in respect of 50% of the 'Eligible Project Costs', being capital costs, to be incurred by it in the construction of two wind turbines in Denmark, Western Australia.

The Grant was payable in instalments on the completion of identified project milestones.

The taxpayer was duly paid the Grant in the 2013 and 2014 years of income.

The taxpayer sought a private ruling on the issues of whether the Grant was assessable under sections 6-5, 15-10 of the ITAA 1997 or as an assessable recoupment under Subdivision 20-A of the ITAA 1997. The Commissioner ruled that the Grant was not included in assessable income under section 6-5 or 15-10 of the ITAA 1997 but was paid by way of indemnity and therefore an assessable recoupment under Subdivision 20-A of the ITAA 1997. The taxpayer lodged its income tax returns for the 2013 and 2014 years of income by including the Grant it received as an assessable recoupment in accordance with the private ruling.

The taxpayer subsequently objected to its assessments for the 2013 and 2014 years of income in respect of the inclusion of the Grant as an assessable recoupment in accordance with subsections 20-20(2) or 20-20(3) of the ITAA 1997. The Commissioner disallowed the taxpayer's objection.

The taxpayer appealed the Commissioner's decision to the Federal Court. The Federal Court found in favour of the Commissioner. The taxpayer subsequently appealed this decision to the Full Federal Court.

Issues Decided by the Court

Subsection 20-20(2) of the ITAA 1997

The first issue before the Federal Court was whether the three requirements under subsection 20-20(2) of the ITAA 1997 were established to characterise the Grant as an assessable recoupment, namely, that:

1. the taxpayer received the Grant as recoupment of a loss or outgoing;
2. the taxpayer received the Grant by way of insurance or indemnity; and
3. the taxpayer can deduct an amount for the loss or outgoing for the current year, or has deducted or can deduct an amount for it for an earlier income year under any provision of the ITAA 1997.

As to the first requirement, the Federal Court held that the Grant, being a portion of the 'Eligible Project Costs', had been received as a recoupment of an outgoing, even though it was treated as being on capital account. [47]

As to the second requirement, the Federal Court noted that the word 'indemnity' is not defined in the ITAA 1997 and properly bears its ordinary meaning. [48] By reference to dictionary definitions and the case of *Batchelor v. Federal Commissioner of Taxation* (2014) 219 FCR 453, it noted that the ordinary meaning of the word 'indemnity' includes 'a sum of money paid to compensate a person for liability, loss or expense incurred by the person' or 'compensation for damage or loss sustained' and 'something paid by way of such compensation'. [50] As such, it held that the Grant was received by the taxpayer as compensation for an 'expense' incurred by it and so fell within the meaning of the word 'indemnity'. [53]

The fact that the taxpayer was required to satisfy certain specified requirements before the instalments of the Grant would be paid did not preclude it from being characterised as an indemnity. [52] Nor did the fact that the Grant was not paid to the taxpayer pursuant to a contract of indemnity. [54]

As to the third requirement, the Federal Court found that the 'Eligible Project Costs' constituted expenditure on capital account and that such expenditure can properly be claimed as a deduction under Division 40 (described as 'Capital allowances') or under Subdivision 328-D (described as 'Capital allowances for small business

entities') of the ITAA 1997. [55] The Court also cited sections 20-40 and 20-45 of the ITAA 1997 which both contain an example of a taxpayer who has an assessable recoupment and who has claimed corresponding deductions for depreciation. These sections therefore envisage deductions for decline in value and the taxpayer's contention that deductions claimed for decline in value were not captured by section 20-20 because the amount claimed can never be 'the loss or outgoing' but rather an amount attributed to the decline in value in that year, was not accepted. [55]

Although the Federal Court accepted that there is a difference in the wording of a deduction 'for the outgoing' as distinct from 'in respect of the outgoing', as contended by the taxpayer, such a contention created an unduly technical and narrow distinction in the present case. [63] Were the taxpayer's contention correct, there would be no circumstance for the inclusion of Division 40 in section 20-30 of the ITAA 1997. [63]

As all three requirements were established, the Federal Court held that the Grant the taxpayer received was an assessable recoupment under subsection 20-20(2) of the ITAA 1997.

Subsection 20-20(3) of the ITAA 1997

The second issue before the Federal Court was whether the two requirements under subsection 20-20(3) of the ITAA 1997 were also established to characterise the Grant as an assessable recoupment, namely, that:

1. the taxpayer received the Grant as recoupment of a loss or outgoing; and
2. the taxpayer can deduct an amount for the loss or outgoing for the current year or has deducted or can deduct an amount for it for an earlier income year under a provision listed in section 20-30 of the ITAA 1997.

As already noted, the Federal Court held that the Grant had been received as recoupment of an outgoing and therefore the first requirement was established.

As to the second requirement, the Federal Court held that as the taxpayer 'can deduct' an amount for the outgoing under Division 40, being a provision explicitly listed in section 20-30, the second requirement was also established. [58] The Federal Court found that it did not matter that the taxpayer had in fact elected to claim the deduction under Subdivision 328-D, rather than under Division 40, as the words of subsection 20-20(3) refers to the capacity for a deduction rather than the actual deduction under a specific provision. [63]

Accordingly, the Federal Court held that the Grant was also an assessable recoupment under subsection 20-20(3) of the ITAA 1997.

Full Federal Court

On 31 May 2017, the taxpayer appealed the Federal Court's decision to the Full Federal Court. On 5 February 2018, the Full Federal Court dismissed the taxpayer's appeal.

The two main issues before the Full Federal Court were whether:

1. the Grant was received 'by way of insurance or indemnity'; and
2. the taxpayer could have deducted an amount 'for the loss or outgoing'.

As to the first issue, the taxpayer argued that the word 'indemnity' is to be construed as part of the composite phrase 'insurance or indemnity'. The Full Federal Court

found, however, that this did not affect the meaning to be given to the word 'indemnity' and agreed with the primary judge that the word is to be given its ordinary meaning. [40]

As to the second issue, the taxpayer argued that the phrase 'for the loss or outgoing' is narrower than the phrase 'in respect of the loss or outgoing'. The Full Federal Court noted that the taxpayer placed too much weight on the distinction between the word 'for' and the phrase 'in respect of'. It held that in the context of subsections 20-20(2) and 20-20(3) of the ITAA 1997, the phrase 'for the loss or outgoing' is sufficiently broad to pick up a depreciation deduction under Division 40 or Subdivision 328-D of the ITAA 1997 where the outgoing was the cost of the depreciating asset. [42] The inclusion of Division 40 in the table in section 20-30 strongly pointed against the taxpayer's construction. [44]

The Full Federal Court held that if the Grant was not an assessable recoupment under subsection 20-20(2) of the ITAA 1997, it would be an assessable recoupment under subsection 20-20(3). [50]

ATO View of Decision

The decisions of the Federal Court and Full Federal Court are consistent with the ATO View in relation to the application of subsections 20-20(2) and 20-20(3) of the ITAA 1997.

This decision impact statement does not consider the issue of whether the Grant should have been assessable under section 6-5 or section 15-10 of the ITAA 1997 as it was not considered by the Courts.

Implications for impacted advice or guidance

The ATO plans to update TD 2006/31 as the alternative view expressed in Appendix 2 of TD 2006/31 was also rejected by the Federal Court and the Full Federal Court.

Comments

We invite you to advise us if you feel this decision has consequences we have not identified, or if a precedential decision such as a Public Ruling or an ATO ID requires reconsideration or amendment. Please forward your comments to the contact officer.

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| Date Issued: | 25 May 2018 |
| Due Date: | 22 June 2018 |
| Contact officer: | Contact officer details have been removed as the comments period has expired. |

Legislative References:

Income Tax Assessment Act 1997
section 6-5
section 8-1
section 15-10
section 20-20
section 20-25
section 20-30
section 20-40
section 20-45
section 40-15
section 40-180
section 40-185
section 328-110
section 328-175
Taxation Administration Act 1953
section 14ZZ
section 14ZZO

Case References:

Falk v. Federal Commissioner of Taxation [2015] AATA 392; 2015 ATC 10-395;
(2015) 101 ATR 445
Batchelor v. Federal Commissioner of Taxation (2014) 219 FCR 453; 2014 ATC 20-
450; (2014) 98 ATR 153
Federal Commissioner of Taxation v. Rowe (1997) 187 CLR 266; (1997) 35 ATR
432; 97 ATC 4317
Federal Commissioner of Taxation v. Wade (1951) 84 CLR 105; (1951) 9 ATD 337

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