Clough Limited v Commissioner of Taxation [2021] FCAFC 197

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| Appeal from: |  |
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| File number: |  |
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| Judgment of: | **KENNY, DAVIES AND THAWLEY JJ** |
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| Date of judgment: | 12 November 2021 |
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| Catchwords: | **INCOME TAXATION** – payments made to bring to an end options and rights held by employees – payments made in the context of a scheme of arrangement pursuant to which the majority shareholder bought all shares in company – whether payments made deductible under either positive limb of s 8-1(1) of the *Income Tax Assessment Act 1997* (Cth) – held not deductible – whether payments on capital account within the meaning of s 8-1(2)(a) of the *Income Tax Assessment Act 1997* (Cth) – held payments on capital account – payments conceded to be deductible under and in accordance with s 40-880 of the *Income Tax Assessment Act 1997* (Cth)  |
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| Legislation: | *Income Tax Assessment Act 1922* (Cth) ss 23(1), 25(e)*Income Tax Assessment Act 1936* (Cth) s 51(1)*Income Tax Assessment Act 1997* (Cth) ss 8-1, 40-880*Taxation Administration Act 1953* (Cth) Pt IVC, s 14ZZ(1)  |
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| Cases cited: | *AusNet**Transmission Group Pty Ltd v Federal Commissioner of Taxation* (2015) 255 CLR 439*BP Australia Ltd* v *Commissioner of Taxation* (1965) 112 CLR 386*Charles Moore & Co (WA) Pty Ltd v Federal Commissioner of Taxation* (1956) 95 CLR 344*Clough Limited v Commissioner of Taxation* [2021] FCA 108*Colonial Mutual Life Assurance Society Ltd v Federal Commissioner of Taxation* (1953) 89 CLR 428*Esso Australia Resources Ltd v Commissioner of Taxation (Cth)* (1998) 84 FCR 541*Federal Commissioner of Taxation v Day* (2008) 236 CLR 163*Federal Commissioner of Taxation v Foxwood (Tolga) Pty Ltd* (1981) 147 CLR 278*Federal Commissioner of Taxation v Payne* (2001) 202 CLR 93*Federal Commissioner of Taxation v Rowe* (1997) 187 CLR 266*Federal Commissioner of Taxation v Sharpcan Pty Ltd* (2019) 269 CLR 370*Federal Commissioner of Taxation v Snowden & Willson Pty Ltd* (1958) 99 CLR 431*Federal Commissioner of Taxation v South Australian Battery Makers Pty Ltd* (1978) 140 CLR 645*Fletcher v Federal Commissioner of Taxation* (1991) 173 CLR 1*GP International Pipecoaters Pty Ltd v Federal Commissioner of Taxation* (1990) 170 CLR 124*Hallstroms Pty Ltd v Federal Commissioner of Taxation* (1946) 72 CLR 634*Her Majesty the Queen v Kaiser Petroleum Ltd* [1990] 2 CTC 439*Imperial Tobacco Canada Ltd v The Queen* [2012] DTC 5003*John Fairfax & Sons Pty Ltd v Federal Commissioner of Taxation* (1959) 101 CLR 30 *Macquarie Finance Limited v Commissioner of Taxation* (2005) 146 FCR 77*Magna Alloys & Research Pty Ltd v Federal Commissioner of Taxation* (1980) 49 FLR 183*Paciocco v ANZ Banking Group Limited* (2016) 258 CLR 525*Ronpibon Tin NL and Tongkah Compound NL v Federal Commissioner of Taxation* (1949) 78 CLR 47*Royal Insurance Co v Watson* [1897] AC 1*Spriggs v Commissioner of Taxation* (2009) 239 CLR 1*St George Bank Limited v Commissioner of Taxation* [2008] FCA 453; (2008) 69 ATR 634*Sun Newspapers Limited and Associated Newspapers Limited v Federal Commissioner of Taxation* (1938) 61 CLR 337*Trustees of the Estate Mortgage Fighting Fund Trust v Commissioner of Taxation* (2000) 102 FCR 15*W**Nevill & Co Ltd v Federal Commissioner of Taxation* (1937) 56 CLR 290*Watson as trustee for the Murrindindi Bushfire Class Action Settlement Fund v Commissioner of Taxation* [2020] FCAFC 92; (2020) 277 FCR 253*Western Gold Mines (NL) v Commissioner of Taxation (WA)* (1938) 59 CLR 729  |
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| Division: | General Division |
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| Registry: | New South Wales |
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| National Practice Area: |  |
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| Number of paragraphs: | 129 |
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| Date of hearing: | 17 August 2021 |
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| Counsel for the Appellant: | Mr DJ McInerney QC with Mr LJS Molesworth  |
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| Solicitor for the Appellant: | Ernst & Young |
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| Counsel for the Respondent: | Mr EF Wheelahan QC with Ms E Luck |
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| Solicitor for the Respondent: | Australian Government Solicitor  |

ORDERS

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|  | WAD 60 of 2021 |
|   |
| BETWEEN: | CLOUGH LIMITEDAppellant |
| AND: | COMMISSIONER OF TAXATIONRespondent |

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| order made by: | KENNY, DAVIES AND THAWLEY JJ |
| DATE OF ORDER: | 12 NovEMBER 2021 |

THE COURT ORDERS THAT:

1. The appeal be allowed.
2. The orders made by the primary judge on 18 February 2021 be set aside and, in lieu thereof, order that the appeal against the respondent’s objection decision dated 15 January 2020 be allowed in part on the basis that the amount of $15,050,487 paid to the appellant’s employees to cancel their rights under either the Clough Employee Option Plan or the Clough Executive Incentive Scheme is deductible under and in accordance with s 40-880 of the *Income Tax Assessment Act 1997* (Cth).
3. The appellant pay the respondent’s costs of this appeal, as agreed or assessed.

Note: Entry of orders is dealt with in Rule 39.32 of the *Federal Court Rules 2011*.

REASONS FOR JUDGMENT

KENNY J:

1. I have had the advantage of reading in draft the reasons for judgment prepared by Thawley J. I agree with the orders that his Honour proposes for the disposition of this appeal, and I do so for the reasons given by him.

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| I certify that the preceding one (1) numbered paragraph is a true copy of the Reasons for Judgment of the Honourable Justice Kenny. |

Associate:

Dated: 12 November 2021

REASONS FOR JUDGMENT

DAVIES J:

1. I agree with the reasons of Justice Thawley and the orders that his Honour proposes.

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| I certify that the preceding one (1) numbered paragraph is a true copy of the Reasons for Judgment of the Honourable Justice Davies. |

Associate:

Dated: 12 November 2021

REASONS FOR JUDGMENT

THAWLEY J:

# INTRODUCTION

1. The appellant (**Clough**) provides engineering, project management and construction services. In 2013, it serviced the ‘energy and chemical’ and ‘mining and mineral’ markets in Australia and Papua New Guinea. It had about 1,000 permanent employees in a workforce of 6,000. Central to the success of the business was the retention and incentivising of key employees. These outcomes were sought to be achieved in part by providing attractive entitlements to employees under an employee option plan (**Option Plan**) and an employee incentive scheme (**Incentive Scheme**). In the reasons for judgment the subject of this appeal, *Clough Limited v Commissioner of Taxation* [2021] FCA 108 at [45] (hereafter “**J**”), the primary judge stated:

[A]n important part of the business activities that were required by Clough in order to generate revenue was the securing of experienced permanent employees who could manage and supervise the activities of Clough through appropriate remuneration. Those employees were rewarded in part through their participation in the Option Plan and Incentive Scheme.

1. It is not necessary to set out in detail the terms and effect of the Option Plan and the Incentive Scheme. It is sufficient to understand the following:
* Under the Option Plan, Clough could offer (and had given) options to employees which entitled the employee, on exercise of the option, to subscribe for and be allotted one share (credited as fully paid) at the specified exercise price. The board could declare that options would vest immediately if in its opinion a “Change of Control Event” occurred, despite the fact that a condition of vesting (such as achieving a particular performance criterion) had not been met. A more detailed explanation may be found at J[49] to [51].
* Under the Incentive Scheme, Clough could issue (and had issued) “Performance Rights”, which entitled the employee, three years after the date of grant of the right, either to acquire one share or receive in cash the market price of one share (at the election of Clough: cl 12.1). A performance right vested automatically after three years and also vested before three years if a “Change of Control Event” occurred. A more detailed explanation may be found at J[52] to [54].
1. A “Change of Control Event” within the meaning of the Option Plan and Incentive Scheme included Clough entering into a scheme of arrangement, as in fact occurred.
2. In 2011, approximately 60% of the shares in Clough were owned by Murray & Roberts Limited,a subsidiary of Murray & Roberts Holdings Ltd, the head company of the Murray & Roberts Group. Murray & Roberts was a South African engineering, contracting and construction services company operating in the underground mining market and selected emerging markets in the natural resources and infrastructure sectors in Southern Africa, the Middle East, Southeast Asia, Australasia and North and South America.
3. In 2012 and 2013, there were negotiations concerning potential terms on which Murray & Roberts might acquire the minority shareholding in Clough. The treatment of options and rights granted to employees under the Option Plan and the Incentive Scheme was a key concern to both Clough and to Murray & Roberts. Both accepted that there was an obligation on the part of Clough to make payments to the employees holding options and rights if the change in control were to occur.
4. On 28 August 2013, two entities in the Murray & Roberts Group and Clough entered into a Scheme Implementation Agreement (**SIA**), under which a Murray & Roberts entity would acquire the remaining shares in Clough pursuant to a scheme of arrangement. Schedule 7 of the SIA set out certain “Incentive Acquisition Principles”. Clause 6 required the parties to ensure that options and rights were dealt with in accordance with those principles: J[76]. Schedule 7 required Clough to make an offer to cancel the options and performance rights and to use its best endeavours to ensure that each person receiving an offer accepted the offer: J[77]. Schedule 7 also dealt with what was to occur if the offers were not accepted.
5. In September and October 2013, Clough made offers to all employees holding options or rights in accordance with the SIA. The offers were conditional on the SIA becoming effective. The employees either accepted the offer to cancel or exercised vested options and, in the latter case, thereby became shareholders who could participate in the scheme of arrangement if implemented: J[97].
6. The scheme of arrangement was implemented on 11 December 2013. On the same day, a subsidiary of Clough made payments totalling $15,050,487 to employees in consideration of the cancellation of their respective options and rights. Clough was delisted from the Australian Securities Exchange (**ASX**) on 12 December 2013.
7. At issue is the correct tax treatment of these payments of a little over $15 million.
8. The deemed assessment made in respect of the 2014 year of income was issued on the basis that the payments were not deductible. Clough objected against the deemed assessment under Part IVC of *Taxation Administration Act 1953* (Cth) (**TAA 1953**) claiming that its 2014 income tax return understated deductible expenditure by the amount of $15,050,487. Clough’s objection was disallowed. Clough commenced proceedings in the original jurisdiction of this Court, those proceedings being an “appeal” against the objection decision under s 14ZZ(1) of the TAA 1953.
9. Clough contended before the primary judge that the payments totalling $15,050,487 were deductible in the income year ended 30 June 2014 under both positive limbs of s 8-1(1) of the *Income Tax Assessment Act 1997* (Cth) (**ITAA 1997**) and were not prevented by s 8-1(2)(a) from being deductible as payments of a capital nature. Sections 8-1(1) and (2)(a) of the ITAA1997 provide:
10. You can ***deduct*** from your assessable income any loss or outgoing to the extent that:

(a)  it is incurred in gaining or producing your assessable income; or

(b)  it is necessarily incurred in carrying on a \*business for the purpose of gaining or producing your assessable income.

…

(2) However, you cannot deduct a loss or outgoing under this section to the extent that:

(a)  it is a loss or outgoing of capital, or of a capital nature; …

1. The Commissioner maintained the position expressed in his objection decision that the amount of $15,050,487 was not deductible under s 8-1, but accepted shortly before trial that the amount claimed was allowable as a deduction over five years under s 40‑880 of the ITAA 1997.
2. The primary judge concluded that the payments did not fall within either of the positive limbs of s 8-1 and therefore did not reach a view about whether the payments would have been excluded as being outgoings of capital by reason of s 8-1(2)(a). The primary judge dismissed Clough’s appeal.
3. In circumstances where the Commissioner had conceded shortly before trial that the payments were deductible over five years under s 40-880, the deemed assessment was necessarily excessive because it treated the payments totalling $15,050,487 as not deductible.
4. It follows that the primary judge should have allowed Clough’s appeal irrespective of whether the payments totalling $15,050,487 were deductible under s 8-1.
5. Questions of characterisation are ones about which minds often differ. The difficulty this case presents is that the payments were made both to facilitate a change in control of Clough and also to honour legal or commercial obligations to employees arising out of the fact that Clough had granted options and rights to its employees in the course of running its business and for the purpose of rewarding and incentivising those employees. For the reasons which follow, in a practical business sense, the payments are better characterised as payments made pursuant to an agreement to secure a change in control rather than as meeting employee entitlements on a change of control. The payments were made to effect a reorganisation of the capital structure of Clough, through a takeover by Murray & Roberts and the delisting of Clough from the ASX. The bringing to an end of the various rights of the employees under the employee schemes was necessary to secure the reorganisation of the company’s capital structure for the enduring advantage of the business. There is no doubt that the payments would not have been made unless the employees had entitlements under the employee schemes and that those schemes had been designed to incentivise and reward those employees. The rights were granted to the employees in gaining or producing assessable income. However, the occasion of the outgoings lay in the takeover and the object behind making the payments was the bringing to an end of the employees’ rights, at the one time, to facilitate the takeover by Murray & Roberts and the delisting of Clough.
6. Accordingly, the payments were not deductible. The payments did not fall within the positive limbs of s 8-1 and were payments on capital account. It follows that the primary judge did not err on the issue which remained in dispute between the parties at trial.
7. Nevertheless, the appeal must be allowed on the basis that the parties necessarily agreed that the assessment was excessive because the amounts were deductible over five years under s 40-880 of the ITAA 1997.

# THE PRIMARY JUDGE’S FINDINGS AND REASONS

1. On 4 July 2013, after Murray & Roberts had decided that it would seek to acquire all of the shares in Clough, Mr Laas (the chief executive officer of Murray & Roberts Holdings Ltd) sent a detailed proposal for the acquisition to the Chairman of Clough, Mr Spence. Of this proposal, the primary judge noted at J[69]:

[I]t stated that Murray & Roberts was strongly supportive of Clough’s existing management and their strategic plan and did not intend to make any material changes to the operations or management of Clough. It included a detailed request for information to advance due diligence. One category of information was: ‘Copies of all employee incentive plans, including details of any relevant performance hurdles and any events which accelerate vesting’. The term sheet sent as part of the proposal stated that Murray & Roberts would ‘acquire or cancel (for consideration) all … unexercised options … and … performance rights’. It went on to state that the proposed method for acquiring the options and performance rights would be agreed with Clough after further information had been provided by Clough. It then said:

Subject to its review of the existing arrangements, it is the intention of [Murray & Roberts] to acquire these rights for cash consideration based on the consideration paid to acquire Clough Shares and any vesting rights triggered by the Transaction.

1. An updated proposal dated 29 July 2013 was considered by Clough at a “Response Sub Committee” meeting held on 30 July 2013: J[70]. On the appeal, the appellant emphasised that the minutes of the meeting record extensive discussion of the proposal including:
* [t]he recognition of management and staff as a specific part of the Scheme Implementation Agreement to reward them for the generation of value in the price;
* [t]he continuity of employment conditions for staff including replacement of incentive schemes …
1. The primary judge recorded that “[n]o evidence was given as to what was meant by the reference to rewarding management and staff for the generation of value in the price”, but noted that Mr Ratneser (Clough’s former Group Legal Counsel) regarded continuity of employment as significant: J[72].
2. The primary judge then recorded at J[73]:

Also on 30 July 2013, Mr Laas had a conversation with Mr Spence. After the conversation, Mr Laas sent an email [dated 31 July 2013] to Mr Spence expressing agreement with principles relating to employees expressed in the following terms:

1. In [sic] is important to Murray & Roberts that this proposed transaction will not be disruptive to the employees of Clough, nor that it would diminish your employment conditions.

2. In terms of the scheme rules, options or performance rights previously issued to you will vest on completion of this deal and must be paid out in full, as per your entitlement under the scheme. However, as M&R wishes to enter into retention arrangements with senior executives, M&R may engage with you to offer you an alternative choice.

3. Options that you may have been awarded in October of this year will be replaced with an alternative scheme. The details of this new scheme will be communicated over the course of the next few months.

4. Your current salary packages will be maintained.

**Both clients and employees will want to know that:**

5. Clough will continue to operate as Clough following the completion of this deal, however, as part of the M&R group.

6. There are no planned changes to leadership.

7. Murray & Roberts is supportive of the Clough leadership and strategy. The strategy was approved by the Clough board which comprise three Murray & Roberts directors.

8. Murray & Roberts would like to welcome Clough upon completion of the proposed transaction, as a wholly owned subsidiary of Murray & Roberts.

1. The primary judge summarised this history at J[75] as follows:

Significantly, the term sheet [sent with the proposal from Murray & Roberts on 4 July 2013] and the email of 31 July 2013 show that an arrangement whereby rights under the Option Plan and the Incentive Scheme would be paid out either by Murray & Roberts or by Clough had its origins in the requirements of Murray & Roberts as to what would be done as part of its proposed acquisition of shares in Clough. It began as a term of the proposal to acquire the shares in Clough. It was developed into principles that would govern the consequences for Clough employees of the acquisition of the shares.

1. The primary judge noted at J[78] that Mr Laas gave the following evidence concerning change of control provisions under which unexercised options and performance rights would be paid out:

A change of control clause of this kind providing for accelerated vesting is relatively common in my experience because it ensures that an employee is not disadvantaged by a takeover if they do not like their employer’s new owner, or the new role they are given under a new ownership structure. In my view it was important that in the event that [Murray & Roberts] acquired the shares in [Clough] the payout of the options and rights, as per the terms of each arrangement, was honoured by [Clough]. This ensured that the executive and management of [Clough] maintained a high level of goodwill and trust, not only in [Clough], but also in [Clough’s] new owners, which encouraged those employees to stay on and continue to perform at a high level post acquisition.

It was important to me to ensure that the existing executives and management had confidence in [Murray & Roberts] and that [Clough] will not put the employees in a worse position or cause them to lose part of their remuneration as a consequence of the transaction. As the options and rights were granted to employees as part of their remuneration, I considered it was important for [Clough] to comply with the terms of each scheme.

1. His Honour did not accept that Mr Laas’ evidence stated in full the reasons why there were to be offers to the employees because his interest in securing the outcomes was as an acquirer of shares in Clough rather than representing the purposes of Clough: J[80].
2. The “Remuneration & Human Resources Committee” (**RHR Committee**) of Murray & Roberts Holdings Ltd met on 27 August 2013. The primary judge incorrectly concluded that the RHR Committee was a committee of Clough and that the minutes of the meeting were Clough’s minutes: J[81]. His Honour incorrectly assumed that those present were employees of Clough and that certain representatives of Murray & Roberts, including Mr Laas, attended by invitation. The primary judge drew certain conclusions about Clough’s actions and purposes on the basis of these minutes, having stated at J[81] that the minutes “record views formed by the members of Clough’s RHR Committee, albeit with representatives of Murray & Roberts in attendance”.
3. The appellant submitted that this error was material, in particular because it supplanted the perspective of the purchaser of the shares with that of Clough. The appellant correctly observed that the payments must be characterised from the perspective of Clough and that it would be wrong to characterise the payments from the perspective of Murray & Roberts.
4. The Commissioner submitted the primary judge’s error in concluding that the RHR Committee was a committee of Clough was immaterial to the outcome. This submission must be accepted. The primary judge’s error in relation to the minutes did not lead his Honour into characterising the payments from the perspective of Murray & Roberts. It is also relevant to note that Murray & Roberts was the majority shareholder in Clough and three of its directors were on the Clough board. The SIA was agreed to by Clough and Murray & Roberts and reflected their common goals. The payments must be assessed from Clough’s perspective, but they are to be characterised by reference to all relevant circumstances.
5. The Murray & Roberts RHR Committee minutes relevantly included:

**Clough LTI [Long Term Incentive] Scheme**

Mr Skudder highlighted the salient features of the briefing note prepared to introduce a retention plan and a phantom FSP following the acquisition of the minority interests in Clough. Due to the change of control provisions in the Clough Share Incentive Schemes, all outstanding options and performance rights vest immediately which will result in a cash payment to Clough Executives of AUD15.6 million.

It was noted that Kevin Gallagher has a material diminution clause in his employment contract that gives right to a payment equal to one year’s salary. Clough’s delisting will result in the clause being invoked and this payout to Kevin Gallagher would be AUD1.2 million. The Committee discussed the legal conditions and enforceability of this clause at length and concluded that it is in the Group’s best interest to retain Mr Gallagher for the foreseeable future. The Committee thus approved the diminution payment.

Mr Laas reported on the negotiations held with Clough Executives to roll over all or a portion of their unvested options and performance rights into a phantom FSP. This was rejected on the basis that the automatic vesting is a right under the Clough Share Incentive Schemes and must be upheld. As a consequence thereof, an executive retention plan was proposed to retain key Clough Executives for a 3 year period. The Committee considered the proposal and approved the Clough retention plan (should the acquisition of the minority interests in Clough be successful).

The final retention and incentive element is the establishment of a Clough Phantom FSP to provide general alignment between the Clough Executives, Murray & Roberts and the Murray & Roberts Shareholders. Mr Skudder discussed the proposed Phantom FSP as contained in the briefing note in more detail. The eligibility, quantum of award and date of grant, will be determined by this Committee and the award levels and performance conditions will be similar to that of the Group’s FSP as per the briefing note. The Committee supported and approved the Clough Phantom FSP (should the acquisition of the minority interest in Clough be successful) on the basis that the Committee will have oversight of the implementation of the Clough Phantom FSP.

1. The substance of the 27 August 2013 minutes of the RHR Committee of Murray & Roberts Holdings Ltd may be summarised as follows:
* The RHR Committee was addressing Clough’s “Long Term Incentive Scheme”. Mr Skudder had prepared a briefing note contemplating the introduction of a retention plan and a phantom FSP following the acquisition of the minority interests in Clough.
* Murray & Roberts’ understanding was that the change in control provisions meant that all *vested* options and rights would result in a cash payment to employees. Clough had an obligation to meet those entitlements as a result of the change in control. It is to be inferred that Murray & Roberts agreed that Clough had such an obligation.
* Mr Laas reported on negotiations Murray & Roberts had held with Clough to roll over all or a portion of the *unvested* options and performance rights into a “Phantom FSP”. This was rejected by Clough because Clough considered there was automatic vesting under the incentive schemes and this should be upheld. Murray & Roberts therefore considered an executive retention plan to retain key Clough Executives for a 3 year period. The Murray & Roberts RHR Committee considered and approved the retention plan at the meeting.
* Separately to the retention plan, the “final retention and incentive element” was the establishment of a Clough Phantom FSP to provide general alignment between the Clough Executives, Murray & Roberts and the Murray & Roberts Shareholders.
1. As noted above, the SIA was entered into on 28 August 2013, requiring Clough to make offers to cancel the options and performance rights: J[77].
2. Clough made offers to all of its employees to accept an amount as a payment to cancel their rights that was based upon a schedule that calculated what their rights would be if they vested immediately: J[65]. The payments were calculated by reference to Clough’s view of the value of the accrued rights, determined by reference to the prevailing share price: J[64].
3. The primary judge stated there was “no evidence of any assessment having been made by Clough of the value of past performance by particular employees and the determination of an appropriate amount to reward employees, in retrospect, for that service”: J[64].
4. It was not in dispute that, after implementation of the scheme of arrangement, Murray & Roberts immediately implemented new retention and long-term incentive arrangements for Clough’s executive management team: J[90].
5. The primary judge held that the reason Clough made the payments was that Clough considered it had an obligation to pay out the accrued entitlements of Clough employees under the Option Plan and Incentive Scheme, that obligation being “triggered” by the acquisition by Murray & Roberts which resulted in a change in control. The primary judge concluded that the payments were not made to ensure that the relevant employees remained with Clough after acquisition of the remaining shares by Murray & Roberts. The primary judge stated:

[86] Therefore, it appears that the Amount was paid on the basis that it represented entitlements that were triggered by the proposed acquisition. From a practical business perspective, on the basis of the contemporaneous records, the terms of the Option Plan and the Incentive Scheme were approached by both Clough and Murray & Roberts on the basis that the acquisition triggered a responsibility to pay out those entitlements and that the final element of the transaction would require a new scheme that would apply to incentivise employees. To the extent that similar incentives were needed to retain key management personnel after the acquisition those incentives were to be created by establishing a new scheme in which management staff of Clough could participate.

…

[91] The other evidence of Mr Laas as to the reason for the payment of the Amount to terminate the entitlements under the Option Plan and the Incentive Scheme must be evaluated in the above context. The contemporaneous documents indicate that the way in which the dealings were viewed at the time was that there was an *obligation* to pay out the existing arrangements by reason of a change in control and a need to put in place a new arrangement if the acquisition proceeded. Further, that obligation was triggered by the change in control.

…

[95] Therefore, on the basis of the contemporaneous records the reason for the payment of the Amount at the time was a view that there was an obligation to pay out what was thought to be accrued entitlements of Clough employees. The payment of the Amount was not directed to retaining employees. Further, on the evidence, Murray & Roberts, by its relevant officers, was concerned to ensure that Clough executives that were important to its business were retained notwithstanding the change in control and were incentivised to do so. It dealt with that concern by formulating the Clough Phantom FSP.

[96] Indeed, it is difficult to see how the unconditional termination of the Option Plan and Incentive Scheme by making large cash payments to employees would create an operative incentive by which Clough might retain employees with rights thereunder. Rather, it would bring to an end the deferred nature of those entitlements which could only be earned by continued association with Clough. It would free the employees to make a decision whether to stay or go when the change in control occurred. No doubt that was why the Clough Phantom FSP was developed and offered to key executives.

1. The primary judge stated that the payments were made “in order to fulfil an obligation that arose upon the change in control of Clough to pay relevant employees an amount to bring their entitlements under the Option Plan and Incentive Scheme to an end”: J[104]. The primary judge concluded that the payments were made “only because of the change in control”, stating at J[107]:

On the evidence the Amount was paid only because of the change in control. Without the change in control, Clough may be expected to have continued with the Option Plan and the Incentive Scheme for the same reason that they were established. It would do so in order to create incentives to stay with Clough and to ‘align’ the interests of its employees with those of Clough.

1. The primary judge stated at J[108]:

On the evidence it has not been shown that the act of buying the Clough employees out of their rights by the payment of a cash amount calculated on the basis that they were then entitled to the options had the potential to operate as an incentive for employees to remain with Clough. There is no suggestion that the employees had to make any commitment to stay with Clough as a condition of receiving the payment or that the cancellation formed part of an arrangement by which there would be a new entitlement when control of Clough was assumed by Murray & Roberts. Rather, it had the character of affording a protection to those employees that in the event of a change in control they would have a freedom to decide whether to continue with the company or leave. Making the payment of the Amount gave Murray & Roberts no leverage with the Clough employees. No doubt for that reason, in addition to the payment of the Amount, upon the completion of the acquisition Murray & Roberts put in place arrangements for the ‘final retention and incentive element’ namely the Clough Phantom FSP, a document that was not in evidence and about which Clough gave no evidence despite a call being made for the document by the Commissioner (albeit late in the day).

1. The primary judge stated that a payment to cancel rights held by an employee under an incentive scheme might occur for a number of reasons and that it is an examination of the contextual reasons that will reveal the character of the cancellation payment, particularly whether its character is such that it may be described as having been made to gain or produce income: at J[110].
2. His Honour then said at J[112]:

[T]he payment of the Amount was made to satisfy a requirement of the bid by Murray & Roberts for shares in Clough and because of a view that employees were entitled to the payment by reason of the change in control. It was also done to facilitate the acquisition of 100% control of Clough by Murray & Roberts. It was not done to reward employees or to retain them. It was not done with a view to Clough gaining or producing income.

1. The primary judge’s conclusions in respect of the two positive limbs of s 8-1(1) were drawn together and summarised at J[113] in the following way:

Therefore, payment of the Amount [of $15,050,487] was not incurred by Clough in gaining or producing assessable income or necessarily incurred in carrying on a business for the purpose of gaining or producing such income. If the scheme of arrangement by which Murray & Roberts acquired the shares in Clough had not occurred the Amount would never have been paid. The incurrence of the outgoing was not involved in or connected to an activity that may be described as carrying on Clough’s business. Its incurrence was part of the activity by which Murray & Roberts acquired the shares in Clough. Clough did not pay the lump sum to produce income. Nor did it pay the lump sum as a necessary part of what was required in carrying on its business.

1. As noted earlier, the primary judge did not reach a conclusion about whether the payments were “a loss or outgoing of capital, or of a capital nature” within the meaning of s 8-1(2)(a).

# THE APPEAL

1. The issue on appeal is whether the primary judge erred in concluding that the payments were not deductible under s 8-1.

## The principles

### Section 8-1

1. Section 8-1 requires an examination of the connection between the expense and the process of derivation of income:
* The first positive limb, in s 8-1(1)(a), directs attention to whether the expenditure was “incurred in” gaining or producing assessable income.
* The second positive limb, in s 8-1(1)(b), directs attention to whether the expenditure was “necessarily incurred in” carrying on a business for the purpose of gaining or producing assessable income.

Under both limbs, the expenditure must, at the least, have some relevant connection to producing assessable income. However, it must do more: the expenditure must also be incurred “in” either: (a) gaining or producing assessable income; or (b) carrying on a business for the purpose of gaining or producing assessable income.

1. Section 8-1(2)(a), the negative limb at issue in the present case, prevents any outgoing of a capital nature from being deductible irrespective of whether the outgoing satisfies the positive limbs in s 8-1(1).
2. It is not necessary in this appeal to determine the question whether the matters in s 8-1(2) are true exceptions to s 8-1(1) or whether they are provided by way of contradistinction, as to which see: Parsons RW,*Income Taxation in Australia: Principles of Income, Deductibility and Tax Accounting*(The Law Book Company Ltd, Sydney, 1985) at [5.8]–[5.12]; *Macquarie Finance Limited v Commissioner of Taxation* [2005] FCAFC 205; (2005) 146 FCR 77 at [104] (French J); *St George Bank Limited v Commissioner of Taxation* [2008] FCA 453; (2008) 69 ATR 634 at [53] (Allsop J). It is sufficient to observe that, if an outgoing is on capital account within the meaning of s 8-1(2)(a), it cannot be deductible under either of the positive limbs in s 8-1(1) whether paragraph (a) is read as an exception or by way of contradistinction.

### Section 8-1(1)(a)

1. The question under s 8-1(1)(a), whether an outgoing is wholly or partly “incurred in gaining or producing” assessable income, is a question of characterisation of the expenditure: ***Fletcher*** *v Federal Commissioner of Taxation* (1991) 173 CLR 1 at 17 (in respect of the predecessor to this section, s 51(1) of the *Income Tax Assessment Act 1936* (Cth) (**ITAA 1936**)).
2. In *Federal Commissioner of Taxation v* ***Payne*** (2001) 202 CLR 93 at [9], Gleeson CJ, Kirby and Hayne JJ noted, in respect of s 51(1) of the ITAA 1936, that the language “incurred in gaining or producing” did not create a test of whether outgoings were incurred “in connection with” the derivation of assessable income or “for the purpose of” deriving such income. Rather, the statutory phrase requires analysis of whether the outgoing was incurred “in” gaining assessable income. Their Honours continued:

… It has long been established that “incurred in gaining or producing” is to be understood as meaning incurred “in the course of” gaining or producing. What is meant by being incurred “in the course of” gaining or producing income was amplified in ***Ronpibon*** *Tin NL and Tongkah Compound NL v Federal Commissioner of Taxation* [(1949) 78 CLR 47 at 57] where it was said that:

to come within the initial part of [s 51(1)] it is both sufficient and necessary that the occasion of the loss or outgoing should be found in whatever is productive of the assessable income or, if none be produced, would be expected to produce assessable income.

1. The “occasion of the loss or outgoing” (being the language in *Ronpibon* extracted immediately above) is to be found after an examination of all relevant circumstances giving rise to the outgoing. As with the process of characterisation necessary to determine whether an outgoing is on capital or revenue account, it is relevant to ask what the outgoing is calculated to effect from a practical or business point of view: *Trustees of the Estate Mortgage Fighting Fund Trust v Commissioner of Taxation* (2000) 102 FCR 15 at [19] (Hill J), referring to *Hallstroms Pty Ltd v Federal Commissioner of Taxation* (1946) 72 CLR 634 at 648.
2. The “occasion of the loss or outgoing” is not necessarily temporally restricted to the immediate causes for the payment, albeit contemporaneous events will be directly relevant and of significant, and on occasion decisive, weight. Questions of causation (including for example whether a payment would have been made were it not for the existence of a particular circumstance) and purpose are relevant, but the ultimate object is one of characterisation having regard to all of the relevant circumstances – see: *Fletcher* at 17. As the High Court observed in *Payne*, the word “purpose” is not employed in s 8-1(1)(a).

### Section 8-1(1)(b)

1. In ***John Fairfax & Sons*** *Pty Ltd v Federal Commissioner of Taxation* (1959) 101 CLR 30 at 49 Menzies J stated (original emphasis):

Disregarding the application of the section to losses and considering the alternative head solely in its application to outgoings, there must, if an outgoing is to fall within its terms, be found (i) that it was necessarily incurred in carrying on a business; and (ii) that the carrying on of the business was for the purpose of gaining assessable income. The element that I think it necessary to emphasise here is that the outlay must have been incurred in the *carrying* *on* of a business, that is, it must be part of the cost of trading operations.

1. In concluding that the relevant outgoing in *John Fairfax & Sons* was not deductible, his Honour described it as having “the character of an outgoing in the course of extending the appellant’s business rather than that of a working expense in the carrying on of the appellant’s business”: at 49.
2. Unlike s 8-1(1)(a), the word “purpose” is used in s 8-1(1)(b). Section 8-1(1)(b) requires, in relation to the purpose of the business (as opposed to the purpose of the outgoing), that the purpose be one of gaining or producing assessable income – see: ***Magna Alloys*** *& Research Pty Ltd v Federal Commissioner of Taxation* (1980) 49 FLR 183 at 186 (Brennan J). Deductibility under the second limb does not depend on whether the business actually derived assessable income, that is, upon “success or failure of what the outlay was intended to achieve”, but rather on the purpose of the business: *John Fairfax & Sons* at 49 (Menzies J); *Esso Australia Resources Ltd v Commissioner of Taxation (Cth)* (1998) 84 FCR 541 at 555.
3. The concept of a loss or outgoing being “necessarily incurred in carrying on” a business was described by Deane and Fisher JJ in *Magna Alloys* at 205 in the following way:

The requirement that the claimed outgoing be “necessarily” incurred in carrying on the relevant business does not, in the context, mean that the outgoing must be either “unavoidable” or “essentially necessary”. Nor does the word “necessarily” import a requisite of logical necessity. What is required is that the relevant expenditure be appropriate and adapted for the ends of the business carried on for the purpose of earning assessable income (see, *Ronpibon Tin NL v Federal Commissioner of Taxation* [(1949) 78 CLR 47 at 55–56]; *Federal Commissioner of Taxation v Snowden & Willson Pty Ltd* [(1958) 99 CLR 431 at 437 and 444]). For practical purposes and within the limits of reasonable human conduct, it is for the man who is carrying on the business to be the judge of what outgoings are necessarily to be incurred (*Federal Commissioner of Taxation v Snowden & Willson Pty Ltd* [(1958) 99 CLR 431 at 444]). It is no part of the function of the Act or of those who administer it to dictate to taxpayers in what business they shall engage or how to run their business profitably or economically. “The Act must operate upon the result of a taxpayer’s activities as it finds them” (per Williams J in *Tweddle v Federal Commissioner of Taxation* [(1942) 7 ATD 186 at 190]; see also, *Ronpibon Tin NL v Federal Commissioner of Taxation* [(1949) 78 CLR 47 at 56–57]; *Cecil Bros Pty Ltd v Federal Commissioner of Taxation* [(1962–1964) 111 CLR 430 at 434 and 441]; *Inland Revenue Commissioner v Europa Oil (NZ) Ltd (No 1)* [(1971) AC 760 at 772]; *Federal Commissioner of Taxation v South Australian Battery Makers Pty Ltd* [(1978) 140 CLR 645 at 653–654].

1. This passage in *Magna Alloys* was referred to with approval in ***Spriggs*** *v Commissioner of Taxation* (2009) 239 CLR 1 at [75]. French CJ, Gummow, Heydon, Crennan, Kiefel and Bell JJ said:

In *Ronpibon Tin*, the overlap between the limbs of the predecessor section to s 8-1 of the ITAA [*Income Tax Assessment Act 1936* (Cth), s 51(1)], which often renders the second limb otiose, was noted [(1949) 78 CLR 47 at 56]. It was held that a loss or outgoing will be “necessarily incurred in carrying on” a business if it is “clearly appropriate” or “adapted” for the carrying on of the business [(1949) 78 CLR 47 at 55-56]. Restating the test another way, the loss or outgoing will be “necessarily incurred” if it is “reasonably capable of being seen as desirable or appropriate from the point of view of the pursuit of the business ends of the business” [*Magna Alloys & Research Pty Ltd v Federal Commissioner of Taxation* (1980) 11 ATR 276 at 295-296; 33 ALR 213 at 235 per Deane and Fisher JJ. See further *Federal Commissioner of Taxation v Snowden & Willson Pty Ltd* (1958) 99 CLR 431 at 437 per Dixon CJ; at 443-444 per Fullagar J].

1. In that passage, the High Court summarised the test in two ways. An outgoing will be “necessarily incurred in carrying on a business” if it is:
2. “clearly appropriate” or “adapted” for the carrying on of the business;
3. “reasonably capable of being seen as desirable or appropriate from the point of view of the pursuit of the business ends of the business”.
4. The High Court also referred in *Spriggs* at [75] to *Federal Commissioner of Taxation v Snowden & Willson Pty Ltd* (1958) 99 CLR 431 at 437, in which Dixon CJ had stated that the word “necessarily”, in this statutory context, meant “dictated by the business ends to which [the expenditure] is directed, those ends forming part of or being truly incidental to the business”.
5. The requirement that expenditure be shown to be appropriate and adapted necessarily involves an examination of all of the business operations carried on over time and the whole course of events relevant to the particular expenditure at issue – see: *Federal Commissioner of Taxation v Day* [2008] HCA 53; (2008) 236 CLR 163 at [33].
6. Clough submitted that the primary judge adopted a more restrictive understanding of the meaning of “necessarily incurred in carrying on a business” than is established in the authorities just referred, in particular *Spriggs* at [75] to which the primary judge referred at J[20].
7. The appellant referred in particular to J[15] and J[19] where the primary judge stated (emphasis added):

[15] The second limb of s 8‑1 is slightly different in its structure. First and foremost, it requires that the outgoing be ‘necessarily incurred in’ the specified activity. **The addition of the word ‘necessarily’ emphasises that the incurrence of the expenditure must have a closer involvement or connection with the specified activity than is required by the first limb**. Second, the activity for which the outgoing must be incurred is described both by reference to its character and its purpose. So it is in undertaking the activity of carrying on a business for the purpose of gaining or producing assessable income that the outgoing must be necessarily incurred. It is the whole of the operations of the business that should be taken into account in making that assessment: *Commissioner of Taxation v Day* [2008] HCA 53; (2008) 236 CLR 163 at [33].

…

[19] Therefore, the second limb requires that the incurrence of the outgoing be properly characterised as being involved in or connected to an activity that may be described as carrying on a business where the purpose of the business is gaining or producing assessable income. It may be so involved or connected if it is preparatory to gaining or producing assessable income. **However, it will not be so involved or connected unless it is not shown [sic – shown] to be necessary to incur the outgoing for an identified business that has the required purpose**. The proprietors of businesses may incur outgoings that have nothing to do with the business. It is not enough that the outgoing was charged to the business. It must be necessarily incurred in the activity of carrying on a business for profit. So, the fact that the outgoing is in fact incurred by a business that is carried on for the purpose of gaining or producing assessable income will not be enough. If the incurrence of the outgoing is not properly characterised as being necessary in the carrying on of an identified business with the requisite purpose, it will not satisfy the second positive limb. **The addition of the requirement that the outgoing be necessarily incurred in the carrying on of the business means that an outgoing that does not satisfy the first limb and is not shown to be necessary in conducting a business that is carried on to gain or produce assessable income is not deductible**.

1. The appellant’s submission has some force given the importance the primary judge attached to the word “necessarily” which qualifies the phrase “incurred in” when used in the second limb of s 8-1(1) and which his Honour observed does not qualify the same phrase when used in the first limb. The significance of the word “necessarily” must be assessed in the context of the legislative history of the two provisions and recognising that the first limb is directed to that which is “incurred in” gaining or producing assessable income, whereas the second is directed to that which is “necessarily incurred in carrying on a business” for that purpose. If an outgoing is appropriate and adapted for the carrying on of the business for the requisite purpose, it will not be denied deductibility on the basis it was not strictly necessary.
2. On balance, and notwithstanding that the primary judge referred at J[20] to *Spriggs* at [75], the primary judge probably understood the second limb more restrictively than the authorities establish given what he stated in the passages at J[15] and [19] emphasised above and when regard is also had to his Honour’s application of the test, particularly at J[113]. The observations made by the primary judge at J[15] and [19] must, however, be read with J[20]. The relevant test is as explained by the High Court in *Spriggs* at [75].
3. Whether or not the primary judge understood the test too narrowly, for the reasons given below, the primary judge correctly reached the conclusion that the second limb did not apply to permit the payments to be deducted under that limb.

### Section 8-1(2)(a)

1. The general principles relevant to whether expenditure is on capital or revenue account have been considered reasonably recently by the High Court in ***AusNet*** *Transmission Group Pty Ltd v Federal Commissioner of Taxation* (2015) 255 CLR 439 and *Federal Commissioner of Taxation v* ***Sharpcan*** *Pty Ltd* (2019) 269 CLR 370. As with the positive limbs, the task is again one of characterisation. In ***Sun Newspapers*** *Limited and Associated Newspapers Limited v Federal Commissioner of Taxation* (1938) 61 CLR 337 at 359, Dixon J made the following general observation:

The distinction between expenditure and outgoings on revenue account and on capital account corresponds with the distinction between the business entity, structure or organization set up or established for the earning of profit and the process by which such an organization operates to obtain regular returns by means of regular outlay, the difference between the outlay and returns representing profit or loss.

1. His Honour then identified (at 363) three matters to be considered:
2. the character of the advantage sought, and in this its lasting qualities may play a part;
3. the manner in which it is to be used, relied upon or enjoyed, and in this and under the former head recurrence may play its part;
4. the means adopted to obtain it – that is, by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payment so as to secure future use or enjoyment.
5. In ***Hallstroms*** *Pty Ltd v Commissioner of Taxation* (1946) 72 CLR 634 at 648, Dixon J (dissenting as to the application of principle to the facts) stated:

What is an outgoing of capital and what is an outgoing on account of revenue depends on what the expenditure is calculated to effect from a practical and business point of view, rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process.

This statement was referred to with approval in AusNet at [22] (French CJ, Kiefel and Bell JJ) and [73] (Gageler J).

1. The statement by Dixon J in *Hallstroms* at 648 does not mean that an examination of the relevant legal rights is irrelevant or unimportant in the process of characterisation – see, for example: *Watson as trustee for the Murrindindi Bushfire Class Action Settlement Fund v Commissioner of Taxation* [2020] FCAFC 92; (2020) 277 FCR 253 at [45] (Kenny, Davies and Thawley JJ). An examination of the legal rights is important, it being part of the circumstances relevant to a proper characterisation of the expenditure and capable of informing what the expenditure is calculated to effect from a practical and business point of view – see: *Federal Commissioner of Taxation v South Australian* ***Battery Makers*** *Pty Ltd* (1978) 140 CLR 645 at 662 (Stephen and Aickin JJ); *AusNet* at [22] (the plurality citing *Battery Makers* at 662); at [74] (Gageler J); and see the analysis of Nettle J (in dissent in the result); *Sharpcan* at [27].
2. Characterising expenditure from a practical and business perspective, having regard to the legal nature of the various rights created, used or brought to an end by that expenditure, requires regard to be had to the whole commercial context. It involves “both a wide survey and an exact scrutiny of the taxpayer’s activities”: ***Western Gold Mines*** *(NL) v Commissioner of Taxation (WA)* (1938) 59 CLR 729 at 740; *AusNet* at [74] (Gageler J citing *Western Gold Mines* at 740). One reason it is necessary to have regard to the whole context is that “expenditure of a kind ordinarily treated as being on revenue account in one set of circumstances may be treated as on capital account in another set of circumstances”: *AusNet* at [19] (French CJ, Kiefel and BellJJ).
3. The question of characterisation must be approached from the perspective of the person incurring the outgoing. An inquiry into the character of the receipt of the outgoing in the hands of the recipient at best distracts attention from the critical task of characterisation. As Dixon J stated in *W****Nevill*** *& Co Ltd v Federal Commissioner of Taxation* (1937) 56 CLR 290 at 306: “there is no necessary connection between the two questions and, indeed, an attempt to obtain guidance in the solution of one by considering the other is not without danger”; see also: *Federal Commissioner of Taxation v Rowe* (1997) 187 CLR 266 at 291-292; *AusNet* at [66] (French CJ, Kiefel and Bell JJ).

## Application

### The facts in summary

1. In an endeavour to attract and retain skilled employees, and to incentivise those employees to perform, Clough introduced the Option Plan and the Incentive Scheme. Clough’s employees came to have options and rights granted by Clough under the Option Plan and the Incentive Scheme. Some had vested some had not. Options entitled employees on exercise to receive shares according to the terms of the Option Plan. Employees might receive shares or cash, at the company’s election, under the Incentive Scheme in accordance with the terms of that scheme.
2. Murray & Roberts, the majority shareholder in Clough, wanted to acquire all of the shares in Clough. Murray & Roberts contemplated that, after the takeover assuming it proceeded, the business of Clough would continue as part of the M&R group. Murray & Roberts stated it had no planned changes to leadership and was supportive of the Clough leadership and strategy, that strategy having been approved by the Clough board which comprised three Murray & Roberts directors – see: [21] above.
3. The proposed acquisition of the minority shareholding meant that the rights under the Option Plan and Incentive Scheme had to be brought to an end. It was not possible for employees to continue to have a right to receive shares (or possibly cash) in circumstances where the object of the transaction was for Murray & Roberts to hold 100% of the shares in Clough. The accrued entitlements held by the employees had to be met in some way. Both Murray & Roberts and Clough proceeded on the basis that there was an obligation to pay the employees. The SIA required Clough to use its best endeavours to cancel the options and rights held by employees. As a matter of legal form and practical reality, the payments were made to bring Clough’s obligations to its employees under the Option Plan and Incentive Scheme to an end.
4. The takeover was the proximate causal event requiring that the payments be made; and the payments would not have been made but for the takeover. However, the options and rights (entitlements) held by employees and the obligation to address those entitlements in the event (amongst other things) of a takeover pre-existed the takeover. The payments would not have been made but for the fact that Clough had granted options and rights to its employees in the course of its business with a view to attracting and incentivising employees.
5. In the case of those employees who held vested or unvested options, Clough wrote to them stating:

In connection with the Scheme, Clough is making an offer to each registered holder of options to acquire ordinary shares in Clough **(Options)** under the Clough Limited Employee Option Plan to cancel their Options for consideration equivalent to the intrinsic value of the relevant Options, determined by reference to the consideration of $1.46 being offered per Clough share under the Scheme. This offer applies to all Options, whether vested or not.

1. The letter also set out what might occur if Clough’s offer were not accepted: Clough might propose an option scheme of arrangement, which might result in the options being acquired by Murray & Roberts or cancelled; Murray and Roberts might compulsorily acquire options after implementation of the scheme; or the scheme might be terminated.
2. In respect of those employees who held performance rights, Clough wrote:

In connection with the Scheme, Clough is making an offer to each registered holder of performance rights **(Performance Rights)** under the Clough Executive Incentive Scheme to cancel their Performance Rights for $1.46 per Performance Right, which is equivalent to the consideration being offered per Clough share under the Scheme.

1. The letter noted that, if the offer was accepted, then – subject to the Court approving the scheme of arrangement – the performance rights would be cancelled and the employee would receive the consideration on the date the scheme was implemented. The letter further stated:

If you do not accept the Offer, your Performance Rights will automatically vest if the Scheme is approved by Clough shareholders. The resulting Clough shares issued to you upon automatic vesting of your Performance Rights will participate in the Scheme and receive the consideration payable for those shares under the Scheme (together with all other Clough shareholders).

1. The offers to the employees were conditional on the SIA becoming effective. The scheme of arrangement was approved. It was implemented on 11 December 2013. All of the options and rights were cancelled on that day and the employees were paid their respective entitlements totalling $15,050,487: J[98], [99]. Murray & Roberts acquired the minority shareholding in Clough and Clough was delisted.
2. As to the cancellation of the options and rights, the primary judge noted that “the case for Clough was put expressly on the basis that the Amount [of $15,050,487] was paid to cancel the entitlements of employees under the Option Plan and the Incentive Scheme and not by way of some form of performance of those entitlements”: J[74]. That correctly reflects the legal character of what occurred. The concession was properly made.
3. It should also be acknowledged that the character of the payment from a legal point of view is not always commensurate with the character of the payment from a practical and business point of view. This can be demonstrated by reference to *Federal Commissioner of Taxation v Foxwood (Tolga) Pty Ltd* (1981) 147 CLR 278. Foxwood sold its business to another company and the purchaser took on all of Foxwood’s employees. By clause 25 of the sale agreement, the purchaser agreed to be liable (amongst other things) for accrued holiday and sick leave provided that Foxwood paid to the purchaser an amount determined to reflect those accrued entitlements. At 285-286, Gibbs CJ stated:

The question “What was the object of the expenditure?” must be answered from a practical and business point of view: see the statement of Dixon J in *Hallstroms* … From a practical, although not from a legal, point of view the payment discharged the obligation of the taxpayer to the employees. It would be too narrow a view to hold that the object of the payment was to enable the purchaser to pay the employees; the object, revealed by cl 25 of the contract, was to discharge the obligation of the taxpayer to the employees by paying the requisite amount to the purchaser and obliging him to pay the employees. The payment therefore had the same character as a payment made directly to the employees would have had …

1. Having regard to those matters the conclusions can be shortly stated.

### Section 8-1(1)(a)

1. The payments were not “incurred in gaining or producing … assessable income” within the meaning of s 8-1(1)(a). The “occasion of the loss or outgoing” (*Ronpibon*) lay in the takeover. That is not to deny that the payments would not have been made were it not for the existence of the rights and options which had been granted to the employees.
2. As noted earlier, the primary judge concluded at J[107] that the payments were made “only because of the change in control”. That conclusion is to be understood as an emphatic statement as to the immediate cause of the payment: the payments would not have been made but for the fact that Clough had agreed to facilitate a takeover and had entered into the SIA which required Clough to seek to cancel the rights and options and because the scheme had been approved and implemented. The primary judge’s observation is not to be understood as denying that the payments would not have been made but for the fact that employees held options and rights, or held certain entitlements, which had to be met. In a strict causal sense, the payment were not made “only” because of the scheme of arrangement or change in control.
3. The primary judge was correct to conclude that the payments were not incurred in gaining or producing assessable income on the basis that the occasion of them lay in the takeover and not in gaining or producing assessable income.

### Section 8-1(1)(b)

1. The payments were not “necessarily incurred in carrying on a business for the purpose of gaining or producing … assessable income” within the meaning of s 8-1(1)(b). The payments were not in the nature of a working expense in the carrying on of Clough’s business – see: *John Fairfax and Sons* at 49 (Menzies J). The payments were not payments by way of reward to the employees. The incurrence of the expense was part of the activity required for Murray & Roberts to acquire the minority shareholding under the scheme of arrangement and to secure 100% control and the delisting of Clough.

### Section 8-1(2)(a)

1. The immediate advantage which Clough sought by making the payments was to bring the various options and rights to an end permanently. The object in making the payments was to complete the takeover of the minority shareholding in Clough by Murray & Roberts such that Clough would be 100% owned by Murray & Roberts and delisted from the ASX.
2. The bringing of the options and rights to an end had an effect on the capital structure of Clough by removal of the options and rights as securities on issue.
3. The options and rights were cancelled by Clough in performance of its obligations under the SIA and pursuant to the scheme of arrangement approved by the Court.
4. Although multiple payments were made (to each relevant employee), so far as Clough was concerned, the payments were all made at once to secure the one enduring change, namely that Clough would become wholly owned by Murray & Roberts.
5. The amounts of the payments were calculated by reference to the share price, not by reference to time served by particular employees or by reference to performance criteria achieved. Payment of the amounts was conditional on the scheme of arrangement proceeding. The payments were unusual and not in the nature of an ordinary working expense. Of course, of itself, the fact that a payment is unusual is not determinative against deductibility: *Nevill* at 306 (Dixon J); *Charles Moore & Co (WA) Pty Ltd v Federal Commissioner of Taxation* (1956) 95 CLR 344.
6. Assessing all of these matters as a whole, the payments were on capital account.
7. Whilst it is relevant in the process of characterisation to have regard to the fact that the payments would not have been made but for the fact that employees had been granted rights and options, the proper characterisation of the payments is nevertheless that they were made on capital account. The payments were calculated to have the effect of bringing the employees’ options and rights to an end. They were made for the purpose of facilitating the takeover to secure 100% ownership of Clough by Murray & Roberts.
8. This conclusion is not denied by the fact that, if the takeover had not occurred, and an obligation to meet performance rights arose, performance rights if paid in cash rather than the issue of shares, might have been characterised as being on revenue account – see: *AusNet* at [19] (French CJ, Kiefel and Bell JJ). In ***Royal Insurance*** *Co v Watson* [1897] AC 1, the purchaser of an insurance business agreed to pay a fixed salary to a continuing employee with an election to commute the salary to a gross sum and terminate the employment. The salary, commuted or not, was held to form part of the consideration for purchase of the business and therefore an outgoing of capital. In *AusNet* at [17], the plurality referred to these facts and set out the following statement of Lord Halsbury LC at 7:

The result is that one of the companies sells to the other, and part of the consideration which was contemplated by both parties, and in respect of which the bargain was made, and without which it would not have been made, was the manager, and all that was incident to the manager, in respect of the payments to be made to him, whether made at once or made in this form of commutation.

1. The plurality then observed that “[i]n the ordinary course, a lump sum paid to an employee to procure his or her resignation would be on revenue account ‘made for the purpose of organising the staff and as part of the necessary expenses of conducting the business’”, quoting *Nevill* at 306 (Dixon J). However, as the plurality noted, the “key factor in characterisation” in *Royal Insurance*, was that the contested payment was part of the consideration for the acquisition of the business.
2. In *Income Taxation in Australia*, Professor Parsons expressed the view that there is no rule that an expense which relieves the taxpayer of a liability to make payments in the future which would be deductible is itself deductible: at [6.268]–[6.271]. At [6.271], Professor Parsons stated (emphasis added):

… A payment made to a managing director, in other respects like the payment in *Nevill,* may be denied deduction if it is made as an aspect of the closing down of the business operations in which he was employed: *Godden v A Wilson’s Stores (Holdings) Ltd* (1962) 40 TC 161. And such a payment may be denied deduction where it is a payment made by a company employer to give effect to an agreement between former and present shareholders that the company would buy out the contracts of its executive directors: *Overy v Ashford Dunn* & *Co Ltd* (1933) 17 TC 497, *Bassett Enterprise Ltd v Petty* (1938) 21 TC 730, *James Snook* & *Co Ltd v Blasdale* (1952) 33 TC 244, *Faulconbridge v Thomas Pinkney* & *Sons Ltd* (1951) 33 TC 415, *George Peters* & *Co Ltd v Smith* (1963) 41 TC 264, *George J Smith* & *Co v Furlong* [1969] 2 All ER 760. **The payment which is the result of a bargain made in the transfer of control of the company is not to be described as “connected with the ever recurring question of personnel” (Dixon J in *Nevill* (1937) 56 CLR 290 at 306) and may be denied deduction. Indeed there is a prospect that a payment to buy out the contract of an executive director may be denied deduction if a change of control of a company has resulted from a take-over bid and the executive director is bought out in order to make way for a nominee of the new controllers. The question is whether the purpose of the payment was to facilitate the exercise of control by the new controllers or to further the derivation of income by the company.**

1. None of this should be understood as suggesting a conclusion that the payments the subject of this appeal do reflect outgoings which relieved Clough of future deductible outgoings. Under the Option Plan (representing roughly two-thirds of the payments), Clough would have been required to issue shares if the options vested. It was only under the Incentive Scheme that cash payments were a possibility.
2. The important point is that the occasion of the outgoing, and identification of what the outgoing is for (*Colonial Mutual Life Assurance Society Ltd v Federal Commissioner of Taxation* (1953) 89 CLR 428 at 454 (Fullagar J); *GP International Pipecoaters Pty Ltd v Federal Commissioner of Taxation* (1990) 170 CLR 124 at 136-137), is not as simple as merely observing that the outgoing relates to employees or that one of the reasons the payments were made was the existence of rights or expectations arising from dealings between employer and employee.

### Canadian Cases

1. The Commissioner referred to two decisions of the Canadian Federal Court of Appeal in which payments similar to those made in the present case were held to be on capital account. The first was *Her Majesty the Queen v* ***Kaiser*** *Petroleum Ltd* [1990] 2 CTC 439. Desjardins JA (with whom Marceau and Linden JJA agreed) described the issue in the appeal in the following way (at 440):

The sole question for determination in this appeal is whether a payment made by the respondent, in order to extinguish a stock option plan held in favour of certain of its officers and key employees, constitutes a deductible expense or an outlay on account of capital.

1. The facts can be briefly summarised for present purposes. On 11 July 1978, Ashland Oil Inc (**Ashland US**) entered into an agreement with **Kaiser** Resources Ltd for the sale of Ashland US’s shares in Ashland Oil Canada Ltd (**Ashland Canada**). Ashland Canada had a stock option plan which was designed to operate as an incentive to ensure superior performance by qualified employees and to enhance the ability of the company and its subsidiaries to attract and retain valued employees. Desjardins JA observed (at 440):

According to the evidence at trial, a prospective takeover of Ashland Canada by Kaiser Resources Ltd caused Ashland Canada’s management concern about ensuring that their key employees would be persuaded to continue as employees with the company following completion of the takeover. It was also felt that since the shareholders were realizing their investment in the growth of the company, the employees should also have the opportunity of realizing their contribution to that gain. There was also a desire to eliminate any uncertainty about the effects which new ownership might have upon the value of the plan.

1. Clause 4.2 of the sale agreement between Ashland US and Kaiser required that, before the closing date, the company make an offer, to each employee holding an employee stock option plan, to obtain the cancellation of such options upon payment of a certain amount.
2. Desjardins JA summarised the parties contentions in the appeal in the following way (at 442):

The appellant submits that the payment by Ashland Canada to its employees for the termination of rights to exercise their stock options was a once and for all transaction which brought into existence an enduring benefit to Ashland Canada, namely the elimination of extraneous shares or share possibilities. Ashland Canada was not in the business of dealing in shares but in the oil and gas business. The payment to terminate rights under the option agreements did not form part of the operation of the profit-making entity. It was designed to acquire a facet of the business entity, namely more certainty about potential shareholders. The company’s original purpose in creating the stock option agreement may have been to create an incentive or form of compensation for employees. However, the company’s purpose in terminating the stock option agreement at the time of the takeover was not as a compensation for employees. It was a capital structuring of the company.

The respondent’s contention is that the sum at issue was paid upon the termination of an agreement initiated to compensate certain key employees for services rendered by them to the respondent. Absent unusual circumstances not present in this case, amounts paid and benefits received in relation to the plan represent taxable benefits to the employees and deductible outlays to the payor. Until such time as shares were acquired under the plan, the plan was an integral part of a member’s compensation package. It is only at the time that shares are actually acquired by an employee pursuant to an option agreement that the contract ceases to be a matter in respect of employment and compensation to become a matter between shareholders and company

1. Her Honour then referred to Canadian authority which had approved the following statement in ***BP Australia*** *Ltd* v *Commissioner of Taxation* (1965) 112 CLR 386:

The solution to the problem is not to be found by any rigid test or description. It has to be derived from many aspects of the whole set of circumstances some of which may point in one direction, some in the other. One consideration may point so clearly that it dominates other and vaguer indications in the contrary direction. It is a commonsense appreciation of all the guiding features which must provide the ultimate answer

1. Her Honour continued at 443:

Following the sale offer … , the potential shares of Ashland Canada in the stock option plan had, in all probability, acquired the same market value. This increase would have reflected itself in the hands of the potential owners of the shares of the stock option plan through a share acquisition, had the plan properly unfolded. Moneys, reflecting the increase in value of the shares, were offered instead of shares. The respondent, in buying out rights under the plan, parted with an asset (the purchase price) and effected a sterilization of future issues of shares. The disbursement was made as a once and for all payment which had a direct effect on the capital structure of the corporation. In fact, the stock option plan was later cancelled. Although the plan originated as a form of compensation and immediate compensation was one of the reasons for its termination, and although the arrangement may appear to have been “seeming novations of the original deal”, as characterized by the trial judge (probably since the compensation was in money terms instead of shares), it does not follow that the payment, from the point of view of the respondent, had the character of an operating expenditure. What is important is not the purpose pursued by the respondent but what it did and how it did it.

1. At 444, Desjardins JA observed:

In the case at bar, there is no evidence that the undertaking of July 11, 1978 was conditional to the sale agreement so as to ensure a share acquisition by Kaiser Resources Ltd. There is, however, evidence that compensation was one element pursued when the termination of the stock option plan took place. Nevertheless, the compensation was made by means of a reshaping of the capital structure of the respondent’s organization. This feature, in my view, dominates the whole set of circumstances revealed by the evidence and constitutes the guiding element under the test set in the *BP Australia Ltd* case cited above

1. The second case to which the Commissioner referred was *Imperial Tobacco Canada Ltd v The Queen* [2012] DTC 5003. The issue was the character of payments made to bring employees’ stock options to an end in the context of a takeover. The Court of Appeal held the payments were made on capital account. The facts were as follows. Imperial Tobacco was the successor by amalgamation to Imasco Ltd. On 11 May 1983, Imasco instituted an employee stock option plan under which employees of Imasco and its subsidiaries could be granted the right to purchase its shares. There was an amendment to the plan in 1995 such that Imasco had the right to offer an option holder the right to surrender the option for cash equal to the amount by which the market value of the Imasco shares that could be acquired by exercising the option exceeded the exercise price: at [6].
2. In March 1999, British American Tobacco plc (**BAT**) approached Imasco to discuss a proposal for a “going private transaction” under which BAT would acquire all of the Imasco shares held by public shareholders: at [7]. On 9 June 1999, the board of directors passed a resolution to amend the stock option plan to give all the option holders the right to surrender their options for cash: at [8].
3. Sharlow JA (with whom Nadon and Dawson JJA concurred) inferred that this amendment was one of the steps taken by Imasco to facilitate the going private transaction. Her Honour stated at [9]:

It is reasonable to infer, as Justice Bowie did at paragraph 12 of his reasons, that this amendment was one of the steps taken by Imasco to facilitate the going private transaction. Imasco contended that the amendment was made to ensure that option holders were treated fairly if the going private transaction was completed. That is also consistent with the documentary evidence. I see no conflict between the objective of facilitating the going private transaction and the objective of treating option holders fairly.

1. The relevant parties entered into a “Transaction Proposal Agreement” on 2 August 1999. Sharlow JA stated at [13] and [16]:

Article 5.8 of the Transaction Proposal Agreement is entitled “Outstanding Stock Options and Employment Arrangements of Imasco”. In that provision, Imasco agreed that its board of directors would unanimously resolve to encourage all holders of employee stock options to exercise them or surrender them immediately prior to the completion of the reorganization. Imasco also agreed that, subject to regulatory and stock exchange approvals, its board of directors would take the steps required to ensure that all employee stock options would vest before the reorganization so that they could be exercised prior to the completion of the reorganization. That was done, but the immediate vesting of the employee stock options above was subject to the condition that if certain closing steps of the reorganization were not completed, the immediate vesting would be deemed never to have occurred.

…

Prior to the closing, employees holding in aggregate options to acquire 4,848,600 Imasco shares elected to surrender their options for cash equal to the difference between $41.60 per share and the exercise price. The surrender payments totalled approximately $118 million. A small number of options (62,800) were not surrendered. They were exercised before the closing, and the shares issued as a result were acquired by Bidco on the closing date. The result was that after the going private transaction, Imasco had no further obligations under the Imasco stock option plan

1. The relevant statutory provision, paragraph 18(1)(b) of the *Income Tax Act*, RSC 1985, c 1 (5th Supp), provided that:

In computing the income of a taxpayer from a business or property, no deduction shall be made in respect of: … (b) … a payment made on account of capital…”.

1. Her Honour observed at [21]:

The statutory prohibition on the deduction of a payment on account of capital requires consideration of the principles for distinguishing capital and income. The determination is driven primarily by the facts of the particular case, with the cases providing guidance on the factors to be taken into account …

1. Her Honour then referred to a number of cases which in turn referred to authorities including *BP Australia* before articulating the question in the appeal and the succinct answer in the following way at [29]:

The specific question is whether Justice Bowie’s conclusion in this case was based on an error in his understanding or application of the relevant jurisprudence. A careful review of Justice Bowie’s reasons discloses no such error. In my view, there are three factors that point to the conclusion that the payments in issue were on capital account. First, they coincided with a reorganization of the capital of Imasco (the going private transaction and amalgamation). Second, the arrangements put in place for making the payments facilitated and were intended to facilitate the capital reorganization. Third, the payments were intended to and did end all future obligations of Imasco to deal with its own shares, which can fairly be described as a once and for all payment that resulted in a benefit to Imasco of an enduring nature.

1. Her Honour pointed also to two factors which favoured the taxpayer, stating at [30] and [31]:

There are two factors that arguably could favour the position of Imasco. First, the employee stock option plan itself was entered into to provide a form of employee compensation and the plan had, at least since 1995, contemplated periodic surrenders of options for cash, albeit at the option of Imasco. Second, the shares represented by the surrendered options represented only a small portion of the Imasco issued shares.

Justice Bowie was clearly aware of these facts, and just as clearly he did not consider them to be of sufficient weight to overcome the factors that supported the conclusion that the payments in issue were outlays on account of capital. In finding as he did, Justice Bowie relied on *Kaiser* (cited above) which he found to be indistinguishable on its facts. The payments in issue in *Kaiser* were held to be on account of capital because their immediate result was to “eliminate extraneous shares or share possibilities”, which was characterized as a form of capital restructuring. Imasco argues that *Kaiser* is distinguishable for a number of reasons. It is true that there are some factual differences. They are listed at paragraph 10 of Justice Bowie’s reasons.

1. Of course, these two Canadian decisions concern different legislation. However, it is the distinction between income and capital which is critical. Here, that distinction does not relevantly turn on specific statutory language. It may be accepted that differences emerge in the common law of different countries and, even where principles remain broadly the same, differences emerge in expression and emphasis. None of this automatically denies the persuasive or instructive value of the reasoning and decisions of other common law jurisdictions – see: *Paciocco v ANZ Banking Group Limited* (2016) 258 CLR 525 at [10] (French CJ).

### W Nevill & Co Ltd v FCT

1. In its written submissions the appellant contended that the payments in *Nevill* were indistinguishable from those in the present case. The facts in *Nevill* were as follows. Until 1 July 1930, Nevill had one managing director, Mr Nevill. The company decided to introduce a new system of joint management and appointed a second managing director, Mr King, for a term of five years from 1 July 1930 at an annual salary of £1,500 and a percentage of profits. As the stated case made clear, the new system was not successful. Mr King had been expected to introduce new business. That expectation was not fulfilled and Mr Nevill did not receive the assistance he had expected. Joint control proved to impair efficiency.
2. An arrangement was made in March 1931 for Mr King to resign. Mr King offered and the company agreed to pay Mr King a sum of £2,500 in consideration of his cancelling his agreement. The main object in accepting Mr King’s offer was to effect a saving of salary which would otherwise have been payable and because it was believed that the abolition of the system of joint management would lead to increased efficiency. An amount of £1,500 was paid in cash and £1,000 by meeting ten £100 promissory notes in each month from March to December 1931. The company claimed the amount of £2,500 as a deduction in respect of the income year ended 30 June 1931.
3. At the time, there was only one positive limb, namely that contained in s 23(1) of the *Income Tax Assessment Act* *1922* (Cth) (**ITAA 1922**). The second positive limb was introduced in 1936 – see: s 51(1) of the ITAA 1936. The relevant provisions were s 23(1)(a) and s 25(e) of the ITAA 1922 which, in relation to the income year ended 30 June 1931, provided:

23(1) In calculating the taxable income of a taxpayer the total assessable income derived by the taxpayer shall be taken as a basis, and from it there shall be deducted—

(a) all losses and outgoings (including commission, discount, travelling expenses, interest and expenses, and not being in the nature of losses and outgoings of capital) actually incurred in gaining or producing the assessable income;

 …

25 A deduction shall not, in any case, be made in respect of any of the following matters:—

…

(e) money not wholly and exclusively laid out or expended for the production of assessable income; …

1. The outgoings were held to be deductible as “incurred in gaining or producing assessable income” and not to be “in the nature of losses and outgoings of capital”. As to the question whether the payment fell within the “positive” aspect of s 23(1)(a), Dixon J said at 305:

Under the first of these provisions it is necessary that the expenditure should have been incurred in gaining or producing the assessable income, that is the assessable income of the given financial year or accounting period. This means that it must have been incurred in the course of gaining or producing the assessable income. It does not require that the purpose of the expenditure shall be the gaining or production of the income of that year. The condition the provision expresses is satisfied if the expenditure was made in the given year or accounting period and is incidental and relevant to the operations or activities regularly carried on for the production of income. This is explained in *Amalgamated Zinc (De Bavay’s) Ltd v Federal Commissioner of Taxation* [(1935) 54 CLR, at pp 303, 307, 309, 310].

The expenditure upon the retiring allowance of the managing director appears to me to fulfil this test, except for the circumstance that some of the promissory notes fell due outside the financial year.

1. It might be observed that this statement of the operation of s 23(1)(a), albeit made in relation to earlier and differently worded legislation, almost precisely mirrors the statements of principle in *Magna Alloys* (s 51(1) of the ITAA 1936) and *Spriggs* (s 8-1 of the ITAA 1997) set out at [55] and [56] above.
2. As to the question whether the payments fell within the negative aspect of s 23(1)(a), as being capital in nature, Dixon J stated at 306-307:

But sec 23 (1) (a) imposes another and a negative condition. The expenditure must not be of a capital nature. For the commissioner it is contended that in, so to speak, buying out the managing director, the taxpayer company, in effect, commuted its loss on his future salary for an immediate capital payment. Some of the reasons given in support of the argument treated the question whether the payment of the retiring allowance by the company should be considered as part of its capital expenditure as interdependent with the question whether its receipt by the managing director should be considered part of his assessable income or as an addition to his capital. In my opinion there is no necessary connection between the two questions and, indeed, an attempt to obtain guidance in the solution of one by considering the other is not without danger. The question whether a receipt or expenditure is to be treated as on account of income or capital depends upon the relation of the taxpayer to the payment in question …

In the present case the payment of a lump sum to secure the retirement of a high executive officer may have been unusual. But it was made for the purpose of organizing the staff and as part of the necessary expenses of conducting the business. It was not made for the purpose of acquiring any new plant or for any permanent improvement in the material or immaterial assets of the concern. The purpose was transient and, although not in itself recurrent, it was connected with the ever recurring question of personnel.

In my opinion it was not an outgoing of a capital nature.

1. *Nevill* is distinguishable. It is sufficient to mention two matters.
2. First, the payment in *Nevill* was made to remove the managing director in circumstances in which it was not in the interests of the efficient conduct of the business operations to keep him; it was made for the purpose of “organizing the staff and as part of the necessary expenses of conducting the business”. It “was connected with the ever recurring question of personnel”. Such a payment has a ready attraction as a revenue or working expense.
3. In the present case, the payments were not made for a similar or analogous purpose. The payments were to cancel the employees’ options and rights in order to facilitate the takeover. The payments were not connected with considerations of business operations, efficiency or expediency. The payments were predominantly connected with facilitating a change in the underlying shareholding of the company.
4. Second, the payment in *Nevill* was one which was seen to have the effect of reducing ongoing expenditure on salary. Such a payment is not *necessarily* deductible simply because of the fact that it replaces a future expense which would be deductible. There is no freestanding principle or rule to that effect. The question always remains one of characterisation of the expenditure taking into account all of the circumstances, including in *Nevill* the fact that the expenditure was incurred to replace future expenditure which would have been deductible. The fact that the payment in *Nevill* was made in part to reduce ongoing revenue expenditure on salaries is relevant in the process of characterisation. The purpose of employing Mr King and agreeing to pay him an annual salary of £1,500 was “for the production of assessable income”. The purpose was ultimately considered better fulfilled by commuting the expenditure on salary to an immediate lump sum payment and a residual to be met by promissory notes. That is easily seen as a revenue expense in the absence of other predominating purposes.
5. In the present case, the payments as a whole were not ones which can properly be regarded as reducing future revenue expenses. Absent the change in control, those employees who held options or rights ultimately may have received shares in Clough pursuant to the Option Plan and Incentive Scheme, but that would not involve any expenditure on Clough’s part; it would result in a dilution of capital. Some employees who held performance rights may have received cash payments, if Clough had so elected.
6. The payments the subject of this appeal were not ones made on the basis of considerations about where to deploy revenue expenditure on salary. Rather, the payments were made as part of an agreement for Murray & Roberts to acquire the minority shareholding in Clough.

# CONCLUSION

1. For those reasons, there is no error in the conclusion reached by the primary judge that the amount of $15,050,487 was not wholly deductible under s 8-1 of the ITAA 1997 in the income year ended 30 June 2014. The appeal would be dismissed but for the fact that the findings made show that the Commissioner’s concession before trial that the amount was deductible over five years under s 40-880 of the ITAA 1997 was properly made. The Commissioner has not acted otherwise than in accordance with this concession. In these circumstances, the deemed assessment in respect of the 2014 year of income was excessive because part, though not all, of the amount was deductible in respect of that year. The primary judge should have allowed the appeal on this basis, and this Court should therefore allow the appeal from his Honour’s judgment, albeit the appellant has not succeeded in respect of the issues argued in the appeal and should therefore bear the costs of it.
2. On 23 March 2021, the primary judge made orders with respect to the costs of the trial. These orders appear to reflect the fact that the Commissioner had conceded that s 40-880 applied. Neither party submitted that these orders should be disturbed if the appellant were unsuccessful on the appeal in relation to the s 8-1 issue.
3. In these circumstances, the following orders should be made:
4. The appeal be allowed.
5. The orders made by the primary judge on 18 February 2021 be set aside and, in lieu thereof, order that the appeal against the respondent’s objection decision dated 15 January 2020 be allowed in part on the basis that the amount of $15,050,487 paid to the appellant’s employees to cancel their rights under either the Clough Employee Option Plan or the Clough Executive Incentive Scheme is deductible under and in accordance with s 40-880 of the *Income Tax Assessment Act 1997* (Cth).
6. The appellant pay the respondent’s costs of this appeal, as agreed or assessed.

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| I certify that the preceding one hundred and twenty-seven (127) numbered paragraphs are a true copy of the Reasons for Judgment of the Honourable Justice Thawley. |

Associate:

Dated: 12 November 2021