

GENERAL PRINCIPLES OF THE TAXATION OF FRINGE BENEFITS*

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1. Scope of Article

The term "fringe benefits" is usually understood to encompass benefits conferred on employees by employers other than immediate payments of salary or wages.¹ Such benefits take two main forms, namely, present benefits in kind or deferred benefits in cash. Although this article will concentrate on the taxation of fringe benefits understood in this sense, it will explore other possibilities such as the conferring of benefits outside a strict employer-employee relationship, and immediate cash payments which are not characterised as salary or wages.

The Income Tax Assessment Act 1936 (Cth.)² now contains a number of specific and detailed sections dealing with particular fringe benefits such as ss. 26AAAA, 26AAAB, and 26AAC. These, however, will not be taken up in detail as this article is concerned with "general principles". Discussion of such principles in relation to the fringe benefits issue usually concentrates on s. 26(e) to the exclusion of ordinary usage notions of income. However, in what follows both matters will be given consideration with the purpose of showing that, save in one important respect which is advantageous to the Revenue, s. 26(e) is but a reflection of ordinary usage notions³ and is not a limited or defective provision as some have suggested.⁴ If this is correct, it suggests that the failure to tax fringe benefits fully up until the present has resulted as much from the fainthearted practice of the Revenue as from defects in the law.

Another purpose of proceeding in this manner is to demonstrate that at the level of general principles, the taxation of fringe benefits is susceptible of exactly the same analysis as any other item alleged to be assessable income in the hands of a particular person. It is hoped thereby to dispel any notion that there is something "special" about the taxation of fringe benefits in the sense that there are special principles applicable to

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¹ See, for example, *Collins English Dictionary* (Aust. ed. by G. A. Wilkes, 1979) at 582.

² Unless otherwise indicated, sections referred to hereafter are from this Act.

³ So far as relevant, s. 26(e) reads, "[The assessable income of a taxpayer shall include] the value to the taxpayer of all allowances, gratuities, compensations, benefits, bonuses and premiums allowed, given or granted to him in respect of, or for or in relation directly or indirectly to, any employment of or services rendered by him, whether so allowed, given or granted in money, goods, land, meals, sustenance, the use of premises or quarters or otherwise. . . ." See *infra* 5. Valuation.

⁴ Taxation Review Committee, *Full Report* (1975) at 118-119.

fringe benefits. Rather fringe benefits pose complex problems for the application of the general principles of income tax law, problems which are highly relevant in the precise and careful formulation of those general principles themselves.

The taxation advantages currently enjoyed by fringe benefits stem not only from a failure by a fainthearted Revenue to tax them fully (or at all) in the hands of the recipient. Two other factors are at work. One is that the cost of the fringe benefit is usually an allowable deduction to the provider of the benefit — if it is not deductible, the tax advantages by and large⁵ disappear. The second is that the Revenue will often be kept ignorant of the provision and receipt of the benefit as it will not be effectively disclosed by provider or recipient.⁶ Neither of these matters will be elaborated in this article.

2. Why Tax Fringe Benefits?

A number of reasons may be advanced for the taxation of fringe benefits. Firstly, if the underlying or unifying principle of the income tax is thought to be the taxation of *gain* (because an individual's gain over a particular period is the best index of his "ability to pay"), then the receipt of a fringe benefit is as much a gain as cash in the hand and accordingly should be brought to tax. The problem with this argument is that it tends to prove too much, for there are many gains which, generally speaking, presently go untaxed under the income tax, for example, capital gains, lottery winnings, and most gifts and bequests; and, if it is replied that this is merely an argument for the taxation of such gains rather than the non-taxation of fringe benefits, it should be noted that even the most fervent advocates of the gain conception of income concede that it would be impractical to tax many items though they are theoretically gains, for example, home grown vegetables.⁷ A cynic may say that this is all pure theorising and that there is no underlying principle of gain in the present income tax.

A second and more down to earth reason for the taxation of fringe benefits is that it is *unfair* to treat differently for taxation purposes two

⁵ But not invariably; for example, some benefits such as shares in an employer company issued under an employee share scheme have no "cost" to the employer (in this case the effective cost, if any, is borne by existing shareholders whose holdings are diluted) or the employer may be tax exempt. One method of countering fringe benefits tax planning has been to deny or limit employer deductions as in ss. 51AB and 57AF but this is not a device to be encouraged as the employee may be taxable on the benefit and as it has no effect on tax exempt employers.

⁶ If there is any collusion between employer and employee, there is a risk that the doctrine of illegality of contracts may become involved with the result that not only is a term of a contract to provide a fringe benefit unenforceable, but possibly the whole employment contract, *Napier v. National Business Agency Ltd.* [1951] 2 All E.R. 264, G. C. Cheshire and C. H. S. Fifoot, *The Law of Contract* (4th Aust. ed. by J. G. Starke and P. F. P. Higgins, 1981) at 359-360, G. H. Treitel, *The Law of Contract* (5th ed., 1979) at 334-335. This consequence is in addition to risks of penalties and prosecutions under the Act.

⁷ This conception of income is usually associated with H. Simons, *Personal Income Taxation* (1938) and receives its most far reaching semi-official approval in *Report of the Royal Commission on Taxation* (Canada, 1966) and Department of the Treasury, *Blueprints for Basic Tax Reform* (U.S.A., 1977; this work also presents a model for a tax system based on expenditure).

persons whose incomes are really the same,⁸ the difference in treatment arising because one person receives his income all in the form of cash salary or wages, while the other receives his income partly in the form of cash salary or wages and partly in the form of tax free fringe benefits. In reply it may be said that the first employee envisaged in the previous sentence has a choice in the matter — he can leave his present employer and find another employer who will offer employment on the same advantageous terms as received by the second employee; this reply is not really convincing because for a number of reasons most employees do not have the kind of option that the reply presupposes. Similarly, unfairness can arise between wage and salary earners receiving tax free fringe benefits and those who receive their income in a form where this method of alleviation from tax is not available, for example, income in the forms of interest, dividends or rent (though in these cases other forms of tax minimisation are available in the form of income splitting⁹).

Another form of the fairness argument would state that tax free fringe benefits form a greater proportion of the salaries of highly paid employees as opposed to lowly paid employees, thereby conferring a taxation advantage on the former and undermining the progressive nature of the income tax rate scales. One may doubt the correctness of this proposition — it is probably true that the kind of fringe benefits varies as between the highly paid and the lowly paid, but the proportion of income received in the form of tax free fringe benefits may not. It cannot be doubted that the progressive rate scale of the income tax (which in the long term has remained largely unadjusted for inflation) has made the provision of tax free fringe benefits attractive at all levels of income from salary and wages and is largely responsible for the fact that, in some instances, fringe benefits now form a substantial part of employees' remuneration.¹⁰

A third argument in favour of taxing fringe benefits is that employees are encouraged by the taxation system to accept benefits when otherwise they would prefer cash in hand, that is, the tax treatment of fringe benefits distorts preferences and interferes in an undesirable way in the even handed (*neutral*) operation of market forces. It may be doubted in many cases whether much distortion occurs in the sense that the employee accepts a benefit which he would forego if it were to be taxed, for example, use of an employer provided car for private purposes, low or no interest loans and retirement benefits; rather, the taxation system makes desirable benefits

⁸ This type of consideration is usually referred to as horizontal equity. Taxation Review Committee, *op. cit. supra* n. 4 at 12.

⁹ *Id.*, Chs. 10 and 11.

¹⁰ The type of consideration elaborated in this paragraph is usually referred to as vertical equity, *id.* 12; in the 1950's, it seems to have been assumed in England that fringe benefits were largely the preserve of the highly paid, Royal Commission on the Taxation of Profits and Income, *Final Report* ((1955) Cmd. 9474) at 67-72, but recent wage bargaining in Australia has been much concerned with fringe benefits which is not unexpected as the average wage approaches the 46% marginal rate. Reductions in income tax marginal rates as part of a shift in the tax mix in Australia would no doubt reduce fringe benefits tax planning but this prospect raises issues of policy beyond the present discussion, see Taxation Review Committee, *op. cit.*, *supra* n. 4 at 23-38, *House of Representatives Weekly Hansard* (No. 3, 1981) at 758-796.

immensely more attractive. Moreover, market forces are by no means the only consideration, and in some cases it may be seen as socially desirable to influence the employee's choice, for example, as between current consumption of income and saving for retirement by special taxation privileges for long term savings such as superannuation.

There are arguments against taxation of fringe benefits, and in practice, it is these views which have tended to prevail up until the present in Australia. Firstly, there is the enormous administrative complexity involved. This arises for a number of reasons: difficulties of computation especially where the benefits in question are small in value and frequently conferred (for example, in the case of lunches provided free in the employer's canteen, is the Revenue and/or the taxpayer to be required to count the number of times during a year that an employee avails himself of this benefit?); problems of valuation (usually where the benefit is in kind); problems of identifying whether there has in fact been an income receipt as in many cases the benefits are part and parcel of the employment rather than additional remuneration to the employee; and the problem of the employee not receiving cash with which to pay the tax — this applies both to benefits in kind and deferred compensation in cash. Notwithstanding the force of these arguments, it is clear that many fringe benefits are individually substantial in amount and relatively easy of identification and valuation, so that administrative difficulties should not stand in the way of their taxation. The administrative problem suggests the formulation of specific provisions to deal with the peculiar problems of different kinds of substantial benefits rather than non taxation, and the application of a *de minimis* principle to fringe benefits of a more trivial kind.¹¹

Another argument is one partly of policy and partly of politics. It is that many individuals have entered into particular arrangements in the context of an existing taxation framework which they would not have entered into in a different framework and which, once entered upon, cannot be easily reversed. This argument may be summed up as the disappointment of justified expectations or in the homely phrase "an old tax is a good tax"¹² and may be used in response to both the fairness and the market distortion arguments referred to above. It is an argument of policy when the expectations as to the structure of the taxation system entertained by the parties to an arrangement are reasonable, and when the existing arrangement cannot be easily undone — the taxation of superannuation benefits provides an example.¹³ It is an argument of politics when expectations are not reasonable or arrangements entrenched, but it is used to defend the privileges of a particular group. There will often be sharp

¹¹ Taxation Review Committee, *op. cit. supra* n. 4 at 61-62, 117-123, *Report of the Royal Commission on Taxation, op. cit. supra* n. 7, Vol. 3 at 290 ff. analyse the various problems in detail.

¹² Report of a Committee chaired by Professor J. E. Meade. *The Structure and Reform of Direct Taxation* (1978) at 22.

¹³ Taxation Review Committee, *op. cit. supra* n. 4, Ch. 21 *Australian Financial System, Final Report of the Committee of Inquiry* (1981) at 243-252, esp. at 249.

disagreement as to whether disappointment of reasonable expectations or defence of (unwarranted) privileges is involved in a particular case.

On the balance of these arguments, independent bodies appointed by governments around the world to investigate the taxation system have had little hesitation in recommending greater taxation of fringe benefits largely on the basis of arguments of fairness or equity.¹⁴ Apart from arguments of policy, a government is also likely to be attracted by the revenue possibilities of such taxation.

3. Derivation

(a) *Constructive Receipt*

An employee will be on a cash or receipts basis for tax accounting purposes with respect to his salary or wages, and so the arising of a mere right to receive salary or wages will not amount to a derivation of income by the employee. Usually derivation will occur when the wages or salary is paid over to the employee but this is not a necessary condition of derivation — if it were, virtually all of an employee's salary could be turned into tax free fringe benefits by the simple expedient of the employer making payments direct to the employee's creditors and family in discharge of his legal and moral obligations.¹⁵ The doctrine of constructive receipt has been devised to meet this kind of difficulty. When the doctrine applies, the analysis required is that the payment or other benefit is treated as if it were paid over to or received by the employee and then returned to the employer and paid out by him to a third party. The element of derivation is thus supplied by the constructive receipt of the payment or benefit by the employee.

The problem is to determine when the doctrine applies. Mere withholding by the employer of salary or wages legally due to the employee either of the employer's own motion or at the employee's request will not amount to a constructive receipt.¹⁶ Two necessary conditions for a constructive receipt would thus seem to be firstly, that the employer parts with something whether in payment of money, transfer of property, surrender of rights or other ways, and secondly, that the employee is thereby benefited directly or indirectly. Yet these conditions alone would not seem to be enough; for example, a Christmas gift by an employer to an

¹⁴ Royal Commission on the Taxation of Profits and Income, *op. cit. supra* n. 10 at 67-72, 410-413, *Report of the Royal Commission on Taxation*, *op. cit. supra* n. 7 Vol. 3 at 43-46, 283-321, Taxation Review Committee, *op. cit. supra* n. 4 at 61-62, 117-123, Department of the Treasury, *op. cit. supra* n. 7 at 53 ff; each of these propose in detail different methods for overcoming the administrative difficulties.

¹⁵ Because of the well known difficulties of assigning employment income, there has been relatively little activity over a period of years aimed at the diversion of such income away from the employee. However, the increased willingness of employers to cooperate in employees' attempts to reduce tax, and a realisation of the consequences of *The Federal Coke Company Pty. Ltd. v. F.C.T.* 77 A.T.C. 4255 (see *infra* (d)) has led to increased use of the kinds of devices considered in the text.

¹⁶ 9 C.T.B.R. Case 10, Case A19, 69 A.T.C. 116, Case A79, 69 A.T.C. 422, *Brent v. F.C.T.* (1971) 125 C.L.R. 418 at 430-431, Case D7, 72 A.T.C. 38; comments by the Chairman in Case A19, 69 A.T.C. 116 at 117 that a final ear-marking by an employer of an amount for the benefit of an employee will be constructive receipt would seem to be incorrect though they are consistent with English authority, *Garforth v. Newsmith Stainless Ltd.* [1979] 1 W.L.R. 409.

employee's wife who is the employer's sister can hardly amount to a derivation by the employee. Some element of intention that the benefit enure to the employee in that capacity would also seem to be necessary for a constructive receipt in this context. This intention will be clear where a payment made by an employer to a third party for the benefit of an employee is debited against the employee's salary in the sense that moneys paid by way of salary directly to the employee are correspondingly less than he would otherwise be entitled to. Hence payments of tax by employers on account of employees under the P.A.Y.E. system are constructively received by the employees. Debiting against salary, however, will not be the only way of finding such an intention — if it were, a constructive receipt could be avoided by the simple device of ensuring that the payment is expressed to be made out of some source other than salary. Hence when an employer agrees to pay an employee a salary of \$X "free of tax", and then pays \$Y tax on the employee's behalf, the employee will be regarded as constructively receiving \$Y.¹⁷

Depending on the facts of the case, it is submitted that the necessary intention will be likely to exist where the payment by the employer goes in discharge of some legal, moral or customary obligation or expense of the employee. Hence, the following payments made or benefits conferred by an employer have been held to be constructively received as income by an employee: household expenses of the employee such as rates, power bills, telephone bills, gardener's wages etc.;¹⁸ premiums on the employee's life policy;¹⁹ board and lodgings provided to an invalid adult stepson the employee regarded as his responsibility;²⁰ payments to the employee's wife during a leave of absence when the employee worked overseas for another employer, the wife and children remaining in Australia and the employee undertaking to work for the employer for at least three years on his return;²¹ payments to a religious order by a University in respect of part time teaching performed by a nun who was a member of the order and was under a strict moral (if not legal) duty to account for the payments to the order;²² and payments of fees to a private school in respect of a child of the employee, who had previously himself paid such fees.²³ On the other hand, the purchase by an employer of a house for an employee's wife has been held not to be a constructive receipt by the employee;²⁴ usually such a large gift would be motivated by considerations other than as a reward for

¹⁷ *Hartland v. Diggines* [1926] A.C. 289, *I.R.C. v. Miller* [1930] A.C. 222, *Janowski v. Institution of Polish Engineers in Great Britain Ltd.* [1951] 1 K.B. 768, P. G. Whiteman and G. S. Wheatcroft, *Income Tax* (2nd ed. by P. G. Whiteman and D. C. Milne, 1976) at 613, J. Tiley, *Revenue Law* (3rd ed., 1981) at 118-119. The fact that the employer is obliged by law, without any choice on the part of the employer or employee, to make a payment on the employee's behalf does not prevent a constructive receipt; hence P.A.Y.E. deductions are not prevented from being income of the employee (see Case D36, 71 A.T.C. 205, *Blankfield v. F.C.T.* 72 A.T.C. 4177 making the same point, though not in the employment context).

¹⁸ *Osborn v. Swyer* (1933) 18 T.C. 445, *Nicoll v. Austin* (1935) 19 T.C. 531.

¹⁹ *Richardson v. Lyon* (1943) 25 T.C. 497.

²⁰ 3 C.T.B.R. (N.S.) Case 57.

²¹ 14 C.T.B.R. (N.S.) Case 20.

²² Case G38, 75 A.T.C. 239.

²³ Case L54, 79 A.T.C. 399. A similar result is reached on differently worded English legislation in *Wicks v. Firth* [1982] 2 All E.R. 9.

²⁴ 12 C.T.B.R. Case 16.

services, and therefore would not have an income nature nor be derived by the employee, but the result on the facts of this decision may be doubted.

It is submitted that, as some of these examples show, the question of constructive receipt does not depend upon whether some legal liability of the employee is discharged by the employer.²⁵ Otherwise, manipulation of the receipt would be easy and results would often be capricious; for example, a payment to an employee's wife would be analysed as constructively received by the employee or not depending on whether in the circumstances he was under a legal obligation to support her which may raise difficult issues in family law. Even the test of legal, moral or customary obligation or expense is not completely water tight. Suppose a child's school fees were initially paid by an employee's working wife and the employer of the husband then assumes responsibility for the fees — could it be said that the husband had some moral obligation to pay the fees and so constructively received them? The answer to this problem is that the proposed test is only an intermediate one — the ultimate test is one of intention that the benefit enure to the employee. The precise formulation of such an intention test does not appear in the cases, as they proceed intuitively by pointing to various factors rather than any particular test. The writer's preference would be for an objective (rather than subjective), substantive (rather than formal) test of the intention of the payment or benefit. To return to the example earlier in this paragraph, if it could be shown that there was no relationship between the employer and the employee's child providing a reason for payment of the school fees (other than the employment relationship), the necessary intention for a constructive receipt would be proved.

The discussion thus far has been dealing with constructive receipt in the context of a payment made or benefit conferred on a third party. The principle can also operate directly between employer and employee. In *Heaton v. Bell*,²⁶ an employer provided an employee with the use of a car for private purposes subject to the employee accepting an amended wage basis consisting of a weekly wage reduction. As the car could only be used by the employee, there were problems of valuation under English law²⁷ if what was derived was the use of the car. A majority of the House of Lords (Lord Reid dissenting on this issue) held that the correct analysis was that the employee constructively received the amount of the wage reduction which was then applied to pay the employer for the use of the car. Similarly, where an employee owes a debt to an employer and salary or wages are withheld in repayment of the debt, there will be a constructive receipt by the employee — this is not a situation of *mere* withholding but involves the employer parting with something, *viz.*, the right to repayment of the debt.²⁸

²⁵ *Contra*, A. Slater, "Scholarships and Benefits" [1980] *Australian Tax Planning Report* 17 at 18 who considers that school fees paid by an employer pursuant to a contract between the employee's spouse and the school are not constructively received by the employee.

²⁶ [1970] A.C. 728; see also *Parker v. Chapman* (1928) 13 T.C. 677, allotment of shares in employer funded out of arrears of salary.

²⁷ See *infra* 5. Valuation.

²⁸ Case A8, 69 A.T.C. 38 is an example of this kind, though not in the employment context.

It is submitted in such a case that what is derived is the salary withheld, not the discharge of the debt.

This discussion of constructive receipt has glossed over its source. Clearly, there is an ordinary usage notion of the doctrine,²⁹ but it also finds expression in s. 19 of the Act.³⁰ Some comments by Rich, J. in *Permanent Trustee Company of New South Wales Ltd. v. F.C.T.*³¹ suggest that the deeming in s. 19 is ineffective,³² or at least superfluous, and it seems probable that the section cannot shift the timing of the derivation.³³ On the other hand, the section is often regarded as but a reflection of ordinary usage notions of constructive receipt;³⁴ and certainly it is submitted that the section cannot operate negatively to restrict the doctrine.

With regard to s. 26(e), the words of derivation are "allowed, given or granted *to him*" and some emphasis has been placed on the words italicised in Board decisions on constructive receipt suggesting that they imply some special limitation.³⁵ It is submitted that no special limitation is involved, but rather an application of the general principle that an item has to be judged for its income quality in the hands of the person who derived it.³⁶ There is no reason to suppose that the doctrine of constructive receipt is not applicable to s. 26(e) either through the operation of s. 19³⁷ or ordinary usage notions of income.³⁸

(b) *Payments Through Intermediaries*

A simple variant on the devices considered under the last head is for an employer to make a payment to a trustee as capital of the trust which the trustee then or ultimately disburses to or for the benefit of the employee or his family as beneficiaries under the trust, for example, school fees paid directly to a private school by the trustee, for the benefit of an employee's child. The doctrine of constructive receipt (or even simple receipt in the case of a payment by the trustee direct to the employee) is available to bring about a derivation by the employee, but the analysis is more complicated.

On payment into the trust by the employer, there may be difficulties because the moneys paid consist of an undissected or unapportioned sum for the benefit of a number of employees, or because there is some contingency attaching to the beneficiaries' rights in the trust so that the

²⁹ See cases cited nn. 18, 19 *supra*, Whiteman and Wheatcroft, *op. cit. supra* n. 17 at 612-613, Tiley, *op. cit. supra* n. 17 at 118-119.

³⁰ "Income shall be deemed to have been derived by a person although it is not actually paid over to him but is reinvested, accumulated, capitalized, carried to any reserve, sinking fund or insurance fund however designated, or otherwise dealt with on his behalf or as he directs."

³¹ (1940) 2 A.I.T.R. 109 at 110-111.

³² If there can be no income until there has been derivation (see *infra* (d)), then it is contradictory to provide, "Income shall be deemed to have been derived . . ."

³³ *Brent v. F.C.T.*, *supra* n. 16 at 430-431.

³⁴ Case A19, 69 A.T.C. 116 at 119, and Australian cases cited *supra* nn. 17, 20-23.

³⁵ For example, Case L54, 79 A.T.C. 399.

³⁶ See *infra* (d).

³⁷ The cases cited *supra* nn. 16, 20-23 make this assumption; cf. *Constable v. F.C.T.* (1952) 86 C.L.R. 402 at 418, and *infra* n. 42.

³⁸ *Constable v. F.C.T.*, *id.* at 422 may be explained on this basis.

beneficiaries may never receive anything. Neither of these difficulties need prevent a constructive receipt though they may affect the valuation of the benefit (and hence the quantum of income) received. On payment out of the trust, three problems can be identified. Firstly, the payment is not made by the employer but by a third party. However, this of itself has never been regarded as preventing a derivation of income, the important question being whether the derivation in the circumstances has an income quality.³⁹ Secondly, the payment consists of an appropriation of trust *capital* to a beneficiary. Again, this would not seem to go to the question of *derivation*, though it may be relevant to the income quality of the receipt. Thirdly, the employee may not be the recipient or even the beneficiary (in the trust sense) of the payment; but if he is not the recipient, there is no reason why the doctrine of constructive receipt may not apply in appropriate circumstances.

As a matter of general principle, therefore, the use of an intermediary should not preclude a sensible analysis of derivation, notwithstanding the complexities. However, there is a directly applicable decision of the High Court which holds that derivation may be precluded by the use of a trust. In *Constable v. F.C.T.*⁴⁰ the taxpayer was a member of a typical superannuation trust fund. The employee contributed 10% of his salary to the fund which, although he was not immediately entitled to its return, he or his estate would ultimately receive back in any event. The employer also contributed to the fund in an amount equal to the employee's contributions, but the employee would only become entitled to the employer's contributions on the happening of certain events, and he might never become entitled to those contributions in which event they would not be returned to the employer but would go to the general purposes of the fund. One of the events which gave rise to a right of payment out occurred while the taxpayer was still in the employ of his employer and the Commission sought to tax *inter alia* the element in the payment out constituted by the employer's contributions to the fund. The provisions of s. 26(d) were not applicable because the taxpayer had not retired and the Commissioner based his assessment on s. 26(e). Three issues may be regarded as being raised by these facts, one of which is the subject of an express decision, one of which is the subject of weighty *obiter dicta* and one of which is a matter (if considered at all) of assumption.

Taking these issues in reverse order, firstly, it would seem to be assumed in the decision that the *employee's* contributions to the fund were derived at the time of payment of the employee's salary and accordingly would be included in his assessable income, even though he never in fact received his contributions in the hand and then paid them over to the fund. This is a simple example of the application of the doctrine of constructive receipt.

³⁹ The obvious example is the taxidriver's tips. *Calvert v. Wainwright* [1947] K.B. 526. *Whiteman and Wheatcroft, op. cit. supra* n. 17 at 598-599, *F.C.T. v. Dixon* (1952) 86 C.L.R. 540 at 556 — the same is assumed of s. 26(e) in many cases.

⁴⁰ *Supra* n. 37.

Secondly, it is stated in *obiter dicta* by the majority⁴¹ that employer payments to the fund were not "allowed, given or granted" to the employee within s. 26(e) as the employer's contributions were not then credited to a particular employee (this happened at a later stage) and even when credited, the employee was not presently entitled to them. Further, s. 19 could not be "used to eke out s. 26(e) and extend its operation or application." The majority judgment could be interpreted as a conclusion that s. 19 can never be applicable to s. 26(e),⁴² but even if this is so, it has already been submitted that the doctrine of constructive receipt, apart from s. 19, can apply to s. 26(e).⁴³ It is submitted that the majority view is that there has been no constructive receipt because the employee is not presently entitled to the employer's contribution. Webb, J. (dissenting on this issue) stated that s. 26(e) operated with respect to the employer's contributions on payment into the fund, saying:

Upon such payment into the fund they ceased to be the property of the company and the payment then enured for the benefit of the appellant, although contingently on his serving for the necessary period to qualify to receive them.⁴⁴

Although he does not say so, Webb, J. must be proceeding on the basis that there is a derivation by constructive receipt and then an application of the income derived on the employee's behalf by the employer. The difference in point of principle between the majority and Webb, J. would seem to relate to the fact that there was some contingency attaching to the final receipt of the employer's contributions which the majority regarded as significant, but Webb, J. as irrelevant. The difference between the treatment of the *employer's* and the *employee's* contributions at the time of payment to the fund can, on the views of the majority judgment, be explained on the basis that there was no contingency attaching to the ultimate receipt of the employee's contributions, so that the correct treatment of them was a derivation by constructive receipt and application on the employee's behalf by the employer.

The third issue raised and in fact the one point which was the subject of express decision in the case, was whether the employee was assessable in respect of the element of the payment to him out of the fund which historically was constituted by the employer's contributions to the fund. The majority held the employee was not assessable because⁴⁵

All that occurred in the year of income with respect to the sum in question was that the future and contingent or conditional right became a right to present payment and payment was made accordingly. This, in our opinion, cannot bring the amount or any part of it within s. 26(e). The amount received by the taxpayer from the

⁴¹ *Id.* 418.

⁴² Either on the basis that s. 26(e) is a code which excludes constructive receipt, or on the basis that s. 26(e) uses the words "allowed, given or granted" rather than "derived". Both explanations are unsatisfactory and are contradicted by other cases, *supra* n. 37.

⁴³ *Supra* n. 38.

⁴⁴ *Supra* n. 37 at 422.

⁴⁵ *Id.* 418.

fund is a capital sum,⁴⁶ and, unless it or some part of it falls under s. 26(e) (there being no other applicable imposition of liability), it is not part of the assessable income.

This seems to represent a conclusion that the payment did not have an income nature as it was not related to the employment in the necessary way⁴⁷ but other parts of the judgment suggest that the majority were holding that there was no derivation by the employee at this point of time.⁴⁸ The judgment of Webb, J. reaching the same conclusion⁴⁹ on this point is clearer. He says in effect that the payment out of the fund to the employee may have been an occasion of derivation, but in the circumstances the item was not of an income nature at that time because it amounted to a payment of capital out of a trust fund and not a remuneration for services rendered.

The implications of the reasoning of the majority judgment, if taken at face value as an expression of general principle (and not being confined to the specific context of superannuation), are fundamental. By the simple device of payments by an employer to a trust instead of direct to the employee, there will be no derivation of income at any time by the employee provided that some contingency attaches to the employee's rights to receipts from the trust (a simple discretionary trust would suffice). Taken by itself, the case suggests that virtually all salary or wages can be turned into non-taxable capital by a trust device — the fringe benefit (that is, the benefit provided to the employee otherwise than by direct payment of salary) in the form of an interest in the trust could be substituted for virtually all of the taxpayer's salary. Not surprisingly such blatant devices have apparently not been attempted.⁵⁰

The English cases dealing with the passing of benefits (especially of a superannuation kind) through trusts present similarities to and distinctions from *Constable's Case*.⁵¹ It has been held⁵² that the *employee's*

⁴⁶ This comment confuses trust law and tax law concepts of income. There is no reason in principle why a payment out of a trust which amounts to capital in the trust law sense should not be income in the tax law sense, see the English cases cited *infra* n. 54 and the comments of Latham, C.J. in *Gair v. F.C.T.* (1944) 71 C.L.R. 388 at 393 on an analogous situation.

⁴⁷ See *infra* 4. Income.

⁴⁸ *Supra* n. 37 at 418, "[it] cannot correctly be said that [the payment] was such an allowance etc. 'allowed, given or granted to him' during the year of income under assessment".

⁴⁹ *Id.* 422-423.

⁵⁰ A modest scheme along the lines suggested came before a Board of Review, (1967) 13 C.T.B.R. (N.S.) Case 68 where the employer made contributions to a trust fund, the employee not being entitled to any payments from the fund until he had 5 years service (the necessary contingency), but being able to make withdrawals thereafter whenever the amount standing to his name was greater than £100. The Board accepted *Constable's Case* as authority for the proposition that the employee did not derive income when the employer made payments to the fund, but distinguished the case so far as payments out of the fund were concerned, because a central feature of the fund here was the right of members to make withdrawals whilst still employed, the fund itself was contributed to only by the employer, the right to withdraw could be exercised on more than one occasion and amounts withdrawn during the currency of employment did not qualify for description as capital sums. Whilst these distinctions no doubt exist on the facts, they hardly offer any distinction as a matter of principle. A similar result was reached in a pre-*Constable* Board decision (14 C.T.B.R. Case 7) though there it was argued that a loan rather than a payment was involved, and it was conceded that if a payment was involved, it was taxable under s. 26(e).

⁵¹ *Supra* n. 37.

⁵² *Hudson v. Gribble* [1903] 1 K.B. 517, *Smyth v. Stretton* (1904) 5 T.C. 36, *Bruce v. Hatton* (1921) 8 T.C. 180.

contributions were derived by the employee by constructive receipt and then applied by the employer on his behalf in payment to the fund, *whether or not* ultimate repayment to the employee of this amount from the fund was subject to some *contingency*. It has also been acknowledged⁵³ that the employer's contributions are not derived by the employee at the time the employer contributes them to the fund, and as any distinction between employee and employer contributions based on contingencies is rejected, it is necessary for the courts to draw a distinction in other directions. That distinction is said to be decided by whether the contributions in question are "in substance" or "in essence" to be characterised as "salary" (if they are not "salary" there is no constructive receipt on payment in). The test is not to be based on mere book entries in the accounts of the employer or on the formal terms of the contract between employer and employee as to contributions to the fund. With respect, however, it is submitted that little distinction in substance can be drawn, once contingencies as to repayment are eliminated, and, in fact, the results in the English cases follow the characterisation of the payment as salary or not in the contract between employer and employee. The only criterion evident in these and other cases of a substantive nature is whether apart from the employer's contributions, the employee can be said to be receiving remuneration adequate to his position. This covers the obvious avoidance device of the employee receiving small payments in hand as salary and huge payments characterised as "employer's contributions" to the trust fund, but otherwise provides little guidance.

With regard to payments out of a trust fund, English cases⁵⁴ have consistently held that these can give rise to a derivation of taxable receipts in the hands of employees, and have rejected arguments that the benefit was too remotely related to the rendering of services to have an income nature or that the benefit was non taxable because a receipt *inter alia* of the capital of a trust fund was involved. There seems to be no reason why the doctrine of constructive receipt should not then operate if payments are made out of a trust to a third party with the intention that the employee be benefited.⁵⁵

The reconciliation of these varying views is not an easy matter. The simplest solution is to accept the majority views in *Constable's Case*⁵⁶ as establishing the general principles applicable to the trust situation, and to discard the English cases as being decided on differently worded and structured legislation. It is submitted that the implications of this solution

⁵³ *Id.*, and *Edwards v. Roberts* (1935) 19 T.C. 618; similarly there will be no constructive receipt if the employer pays an unapportioned sum to a trust in respect of a number of employee discretionary beneficiaries, *Barclays Bank Ltd. v. Naylor* [1961] Ch. 7 (payment to a trust for estimated school fees of a number of employees' children), or if the employer simply lends money to a trust covering a number of employees at a low rate of interest, *Brumby v. Milner* [1976] 1 W.L.R. 1096.

⁵⁴ *Edwards v. Roberts*, *supra* n. 53, *Patrick v. Burrows* (1954) 35 T.C. 138, *Brumby v. Milner*, *supra* n. 53.

⁵⁵ *Barclays Bank Ltd. v. Naylor*, *supra* n. 53, raised this issue and held that the employer was not taxable but the decision involves (in part at least) the assignment of income under a covenant in a way which is a feature of English law and finds no counterpart in Australian law, see *Tiley, op. cit. supra* n. 17 at 119, *cf. Whiteman and Wheatcroft, op. cit. supra* n. 17 at 613.

⁵⁶ *Supra* n. 37.

are not acceptable⁵⁷ and would not find favour with a present day court. Once the step is taken of rejecting the majority views in *Constable's Case*,⁵⁸ a wide range of possibilities is opened up. The writer's preferred solution which, it is submitted, allows a sensible operation of the tax system, is along the lines of the judgment of Webb, J. in *Constable's Case*.⁵⁹ When a payment is made to a trust in an apportioned amount in respect of a particular employee with the intention that it enure to his benefit, that should amount to a constructive receipt by the employee whether or not its ultimate payment to the employee is subject to a contingency;⁶⁰ a payment out of the trust in such a case would not be taxable again, on the basis of a commonsense principle against double taxation of the same item.⁶¹ If the payment to the trust does not amount to a derivation because it does not satisfy the conditions stated, then there should be held to be a derivation with an income nature on payment out of the trust,⁶² the doctrine of constructive receipt applying if the payment is made to a third party for the employee's benefit.⁶³ These conclusions should follow, it is submitted, whether the issue is viewed as one of ordinary usage notions of income or the interpretation of s. 26(e).⁶⁴ If correct, they will defeat much current fringe benefits tax planning in the form, for example, of education trusts for employee's children. This approach need not involve complete dislocation of the present taxation arrangements for superannuation; it is arguable that ss. 82AAA-82AAT and s. 159R amount to an implied enactment that employer contributions to a fund, though derived, are not taxable to the employee, thus reversing in this specific context the reasoning of Webb, J.; the principle against double taxation will preclude an income nature on payment out of the fund on general principles (thus coinciding with the majority views in *Constable's Case*⁶⁵ in the specific context of superannuation only).

It remains to add that the above discussion has been concerned with the taxation of the *employee* in respect of payments to or from a trust of trust capital. The tax position of others such as the employee's relatives will be adverted to briefly later. So far as the trust generates income which is subject to tax (that is, most trusts apart from superannuation funds), it will be advisable to distribute that income in the year of derivation usually to the employee's spouse or children. It has been established in the areas of income assignment and service trusts that the doctrine of constructive

⁵⁷ *Supra* n. 50.

⁵⁸ *Supra* n. 37.

⁵⁹ *Id.* 422-423.

⁶⁰ This is contrary to both the majority view in *Constable's Case*, *supra* nn. 42-43 and the English cases, *supra* n. 53.

⁶¹ Such a principle seems inherent in many of the cases considered in this part of this article and explains, it is submitted, the ultimate conclusion of Webb, J. in *Constable's Case*, *supra* nn. 44, 49 that the payment out of the fund was not assessable income.

⁶² This is contrary to the majority view in *Constable's Case*, *supra* nn. 45-48, but is consistent with the English cases, *supra* n. 54.

⁶³ This is inconsistent with case law on the point but the case is subject to special considerations, *supra* n. 55.

⁶⁴ See *infra* nn. 106, 188.

⁶⁵ *Supra* nn. 41-43, 45-48. There may of course be a derivation under the specific provisions of s. 26(d), and pension payments are the subject of other considerations altogether.

receipt (and s. 19 in particular) will not operate to tax the employee on beneficial distributions to others of trust income (in both the trust and tax law senses).⁶⁶

Other intermediary situations can be disposed of briefly. One obvious choice is the company. So far as an employer makes payments to a company controlled by an employee, there being no legal relationship between the company and the employer, the analysis is an easy one of constructive receipt of the payment by the employee and application of it in payment to the company, so that the employee will be taxed. What will be sought to be achieved with a company, however, is not this situation but rather that the company is in a contractual relationship with the "employer" to provide services, while the controller of the company is not in a contractual relationship with the "employer" though he is in a contractual (employment) relationship with the company. It may not be easy in many cases to bring about this desired legal result, and if the result is not achieved, the controller of the company will be the "employee" and payments to the company will be treated as constructively received by the employee. Even if the desired legal relations between "employer", company, and company controller are achieved, the "principle" against diversion of employment income may nullify the effectiveness of the arrangement for tax purposes. Assuming that the desired result can be achieved for tax purposes so that income from the "employer" is derived by the company, the advantages thereby conferred do not involve any important principles of tax law. Rather the advantages are of a practical kind. The controller of the company gets control of his remuneration package and can build as many desired non-taxable fringe benefits into it as possible; moreover, it will probably be easier to get deductions of various kinds allowed than would be the case if the company structure were not being used. The interpositioning of a partnership consisting of say the "employee" and his wife or a trading trust between the "employer" and "employee" gives rise to similar considerations.

A converse of the situation of a payment to an intermediary which ultimately benefits an employee is the case of a payment by the employer to the employee which the recipient alleges is subject to some obligation to disburse in a particular way. If the obligation alleged to exist involves some benefit to the employee in his private or personal capacity and no trust is involved, then clearly, it is submitted, the payment is derived as income by the employee and applied by him in accordance with the obligation; for example, contributions by a university to the airline fares of the wife and children of a lecturer proceeding overseas on sabbatical leave,⁶⁷ payments by a salesman into the bank account of his family company.⁶⁸ This situation

⁶⁶ *Phillips v. F.C.T.* 77 A.T.C. 4169 at 4181, *Bayly v. F.C.T.* 77 A.T.C. 4045 at 4052-4053, *Jones v. F.C.T.* 77 A.T.C. 4058 at 4064, *F.C.T. v. Everett* (1980) 54 A.L.J.R. 196 at 200, cf. *Poole and Dight v. F.C.T.* (1970) 122 C.L.R. 427 at 442 in relation to a different situation concerning a partnership.

⁶⁷ Case J53, 77 A.T.C. 468.

⁶⁸ Case N70, 81 A.T.C. 379 — the employer had refused to contract with the company but the employee claimed to be under a fiduciary obligation as director of the company to account for his salary to the company.

is to be contrasted with the position where the obligation involves a benefit to the employer and forms part of the employment relationship.⁶⁹

(c) *Defining What Is Derived*

It is important to define what is derived for a number of reasons. Firstly, the valuation principles considered below will apply to whatever is derived and not something else; it is obvious that different things may have different values. Secondly, the application of the principles of derivation already outlined may depend in part on what is derived. Logically it may be thought that the present issue should therefore be considered before the principles of derivation; but it is not possible to be perfectly logical with the income tax and it is convenient to deal with constructive receipt first because it will be necessary where an employee receives a benefit in kind to decide which of two possible analyses is appropriate.

One analysis is to say that the employee has derived *cash* by constructive receipt which has then been applied in payment for the benefit in kind. This analysis sidesteps problems of valuation because the employee is regarded as having derived a certain dollar amount. It will be appropriate where, as in *Heaton v. Bell*⁷⁰ (which has already been considered on this point), the benefit is paid for by a deduction from salary which would otherwise be payable. If the constructive receipt approach is not available on the facts, the other approach is to regard the benefit in kind itself as being the subject matter of derivation. This will be the usual case in practice for fringe benefits in kind, as the benefits will not be expressly related to any deduction salary. It is this situation which gives rise to the problems of valuation discussed below.

To say that the benefit in kind is the subject matter of derivation in the usual case is not an end of the issue of defining what exactly is derived, for it may be either the *right* to something in kind which is the fringe benefit derived, or the *receipt* and enjoyment of that something in kind. As the taxpayers with whom the discussion is dealing will be taxed on a cash accounting basis, the simple answer will usually be that the arising of a right will not amount to derivation of income, but only the receipt (including constructive receipt — that doctrine, however, is not often needed in the case of benefits in kind as they are usually received directly by the employee). As a general principle, this view is endorsed by the cases,⁷¹ although it is not usually related expressly to taxation on a cash accounting basis.⁷²

An exception will exist when a right conferred on an employee potentially has a separate value in itself independent of the thing to which it is a right. Examples will make the exception clearer. A one year option to purchase shares at today's ruling price has a potential value in itself because

⁶⁹ See *infra* 4(d).

⁷⁰ *Supra* n. 26.

⁷¹ *Wilkins v. Rogerson* [1961] Ch. 133, as explained in *Heaton v. Bell*, *supra* n. 26 at 755, 758, *cf. id.* 745, 766.

⁷² The dissenting judgment of Lord Denning in *Abbott v. Philbin* [1961] A.C. 352 at 383-387 comes very near to the point — his dissent was not related to this issue.

the shares may rise in price during that period. On the other hand, a right to personal use of a car for the next year has no potential value independent of the use of the car — an analogy in the share option context may be a one year option to purchase shares at the market price ruling on the day the option is exercised. It is difficult to escape the world of choses in action and find an example of a thing with a potential value in itself which corresponds to an option for a year to purchase shares at today's ruling price, but a suggestion is the provision by an employer of a credit card (which charges an annual fee) to an employee and permission to use the card for private purchases up to a fixed amount. Any purchases made on such a private expense account would be taxable fringe benefits, but so, it is submitted, is the provision of the credit card itself for it has value in itself independent of the expense account, even though it only serves as a means of access to the account (just as the option is a means of access to the shares). One way of expressing the exception perhaps is to ask if the right or thing constitutes a piece of property independent of other property or rights to which it gives access. Such a formulation leads to fruitless arguments of what is or is not property and is therefore to be rejected.⁷³ However, it is useful for pointing up that the "exception" is not a real exception at all but is merely the identification of an item derived and its occasion of derivation, because the taxpayer *receives* something of potential intrinsic value in itself. In this sense to receive from your employer a one year option to purchase shares at today's market value is the same as receiving a lump of coal to burn in your fire;⁷⁴ both are quite naturally accounted for upon receipt by a taxpayer on a cash basis. Accordingly, it was held in *Abbott v. Philbin* by majority⁷⁵ that in the case of 10 year options to purchase at the market value on the date of grant, there was a derivation at the date of grant on the basis that the option had a potential intrinsic value in itself apart from the shares,⁷⁶ a conclusion which has been approved in Australia as it relates to ordinary usage income⁷⁷ and applied to s. 26(e) in *Donaldson v. F.C.T.*⁷⁸ Options over shares are now covered by s. 26AAC, but the reasoning of these cases remains valid in other option situations (such as options over land).

In fairness to the dissentients in *Abbott v. Philbin*,⁷⁹ it should be pointed out that the options in question were subject to restrictive conditions which makes their point of view (that the options had no intrinsic value in themselves) attractive, *viz.*, they were expressed to be non-transferable and could only be exercised while the taxpayer remained in the employment of the grantor of the options. Their argument may be regarded as in one aspect asserting that there was no derivation because the option in

⁷³ *Id.* 365, *cf. id.* 386.

⁷⁴ To vary an example given by Lord Denning in *Abbott v. Philbin*, *id.* 385.

⁷⁵ *Id.*; the decision was unanimously approved by the House of Lords in *Heaton v. Bell*, *supra* n. 26.

⁷⁶ That this was the basis is clearly demonstrated by the point of difference between majority and minority; the latter did not dispute that if the options had a potential intrinsic value in themselves, they would be derived on the grant of the option — rather they held that the options had no potential intrinsic value, *id.* 381, 386-387.

⁷⁷ *F.C.T. v. Cooke & Sherden* 80 A.T.C. 4140.

⁷⁸ 74 A.T.C. 4192.

⁷⁹ *Supra* n. 72.

the circumstances had no market value. One response of the majority was to deny that the options had no market value, but it is submitted that in this regard both majority and minority run together the two different issues of derivation and valuation. All members of the majority are, however, aware of the difference.⁸⁰ It may be thought that there is no variation in tax consequences between saying on the one hand, no derivation, or on the other hand, derivation but no taxable value. If, however, a principle against double derivation is operative in this context, there will be advantages to a taxpayer in arguing for a derivation with no (or little) taxable value at one point in time because then a later benefit arising out of the derivation will not itself be the subject of derivation.

The credit card example suggests a convenient path of analysis — it was suggested that more than one derivation was involved, namely when the card is received and whenever it is used. At first glance this might seem to involve the possibility of double taxation, but such is not the case because what is to be brought to tax on the receipt of the card is the value of the card in itself, that is, the annual fee, and not the amount of the private expense account which is only brought to tax as it is expended. A similar analysis can be applied to a one year option to purchase shares at today's market value given to an employee under seal and without formal consideration — a derivation of the value of the option occurs on its receipt and a further derivation on its exercise of the then value of the shares less the value of the option previously brought to account and the amount paid on exercise of the option. The existence of this double derivation does not necessarily mean that there will be income at both points — there must be circumstances present giving rise to an income characterisation of an occasion of derivation before income arises. In the credit card example this income nature is fairly evident throughout, but in the case of the option it may not be, as will appear below. The possibility of double taxation is much more evident in the option example — it comes easily to say that what is derived at first instance is the value of the option, and then in the second instance the value of the shares which *includes* the value of the option. The problem can be simply averted by giving credit for the value of the option against the value of the shares on the second occasion of derivation but there is a temptation intuitively to invoke a principle against double taxation and deny a double derivation.

The point ultimately at issue in *Abbot v. Philbin*⁸¹ was not whether there was an occasion of derivation when the option was granted, but whether any income arose when the option was exercised. The decision of the majority that there was a derivation at the earlier point of time, as has just been suggested, need not preclude automatically a derivation at the later time. The short answer is that the Revenue conceded that there could

⁸⁰ Viscount Simonds says, *id.* 366, "I must say that it is really irrelevant whether a value could be ascribed to it or not. If it had no ascertainable value, then it was a perquisite of no value". He adds, *id.* 368, "Nor . . . can I accept the view . . . that, if in the year of grant the option had no value, there was nothing to tax, and that is the end of the matter". See also *id.* 371, 377.

⁸¹ *Id.*

only be one point of derivation and this explains why the judgments concentrate on the earlier point even though the later point was the real issue in the case. Nevertheless, the majority do express various views on the matter. They are divided on the issue of whether there could be a derivation at the later point of time,⁸² but were unanimous in the view that if there were a derivation, it could not have an income quality because the benefit arose from an increase in the market value of the shares, and not from the taxpayer's employment.⁸³ The analysis is not any further advanced in *Donaldson v. F.C.T.*⁸⁴ as there the Revenue was seeking to levy tax on the receipt of the options, and the options had not yet been exercised, so that the question of double derivation did not arise.⁸⁵ The judgment does seem to indicate, however, that whatever the correct position, Australian law in general and s. 26(e) in particular do not depart in this regard from English law. As the question is an open one, it is submitted that in the interests of full taxation of the benefit, there can be a second derivation when options are exercised. It is further submitted that the courts should be unwilling to follow *Abbott v. Philbin*⁸⁶ in the conclusion that such a derivation does not have an income quality; in *Donaldson v. F.C.T.*,⁸⁷ for instance, the taxpayer had to remain in his employment for a further specified period before he could exercise the options, and this fact may be enough to distinguish *Abbott v. Philbin*⁸⁸ and give rise to a conclusion that any further benefit arising on exercise of the option was sufficiently related to employment to have an income quality.

There is one respect in which s. 26(e) may have a narrowing effect with respect to defining what is derived, for it only covers "allowances, gratuities, compensations, benefits, bonuses and premiums" "in money, goods, land, meals, sustenance, the use of premises or quarters or otherwise" and if what is derived falls outside these terms, then it is outside s. 26(e). In *Buckingham v. F.C.T.*⁸⁹ Evatt, J. held in relation to s. 16(g) of Income Tax Assessment Act 1922 (Cth.), a more narrowly worded precursor of s. 26(e), that the provision of meals on board ship to the Captain of a coastal steamer was neither an "allowance" which meant a definite portion or amount, nor an "allowance in sustenance" which meant a limited portion of food such as a drawing of rations.⁹⁰ Nevertheless the word "benefits" in s. 26(e) seems apt to cover such cases, and the word "meals" was expressly added to deal with *Buckingham's Case*.⁹¹ It would seem to be arguable that s. 26(e) does not cover choses in action because the

⁸² *Id.* 365, 367, 372-373, 377, 379.

⁸³ *Id.* 367, 372-373, 379.

⁸⁴ *Supra* n. 78.

⁸⁵ There are suggestions of a principle against double derivation, *id.* 4207.

⁸⁶ *Supra* n. 72.

⁸⁷ *Supra* n. 78.

⁸⁸ *Supra* n. 72.

⁸⁹ (1934) 3 A.T.D. 37.

⁹⁰ Similarly in *C.I.R. v. Parson* (No. 2) [1968] N.Z.L.R. 574, it was held that an allotment of shares to an employee on advantageous terms was not "allowances" within the phrase "all salaries, wages or allowances (whether in cash or otherwise) including all sums received or receivable by way of bonus, gratuity, extra salary, or emoluments of any kind". This case is the New Zealand equivalent of *Abbott v. Philbin*, *supra* n. 72.

⁹¹ *Supra* n. 89.

words "in money, goods, land, meals, sustenance, the use of premises or quarters" cover only concrete items and the words "or otherwise" are to be construed *ejusdem generis* with the preceding words. This argument must be taken to be rejected by *Donaldson v. F.C.T.*⁹² and Board decisions⁹³ applying s. 26(e) to choses in action such as shares. It may be more difficult to make s. 26(e) fit to fringe benefits in the form of relief from expenses such as low interest loans, discounts on goods and services and cheap accommodation, for what is derived here may be the relief from expense rather than something in kind. Nevertheless it would be odd if s. 26(e) applied when something is given free but did not apply when there is simply partial relief from expenses. Section 26 AAAB clearly assumes that s. 26(e) is applicable in both cases.⁹⁴

(d) *The Attaching of Income Characteristics to a Derivation*

It is clear from the previous discussion that the necessary characteristics to give a receipt an income quality must exist at the time of derivation. If there are a number of possible times of derivation, it is necessary to define what it is that is derived and discover the time of derivation in accordance with the principles already discussed; all that can be then investigated are the circumstances existing as regards the item derived at that time. If double derivation is possible, and has occurred on the facts, it is necessary to investigate the circumstances at each occasion of derivation for an income quality, and it is quite possible (though not necessary) that such quality will be present on one occasion but absent on the other, or that the quality is not present on either occasion. These conclusions follow from *Constable v. F.C.T.*,⁹⁵ *Abbott v. Philbin*⁹⁶ and the other cases already considered and require no further elaboration. What characteristics will constitute an income nature are the subject of the next part of this article.

These conclusions are manifestations of the basic principle that there is no such thing as income "in the air", that is, income apart from derivation. Another corollary is made evident by *The Federal Coke Company Pty. Ltd. v. F.C.T.*,⁹⁷ viz., that the income quality of a receipt is to be judged according to the circumstances of the person who derived it and not according to the circumstances of some other person. This case did not concern the employment context or the rendering of services and it is not intended to explore its facts which are far removed from fringe benefits. Nevertheless, the principle it expresses is as applicable to fringe benefits as any other area of income tax law.⁹⁸ Its significance is, in this context, that if the benefit consists of a payment by an employer to a spouse or child of an

⁹² *Supra* n. 78 at 4207.

⁹³ 14 C.T.B.R. (N.S.) Case 64, Case G40, 75 A.T.C. 248.

⁹⁴ Section 26 AAAB(1) which supplies the value of employees' housing for s. 26(e) applies to both free and subsidised accommodation.

⁹⁵ *Supra* n. 37.

⁹⁶ *Supra* n. 72.

⁹⁷ *Supra* n. 15.

⁹⁸ It is possible to find expressions of the principle in earlier cases in the employment/services context, though their significance has often been overlooked, for example *Gair v. F.C.T.*, *supra* n. 46 at 393-394.

employee (either directly or through an intermediary), it will be irrelevant in judging the income nature of the receipt in the hands of the spouse or child that the payment was brought about by services rendered by the employee. Any such income nature will have to be sought in other principles besides reward for services, such as periodical payments, income from property etc. which are unlikely to be satisfied in the usual fringe benefit situation.

It follows that if there is no derivation by constructive receipt (or s. 19) on the part of the employee but only a derivation by the spouse or child, the payment will escape income tax altogether. The wide scope suggested for the doctrine of constructive receipt is the only means of escape from this conclusion and in the interests of a sensible operation of the income tax system, it is submitted that the necessary scope should be permitted to the doctrine. The principle in *Federal Coke* finds express statement in s. 26(e) in the words "to him". However, it has already been argued that the words "allowed given or granted to him" do not exclude the operation of the doctrine of constructive receipt or s. 19 from s. 26(e) and so any adverse consequences (from the Revenue's viewpoint) can be averted.⁹⁹

Just as *Federal Coke*¹⁰⁰ may dictate a result in certain situations that no one is subject to tax, so equally it may follow that two persons are subject to tax in respect of the one payment. This will occur in the case of a payment by an employer direct to an employee's child where there is a constructive receipt by the employee, and the receipt by the child amounts to a derivation with the necessary characteristics, for example, because the payments are periodical and are intended to provide an income on which the child can live.¹⁰¹ It is not intended to explore in any detail what circumstances may give an income character in the hands of a spouse or child; suffice it to say that the main situations to be avoided are periodical payments, the provision of an income on which to live, and income from property. Provided the spouse or child has no other income, the employee may have no objection to a payment being treated as income in their hands.

A derivation which has an income nature may attract an exemption from tax by virtue of various provisions of the Act. A number of exemptions in s. 23 are relevant to employees or persons who render services — these will not be explored. Two exemptions which are important in the fringe benefits area are in respect of the income of superannuation funds (s. 23(jaa), (ja), s. 23F, Div. 9B, and see s. 79) and scholarship income (s. 23(z)).

4. Income

There is not, at first sight, much scope for fringe benefit tax planning by manipulation of the circumstances of a receipt in order to ensure that it

⁹⁹ *Supra* nn. 35-38. English tax law is different from Australian law in this regard. It does in certain situations permit there to be income "in the air" which will be derived as income by the person who receives it pursuant to a special covenant procedure, regardless of whether the circumstances of the person deriving it give the receipt an income nature. This part of English law was involved in *Barclays Bank Ltd. v. Naylor*, as to which, see *supra* n. 55.

¹⁰⁰ *Supra* n. 15.

¹⁰¹ *Cf. F.C.T. v. Dixon* (1952) 81 C.L.R. 540.

escapes an income characterisation. The income nature of the benefit as regards the employee is usually all too apparent and the object of taxpayers generally is rather to prevent a derivation in ways already considered, or to attract a low valuation under the rules of valuation considered hereafter. Nevertheless, it is well established that the mere fact that a receipt derived has some relationship to an employment or the rendering of services does not necessarily entail an income characterisation. The difficulty is that there is no simple and definitive test of the necessary degree of relationship to an employment or the rendering of services; rather the courts look to a wide variety of factors and make an impressionistic or intuitive assessment of them in deciding whether a receipt has an income nature or not.

The vagueness of the borderline may be demonstrated by taking attempted expressions of the appropriate test in some illustrative cases. In *Hayes v. F.C.T.*,¹⁰² Fullagar, J. states the following forms of the test of connection, "a real relation between the receipt and an employment or services", "so related to an employment . . . or to services rendered . . . that it is, in substance and in reality . . . the product of an income-earning activity", "any employment or personal exertion, of which the receipt . . . was in any real sense an incident, or which can be fairly said to have produced that receipt", "really incidental to an employment", "in [a] true sense a product or an incident of any employment" and "earned in the sense — the only relevant sense — that it is the product of a revenue earning activity". In *Scott v. F.C.T.*,¹⁰³ Windeyer, J. is equally as prolific and vague: "in truth rewards of a taxpayer's employment or calling", "a product or incident of his employment or a reward for his services", "a common incident of a man's calling or occupation" and "in any relevant sense a product of them". The terms which stand out in this catalogue are "product", "incident", "real" and "relevant": all of which are expressions of a failure to state any clear test. The English judges have shown an affection for Latin terms — perhaps in the hope that they will lend a (spurious) appearance of logic and certainty. If the employment or services is to be characterised as the "causa causans" of the receipt, then it is income; but if they are merely the "causa sine qua non" then it is not income.¹⁰⁴ This test is as empty as those stated in the Australian cases.

It is not intended to undertake a detailed analysis of the voluminous case law in this area or to construct a list of factors for and against an income characterisation — for ultimately it is an unrewarding task as the results in the cases are so much a matter of impression of their particular facts and combinations of factors.¹⁰⁵ Rather it is intended to take up a number of particular issues which raise important questions of general principle or difficulties of analysis in the fringe benefit area.

¹⁰² (1956) 96 C.L.R. 47.

¹⁰³ (1966) 117 C.L.R. 514.

¹⁰⁴ *Cowan v. Seymour* [1920] 1 K.B. 500, 517-518, *Hochstrasser v. Mayes* [1960] A.C. 376, *Laidler v. Perry* [1966] A.C. 16, cf. the caustic comments in *Pritchard v. Arundale* [1972] Ch. 299 and in *Brumby v. Milner*, *supra* n. 53.

¹⁰⁵ For some attempts, see Whiteman and Wheatcroft, *op. cit. supra* n. 17 at 595-610, Tiley, *op. cit. supra* n. 17 at 120-131, *CCH Federal Tax Reporter* para 11-710 ff., para 13-655 ff.

The statement of the necessary income nature in s. 26(e) is found in the words "for or in relation directly or indirectly to, any employment of or services rendered by him". It has been said on more than one occasion that, notwithstanding the literal width of those words, they are probably an embodiment of the general usage notions of income with respect to services or employment receipts.¹⁰⁶

It is important to note, however, that the application of 26(e) is limited to employment or services whereas, of course, general usage notions of income are not so limited. As a result, the test of valuation found in s. 26(e) is inapplicable if there is no employment or services in question, and the more limited general usage notion of valuation applies.¹⁰⁷ The general usage valuation test will often produce a nil value for a benefit in kind and hence a nil quantum of income.

These matters were considered in *F.C.T. v. Cooke & Sherden*¹⁰⁸ which concerned free holidays provided by manufacturers of soft drinks to husband and wife partnerships who canvassed for custom, and sold and delivered the soft drinks direct from a truck. The partnerships were fully stocked and equipped by the manufacturer and given fixed runs which virtually guaranteed a certain level of custom but matters were so arranged between the manufacturer and partnerships that the latter were independent contractors who bought and sold the soft drinks on their own account and in their own time. The income nature in the sense being considered under this heading of the free holidays was not in question as they clearly had the requisite relation to the income earning activities of the partnerships — what was in issue was the basis of valuation of the holidays and that depended on whether the holidays were the product of services or employment. It was held that they were not and hence were outside s. 26(e); the relationship between manufacturer and partnerships was that of seller and buyers of soft drinks, notwithstanding that the partnerships conducted (and in effect were required to conduct) their business in a way which provided a market for the manufacturer's products. The remarks in the case as to the precise bounds of s. 26(e) are inconclusive. The concept of employment is much elaborated in industrial and tort law which no doubt will be applied in the s. 26(e) context as the judgment seems to indicate.¹⁰⁹ A number of meanings for "services rendered" are canvassed¹¹⁰ — the ideas of a contract for services in the workers' compensation area, of "work and labour done", and of rendering services considered in income tax cases on the mutuality principle ("the doing of an act for the benefit of another, which is more than the mere making of a contract and which goes beyond the performance of an obligation undertaken in the course of an ordinary commercial contract"). None of these was regarded as satisfied on the facts.

¹⁰⁶ *F.C.T. v. Dixon*, *supra* n. 101 at 553-554, *Hayes v. F.C.T.*, *supra* n. 102 at 54, *Scott v. F.C.T.*, *supra* n. 103 at 525-526. One situation where this may not be the case is taken up *infra* 4(c).

¹⁰⁷ *Infra* 5. Valuation.

¹⁰⁸ *Supra* n. 77.

¹⁰⁹ *Id.* 4150.

¹¹⁰ *Id.* 4150-4151.

There is scope for the avoidance of s. 26(e) on the basis of this decision in situations involving the packaging, selling and delivery of goods, but it is submitted that the scope is not all that great. In many cases, it would be a very complicated exercise to set up procedures which produce a buying and selling categorisation (for example, deliveries from department stores); and in some cases there would be doubts whether there was a genuine dealing on his own account by the "buyer" of the goods — at least the partnerships in the case did do their own canvassing to a degree and it would be hard to satisfy this kind of requirement in the case, say, of a driver of a concrete truck.

(a) *Payments for Giving up Rights, or Restrictions on Rights*

A payment prior to or on entering into an employment or services relationship may not have an income nature if it is for the giving up of rights or advantages of the taxpayer.¹¹¹ An issue of shares in one case¹¹² was expressed to be in consideration for the taxpayer's serving the company, which as a matter of form points to an income characterisation, but the Court applied a substance test to find the real nature of the payment, which was held on all the facts to be for giving up existing rights in a partnership. This clear adoption of a substance approach will prevent payments, expressed to be for giving up rights or advantages, but really being part of remuneration, being characterised as of a non-income nature. Even apart from a substance approach, the borderline is a narrow one¹¹³ and the vagueness as regards the dividing line evident in the cases makes manipulation of the circumstances by the taxpayer difficult.

The position is similar with respect to payments made during the period of employment purportedly for giving up rights.¹¹⁴ The type of device suggested by the cases is to create by a service agreement or in the articles of association of an employer company rights such as pension rights, rights of control, rights to compensation for loss of office etc. and then to make a payment under a further agreement in respect of surrender of those rights, avoiding the association of any adjustment to salary with the surrender agreement. The difficulty is that the employee, once the rights are created, may be unwilling to give them up if they are genuinely valuable and enforceable, whilst a substance approach will defeat the device if the "rights" are mere "window dressing".

Special considerations apply to payments on retirement (payments a considerable time after retirement hardly come within the purview of fringe

¹¹¹ *Jarrold v. Boustead* (1964) 41 T.C. 701 (payments to footballer on turning professional, for giving up amateur status), *Pritchard v. Arundale*, *supra* n. 104 (issue of shares to managing director on taking up position and giving up partnership in firm of accountants).

¹¹² *Pritchard v. Arundale*, *supra* n. 104.

¹¹³ In *Riley v. Cogan* [1967] 1 W.L.R. 1300, a payment on a footballer's turning professional was held to be income because the player agreed to serve the club for the rest of his career or twelve years (whichever was the greater) and if he failed to observe this condition a proportionate part of the payment was refundable (see also case D 38, 72 A.T.C. 21).

¹¹⁴ Compare *Henry v. Foster* (1932) 16 T.C. 605, *Prendergast v. Cameron* [1940] A.C. 549, *Tilley v. Wales* [1943] A.C. 386, *Bennett v. F. C. T.* (1947) 75 C.L.R. 480 and many other cases.

benefits unless they are retirement pensions in which case the normal rules as to taxation of pensions or annuities will be applicable). Under ordinary usage notions of income, a payment will not have an income nature if it is in the nature of damages for wrongful dismissal¹¹⁵ or in the nature of a surrender of rights to serve for a longer period under an unexpired service contract.¹¹⁶ On the other hand, a simple contractual payment on normal retirement or proper dismissal will have an income nature on ordinary usage notions (even though expressed to be in lieu of notice, or as compensation for loss of office¹¹⁷) as will arrears of salary.¹¹⁸ Manipulation of contractual provisions is clearly possible so far as ordinary usage notions are concerned, though again the adoption of a substance approach by the courts will limit the manipulation. The special considerations mentioned at the outset of this paragraph arise from s. 26(d). Because this provision catches payments whether of an income nature or not according to ordinary usage notions but then treats the payments in an extremely generous manner,¹¹⁹ it is usually safer to accept s. 26(d) treatment, rather than to avoid it, and tax payers efforts are more likely to be directed to that end. It is only where the payee can be sure that the payment does not have an income nature (such as in the case of a lump sum payment from a superannuation fund on the authority of *Constable's Case*¹²⁰) that taxpayers will seek to avoid s. 26(d).¹²¹

It has been assumed in the foregoing that a single payment (or at least very few payments) will be involved. If the payments consist of a regular series over a period of time (especially if they closely match payments that would have been made under the rights that are surrendered) then they are likely to have an income nature as periodical or compensation receipts whether or not they are also to be characterised as the product of employment or services.¹²²

A payment to an employee or person rendering services under an agreement whereby he is restricted from exercising rights he would otherwise have (the restrictive covenant against competing is the usual example) is likely not to have an income nature.¹²³ If a substance approach is applied, there must be a genuine restriction of rights, which may not always be easy to judge. Australian Board Decisions have taken such a substance approach with a consequent limitation on the possibilities of the restrictive covenant.¹²⁴

¹¹⁵ *Du Cross v. Ryall* (1935) 19 T.C. 444, *Scott v. Commissioner of Taxation* (1935) 35 S.R. (N.S.W.) 215.

¹¹⁶ *Chibbert v. Joseph Robinson & Sons* (1924) 9 T.C. 48, *Carter v. Wadman* (1946) 28 T.C. 41, *Henley v. Murray* (1950) 31 T.C. 351, *Comptroller General of Inland Revenue v. Knight* [1973] A.C. 428.

¹¹⁷ *Henry v. Foster*, *supra* n. 114.

¹¹⁸ *Carter v. Wadman*, *supra* n. 116.

¹¹⁹ *Reseck v. F.C.T.* (1975) 113 C.L.R. 45.

¹²⁰ *Supra* n. 37.

¹²¹ As in *McIntosh v. F.C.T.* 79 A.T.C. 4325.

¹²² *Commissioner of Taxes (Victoria) v. Phillips* (1936) 55 C.L.R. 144.

¹²³ *Beak v. Robson* [1943] A.C. 352, *Higgs v. Olivier* [1952] Ch. 311.

¹²⁴ Case A14, 69 A.T.C. 80, Case C31, 75 A.T.C. 186, Case A14, 78 A.T.C. 130, Case M86, 80 A.T.C. 620. It is noteworthy that in three of these decisions one member of the board dissented and that they divide equally between an income and non-income nature.

The main significance of the discussion under this heading is not the tax avoidance possibilities suggested by many of the cases but rather the thoroughgoing application of a *substance approach* by the courts in seeking to determine the income quality of a particular item.

(b) *Conditions of Employment*

This and the next heading — reimbursements of expenses, allowances and salary deductions — deal respectively with benefits in kind and payments in cash (or the equivalent) by an employer to an employee which have the most direct possible relation to the employment, but nevertheless do not have an income nature because the purpose of the benefit or payment is to serve genuine and legitimate ends of the employer's business so that any incidental advantage to the employee is disregarded (the question of apportionment is taken up below). This analysis of a receipt is to be distinguished (especially in the cash payments area) from a derivation of assessable income counter-balanced by an allowable deduction; the results of the two approaches will often coincide, but certainly not in every case.

To take an obvious example, the provision by an employer of pleasant or even luxurious working premises for employees clearly benefits an employee (when compared to unpleasant working conditions) but serves the employer's end of creating an efficient working environment and a staff anxious to please; clearly no derivation of an income nature is involved. In a similar way, the provision of benefits which would usually have an income nature will in certain circumstances be deprived of that nature because the benefit is part and parcel of the conditions of employment. Thus the provision of a flat for a permanent caretaker does not have an income nature¹²⁵ and one would think the same applies to the cabin and meals provided to a sailor on a ship, and the air travel, hotel rooms and restaurant meals provided by an employer for an employee travelling on the employer's business. Often of course the employer in the latter example does not pay these expenses direct but makes a payment to the employee in respect of them in which case the discussion in (c) below is relevant — a case where the employer provides these things in effect directly is where the expenses are charged to a credit card in the employer's name.

The close relationship between the analyses that such items do not have an income nature, and that they do have an income nature but are matched by equivalent deductions will be evident from these examples. That the analyses do not produce identical results in all cases, however, and that the former analysis is correct can be shown by a simple example: if an employer does not provide airconditioning in an office and an employee goes out and hires an air conditioning unit himself for his and his friends' personal comfort, the employee will have the benefit of an airconditioned office but no deduction will be available to him in respect of the hiring fees and he will be out of pocket to that extent, whereas if the employer provides airconditioning the employee will not be out of pocket because the benefit

¹²⁵ *Heaton v. Bell*, *supra* n. 26 at 764, *per* Lord Diplock.

does not have an income nature. The discrepancy arises because any actual or notional expense by the employee on airconditioning will be of a private non-deductible nature (exceptional cases aside) and accordingly, it is only by the non-income nature analysis that the obviously correct result can be reached.

It is clear that some test is needed to separate benefits with and benefits without an income nature. The mere fact that the employer requires the employee to accept the benefit cannot be the test as the scope for rendering all benefits non-taxable on such a test is obvious. A test that the provision of the benefit serves some genuine and legitimate (or proper) business end may be suggested. The test is bound to be vague and impressionistic because the areas of non-income nature and income nature shade off into each other; it is also likely to follow closely (but as already explained not exactly) the contours of the tests of deductibility under s. 51 of expenses incurred by employees.

The following lines may be drawn in particular common situations.¹²⁶ The provision of a car to use while at work will be of a non-income nature whereas provision of a car to drive to and from work will be of an income nature. Meals provided by an employer as part of a function to entertain business clients will be of a non-income nature while lunches provided in the office canteen will be taxable. Uniforms and special clothing provided will be non-taxable,¹²⁷ while suits and ordinary clothing provided will be taxable.¹²⁸ Travelling on an employer's business will not be taxable while free holidays provided by the employer will be.¹²⁹ A caretaker's flat or sailor's cabin will not be a taxable benefit while employer provided accommodation for ordinary family living will be.

The discussion above relates to ordinary usage notions of income and is not specifically directed to s. 26(e). Taken literally, the terms of that section would cover all of the benefits discussed above which it has been said do not have an income nature. It is submitted that, nevertheless, s. 26(e) in this regard merely reproduces the ordinary usage notions — this point is elaborated more conveniently in the discussion below.

(c) *Reimbursement of Expenses, Allowances and Salary Deductions*

The same kind of reasoning can apply in relation to actual or constructive payments by employers to employees. To continue the airconditioning example from the previous discussion, if the employees in an unairconditioned office are complaining of the heat and the employer

¹²⁶ A number of these are drawn by analogy from the cases referred to *infra* nn. 132-137.

¹²⁷ *Fergusson v. Noble* (1919) 7 T.C. 176.

¹²⁸ *Wilkins v. Rogerson*, *supra* n. 71.

¹²⁹ Scope for provision of fringe benefits of a non-taxable kind is demonstrated by this discussion so far as certain ways of securing an employer's business ends such as overseas travel on business and entertaining clients or customers are regarded (as they probably generally are) as desirable benefits or advantages from an employee's personal point of view. The "annual conference" of all employees of a particular employer at a desirable tourist resort comes close to the line but is, it is submitted, not of an income nature; if spouse and/or family are included, the correct characterisation so far as they are concerned would be a free holiday constructively derived by the employee and even the business nature of the conference so far as the employer is concerned may then be thrown in doubt.

allows one of them to draw on petty cash for the hire of an airconditioning unit (the expense being vouched in the usual petty cash way), that employee has not derived income, because the payment serves the employer's proper business purposes and does not have an income nature. In the payment context, however, it is necessary to carefully distinguish the non-income nature case from the income case (with the possibility of a deduction). Three situations can be distinguished, which it has been sought to identify in the words of the heading — "reimbursement of expenses", "allowances" and "salary deductions". Only the first of these will attract a non-income characterisation.

The deduction from salary case has already been discussed in relation to *Heaton v. Bell*.¹³⁰ That case, however, involved a clear private benefit which did not serve the employer's proper business purposes. Where a deduction is made from salary to pay for some benefit in kind which arguably is conferred in a context involving business purposes of the employer, it is clearly established by a number of English cases that the salary deducted is to be regarded as constructively derived by the employee as income and the employee must then attempt to claim a deduction.¹³¹

Where a payment is made to an employee (or to a third party in discharge of some obligation of the employee, so giving rise to a constructive receipt), and is by way of reimbursement of some expenditure that the employer requires the employee to make and serves some proper business purpose of the employer, then the payment will not have an income nature. If it is not by way of reimbursement, it may be termed an allowance: in this case, the payment will have an income nature and the employee must attempt to claim a deduction. To achieve a non-income nature it will be apparent that two conditions must be fulfilled: (i) reimbursement of required expenditure; and (ii) a proper business purpose of the employer.

The second of these has already been explored.¹³² Examples where it has not been fulfilled are clothing allowances for "plain clothes" policemen,¹³³ "colonial" allowances for the higher cost of living in Singapore and associated housing allowances,¹³⁴ meal allowances,¹³⁵ army lodging allowances,¹³⁶ and rent allowances.¹³⁷ Although in these examples there was some relationship to the employer's business purposes, it was not significant enough.

The similarity to private expenses deduction cases under s. 51 will be evident.¹³⁸ That the relationship to s. 51 is one of similarity only and not

¹³⁰ *Supra* n. 26.

¹³¹ *Cordy v. Gordon* [1925] 2 K.B. 276.

¹³² *Supra* nn. 125-129.

¹³³ *Fergusson v. Noble*, *supra* n. 127.

¹³⁴ *Robinson v. Corry* [1934] 1 K.B. 240.

¹³⁵ *Sanderson v. Durbridge* [1955] 1 W.L.R. 1087.

¹³⁶ *Nagley v. Spilsbury* (1957) 37 T.C. 178.

¹³⁷ 12 C.T.B.R. Case 14.

¹³⁸ *Pook v. Owen* [1970] A.C. 244, a travelling allowance case where the similarity is particularly evident.

identity is demonstrated by *Hochstrasser v. Mayes*.¹³⁹ There an employee, who was required by his employer to transfer his place of employment, sold his house at a loss and was reimbursed for the loss under a scheme specially instituted by the employer for that purpose. It was held that the reimbursement lacked an income nature for a variety of reasons. One line of reasoning was that it was not the product of his employment — hardly a satisfactory explanation. The best explanation, it is submitted, is found in Lord Denning's judgment — namely that the payment was a reimbursement for a loss required by a proper business purpose of the employer.¹⁴⁰ It is highly doubtful whether situations of this and similar kinds would always give rise to a deduction under s. 51 if the reimbursement were held to be income.

The other essential element for a non income characterisation is that the payment be categorized as a reimbursement of expenditure the employer requires the employee to make. Where an employee is required to vouch an expense, there will be the necessary reimbursement, whether payment is made in advance or in arrears by the employer (it is being assumed that if a payment in advance exceeds the expense vouched, the excess will be refunded to the employer).¹⁴¹ Even if a strict vouching procedure is not followed, a payment in advance which is a genuine pre-estimate of a particular expense in particular circumstances will be a sufficient satisfaction of this requirement.¹⁴² On the other hand, a mileage allowance laid down in an industrial award designed to cover a multitude of cases is unlikely to be treated as a reimbursement.¹⁴³ The same comment applies to an annual entertainment allowance.

If the employee cannot prove clearly that both parts of the test for a non-income nature are satisfied, then any allowance will be of an income nature.¹⁴⁴

A view has been expressed that s. 26(e) modifies the ordinary usage notions of income in this area and that now all payments to the employee of the kinds being considered are assessable, even if they satisfy the two conditions set out above of reimbursement of expenses.¹⁴⁵ It is submitted that this view is incorrect and that the Commissioner's practice, for

¹³⁹ *Supra* n. 104.

¹⁴⁰ See R. W. Parsons, *Notes on the Law of Income Tax in Australia* (1981), Chapter II, at 52-53. There is an unacceptable extension of Lord Denning's reasoning found in a number of cases, though not in the fringe benefits context, namely that a payment required by an employer to be expended in a way which involves an affair of capital as regards the employee will not have an income nature. If correct, this extension has enormous consequences for fringe benefits — a payment which the employee was required to spend on an extension to his home would not be income. It is submitted that this extension is not correct, *id.* 53-56; there is a Board decision where it is clearly rejected (Case B82, 70 A.T.C. 379 — payment to architect on account of fees which he was obliged to invest in shares of the paying company held assessable income).

¹⁴¹ *Isaacs v. Commissioner of Income Tax* [1916] St. R. Qd. 95 (travelling expenses), Case B55, (1951) 2 T.B.R.D. 227 (entertainment expenses).

¹⁴² *Campbell v. Commissioner of Taxes* (1920) 16 Tas. L.R. 26, (Commonwealth public servant's travelling allowance), *Pook v. Owen*, *supra* n. 138 (mileage allowance — there being a concession that it was a genuine reimbursement).

¹⁴³ *Harrison v. F.C.T.* 70 A.T.C. 57, 4097 and see Case B55, (1951) 2 T.B.R.D. 227.

¹⁴⁴ *Dingley v. MacNulty* (1937) 21 T.C. 152, *McLeish v. I.R.C.* (1958) 38 T.C. 1.

¹⁴⁵ *CCH Federal Tax Reporter* para 13-655.

example, of not regarding public servants' travelling allowances as being of an income nature under s. 26(e) is correct. There seems to be no reason why the views expressed in many cases¹⁴⁶ on the effect of s. 26(e) on ordinary usage notions of income characteristics should not be applicable.

(d) *Apportionment*

Where there is a receipt of a payment or benefit and the circumstances surrounding the receipt are mixed in the sense that part of the receipt has an income nature and part a non-income nature, or that some factors point to an income nature and some to a non-income nature, one solution to the problem of characterising the receipt as being income or not is to apportion it so that part only is treated as income and part not. Apportionment in some cases at least does seem to be possible, but it is necessary to distinguish different situations in deciding where it is to be applied or not.

The simplest case is a benefit in kind which on some occasions will exhibit a condition of employment (non-income) nature and on other occasions a private use (income) nature. A simple example is provision of a car which is used part of the time for work, and part of the time privately. Such a benefit is being derived continuously and so when it is enjoyed privately there is a derivation with an income nature, while when it is enjoyed as a condition of employment there is a derivation with a non-income nature. It is possible therefore to apportion the use of the benefit in kind and bring to tax the private enjoyment. This is not a true case of apportionment at all because there are separate occasions of derivation, some of which are clearly of an income nature, and some of a non-income nature. True apportionment will be necessary only when there is a single occasion of derivation.

Where there is a single occasion of derivation but the receipt in question has two distinct or separate (but not necessarily quantified) elements, one being of an income nature and one of a non-income nature, this would seem an appropriate case for a genuine apportionment, for example, a single payment in respect of a future reduction in salary (income) and in respect of giving up pension rights (non-income) with no quantification of the two elements. Even where there are no distinct elements in a receipt but the receipt has distinct aspects of an income nature and a non-income nature, again apportionment would seem appropriate. Hence a receipt by an employee of an overseas airline ticket (or the money for one), it being understood by employer and employee that the latter would spend one week in the overseas country on his employer's business and one week holidaying, should be the subject of apportionment even though it cannot be said that the air flight has two distinct or separate elements but only has distinct aspects. On the other hand, if there are not distinct aspects but only a variety of factors, some pointing in an income direction and some in a non-income direction, then a primary purpose test

¹⁴⁶ *Supra* n. 106. Certainly decisions like Case B55, (1951) 2 T.B.R.D. 227 assume this to be so.

is appropriate and apportionment is not. Hence a gift by employer to employee will usually be the subject of a primary purpose test, and not apportionment¹⁴⁷ The distinction being drawn is admittedly a matter of degree but nevertheless is, it is submitted, a valid one.

There is a question whether apportionment of the kinds considered in the previous paragraph is available in Australia to the extent asserted, for two decisions of the High Court give a very limited right of apportionment in the case of receipts of a mixed nature.¹⁴⁸ The test to be applied has been stated as follows:

It is true that in a proper case a single payment or receipt of a mixed nature may be apportioned amongst the several heads to which it relates and an income or non-income nature attributed to portions of it accordingly. . . . But while it may be appropriate to follow such a course where the payment or receipt is in settlement of distinct claims of which some at least are liquidated, . . . or are otherwise ascertainable by calculation: . . . it cannot be appropriate where the payment or receipt is in respect of a claim or claims for unliquidated damages only and is made or accepted under a compromise which treats it as a single, undissected amount of damages. In such a case the amount must be considered as a whole. . . .¹⁴⁹

So for apportionment to be available, the income or non-income amounts must be liquidated or otherwise ascertainable by calculation. If apportionment is not available, *none* of the receipt is taxable. It is true that both cases did not involve fringe benefits or the employment context but the English authorities cited¹⁵⁰ (and it must be added, misapplied and misunderstood¹⁵¹) by the High Court did, and the test is clearly applicable in this area.¹⁵² Such a test would usually preclude apportionment in the cases considered in the previous paragraph. Both High Court decisions state and apply the narrow apportionment test in a giving up of rights situation but there is no reason in principle why it should not extend to other situations such as the airline ticket example in the previous paragraph. Nevertheless, it is submitted that the decisions are undesirable from a policy point of view¹⁵³ and accordingly should be restricted as much as possible, restricted in fact to the giving up of rights/ restrictions on rights area. This may not be logical, but it is consistent with the results and statement of the apportionment test in the High Court decisions.

¹⁴⁷ *Hayes v. F.C.T.*, *supra* n. 102, *Scott v. F.C.T.*, *supra* n. 103.

¹⁴⁸ *McLaurin v. F.C.T.* (1961) 104 C.L.R. 381, *Allsop v. F.C.T.* (1965) 113 C.L.R. 341.

¹⁴⁹ *McLaurin v. F.C.T.*, *supra* n. 148 at 391.

¹⁵⁰ *Carter v. Wadman*, *supra* n. 116; *Tilley v. Wales*, *supra* n. 114; *Du Cros v. Ryall*, *supra* n. 115.

¹⁵¹ The view of the English cases, *supra*, n. 150, generally is that if an item has a mixed income and non income nature, and it is not possible to apportion the two, then the whole item is taxable. *Parsons, op. cit. supra* n. 140 at 154, *cf. Tilley, op. cit. supra* n. 17 at 129; moreover the English cases suggest that apportionment is not so narrowly confined as the High Court suggests.

¹⁵² Case L60, 79 A.T.C. 480.

¹⁵³ Taxation Review Committee, *op. cit. supra* n. 4 at 76-77.

5. Valuation

It was pointed out early in this article that part of fringe benefits tax planning involves deductibility of the cost of the benefit to its provider.¹⁵⁴ Where the benefit is taxable, it might be thought that the valuation of the benefit should be based on cost to the provider to achieve complementarity of the provider's deduction and the recipient's income. It is clear, however, that this is not the basis of valuation, and accordingly the quantum of income derived by the recipient may be greater than the cost (for example, where the employer provides free meals in a staff canteen, there will be no profit element in the cost of the meals, but the amount brought to tax on the employee should include in theory at least the profit element which would be present if the employee purchased the meal elsewhere).¹⁵⁵ Equally the amount brought to tax on the recipient may be less than cost to the provider; thus a gift of a suit to an employee will be brought to tax at its market (that is, second hand) value which will be less than cost¹⁵⁶ (s. 26(e) aside). Some fringe benefits will not have a cost to the provider such as shares in an employer company.

Where a fringe benefit consists of an actual or a constructive payment of money, there will be no difficulty of valuation as the amount of money paid will be income (so long as a derivation and income nature are involved — apportionment may be necessary in some cases). At least this is so where the money is being treated as currency and not as a commodity. In the latter case the valuation will be based on the principles for benefits in kind considered below.¹⁵⁷

The starting point for the principles of valuation of benefits in kind is *Tennant v. Smith*¹⁵⁸ which concerned a house adjacent to a bank's premises provided for the bank's manager who was required by the bank to live in the house, in effect as a caretaker, and was not able to sub-let or licence the house for occupation by another. Tax on the annual value of the house had been paid by the bank under Schedule A of the English tax legislation (on the basis that the bank was the occupier of the house, the manager merely being the bank's representative for this purpose) and it was sought to tax the manager on its annual value also under Schedule E which referred at that time to (*inter alia*) "profits or perquisites" "payable" by the employer. At least four different lines of reasoning can be found in the judgments for the conclusion that the manager was not taxable under Schedule E on the annual value of the house: (i) tax having been paid by the bank under Schedule A, the structure of the Act made clear the annual value was not to be further taxed under Schedule E; (ii) the occupation by the manager amounted to a condition of employment and not a perquisite of office; (iii) the structure of the Act, and particularly the word "payable" indicated that all that was taxable under the Act was money or that which could be turned

¹⁵⁴ *Supra* n. 5.

¹⁵⁵ 12 C.T.B.R. Case 14 comes close to being a case of this kind.

¹⁵⁶ *Wilkins v. Rogerson*, *supra* n. 71.

¹⁵⁷ As the employee who was paid in gold sovereigns (still legal tender in England) discovered in *Jenkins v. Horn* (1979) 52 T.C. 591.

¹⁵⁸ [1892] A.C. 150.

or converted into money; and (iv) (which probably amounts to the same as (iii)) the concept of income was concerned with money or that which could be turned into money.

Subsequent decisions of the House of Lords have established that the decision is authority for proposition (iv) (and proposition (iii) with the modification that the deletion of the word "payable" from Schedule E in subsequent re-enactments of the taxing statute is not of significance).¹⁵⁹ It is therefore necessary in the case of any benefit in kind under English law to determine whether it is purely personal to an employee and non-convertible (such as free meals and lodgings which cannot be sub-let) or convertible into money. Neither proposition (iii) nor (iv) involves in itself a principle of valuation, but it is a short step from saying that a benefit which is convertible into money is an income receipt to a principle of valuation that the quantum of income is the amount of money into which it can be converted. This valuation principle is more assumed than stated in the cases though it finds clear expression in *Wilkins v. Rogerson*.¹⁶⁰ If a benefit is convertible, the fact that in the particular circumstances of the case it has a nil market value, does not mean that there is no derivation or income nature but simply that the principle of valuation provides a nil quantum of income. This point has been made in the previous discussion.¹⁶¹

The English cases certainly suggest, however, that if the benefit is non-convertible, then there is either no derivation or no income nature so that valuation does not arise — this seems to be the understanding of them in *F.C.T. v. Cooke & Sherden*:

If a taxpayer receives a benefit which cannot be turned to pecuniary account, he has not received income as that term is understood according to ordinary concepts and usages.¹⁶²

A preferable analysis, it is submitted, in the case of a non-convertible benefit is that there is a derivation and income nature but no quantum of income because a non-convertible benefit can never have a convertible value. In other words, the only difference from an analytical point of view between non-convertible and convertible benefits is that, in the case of the former, an investigation of value never needs to be made because *ex hypothesi* the benefit can have no value, whereas in the case of the latter an investigation of value needs to be made, although that value may turn out to be nil. Which method of analysis is adopted will be important, for example, if there is a principle against double derivation¹⁶³ because a non-convertible benefit would still be derived, and could not therefore be the subject of a further derivation if it later becomes convertible.

Whichever analysis is adopted, one important consequence of the discussion is that the first question in any case is not what is the value, but whether the benefit can be converted; and the second question if the benefit

¹⁵⁹ *Abbott v. Philbin*, *supra* n. 72; *Heaton v. Bell*, *supra* n. 26.

¹⁶⁰ *Supra* n. 71.

¹⁶¹ *Supra* n. 80; see also *infra* nn. 162-163.

¹⁶² *Supra* n. 77 at 4148.

¹⁶³ *Supra* nn. 80-88.

can be converted, will be the amount for which it can be converted. The second question is often treated as equivalent to a market value principle of valuation, (in the sense of establishing a value for the benefit based on ordinary trade) and so it will be in the usual case. The ultimate principle, however, is the amount for which the benefit can be converted and there is no need to establish the existence of a market in the ordinary sense. *Heaton v. Bell*¹⁶⁴ is the authority for this analysis. There the use of the car could not be traded away so that there was no market in the ordinary sense, but it could be converted into money by surrendering the car to the employee in which event a deduction from salary ceased, and the employee received more salary in hand. In effect there was a market of one person, the employer. If the principle of valuation is to be stated as a market value test, it needs to be understood that market value is being used in a special extended sense.

The test of whether a benefit in kind is convertible or not has received elaboration in recent times. Non-convertibility will not be established in all cases merely because a benefit is provided by the employer on condition that the benefit is non-transferable. Thus, the share options in *Abbott v. Philbin*¹⁶⁵ and *Donaldson v. F.C.T.*¹⁶⁶ were non-transferable but were nonetheless convertible because the employee could have agreed with a third party for valuable consideration to remain in his current employment, to exercise the options when that was possible, and then to transfer the shares (when they were received) to the third party.

It is further established that non-convertibility need not arise from the nature of the benefit, but may be imposed simply by contractual stipulation.¹⁶⁷ Indeed, it is really only by a contractual stipulation that non-convertibility can arise. Examples usually given of intrinsically inconvertible benefits such as free meals, or board and lodgings, involve an implicit contractual condition that they are only available to the employee and cannot be disposed of by him to other persons. The distinction which is really being made by these examples is that benefits in kind which are consumed will be non-convertible if a simple condition of non-transferability is imposed, whereas benefits which are not consumed will not be rendered non-convertible by a condition of non-transferability (the option situation being an example).

The case of theoretical but not practical convertibility is answered by the view that if a benefit is convertible (that is, in theory), it does not matter that it had a nil market value in fact (that is, non-convertible into money in practice).¹⁶⁸ The problem of conversion being forbidden, but in fact occurring, is answered by an investigation of whether the restrictive

¹⁶⁴ *Supra* n. 26.

¹⁶⁵ *Supra* n. 72.

¹⁶⁶ *Supra* n. 78.

¹⁶⁷ *Heaton v. Bell*, *supra* n. 26 at 746, *F.C.T. v. Cooke & Sherden*, *supra* n. 77 at 4148 which answer one of the questions posed in *Abbott v. Philbin*, *supra* n. 72 at 378.

¹⁶⁸ *Abbott v. Philbin*, *ibid.*, poses the problem and the decision in the case answers it, *supra* n. 80.

condition is a sham in which case it is ignored.¹⁶⁹ It is submitted that a restrictive condition can be treated as of no effect where either it is habitually ignored by the parties, or it is commonly waived by the employer on request from the employee. The fact that one employee has ignored the condition, unbeknown to the employer, will not be sufficient to disregard a restrictive condition generally. A further issue is the case where the benefit, though convertible, will not in fact be converted by an employee, either because the employee does not desire to convert the benefit into money, or because the employer disapproves of conversion (though a contractual condition (express or implied) has not been imposed). The short answer is that the benefit in such cases will be treated as convertible for tax purposes.¹⁷⁰

Once convertibility is established, then the quantum of income will be the amount of money for which conversion is possible at the time of derivation, as the English cases show. No discount should be applied, it is submitted, because the employee does not desire to convert, or will incur the employer's disapproval if he does convert.¹⁷¹ Nor will a discount be allowed because the employee did not convert at the time of derivation but at some other time and received less money due to a fall in market value.¹⁷² However, if convertibility is possible but restrictive conditions attaching to the benefit at derivation mean that the amount of money into which it can be converted is less than otherwise it would have been, the depressing effect that the condition has on value must be taken into account. This means in some cases, it will be of advantage to the employee in the case of benefits which are not consumed to receive a benefit that is convertible but at a low value because of restrictive conditions, rather than to receive a non-convertible benefit. Such a method will be appropriate where the restrictive conditions are later to be removed in accordance with the terms on which the benefit was granted because it will be possible to argue for a principle against double derivation if the Revenue seeks to tax again when the conditions are removed.¹⁷³ If a benefit is initially non-convertible because of conditions attaching to it which are in due course to be removed, the courts may take an approach (contrary to the view taken by the author) that no derivation occurs where the benefit is initially received, and accordingly it will not be possible to rely on a principle against double derivation if the Revenue seeks to tax when the restrictive conditions are removed.

Although the discussion to date has largely been based on English cases, it is clear that the principles described are part of the ordinary usage notion of income in Australia as is shown by *Donaldson v. F.C.T.*¹⁷⁴ and

¹⁶⁹ *Heaton v. Bell*, *supra* n. 26 at 746 discusses this problem which also is posed in *Abbott v. Philbin*, *supra* n. 72 at 378.

¹⁷⁰ See, for example, *Abbott v. Philbin*, *supra* n. 72 at 360.

¹⁷¹ 14 C.T.B.R. (N.S.) Case 64 is incorrect in this regard it is submitted.

¹⁷² Case D59, 72 A.T.C. 364.

¹⁷³ *Abbott v. Philbin*, *supra* n. 72.

¹⁷⁴ *Supra*, n. 78.

*F. C. T. v. Cooke & Sherden*¹⁷⁵ (the effect of s. 26(e) is taken up below). They find partial expression in ss. 20 and 21 of the Act.

If that were an end of the matter in Australia, enormous scope would be available for fringe benefits tax planning through the provision of non-convertible benefits in kind. However, s. 26(e) contains a specific test of valuation, "the value to the taxpayer" which is intended to change the ordinary usage notions of valuation so as to permit the taxation of non-convertible benefits in kind.¹⁷⁶ Although this effect of s. 26(e) has been long recognized, the precise nature of the principle of valuation involved did not receive judicial elaboration until *Donaldson v. F. C. T.* where Bowen, C.J. in Equity said:

Where what is given is freely transferable, its value may be found by determining what a willing but not anxious purchaser might pay for it. Where what is given is subject to restrictions, its value may be found by determining what a willing but not anxious purchaser, who would, if he bought it, be subject to the same restrictions, might pay for it. Where, as here, what is given to the employee is subject to restrictions and conditions which he alone can fulfil, valuation is more difficult.¹⁷⁷

Then after expressing the view that the options in the case were convertible in the same ways as the options in *Abbott v. Philbin*,¹⁷⁸ he concluded:

If one adopted this approach, one would find the value of the benefit by determining what a willing but not anxious purchaser would pay for such an arrangement. But there is, I think, a simpler approach and it is one which I would prefer to adopt. Section 26(e) speaks of "value to the taxpayer". This is a notion familiar in valuing to determine compensation for resumption purposes. In a case such as the present under sec. 26(e) I consider it is appropriate in ascertaining value to the taxpayer to determine what a prudent person in his position would be willing to give for the rights rather than fail to obtain them.¹⁷⁹

This process of valuation requires, it is submitted, that the conditions which make a benefit non-convertible be disregarded. That is not, however, the only effect, as the case itself shows, for the benefit there was convertible. The further effect, it is submitted, is that any restrictions on transferability are also to be disregarded, but not other restrictions which may have a depressing effect on value, for example, that the employee can only exercise an option whilst still in the same employment, and that a further period of employment must be served before the option becomes exercisable. This is a difficult valuation test to apply in some circumstances as the expert evidence in the case shows, and it is likely that, as a matter of practice, valuers will not discount entirely the restrictions on convertibility or transferability, and so produce lower valuations than otherwise would be

¹⁷⁵ *Supra*, n. 77.

¹⁷⁶ P. Burgess, "Non-Monetary Benefits" (1982) 10 *A.B.L.R.* 31 at 34 quoting the Treasurer's explanatory memorandum.

¹⁷⁷ *Supra* n. 78 at 4207.

¹⁷⁸ *Supra* n. 72.

¹⁷⁹ *Supra* n. 78 at 4207.

the case. In most cases of benefits in kind which are consumed, for example, free meals, the value to the taxpayer will be the market value of the benefit in question if acquired in an ordinary commercial transaction, for example, the cost of a meal purchased in a non-subsidised canteen.

It is submitted that the test of value to the taxpayer is still an objective one and that therefore a taxpayer cannot argue that he would not have acquired the benefit in kind at all or would have acquired a less luxurious benefit if required to do so out of his personal (after tax) resources.¹⁸⁰ This is implicit, it is submitted, in the way that Bowen, C.J. in *Equity* adopts a variant of a well known and objective test of valuation. Conversely, there is disregarded any special knowledge of the taxpayer which makes him personally place a higher value on the benefit than the objective test produces. Hence, while a condition that the employee must remain in the same employment for a stated period before he can exercise an option over shares will affect value to the taxpayer on an objective basis (not being a restriction on transferability required to be disregarded), the fact that the particular employee has every intention of remaining in his present employment come what may will be disregarded.

The test of "value to the taxpayer" applies only for the purposes of s. 26(e) and is not the general principle of valuation in Australian tax law. Hence, if the terms of s. 26(e) are otherwise not fulfilled on the facts, the special s. 26(e) valuation principle will be inapplicable.¹⁸¹

Clearly in this area s. 26(e) produces a departure from ordinary usage notions. If it is the case that a non-convertible benefit is not derived at all on ordinary principles,¹⁸² then s. 26(e) changes derivation principles as well as valuation principles, for non-convertible benefits are derived for the purposes of s. 26(e). It has been suggested earlier that non-convertible benefits are in fact derived, and if this is so, s. 26(e) does not change ordinary principles in this regard so that the conclusion to that effect expressed earlier¹⁸³ requires no modification.

6. Interpretation and Structure of the Act (including Part IVA)

(a) *Substance Approach*

It has been indicated on a number of occasions previously that the courts have adopted a substance approach to determining when there is a derivation of income according to ordinary usage concepts,¹⁸⁴ and applied that approach in the fringe benefits area. There is no room, it is submitted, for the application of certain of the trends abandoning a substance

¹⁸⁰ Section 26AAAA departs from this view but, is, it is submitted, to be regarded as a change in the law for the specific purposes of the section.

¹⁸¹ *F.C.T. v. Cooke & Sherden*, *supra* n. 77. Planning of the type which uses restrictive conditions (other than transferability of benefits restrictions) to depress value on derivation and relies on a principle against double derivation when the conditions are removed is as available under s. 26(e) as it is under the general law — in this regard the scheme in *Donaldson*, *supra* n. 78, (s. 26(e)) achieved the same success as the scheme in *Abbott v. Philbin*, *supra* n. 72 (ordinary usage principles).

¹⁸² *Supra* nn. 162-163.

¹⁸³ *Supra* nn. 106, 107.

¹⁸⁴ *Supra* n. 112.

approach to s. 51.¹⁸⁵ On occasions, substance may be hard to find, for example, in the distinction drawn between employer and employee contributions to trust funds¹⁸⁶ but generally this will not be the case. In so far as s. 26(e) embodies ordinary usage notions, a substance approach is similarly appropriate, although in setting the borderline between s. 26(e) and ordinary usage, a more literal approach may be likely.¹⁸⁷

(b) *Structure of Act*

The relationship between s. 26(e) and ordinary usage notions has been explored above on a number of occasions. In all but one respect, that of valuation, it has been submitted that s. 26(e) within its particular limits, does not embody any different principles to ordinary usage notions of derivation and income nature. What is the analysis to be when valuation principles produce different amounts of income as between ordinary usage notions and s. 26(e)? The possibility that both amounts are to be included in the taxpayers income can be disregarded; the choice lies between the Commissioner's having a discretion as to which amount is to be included (no doubt he would opt for the higher amount) and the operation of s. 26(e) as a code which within its limits abrogates the operation of ordinary usage notions of income independently of it (the ordinary usage notions are largely reintroduced by s. 26(e) but on this view they can only operate through s. 26(e) and not independently of it). It is submitted that the latter view is correct, although a number of cases seem to assume the contrary (in situations where no difference in result is produced).¹⁸⁸

It should be emphasised that the code argument cannot be relied upon, it is submitted, to exclude the doctrine of constructive receipt from s. 26(e). Either that section may be regarded as itself incorporating the doctrine just as it incorporates many other aspects of ordinary usage notions of income or the code should be construed to be so limited as to allow s. 19 or the ordinary usage doctrine to apply to it.¹⁸⁹

It follows from this view that in a sense it is correct to discuss fringe benefits primarily in the context of s. 26(e) and to generally disregard ordinary usage notions independent of s. 26(e). Because, however, s. 26(e) largely reincorporates ordinary usage notions it is necessary when considering s. 26(e) to take into account the large body of law dealing with ordinary usage income.

(c) *Part IVA*

It is not intended to explore the operation of Part IVA in detail. Where there is a fringe benefit being conferred on an employee, the general conclusion from the previous discussion is that the value to the taxpayer of the benefit will usually be assessable income. If, as a matter of practice, the

¹⁸⁵ For example, *Europa Oil (N.Z.) Ltd. v. I.R.C.* [1976] 1 W.L.R. 464; *F.C.T. v. South Australian Battery Makers Pty. Ltd.* (1978) 140 C.L.R. 645.

¹⁸⁶ *Supra* n. 53.

¹⁸⁷ *F.C.T. v. Cooke & Sherden*, *supra* n. 77.

¹⁸⁸ See generally, R. W. Parsons, "The Meaning of Income and the Structure of the Income Tax Assessment Act" (1978) 13 *Taxation in Australia* 378.

¹⁸⁹ *Supra* nn. 25-27.

benefit is not taxed at all or in full, this is a case for the proper application of s. 26(e), not Part IVA.

If a benefit is not taxable apart from Part IVA, for example, a payment for a restriction on rights of the taxpayer to engage in certain conduct, and if payments or benefits in kind have a long history in the field concerned, then it may be doubtful whether there is a tax benefit, and even if there is, doubtful whether the necessary s. 177D purpose is present. Apart from this, it is unlikely as a matter of practice that Part IVA will be invoked if the fringe benefit involves an ordinary commercial transaction (that is, ordinary so far as the particular employer involved is concerned). On the other hand fringe benefit schemes based on *Constable's Case*¹⁹⁰ (but not in the traditional superannuation area) may be expected to attract Part IVA treatment.

7. Conclusion

It has been demonstrated in the discussion that s. 26(e) can be so interpreted to provide a satisfactory theoretical framework of general principle for the taxation of fringe benefits. It has also been shown that there are difficult questions of general principle raised by fringe benefits and areas of doubt (at least) in the existing law. When these latter matters are combined with the administrative problems of taxing fringe benefits, and the current practice of not taxing fringe benefits to the extent that s. 26(e) presently permits, the conclusion emerges that, notwithstanding the satisfactory theoretical framework which can be built up around s. 26(e), the better course from a practical viewpoint is to formulate detailed and precise rules (whether in the Act or in regulation form) for specific fringe benefits. In this way both taxpayers and the Revenue will be more certain where they stand, and it will be possible to deal with particular problems by particular provisions.

Australia has begun to follow other countries (such as Canada and the United Kingdom) down the road of detailed provisions, but as yet little progress has been made. It is, therefore, an appropriate time to pause and to formulate a comprehensive package of detailed rules for taxation of fringe benefits — that is a matter for another occasion. In the meantime, it is necessary to formulate, protect and apply the general principles as found in s. 26(e). The effort of doing so helps in identification of the problems of taxing fringe benefits and in many cases suggests the appropriate detailed solution.

¹⁹⁰ *Supra* n. 37.