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The Limited Impact Of Whitfords Beach In Urban Land Development.

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Abstract
When Whitfords Beach was handed down a quarter of a century ago, it was hailed as a landmark decision which had all but overruled Scottish Australian Mining Co Ltd v FCT (1950)81 CLR 188. It also seemed to indicate that the second limb of s 26 (a) of ITAA 1936 had been unnecessary. The subsequent decision in FCT v Myer Emporium Ltd (1987) 163 CLR 199 indicated that the first limb of that subsection had also een unnecessary. Yet subsequent decisions have avoided the application of Whitfords Beach and shown that Scottish Australian Mining is the more dominant precedent. Despite the prevalence of some dicta about carrying on land development business, Whitfords Beach was a profit-making scheme case and the central issue was whether a profit making scheme could be constituted by selling alone. Whitfords Beach indicated that it could, though no subsequent case has been decided on this ground. The limited legacy of Whitfords Beach remains significant because, although corporate tax rates are now 30% for revenue and capital gains alike, there is much farmland that is being subdivided by individuals who are escaping tax because of the limited impact of Whitfords Beach.

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THE LIMITED IMPACT OF WHITFORDS BEACH IN URBAN LAND DEVELOPMENT

GEOFFREY HART*

When *Whitfords Beach* was handed down a quarter of a century ago, it was hailed as a landmark decision which had all but overruled *Scottish Australian Mining Co Ltd v FCT* (1950) 81 CLR 188. It also seemed to indicate that the second limb of s 26 (a) of ITAA 1936 had been unnecessary. The subsequent decision in *FCT v Myer Emporium Ltd* (1987) 163 CLR 199 indicated that the first limb of that subsection had also been unnecessary. Yet subsequent decisions have avoided the application of *Whitfords Beach* and shown that *Scottish Australian Mining is* the more dominant precedent. Despite the prevalence of some dicta about carrying on land development business, *Whitfords Beach* was a profit-making scheme case and the central issue was whether a profit-making scheme could be constituted by selling alone. *Whitfords Beach* indicated that it could, though no subsequent case has been decided on this ground. The limited legacy of *Whitfords Beach* remains significant because, although corporate tax rates are now 30% for revenue and capital gains alike, there is much farmland that is being subdivided by individuals who are escaping tax because of the limited impact of *Whitfords Beach*.

When *FCT v Whitfords Beach Pty Ltd*[1] was handed down a quarter of a century ago, it was hailed as a watershed decision.[2] It showed that most, if not all profit making schemes, could come within the scope of income on ordinary principles. There was no need to have recourse to either limb of s 26 (a), and indeed that section had probably never been necessary in Australia. It even contained statements to the effect that modern urban real estate development involves sufficient activity to constitute a business regardless of the intention of the taxpayer. This means that a taxpayer could embark on a profit making scheme after property was acquired for a different purpose. A profit making scheme could be carried out by selling alone. This was a proposition denied[3] in older cases. Parts of the judgment also implied that *Scottish Australian Mining Co Ltd v FCT*[4] was no longer[5] a persuasive authority in the field of land development. As far as the need for either limb of s 26 (a) was concerned the implications of *Whitfords Beach* have been fulfilled.[6] Yet in its other implications that land development and subdivision could constitute by sheer degree[7] *of activity a business or a profit-*

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1 (1982) 150 CLR 355.

2 Lehmann and Coleman, *Taxation Law in Australia* (Butterworths 2nd edn) para 2.31.

3 *C H Rand v Alberni Land Co Ltd* (1920) 7 TC 629 and *Alabama Coal, Iron and Colonisation Co Ltd v MyLam* (1936) 11 TC 232: 'there must be something in the nature of buying at any rate, and not merely selling, which is mere turning your property into money'. This case was applied in *Scottish Australian Mining Co Ltd v FCT* (1950) 81 CLR 188.

4 (1950) 81 CLR 188.

5 Mason J (1982) 150 CLR at 385 thought that the taxpayer had commenced the business of land development, and Wilson J at 398 regarded *Scottish Australian* as no more than an illustration of the operation of basic principles.

6 Though the first limb was not rendered otiose until *FCT v Myer Emporium Ltd* (1987) 163 CLR 199.

7 Mere extensiveness of organisation set up to realise the asset does not cause the realisation to be a business: *Commissioner of Taxes v British Australian Wool Realisation Association Ltd* [1931] AC at 252. However, this does not mean that magnitude is wholly irrelevant: Wilson J. in *Whitfords Beach* (1982) 150 CLR at 399.

making scheme, Whitfords Beach has had practically no impact on Australian income tax law. *Stevenson v FCT*[8] is the only reported case where a taxpayer had acquired a farm and used it for the purposes of farming and subsequently subdivided and sold the land was held to be carrying on a land development business.[9] In every other subsequent case where the taxpayer has been assessable on the profit, the land has been acquired with a profit making purpose.[10] What appeared to make *Whitfords Beach* unusual was that a taxpayer who had originally acquired property for a domestic purpose, could subsequently embark that property in a profit-making scheme. This may be so because new shareholders or owners have taken over the company,[11] or the sheer scale of activity of land development and the taxpayer's involvement in that activity constitutes a business or profit-making scheme.[12]

BACKGROUND TO WHITFORDS BEACH

In *Jones v Leeming*[13] the House of Lords held that if a taxpayer acquired property outside the scope of its business with the intention of resale at a profit, that profit was not inevitably income on ordinary principles. There was an additional requirement that the transaction be commercial, and the Commissioners had made a finding that there had been no adventure in the nature of trade. Australian courts[14] have said that buying an asset with the intention of resale at a profit is inevitably commercial. Following the decision in *Jones v Leeming*, s 26 (a) was enacted in 1930 and retrospective to all assessments back to 1922-3.[15] It was subsequently re-enacted as s 25A of ITAA 1936,[16] and currently s 15-15 which does not apply to ordinary income[17] or sale of property acquired on or after 20 September 1985. Section 26 provided that 'the assessable income of the taxpayer shall include (a) profits arising from the sale by the

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8 (1991) 22 ATR 56.

9 Usually where the court finds a business of land development, in the absence of that finding it would have found a profit-making scheme, see for example *Crow v FCT* (1988) 19 ATR 1565, 1574.

10 For example, *Crow* (above), *Antlers Pty Ltd v FCT* (1997) 35 ATR 64, *McCurry v FCT* (1998) 39 ATR 121; and see *Allied Pastoral Holdings Pty Ltd v FCT* (1983) 13 ATR 825 where a property developer was able to rebut the inference that land sold for a profit had been acquired as part of a profit-making scheme. In *Whitfords Beach* the land was not acquired for a profit making purpose, the shares were acquired with a view to making profit but they were not sold, and hence the first limb of section 26 (a) could not apply: Gibbs C J (1982) 150 CLR at 367 applying *Steinberg v FCT* (1975) 134 CLR 640.

11 Gibbs CJ 150 CLR at 369, and this appears to be the explanation of *Fox (Official Receiver) v FCT* (1956) 96 CLR 370 where the taxpayer was assessable under the second limb of s 26 (a): Mason J *Whitfords Beach* 150 CLR at 385.

12 Mason J at 385-6 and Wilson J at 401 in *Whitfords Beach* found that a business was being carried on and that the gross proceeds were assessable, but they also held that in the absence of this finding there would have been a profit-making scheme.

13 [1930] AC 415.

14 See Barwick CJ in *FCT v Steinberg* (1975) 134 CLR 640, 687 and Mason J in *Whitfords Beach Pty Ltd v FCT* 150 CLR at 380, where his Honour cites conflicting authority as to whether the second limb captures capital amounts. There can hardly be any point in the second limb if it had not extended the capital amounts, but a majority of the Privy Council in *McClelland v FCT* (1970) 120 CLR 487, 495 said that the second limb did not apply to capital amounts. The first limb of s 26 (a) was specifically designed to overcome the effect of *Jones v Leeming* (above). *Jones v Leeming* was in effect overruled in England by *Edwards v Bairstow* [1956] AC 14.

15 See the explanation of Mason J in *FCT v Whitfords Beach Pty Ltd* (1982) 150 CLR at 373.

16 This section still applies to assets acquired with a profit-making intention before 20 September 1985: note to s 15-15.

17 Which is a statutory acknowledgement that profit making schemes within the statutory definition of s 15-15 include capital profits.

taxpayer of any property acquired by him for the purpose of profit making by sale,[18] or from the carrying on or carrying out of any profit making undertaking or scheme'.[19]

Whitfords Beach

In *Whitfords Beach* a company was formed by several individuals for the purpose of acquiring 1584 acres of land and fishing shacks in 1954, for a cost of £ 23,760. On 20 December 1967 the company was taken over by three shareholders who had a history of land development. The new shareholders caused the company to change its articles to enable land development and then to apply for rezoning and then to subdivide and sell the land. The price of the shares was $1.6 million and the estimated profit which would flow from the next few years was about $7 million. Following the holding in the High Court that the taxpayer was assessable on a profit making scheme,[20] the matter was remitted to the Full Federal Court[21] to calculate the profit. The Commissioner and the taxpayer agreed that the land was not trading stock because the High Court had found the taxpayer was carrying out a profit-making scheme, rather than carrying on a business.[22] In the absence of a takeover and development of the land, Whitfords Beach Pty Ltd would not have been liable if they had sold their land since it had been acquired for a domestic purpose, nor would the shareholders have been assessable on the sale of their shares since these had not been acquired for the purpose of resale at a profit.

The High Court assessed the net profit as ordinary income under s 25[23] of ITAA 1936. Gibbs CJ thought that the takeover of the company by property developers was critical, and he

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18 This part of s 26 (a) is known as the first limb and cannot apply to property acquired on or after 20 September 1985.

19 This part of s 26 (a) has been retained for property acquired before or after 20 September 1985, provided that the profit making scheme does not involve sale of property. The words of the second limb were taken from *Ruhamah Property Co Ltd v FCT* (1928) 41 CLR 148, 151: 'The principle of law is that profits derived directly or indirectly from sources within Australia in carrying on or carrying out any scheme of profit-making are assessable to income tax …' These words were taken from the judgment in *California Copper Syndicate v Harris* (1904) TC 159, where they were qualified by the requirement that there must also be 'an operation of business in carrying out the scheme of profit-making'. The whole point of the second limb appears to have been to remove this requirement that there be the carrying on of a business, though this requirement of a business operation was read back into the section by the majority of the Privy Council in *McClelland* 150 CLR at 495, despite observing that the words 'business deal' do not appear in the section. The justification for this interpretation is the use of the word 'profit', and a business deal is something short of carrying on a business.

20 *Whitfords Beach* 150 CLR Gibbs CJ at 371, Murphy J at 386; Mason J at 386 held that the gross proceeds were assessable as the product of a business, and Wilson J at 401 held that the proceeds were assessable without saying whether they were net or gross. When the matter was remitted the Full Federal Court it had to determine the profit which meant that the views of the Chief justice prevailed. On valuation the Full Federal Court adopted the views of Wickham J so the land when the scheme commenced 20 December 1967 was then valued at $3.1 million.

21 *Whitfords Beach Pty Ltd v FCT* (1983) 14 ATR 247. For the purpose of working out the cost of the asset the High Court took the value of the land as at the date of the takeover which the parties agreed was $3.1 million. The parties also agreed that the land was not trading stock: 14 ATR at 249.

22 At first instance, Wickham J found that the taxpayer was carrying on a business: (1978) 8 ATR 593, 599 and that the land was accordingly trading stock. The Full Federal Court and the High Court included in assessable income a net profit which would not be possible in this context if the company were carrying on a business. Section 70-30 of ITAA 1997 now makes it possible to fix a cost price for trading stock where an item which was initially capital has been treated by the taxpayer as stock. There was no equivalent provision in the 1936 Act.

23 Now s 6-5 of ITAA 1997.

gravely[24] doubted whether there could have been a profit-making scheme in the absence of this factor. He thought it inappropriate to take the scale of development into account. Mason J[25] said that the taxpayer conceded that would have been carrying on a business of land development if it had purchased the land from the company and proceeded to develop and sell it. He distinguished *Scottish Australian* on the ground that subdivision and sale of land may have been just an enterprising way of realising an asset in the 1950s but given the degree of activity in the modern subdivision, that activity[26] alone will constitute a business. Wilson J[27] was inclined to question the earlier decisions which treated subdivision as being merely an enterprising way of realising an asset, but distinguished the earlier cases on the ground that the land could not be sold in a subdivided state at the time of takeover and the degree of activities necessary to obtain permission to develop the land and then subdivide were sufficient to constitute the carrying on of a business or a profit-making scheme.

Although *Whitfords Beach* was a profit-making scheme case, and so could have fallen within the second limb of s 26 (a), the judgments of Mason and Wilson JJ proceed on the basis that the taxpayer was carrying on a business in the circumstances. The judgment was remarkable in that it seems to indicate that the second limb of s 26 (a) was not necessary and that the general concept of income could have embraced such a profit making scheme in the second limb of the section. It would be a very rare case[28] for the second limb to apply, but some judges were of the opinion that it could apply to capital gains, otherwise the section was entirely otiose.[29]

Whitfords Beach did not deal with the situation where the taxpayer acquires an asset with the intention of resale at a profit. This is because the asset which was acquired, namely shares, was not the asset which was subsequently sold which was land. *FCT v Myer Emporium Ltd*[30] held that such profits were assessable income on ordinary principles. Although it is proposed primarily to deal with profit-making schemes such as those in *Whitfords Beach* which commenced after acquisition of the property, inevitable reference will be made to schemes which commenced at the time of acquisition of property since the issues are intertwined.

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24 150 CLR 369. He attributed the subjective state of mind of profit-making of the directors to the company and distinguished *Scottish Australian Mining Co Ltd v FCT* (1950) 81 CLR 188 where no profit making scheme or business was found on the ground that there had been no takeover by property developers. He held that the first limb of section 26 (a) could not apply to the new shareholders because the land that was sold by the taxpayer was not the same asset as that acquired by the new shareholders: 150 CLR 355, 367 citing *Steinberg v FCT* (1975) 134 CLR 640, 695.

25 150 CLR at 384.

26 150 CLR at 385 he said, 'I do not agree …that sale of land which has been subdivided is necessarily no more than the realisation of an asset merely because it is an enterprising way of realising the asset to the best advantage. That may be so in the case where an area of land is merely divided into several allotments. But it is not so in a case such as the present where the planned subdivision takes place on a massive scale, involving the laying out and construction of roads, the provision of parklands, services and other improvements. All this amounts to development and improvement of the land to such a marked degree that it is impossible to say that it is mere realisation of an asset. We need to bear in mind that subdivision of broadacres into marketable residential allotments involves much more the way of planning, development and improvement than was formerly the case'.

27 150 CLR at 397.

28 In *Official Receiver (Fox's case) v FCT* (1956) 96 CLR 370, the Court found that the taxpayer was not carrying on a business of land development, but it was carrying out a profit-making scheme within the second limb of s 26 (a). Many judges have questioned the correctness of this decision see Gibbs CJ in *Whitfords Beach* 150 CLR at 369; and Gibbs J in *FCT v Williams* (1972) 127 CLR 226, 249.

29 In *Whitfords Beach* at 401 Wilson J said that the matter had not yet been settled.

30 (1987) 163 CLR 199, as explained in *Westfield v FCT* (1991) 21 ATR 1398. See further *FCT v Cooling* (1990) 21 ATR 13 and *FCT v Montgomery* (1999) 42 ATR 475, *Moana Sands Pty Ltd v FCT* (1988) 19 ATR 1853.

Precedent before *Whitfords Beach* - can there be a profit-making scheme by selling alone?

The distinction was drawn in *California Copper Syndicate v Harris*[31] between a mere enhancement in value by realising a security and a gain made in the operation of a business by carrying out a profit-making scheme. That case was easily resolved where the tribunal made a finding that the mine had been acquired with the intention of resale of a profit. However, the question of whether a scheme of profit making could arise after the asset has been acquired had never been answered in the older cases. Rowlatt J[32] had said that in the absence of a profit-making intention at the time of acquisition, a profit-making scheme could not arise by mere selling alone. Much of the case law on the general income concept was not developed because of the enactment of s 26 (a), but it seems now that *Myer Emporium* has entirely replaced the first limb, and *Whitfords Beach* has entirely replaced the second limb.

In *Scottish Australian Mining Co Ltd v FCT*[33] Williams J held that a mining company,[34] which subsequently subdivided and sold its land, was not carrying on a business of land development. He relied, in particular, on the decision in *Alabama Coal, Land and Colonisation Co Ltd v MyLam,*[35] which held that the business required something of the nature of buying and not merely selling. This approach initially appeared to have been severely undermined by the decision in *Whitfords Beach*[36] but subsequent cases will show that it still remains substantially true.

In *Official Receiver (Fox's case) v FCT*[37] it was held that there was no business being carried on, but nevertheless the taxpayer was assessable under the second limb of s 26 (a) involving the 'carrying on or carrying out of any profit making undertaking or scheme'. A person called Rankin had proceeded to develop property which had been reclaimed tidal land at Southport, Queensland. This involved expenditure in pumping sand in a fluid state into the area so that it would be above sea level and in top dressing, forming roads, constructing water channels, drainage and subdividing land into allotments for sale. Rankin went bankrupt and died and the land was placed on the hands of the Official Receiver, who, having consulted the creditors, continued with the development with the use of the estate's funds and sold subdivided blocks. The Court found that the purpose of the trustee was to realise the estate, and the trustee had not been carrying on a business of trading in land. Nevertheless, the Court found that there was a profit-making scheme commenced by the official trustee under the second limb of s 26 (a). Although counsel for both sides cited *Scottish Australian Mining Co Ltd* v *FCT*[38] and although Williams J sat on the Court, the case was not cited in the joint judgment. The Court said:[39]

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31 (1904) 5 TC 159, 165.

32 *Alabama Coal, Land and Colonisation Co Ltd v Mylam* (1926) 11 TC 232.

33 (1950) 81 CLR 188.

34 Williams J at 192 and 197 placed great emphasis on the main object of the company, which is of far less significance today when the objects are drafted very widely, though Lockhart J in *Antlers Pty Ltd v FCT* (1997) 35 ATR 64, 71 still thought the object clauses should be considered, though they were only one circumstance amongst many. In *Whitfords Beach* 150 CLR at 398 Wilson J regarded the change of articles to enable land development as of great significance. Gibbs CJ and Mason J did not refer to this, relying on the intention of the new shareholders.

35 (1926) 11 TC 232, 254.

36 At least from the perspective of Mason and Wilson JJ in *Whitfords Beach*, though Gibbs CJ would not have been able to distinguish *Scottish Australian* in the absence of the takeover by property developers.

37 (1956) 96 CLR 370.

38 (1950) 81 CLR 188.

39 150 CLR at 387.

> But there can be little doubt that in embarking, in pursuance of the resolution of creditors, upon the course of strengthening the title to the land, persuading the Southport Town Council to continue the agreement and allow him to fulfil it, causing the work to be completed under the contract and causing the subdivisional sales to be made through commission agents, the official receiver was adopting asset plan with a view of securing from the ultimate sale of the land a much greater net return than otherwise could be expected. These activities were planned, organised and coherent. True it is they formed only the final stages of a plan conceived by Rankin and carried partly into execution by him. But given the basal facts that land of a definite value was thus made to yield net proceeds considerably in excess of what could be obtained, it seems too difficult to deny that the official receiver adopted and pursued an undertaking or scheme that from his point of view is satisfied by the description 'profit making' and that he 'carried it out'.

Although this decision was approved of by Mason J in *Whitfords Beach*,[40] Gibbs CJ[41] had reservations about it. He said the decision was somewhat difficult to understand, in that the Court seemed to turn an advantageous realisation into a profit-making scheme and said that there was inconsistent with numerous authorities unless on the facts it could be said that the official receiver went beyond mere realisation. The approach in *Fox's* case was to treat the second limb of s 26 (a) as being wider[42] than the ordinary income concept and in some cases capturing capital gains.

In *White v FCT*[43] a timber merchant had acquired land for the purpose of grazing animals. When this proved to be impracticable, he devoted the land exclusively to the preservation and sale of standing timber by *Stanton* style agreements. The taxpayer was held to be assessable as carrying on a business, and no deduction was allowed for the initial cost of the timber. The taxpayer had abandoned the use of the land for grazing purposes, and it proceeded to sell the regenerating timber in a systematic way. This case does show that a property acquired for one business, can subsequently be embarked on another business, though Taylor and Owen JJ[44] observed that a person who buys property not for the purpose of resale does not become involved in business merely because they resell it in several parcels at several different times. Barwick CJ[45] also expressed reservations about the decision in *Official Receiver (Fox's case) v FCT*[46] which he regarded as a case of moneymaking, ie realising an asset to best advantage rather than profit making.

In *McClelland v FCT*[47] a majority[48] of the Privy Council held that the second limb of s 26(a) did not apply and no business was being carried on where a woman inherited a half interest in

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40 150 CLR at 378.

41 150 CLR at 369: 'However, the reasons for judgment suggest that the facts that the activities were planned, organised and coherent, and that they produced profits considerably larger than could otherwise have been obtained, meant that an advantageous realisation was converted into a profit-making scheme. If that is the ratio of the decision the case cannot stand with numerous other authorities'. He suggested the case might be supported on the basis that the official receiver went beyond merely realising the land. The degree of activity seemed to surpass a normal subdivision since the land had to be reclaimed.

42 There are cases which support this view and there are cases which oppose this view: see Gibbs CJ in *Whitfords Beach* 150 CLR at 362 and 364. It would seem that after *Whitfords Beach* the ordinary income concept applies and is more or less coextensive with the second limb of s 26(a).

43 (1968) 120 CLR 191.

44 150 CLR at 222.

45 150 CLR at 216.

46 (1956) 96 CLR 370; *Fox's* case involved reclamation, and *White* involved the sale of a regenerating asset, so there seems to be some factual similarity.

47 (1970) 120 CLR 487 (High Court); (1970) 120 CLR 487 (Privy Council).

48 Lord Donovan, Viscount Dilhorne and Lord Wilberforce; Lord MacDermott and Lord Pearson dissenting.

3600 acres of land as a tenant in common, purchased the other tenant's interest and then proceeded to subdivide and sell the entire land. The proceeds were not part of a profit making scheme, nor were they income. For the second limb of s 26 (a) to apply the transaction must have the characteristics of a business deal. It is implied in the majority decision that the second limb adds nothing to the general concept of income and this anticipates the judgments of Mason and Wilson JJ in *Whitfords Beach*. Though Mason J[49] had difficulty with this conclusion because he thought the activities did manifest the characteristics of a business deal.

In *FCT v Williams*[50] the taxpayer's husband was a senior partner in a firm of real estate agents. He purchased an interest in some land which was zoned urban, and subsequently gave it to his wife without informing her[51] at the time of the gift. She could not be assessed under the first limb of s 26 (a) since she could have no profit making purpose at the time of acquisition. In upholding the approach that a scheme could not be constituted by selling alone, Barwick CJ[52] said of the second limb:

> I remain of the opinion that the realisation of a gift, however elaborately made, can neither yield a profit[53] nor in itself be a profit making scheme. Her contribution to the cost of subdividing land was part of her expense of realisation and nothing more. In the second place, neither the resolution to realise the land by subdivision on sale, nor the subdivision and sale could, constitute a profit making scheme so far as the respondent was concerned.

Similarly, Gibbs J[54] said;

> An owner of land who holds it until the price of land has risen and then subdivides it and sells it is not thereby engaging be in an adventure in the nature of trade, or carrying out a profit making scheme. The situation is not altered by the fact that the land owner seeks and acts on the advice of an expert as to the best method of subdivision and sale or by the fact that he carries out work such as grading, levelling, road building and the provision of reticulation for water and power to enable a land be sold to its best advantage. The proceeds resulting from mere realisation of a capital asset are not income either in accordance with ordinary concepts or within the second limb of section 26 (a), even though the realisation is carried on in an enterprising way so as to secure the best price: *McClelland v FCT*.[55]

The approach of Barwick CJ and Gibbs J appears to be substantially undermined by observations of Mason and Wilson JJ in *Whitfords Beach*. However, Gibbs J did not resile from the above comments in his judgment.

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[49] 150 CLR at 378 and 380 citing Barwick CJ in *Steinberg v FCT* (1975) 134 CLR 640, 687 where he said that, ' the acquisition of property by a taxpayer with the purpose of resale at a profit…. is in truth a commercial dealing'.

[50] (1972) 3 ATR 283.

[51] Such gifts may be maybe disclaimed once it comes to the recipient's knowledge: *Vegners v FCT* (1991) 21 ATR 1347, 1349 and cases cited therein. See also *FCT v Ramsden* (2005) 58 ATR 485.

[52] 3 ATR at 286, though his Honour considered that the building of houses on inherited land would be venturing that land in a 'business' and that the value of the land at the start of the venture would be deductible in order to work out the profit.

[53] There could be no 'profit' in the case of such an elaborate realisation since the land had no cost. This approach was substantially undermined in *Whitfords Beach*.

[54] 3 ATR at 291.

[55] (1970) 120 CLR 487, 494 and 496 (Privy Council).

Cases subsequent to *Whitfords Beach*

It is against this background that *Whitfords Beach* must be measured. It appeared to endorse the theory that given enough scale of activity a business or profit making scheme might arise on the sale of land which has been acquired for a purpose other than profit making by resale. A scheme could be constituted by selling alone.

Allied Pastoral Holdings Pty Ltd v FCT[56] showed that where a taxpayer acquired land for farming purposes, and then subsequently split it up into blocks of 25 acres and sold it, there would be no profit making scheme. This was acknowledged by Mason J[57] in *Whitfords Beach*. What made the case unusual was that the taxpayers had a history of property development, and then purchased a farm in an area ripe for subdivision. They then proceeded to improve the property for the purposes of farming and only reluctantly sold when an imminent change to zoning would have prevented them from some of the land in other than 100 acre blocks.

Where the taxpayer has acquired land for domestic or farming purposes and subsequently realises it by subdivision, there is a formula to avoid being assessed either as carrying on a business or carrying out a profit making scheme. This is to be found in *Statham v FCT*,[58] where the taxpayers were trustees of the estate of a person who an acquired 240 acres of land for a farm in 1970. From 1976 to 1980 the executor of the deceased in partnership with SV and NV Bickerton Holdings Pty Ltd (Bickerton Holdings) had started to develop the property and sell it. The deceased died in 1980, and permission to subdivide was granted after his death. The subdivision was carried out by the Kingaroy Council, who approved the application and undertook all the necessary subdivision or work. On these facts, the trustees made their gains on capital account. The Full Federal Court[59] considered the following matters significant:

> (a) the owners were at first content to sell the land is one parcel but were unable to do so;
>
> (b) no moneys were borrowed by them, although a guarantee was provided to the Kingaroy Shire Council by way of bank guarantee;
>
> (c) only very limited clearing and earthworks were involved;
>
> (d) the owners relied on the Kingaroy Shire Council to itself carry out roadworks, kerbing, electricity and sewerage works which were required to be done;
>
> (e) the owners did not erect buildings on the land, not even, for example, a site office;
>
> (f) they had no business organisation, no manager, no office, no secretary, and no letterhead;
>
> (g) Dr Bickerton maintained his medical practice;
>
> (h) the owners did not advertise the land for sale;
>
> (i) apart from the Kingaroy Shire Council's activities, the owners did not engage any contractors, although they did obtain some professional advice;
>
> (j) the books kept in relation to the sales of land were kept by Mrs Bickerton; and
>
> (k) the land was sold simply by listing it with local real estate agents. The matters which have been listed above strongly suggest to us that the owners were not conducting a business or engaging in a profit making undertaking or scheme.

This case provides a formula whereby an owner who has acquired land for purposes unrelated to property development can engage others to subdivide and sell the property and

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[56] (1983) 13 ATR 825.

[57] 150 CLR at 385 where he said that splitting land into allotments did not involve sufficient activity to constitute a profit making scheme.

[58] (1988) 20 ATR 228, which was applied in AAT case 13,136 *Re McCorkell and FCT* (1998) 39 ATR 1112.

[59] Woodward, Lockhart and Hartigan JJ at 235-6.

thereby participate in the increased value of development without the gain resulting in assessable income either as the proceeds of a business or a profit making scheme. Even the far reaching comments of Mason J[60] in *Whitfords Beach* would not have made the trustees assessable in this context since they did not carry on the business or carry out the profit making scheme even if others did. The High Court has made it clear that a taxpayer cannot be assessed under a profit-making scheme unless the taxpayer carries out the scheme, or the scheme is carried out on behalf of[61] the taxpayer. Where the other party is carrying on their own business or scheme and the taxpayer merely participates in the enhanced value, the taxpayer will not be assessable. Not all the above cited factors are critical, but it is suggested that factors (b) (d) (e) (f) (h) and (k) are essential parts of the formula. In other words, quite extensive land development and subdivision can take place and the taxpayers will not be assessable on the profits provided they did not participate in these activities. Basically, all the landowners do is to sign the contract of sale and any relationship between the land owner and contractors must not amount to a partnership. This inference can be effectively eliminated by providing there is no agency between the contractors and the landowners.

The *Statham* formula was applied in AAT case 13,136 *Re McCorkell and FCT*,[62] where the taxpayer had inherited land in 1960 which had originally been acquired by the taxpayer's father in 1917 for the purpose of running an orchard outside Shepparton in Victoria. As the town expanded urban neighbours abutted the property, and they complained about being sprayed with pesticide. The taxpayer had no family who could inherit the business, so he decided to dispose of the land in a subdivided state. The gain[63] made by the taxpayer was on capital account. The Tribunal set out the facts[64] as follows:

> (a) Mr McCorkell had initially contemplated selling the land as one parcel but had not been able to attract a satisfactory offer;
>
> (b) a small amount of money was borrowed for a short period but he was not prepared to risk funds for the complete subdivision at the outset. A guarantee was provided by Mr McCorkell's bank to the Shepparton water board in connection with the provision of water and sewerage reticulation in the normal form required by that authority;
>
> (c) the works carried out in developing the subdivisions were no more than what was necessary to secure the approval of the authorities and enhance the presentation of the individual allotments for sale. In the words of Mr Muir 'it was no different to any other residential subdivision, and a fairly straightforward one that'.
>
> (d) Mr McCorkell relied upon the surveyors and engineers represented by Mr Muir to carry out the work required. The firm engaged the contractors and approved their accounts for payment by Mr McCorkell. He had no direct contractual relationship with any contractor.
>
> (e) Mr McCorkell had no site office or building on the land and no direct contact with contractors or potential purchases.

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60 150 CLR at 385.

61 *Clowes v FCT* (1954) 91 CLR 209, 217-8 followed in *Milne v FCT* (1975) 5 ATR 785.

62 (1998) 39 ATR 1112.

63 Barwick CJ pointed out in *McClelland v FCT* (1968) 118 CLR 353, 371 that where land has been inherited there will be no acquisition cost, and of the taxpayer embarks it on a business of land development the gross proceeds will be assessable income. *Whitfords Beach* was remarkable in that the court could find an acquisition cost of $3.1 million for the land, whereas in fact it was the purchase of the shares for $1.6 million that enabled the land to be developed. Section 70-30 of ITAA 1997 now deals with the situation where the taxpayer converts a domestic asset into trading stock. The taxpayer has an election as to whether the valued the stock at cost or market at the time of conversion. Of course, the section will not be relevant where the court finds a profit-making scheme.

64 At 39 ATR in 1118.

(f) Mr McCorkell had no business organisation, office or letterhead.

(g) he continued as an orchardist until 1991 when he retired and leased the balance of the property as an orchard.

(h) he had no involvement in advertising or promoting the sale of the land. The only evidence of any connection with advertising was the building by him of a board on which advertising prepared by the agents was placed and a contribution to the costs of advertising designed and arranged by the agents.

(i) Mr McCorkell obtained professional advice from surveyors, his solicitor a consultant and estate agents but in all cases relied on their advice and appointed them to carry out the required functions.

(j) a separate account was maintained to which proceeds of sale were deposited directly by the estate agents or the solicitor. No evidence of any more formal records or accounts was provided.

(k) the land was sold simply by placing it in the hands of two local real estate agents who recommended and had accepted prices. All negotiations for sale were conducted by the agents. Mr McCorkell had no direct contact with potential buyers other than three relations who were sent by him to the estate agents to discuss possible purchase.

Although these factors have been set out and the taxpayer has slavishly followed the formula in *Statham*, no doubt out of an abundance of caution, it seems the essential points are that the taxpayer did not borrow money, was not involved in the development and subdivision of the land and did not partake in its sale apart from signing the contract for sale. All of these activities were carried out by the property developers on their own behalf. Taxpayers who follow this formula have nothing to fear from the apparent expansion of the law which was apparent in *Whitfords Beach*. Not all taxpayers have applied this formula.

Cases after *Statham*[65]

These cases often involve not only the issue of the degree of activity, but whether the property was acquired in the first place for the purpose of profit-making. Where there is a pattern of buying and selling the inference[66] may be drawn that the taxpayer has acquired the property for the purpose of resale at a profit and thus come within the principle now encapsulated *FCT v Myer Emporium Ltd*[67] as explained in *Westfield Ltd v FCT*.[68]

The taxpayer in *Crow v FCT*[69] had acquired land on eight different occasions starting in 1962 and had used some of the land for farming, grazing and growing crops. He then proceeded to subdivide and sell land from 1968 down to 1981. He was assessed on sales of the four years of income of 1973 to 1976. In purchasing the land the taxpayer incurred substantial debts with no way of repaying them except by subdividing and selling the land.

Lockhart J found that the taxpayer was carrying on a business of land development so that the profits were assessable income on ordinary concepts, and held that, but for this finding, the taxpayer would also be assessable as having acquired the property for the purpose of

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65 *Crow v FCT* (1988) 19 ATR 1565, *Stevenson v FCT* (1991) 22 ATR 56, *Casimaty v FCT* (1996) 37 ATR 358, *Antlers Pty Ltd v FCT* (1997) 35 ATR 64, *McCurry v FCT* (1998) 39 ATR 121.

66 It is the taxpayer's subjective intention that is relevant here and in the context of the s 26 (a) case of *Warriewood Valley Pty Ltd As Trustee of the Jill Trust v FCT* (1993) 26 ATR 270, 279-80 Lockhart J said that the taxpayer bears the onus of proof and the taxpayer's evidence of intention must be considered on its merits in the light of the circumstances of the case without any preconceived finding favourable or unfavourable: applying Barwick CJ in *Gauci v FCT* (1975) 135 CLR 81 and 86.

67 (1987) 163 CLR 199.

68 (1991) 21 ATR 1398.

69 (1988) 19 ATR 1565.

resale of the profit, and for the purpose of carrying out a profit-making scheme. The taxpayer did not need a profit-making intention to be carrying on a business, though such an intention was present. The taxpayer's financial position before the purchase was such that he would have to develop and sell it to meet debts. In this case even if the taxpayer could not have the intention of resale at a profit, he would have been assessable on the degree of activity involved, the repetition over different blocks of land and his personal involvement in the development and resale of the land. *Crow's* case illustrates that where a taxpayer has purchased several different blocks of land and subsequently developed and resold them the carrying on of a business and profit-making schemes will probably be found.

Where a taxpayer has a single block of land acquired for a domestic or farming purpose or by gift which is then subdivided and sold, the taxpayer has the safe precedent of *Statham*. However, in *Stevenson v FCT*[70] the taxpayer was assessable for developing and subdividing a single block of land which had originally been acquired for farming operations. Although the subject land had been in the family since 1904, the taxpayer had bought 476 acres in 1953 and carried on farming operations until 1971. There was no question of the land having been acquired for the purpose of land development or a profit-making scheme. In the early 1960s, he sold 26 acres to the State Rivers and Water Supply Commission, and in the 1970s he sold 360 acres to a plantation company. He commenced development of the remaining land from 1977 onwards and the subdivided blocks were sold from 1980 to 1986. Jenkinson J[71] found that the taxpayer was carrying on a business, and if he had not made that finding the taxpayer would have been carrying on a profit-making scheme according to the formulation of Mason J in *FCT v Whitfords Beach*. To this extent *Stevenson* recognises that there can be a business or profit-making scheme commenced after the acquisition of an asset for an unrelated purpose. There can be a business by selling alone. This proposition was denied in *Alabama Coal, Iron Land and Colonisation Co Ltd v Mylam*[72] which was the principal authority relied upon in *Scottish Australian Mining Co Ltd v FCT*.[73] But *Stevenson* also refers to the degree of activity necessary to find that the business of land development or a profit making scheme has commenced. Jenkinson J[74] referred to the taxpayer's being the sole decision maker in respect of business decisions, the raising of finance for which he was personally liable, the marketing and selling of the land, the method of development including the provision of a sea wall, and even physical labour to the extent that he personally cut and cleared bulrushes growing in the lake adjacent to the land.

Although *Stevenson's* case is instructive and illustrates that *Whitfords Beach* had changed the law as it previously stood, its application is easy to avoid using the formula in *Statham*. Indeed, although *Statham's* case was explained[75] as involving not much complexity, it was also in that case that the taxpayer was totally uninvolved in the development subdivision on sale of the properties. This lack of involvement in decision-making, borrowing and the absence of agency are the crucial factors. *Casimaty v FCT*[76] involved sale of farming land which had been obtained from the taxpayer's father by way of gift in 1955. Because of financial hardship and deteriorating health, the taxpayer had to sell the land and this

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70 (1991) 22 ATR 56.

71 22 ATR at 62, para 59, and as to the application of *Whitfords Beach* 22 ATR at 64.

72 (1926) 11 TC 232, 254: 'there must be something in the nature of buying at any rate, and not merely selling, which is mere turning your property into money'.

73 (1950) 81 CLR 188, 195. It was also, in effect, denied in *FCT v Williams* (1972) 127 CLR 226 by both Barwick CJ and Gibbs J, though Barwick CJ thought that the building of houses on inherited land could constitute a business or profit making scheme.

74 22 ATR at 62, para 31.

75 22 ATR at 63, para 60.

76 (1996) 37 ATR 358.

involved eight separate subdivisions selling nearly two-thirds of the property between 1975 and 1995. The taxpayer was not personally involved in the subdivision, sale and marketing of the land. It was held by Ryan J, applying *Scottish Australian Mining Co Ltd,* that this was no more than realising the land in an enterprising way. Ryan J reviewed the early authorities[77] which had held that mere selling in this context could not amount to the carrying on of a business or a profit-making scheme. He then reviewed the later authorities[78] reaching no conclusion as to the status of Scottish Australian given the difference of opinion is between Gibbs CJ and Mason and Wilson JJ. He held that the case was distinguishable,[79] given the length of time the land was used for mining prior to its subdivision and sale. *Stevenson* was also distinguishable,[80] given the degree of activity and personal involvement of the taxpayer in the subdivision and sale. Where the taxpayer is merely passive he will not be carrying on a business, even though the contractors are carrying on such a business. Nor will the taxpayer[81] be carrying on or carrying out a profit-making scheme.

His Honour also approved of the decision in *Crow v FCT*,[82] though he distinguished[83] it because of the number of different properties subject to acquisition and disposal. There is no doubt that a business of land development was being carried on, but the taxpayer was not involved in that business. A finding[84] was made that the taxpayer had not undertaken any works beyond what was necessary to secure approval for development from the municipal authorities. He constructed no dwellinghouses, internal fencing or other improvements and he had no sales organisation, content to leave that matter to land agents.

In *Antlers Pty Ltd v FCT*[85] the taxpayer was a shelf company incorporated by a person with a history of land development. In 1972 the taxpayer purchased land in an area suited to urban land development on which were located some rudimentary housing, which provided rent that was so low that this cannot have been the reason the purchase the property. The property was sold in 1992 for a substantial profit. The person who incorporated the company appeared in the witness box saying that the intention of the company was not to acquire property for the purpose of resale at a profit. Lockhart J rejected this evidence, finding that a profit-making intention existed at the time of acquisition. He was influenced by the prior history of the major shareholder, the nature of the land, the low return of rental and the fact that the major shareholder had a business card which described her as a property developer! One can expect that few taxpayers will be so obliging in providing evidence as to intention. One thing is apparent from this case is that if a person has a history of land development, and acquires land and does not proceed to use it for a purpose such as farming, when it is subsequently sold for a profit, there is only one inference open as to the taxpayer's purpose of acquisition.

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77 *California Copper Syndicate v Harris* (1905) 5 TC 159, *Hudson's Bay Co v Stevens* (1909) 5 TC 424, *Commissioner of Taxes v Melbourne Trust Ltd* [1914] AC 1001, *CH Rand v Alberni Land Co Ltd* (1920) 7 TC 629, *Alabama Coal, Iron, Land and Colonisation Co Ltd v Mylam* (1936) 11 TC 232 and *Ruhamah Property Co Ltd v FCT* (1928) 41 CLR 148.

78 *McClelland v FCT* (1970) 120 CLR 487, *FCT v Whitfords Beach Pty Ltd* (1982) 150 CLR 355, *Crow v FCT* (1988) 19 ATR 1565, *Scottish Australian Mining*, *Stevenson v FCT* (1991) 22 ATR 56.

79 37 ATR at 371.

80 37 ATR at 373.

81 This point is not referred to in *Stevenson's* case, but the High Court so held in *Clowes v FCT* (1954) 91 CLR 209 and *Milne v FCT* (1976) 133 CLR 526, 5 ATR 785.

82 (1988) 19 ATR 1565.

83 37 ATR at 370-1.

84 150 CLR at 376.

85 (1997) 35 ATR 64.

In *McCurry v FCT*[86] the witnesses were even less sophisticated. The taxpayers acquired property in a country town in early 1986 and subsequently built three townhouses which were offered for sale in May 1987. They lived in two of the townhouses, but made no attempt to lease the third. The taxpayers then purchased a newsagency. In December 1988, all three of the units had been sold for a profit of $75,811 each. This case involved a lot more than subdivision since the taxpayers had actually built units on the land. Barwick CJ in *FCT v Williams*[87] had previously said that this would constitute a business. The taxpayers did not help their case much by saying in an affidavit:[88]

> At the time my brother and I purchased the land it was my intention to have three townhouses constructed subject to council approval and to either sell or rent them out on completion.

Of course, this was enough to constitute a profit-making scheme. Davies J said:[89]

> Schemes may be precise or vague; every detail may be arranged in advance, or the working out of the plan may be left for decision in the light of circumstances as they may arise. It is no objection to a plan that it allows room for manoeuvre. Where property is bought with the purpose of making a profit in the easiest and most advantageous way that may present itself, and the taxpayer adopts 'one of the many alternatives' that his plan leaves open, thereby returning himself a profit, he will rightly be said to be carrying out a profit-making scheme: cf *Premier Automatic Ticket Issuers Ltd v FCT*;[90] *Buckland v FCT*.[91]

This comment was made in the context of s 26 (a), but it is applicable to income on ordinary concepts following the decision in *FCT v Myer Emporium Ltd*[92]. Davies J held[93] that there were two purposes of acquisition, namely, that of resale at a profit and rental. Of these two purposes resale at a profit was the dominant[94] one. The following factors were relevant in drawing this inference: (1) as well as the affidavit the taxpayers had borrowed money to develop the property and had no way of repaying those funds without sale of the property; (2) the units were first on the market shortly prior to their completion, the intention being to realise a profit which had been foreseen; (3) no efforts were made to secure tenants for the third townhouse. In this case the taxpayers do not seem to have been well served by their tax advisers, but they were always going to have trouble in discharging their onus of proof,[95] given that they had acquired land, built on it and sold the units shortly thereafter, and they had had a previous experience of land development.

CONCLUSION

Although *FCT v Whitfords Beach Pty Ltd* was hailed as a watershed decision, it is had very little practical impact on the law of land development in Australia. It had established that a

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86 (1998) 39 ATR 121.
87 (1972) 3 ATR 283, 286.
88 39 ATR at 126.
89 Ibid, 125.
90 (1933) 50 CLR 268, 300.
91 (1960) 48 ALJR 60, 62.
92 (1987) 163 CLR 199.
93 39 ATR at 127.
94 Where a taxpayer acquires an asset with more than one purpose, one of which involves the resale at a profit, the resultant profit will be assessable as part of a profit making scheme, even though such resale at a profit was not the dominant reason for acquiring the asset: *Moana Sand Pty Ltd v FCT* (1988) 19 ATR 1853, where the Full Federal court applied the judgment of Jacobs J in *London Australia Investment Co Ltd* v *FCT* (1977) 138 CLR 106, 127-8.
95 See the comments of Cross J in *Turner v Last* (1965).

profit-making scheme can be undertaken on land that was originally acquired for a different purpose such as farming or a domestic purpose. This proposition had been doubted earlier and was part of the basis of the decision in *Scottish Australian Mining*. When combined with the subsequent decision in *Commissioner of Taxation v Myer Emporium Ltd*[96] it demonstrated that there was no need for a provision such as s 26 (a).

Yet, since the decision in *Whitfords Beach*, only one person[97] who acquired land for a farming purpose and subsequently subdivided and sold it has been held to be carrying on a business or alternatively a profit-making scheme. In every other case of assessability the taxpayer had either acquired additional parcels of land or had acquired the land with a profit-making intention at the time of acquisition. Thus, the only cases where the taxpayer commenced a profit-making scheme after acquisition of the land and therefore had a scheme by selling alone are *Official Receiver (Fox's case) v FCT*,[98] *Whitfords Beach* and *Stevenson*. *Statham* and *McCorkell* have shown the formula whereby *Whitfords Beach* can effectively be circumvented by those farmers wishing to sell land and participate in the added value of subdivision. *Casimaty* illustrates that the taxpayer need not be as methodical as those in *Statham* and *McCorkell*, but that, in general, *Scottish Australian* appears to be more mainstream than *Whitfords Beach*. So, although some slight difference in principle has emerged from *Whitfords Beach*, it will have little practical impact on the future of land development in Australia.

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96 (1987) 163 CLR 199.

97 *Stevenson v FCT* (1991) 22 ATR 56.

98 (1956) 96 CLR 370.