FEDERAL COURT OF AUSTRALIA

BAE Systems Australia (NSW) Pty Limited v Commissioner of Taxation for the Commonwealth of Australia

[2008] FCA 48

TAXATION – notice of motion – adequacy of Commissioner's appeal statement – any deficiency in appeal statement remedied by provision of further particulars

Federal Court Rules O 52B r 5
Income Tax Assessment Act 1936 (Cth) ss 73B, 73CA
Taxation Administration Act 1953 (Cth) ss 14ZZ, 14ZZO

Bailey v The Commissioner of Taxation of the Commonwealth of Australia (1977) 136 CLR 214 considered
Clark v Commissioner of Taxation [2007] FCA 1426 referred to
Jackson v Federal Commissioner of Taxation (1989) 20 ATR 611 referred to
George v Federal Commissioner of Taxation (1952) 86 CLR 183 considered
Rio Tinto Ltd v Federal Commissioner of Taxation (2004) 55 ATR 321 considered
WR Carpenter Holdings Pty Ltd v Commissioner of Taxation (2006) 234 ALR 451 cited

"Anatomy of a Federal Court Tax Case" (2000)(23)(2) *UNSW Law Journal* 237

BAE SYSTEMS AUSTRALIA (NSW) PTY LIMITED v COMMISSIONER OF TAXATION FOR THE COMMONWEALTH OF AUSTRALIA
NSD 2452, NSD 2453 & NSD 2454 OF 2006

STONE J
5 FEBRUARY 2008
SYDNEY

GENERAL DISTRIBUTION

IN THE FEDERAL COURT OF AUSTRALIA

NEW SOUTH WALES DISTRICT REGISTRY **NSD 2452, NSD 2453 & NSD 2454 OF 2006**

BETWEEN: **BAE SYSTEMS AUSTRALIA (NSW) PTY LIMITED**
Applicant

AND: **COMMISSIONER OF TAXATION FOR THE COMMONWEALTH OF AUSTRALIA**
Respondent

JUDGE: **STONE J**

DATE OF ORDER: **5 FEBRUARY 2008**

WHERE MADE: **SYDNEY**

THE COURT ORDERS THAT:

1. The notices of motion filed by the applicant on 28 August 2007 be dismissed.

2. Costs of the notices of motion be costs in the cause.

Note: Settlement and entry of orders is dealt with in Order 36 of the Federal Court Rules.

GENERAL DISTRIBUTION

IN THE FEDERAL COURT OF AUSTRALIA

NEW SOUTH WALES DISTRICT REGISTRY **NSD 2452, NSD 2453 & NSD 2454 OF 2006**

BETWEEN: **BAE SYSTEMS AUSTRALIA (NSW) PTY LIMITED**
Applicant

AND: **COMMISSIONER OF TAXATION**
Respondent

JUDGE: **STONE J**

DATE: **5 FEBRUARY 2008**

PLACE: **SYDNEY**

REASONS FOR JUDGMENT

Introduction

1 A taxpayer whose objection to an amended assessment of income tax has been rejected by the Commissioner may appeal to this Court by filing and serving an appropriate application. The second step is generally for the Commissioner, pursuant to an order of the Court, to file and serve an appeal statement which, as defined in O 52B r 5(3) of the *Federal Court Rules*, is:

> *a statement outlining succinctly the Commissioner's contentions and the facts and issues in the appeal as the Commissioner perceives them.*

2 As discussed below at [10] to [19], the appeal statement is intended to be a practical document that informs the taxpayer of the Commissioner's view, at that time, of the bases of the Commissioner's rejection of the objection to the amended assessment.

3 The applicant in these three linked proceedings complains that the identical second appeal statements filed by the Commissioner in each matter on 4 July 2007 do not meet the standard required by the definition in O 52B r 5(3). By notices of motion filed on 28 August 2007, the applicant seeks orders that these statements be removed from the Court files; that the respondent file and serve amended appeal statements that comply with the *Federal Court Rules*; that within 14 days of receiving the amended appeal statements, the applicant serve any request for further and better particulars; and that the respondent provide such particulars

within 21 days of receiving the applicant's request. In the alternative the applicant seeks an order that the appeal statements be struck out or that the respondent be ordered to amend the statements so that they comply with the *Federal Court Rules*.

Background

4 The motions are brought in respect of three appeals under Part IVC of the *Taxation Administration Act 1953* (Cth) ('TAA'); s 14ZZ. The applicant taxpayer appeals from the Commissioner's disallowance of objections made by the applicant in respect of amended income tax assessments issued by the Commissioner for the years of income ending on 31 March of 1993, 1994 and 1996. Order 52B of the *Federal Court Rules* applies to appeals brought under Part IVC. Rule 5(2)(b)(i) requires the Commissioner to serve on the applicant for relief under Part IVC a copy of the appeal statement or the appeal affidavit filed in accordance with r 5(2)(a)(iv).

5 For reasons that follow I am of the opinion that there is no basis for an order that the appeal statements be removed from the file nor for striking them out. In my view such deficiencies as may be found in the appeal statements may be remedied by the provision of further particulars pursuant to a proper request by the applicant.

Issues in the proceeding

6 The substantive issue in these proceedings is whether the applicant is entitled to deductions under s 73B of the *Income Tax Assessment Act 1936* (Cth) ('ITAA'). The deductions claimed are for expenditure incurred in each of the relevant years of income in carrying on research and development activities ('R&D') in respect of the Jindalee Operational Radar Network Project ('Jindalee Project').

7 Section 73B(9) provides that a deduction is not allowable if the R&D is carried out "on behalf of any other person". Section 73CA(2) and (3) provide that certain deductions otherwise allowable under s 73B will not be allowable if the Commissioner is satisfied that the expenditure on R&D was not at the risk of the taxpayer either in whole or in part.

8 The design and construction of the Jindalee Project was the subject of a number of agreements. According to the respondent's appeal statements, the Commonwealth of

Australia entered into a contract (the 'Prime Contract') with the corporation now known as Telstra Limited, for the "design, development and supply of a fully tested and operational over the horizon radar network". Some of the work under the Prime Contract was subcontracted by Telstra to Marconi Overseas Ltd which in turn subcontracted some of that work to the applicant. Telstra also directly subcontracted the applicant to do some of the work under the Prime Contract.

9 The respondent accepts that, within the meaning of s 73B(1) of the ITAA, the expenditure was incurred in respect of R&D but alleges that the applicant is not entitled to the deduction because:

(a) the applicant carried on the R&D "on behalf of" another person within the meaning of s 73B(9); or

(b) the applicant was not "at risk" in relation to the expenditure within the meaning of s 73CA of the ITAA.

General principles

10 The Commissioner relies on s 14ZZO of the TAA which puts the onus on the applicant to prove the facts on which the applicant seeks to rely to show that the assessment is excessive and, unless the Court otherwise orders, limits the proceedings in this Court to the grounds stated in the taxation objection. In considering what the Commissioner must disclose in the appeal statements it is necessary to take account of the fact that the taxpayer has the burden of proof under s 14ZZO. This factor was also an issue in *George v Federal Commissioner of Taxation* (1952) 86 CLR 183 which was the earliest case involving the Commissioner's obligation to provide particulars with respect to assessments, albeit that the question arose in the context of earlier legislation.

11 In *George,* the taxpayer claimed that his taxable income was less than the amount assessed by the Commissioner. He sought orders that the Commissioner furnish particulars of the source from which it was alleged that he had derived that income. Kitto J declined to make the orders sought on the basis that it was the taxpayer and not the Commissioner who had the burden of proving that the assessment was excessive. His Honour commented, at 189, that in order to discharge the burden of proof the taxpayer,

must necessarily exclude by his proof all sources of income except those

> *which he admits. His case must be that he did not derive from any source taxable income to the amount of the assessment.*

12 The Full High Court (Dixon CJ, McTiernan, Williams, Webb and Fullagar JJ) dismissed an appeal from the judgment of Kitto J. In their joint judgment, at 203, the Court pointed out that:

> *… even were it true that the commissioner must … affirmatively prove by evidence that he formed a judgment of the amount of the income upon which the appellant ought to be taxed, it could not be part of his case to establish the facts upon which he acted in forming the judgment or the grounds on which he proceeded, the materials before him, or the reasoning actuating him. The need supposed of showing that he formed such a judgment could be no ground for requiring particulars of the sources of the taxable income ascribed by the assessment to the appellant.*

13 Subsequently, however, the High Court has held that despite having the burden of proof, the taxpayer is entitled to know the basis on which the Commissioner has made an assessment. In *Bailey v The Commissioner of Taxation of the Commonwealth of Australia* (1977) 136 CLR 214, the High Court discussed the Commissioner's obligation to provide particulars in the context of s 260 of the ITAA. Barwick CJ observed, at 217 - 218:

> *The taxpayer should be told the taxable facts. This inevitably, in my opinion, requires the Commissioner to inform the taxpayer of the operation of s 260 which has warranted the adoption of his view of the taxable facts. This involves the identification and disclosure of the contract, agreement or arrangement which has been treated as avoided by s 260 …. [T]he Commissioner must, in my opinion, be specific in his identification of the contract, agreement or arrangement … which justifies the amount of the assessment.*

14 In the same case Aicken J commented at 227:

> *The purpose of particulars is to assist in the defining of issues and there is in my opinion no reason why in appropriate cases the Commissioner should not give particulars where they are necessary in order that both the appellant and the court may understand the basis upon which the assessment has been made.*
>
> *…*
>
> *It is not in the interests of the proper administration of justice that, when the matter comes before the court, the appellant should have to speculate about, and adduce evidence to negate, every possible kind of agreement …*

15 In *Bailey*, the High Court did not regard the obligation to provide particulars as inconsistent with, or in any way compromising, the taxpayer's burden of proof. Rather their view was to the contrary. Gibbs J commented at 219 that:

> *The fact that the taxpayer bears the onus of proving that the assessment is excessive makes it all the more necessary that he should be given particulars of the basis of the assessment.*

At 221 Mason J said that because the taxpayer has to prove that the Commissioner's assessment is excessive:

> *… the relevant facts in the appeal include the view of the facts on which the Commissioner has based his assessment, the manner in which he arrived at his assessment. These facts are not within the knowledge of the taxpayer; they are within the knowledge of the Commissioner.*

More recently, Greenwood J expressed a similar view in *Clark v Commissioner of Taxation* [2007] FCA 1426 at [37]. Jacobs J acknowledged in *Bailey* that particulars are essentially factual rather than legal, however his Honour recognised that for a request for particulars to be appropriately directed to the matter in dispute the issues must be sufficiently defined. At 221-2, his Honour made the following comment:

> *… when there are no sufficiently defined issues it is not always possible to obtain particulars of facts without first ascertaining whether those facts will be relevant to questions which may be raised. In the present case it is therefore necessary for the taxpayer and the Court to know the basis of the assessments.*

16 In *Rio Tinto Ltd v Federal Commissioner of Taxation* (2004) 55 ATR 321 there was, as here, a dispute as to whether the statement of facts, issues and contentions was so inadequate that it should be struck out or whether it would be sufficient to supplement it with particulars. In that case the Commissioner's statement listed the issues and contentions in a table against which the Commissioner indicated his position by a simple "yes" or "no". Sundberg J held that the deficiencies in the statement could not be cured by further particulars. His Honour noted, at 331, that the ultimate decision in the appeal before him would "turn on the facts established by the applicant, and not on those perceived and stated by the [Commissioner]" and rejected the claim that the applicant was seeking to invert the onus of proof.

17 In outlining his conclusions on the application before him Sundberg J referred to Gummow J's comments in *Jackson v Federal Commissioner of Taxation* (1989) 20 ATR 611 at 618 that the taxpayer was entitled to know both the Commission's view and the facts on which that view was based. His Honour also said that he was in agreement with an extra-judicial observation of Beaumont J that the Commissioner's statement "must propound all the necessary ingredients of the claim for which, as a matter of legal substance, that party

contends" ("Anatomy of a Federal Court Tax Case" (2000)(23)(2) *UNSW Law Journal* 237 at 238-9) and added, at 342:

> *It is now well-established that the statement takes the place of pleadings so that after the exchange of statements the parties to a tax appeal know the case each has to meet. A statement that leaves the taxpayer uncertain as to how the case is put against it is embarrassing and oppressive. A statement that does not disclose the facts on which the respondent has based his assessment and the manner in which he has arrived at it, suffers from these twin vices.*

18 His Honour did not suggest that in taking the place of pleadings, the statement should be treated in the same way as pleadings. The difference between pleadings and a statement of facts, issues and contentions or an appeal statement was recognised by Lindgren J in *WR Carpenter Holdings Pty Ltd v Commissioner of Taxation* (2006) 234 ALR 451 where his Honour stated unequivocally, at 459, that a statement of facts, issues and contentions is not a pleading even within the extended definition of "pleading" in O 1 r 4 of the *Federal Court Rules*.

19 Ultimately, however, what is clear from all of the authorities is that the issue is one of substance; the taxpayer, and the court, must be given a clear and succinct statement of the Commissioner's position without imposing any element of a burden of proof on the Commissioner. In substituting such a statement for pleadings the legislature has provided for a very practical approach to the unusual situation where the taxpayer bears the burden of proving that the Commissioner's assessment is excessive. In my view, such a statement should not be overly scrutinised in an attempt to find errors or inadequacies. The question is: does the statement give the taxpayer a practical understanding of the Commissioner's position?

The respondent's appeal statement

20 The applicant's complaints about the inadequacies it perceived in the respondent's appeal statements are set out in detail in a letter dated 3 August 2007 from its solicitor to that of the respondent. While expressly not conceding that those deficiencies could be cured by further particulars, a request for further and better particulars was enclosed with the letter. In its response dated 17 August 2007, the respondent's solicitor declined to amend the statements but said that its client was prepared to give further particulars. Despite this, no further particulars had been given by the time of the hearing of the applicant's motions.

21 The issues listed in the respondent's appeal statements include the proper construction of the phrase, "on behalf of" in s 73B(9) of the ITAA as well as:

> *Whether the research and development activities that were carried out by the applicant in relation to the [Jindalee] Project were carried out "on behalf of" any other person …*

Another issue is whether the concessional component of an otherwise allowable deduction in respect of R&D expenditure incurred by the applicant is disallowed by s 73CA of the ITAA. This involves consideration of the concept of being "at risk" in respect of R&D expenditure.

Section 73B

22 Section 73B(9) of the ITAA provides:

> *A deduction is not allowable under this section in respect of expenditure incurred by an eligible company for the purpose of carrying on research and development activities* ***on behalf of*** *any other person and expenditure of that kind shall be disregarded for the purposes of the application of this section to the company.*
> [Emphasis added]

23 Under the heading "Contentions", paragraph 54 of each appeal statement says that the proper construction of s 73B(9) and the test to be applied is "detailed in Income Tax Rulings IT 2442 and IT 2451". The statements continue with this summary:

> *In short, in considering whether an eligible company carried on research and development activities on behalf of any other person, the question is whether in all the circumstances, the research and development was carried out in substance for the benefit of, or in the interests of, the other person. This is a question of fact.*

24 Both the Income Tax Rulings referred to in the respondent's appeal statements discuss the operation of s 73B(9) however neither uses the language employed in the statements. Ruling 2442 states that the subsection prevents "double deductions" and "restricts entitlement to section 73B deductions to the company that bears the financial risk … and effectively owns the project results". It gives as an example a company asked by a client to develop a project for the client's business.

25 According to the Ruling if the development was done at the risk of the company so that the client was required to pay only for the final product, the company would qualify under s 73B, "since it would in fact be performing the R&D activities on its own behalf". In contrast where the company carrying out the development is reimbursed by another for its

expenditure then it would not be entitled to s 73B deductions unless it retained ownership of the results. Without that, it would be carrying on the R&D on behalf of another.

26 Ruling 2451, under the heading "General Principles" says that for research and development activities to be carried out by or on behalf of a company "there must be a close and direct link between the company and the work undertaken". It says that the company must "effectively own" the result and "have proper control over the conduct of those activities". Arrangements that "in substance" do not allow the company ownership and control "could compel the conclusion" that the development was not for or on behalf of that company. The Ruling also says that if a company incurs expenditure in carrying on research and development on behalf of another, it does not necessarily follow that the other owns the results, adding that, "The concept is broader and extends to a more indirect effective benefit to the other person". There is further discussion of the implications of formal ownership.

27 As can be seen neither Ruling gives a succinct account of the application of s 79B(9). Reference to these Rulings cannot, by itself, meet the requirement of a succinct outline of the respondent's contentions however the appeal statements also contain the summary quoted above at [23]. The respondent asserts that this summary "propounds all the necessary ingredients of the test. The test is a simple one, which is clearly multifactorial. It neither requires, nor permits, greater elaboration". The applicant conceded that the summary would be sufficient taken by itself however it submitted that the reference to the test being "detailed" in the Income Tax Rulings deprives the summary of the succinctness it might otherwise have. I do not accept this submission. In my opinion it is apparent, on a sensible reading of paragraph 54 of the appeal statements, a reading that takes account of the practical purpose of an appeal statement, that the succinct statement of the test is to be found in the summary. The Rulings, as the respondent submits, "provide elaboration of potential application of the test".

Relevant factors

28 The statements assert that the factors relevant to answering the question whether the research and development was carried out for the benefit of, or in the interests of, another person "include" whether the eligible company controls the research and development, whether it has "effective ownership" of the results and whether it bears the financial risk

associated with the R&D. It is true that the use of "include" after the words, "this question of fact", appears to indicate that other, relevant factors are not specified however, if this is so the provision of further particulars would resolve the matter.

29 According to the appeal statements, the facts on which the respondent has based his view that the applicant's R&D was carried out on behalf of another, are to be found in paragraphs 15, 16, 19 and 20 to 39 of the statements. The statements allege that these facts show that the applicant's R&D was carried out "for the benefit of and in the ultimate interests" of Telstra. Specifically, it is alleged that (a) the facts in paragraph 16 show that Telstra had "ultimate control" of the R&D carried out by Marconi and the applicant; (b) the facts in paragraphs 26 to 29 show that Telstra had "effective ownership of the results" of the applicant's R&D; and (c) the facts in paragraphs 15, 19, and 20 to 25 show that the applicant did not bear any financial risk.

30 Paragraph 16 of each of the statements contends that the terms of three of the contracts, namely those between the Commonwealth and Telstra (the "Prime Contract"), between Telstra and Marconi, and between Marconi and the applicant, show that Telstra was responsible for the Jindalee Project and had ultimate control in relation to the applicant's R&D. The particulars given in respect of paragraph 16 refer to specific clauses of the latter two contracts but not to any provision of the Prime Contract. The applicant points out that despite its location in the part of the respondent's statements dealing with facts, paragraph 16 contains some of the respondent's contentions in relation to the issue of control. It submits that each of the statements "neither identifies all the facts on which the Respondent makes his contentions (for example, no provisions of the Prime Contract are identified) nor outlines how the Respondent says those facts have the stated effect". The failure to identify relevant terms of the Prime Contact could be remedied by provision of further particulars as can any deficiency in identifying the facts on which the respondent has based his contentions. The construction of the terms of the various contracts is a matter for another day.

31 So long as the relevant terms and facts have been identified it is not incumbent on the Commissioner to make submissions on the construction of the contracts at this stage. It is necessary for the Commissioner to indicate what has led him to the conclusion that the relevant contracts provide for the R&D to be carried out on behalf of someone other than the

taxpayer, but it is not necessary for him to identify the persons on whose behalf the R&D was allegedly carried out.

32 Paragraphs 26 to 39 deal with the ownership and licensing of the intellectual property produced by the R&D. The appeal statements detail the provisions of the various contracts that they allege deal with these issues and which ultimately give Telstra control of the intellectual property. The respondent's contentions on this question may be right or wrong but that is not the issue here. The appeal statements provide a coherent account of the Commissioner's contentions on this issue and the facts on which they are based. Again, it may be that further particulars would provide greater illumination.

33 According to the appeal statements, the factors relevant to the Commissioner's contentions on the financial risk of the R&D are identified in paragraphs 15, 19, and 20 to 25. That issue is considered below in the context of the discussion of s 73CA.

Section 73CA

34 As previously indicated, s 73CA provides that the deductions claimed by the taxpayer will not be allowable if the Commissioner is satisfied that the expenditure on R&D was not at the risk of the taxpayer either in whole or in part. The appeal statements also identify as an issue in the proceedings whether the taxpayer bears the risk of the R&D. In paragraph 55 of the appeal statements the Commissioner says:

> *The proper construction of the phrase "at risk" is that a company will not be "at risk" in respect of research and development expenditure where the relevant underlying expenditure is reasonably likely to be reimbursed, recouped or recompensed to the company in some way connected to the performance of the activities to which the expenditure relates, as distinct from any subsequent consideration arising from the exploitation of the results of the expenditure on normal commercial terms.*

35 In paragraph 59 of the appeal statements, the Commissioner expresses the following opinion:

> *The applicant was not at risk in respect of the research and development expenditure because, by reason of the provisions of the agreements referred to in paragraphs 6 to 26* [sic- 25], *the expenditure was reasonably likely to be reimbursed, recouped or recompensed to the applicant regardless of the ultimate commercial exploitation of the results of the expenditure as a result of performing the research and development activities referred to in*

paragraphs 13, 14, 17 and 18. Accordingly ss 73CA(3) operates to disallow the concessional component of the deductions claimed by the applicant.

36 The provisions referred to in paragraphs 6 to 25 relate to (a) the Prime Contract between the Commonwealth and Telstra, (b) the contract between Telstra and Marconi, (c) the contract between Marconi and the applicant; and (d) that between Telstra and the applicant. As described in the appeal statements, by these contracts part or all of the obligations accepted by Telstra under the Prime Contract are subcontracted either directly to the applicant or to Marconi and thence from Marconi to the applicant. The respondent alleges in paragraphs 15 and 19 respectively, that the applicant was remunerated by Marconi for its work under the contract with Marconi and by Telstra for its work under the contract with Telstra. Paragraph 21 describes the flow of funds by way of progress payments from the Commonwealth to Telstra and thence to the applicant either directly or through Marconi. The respondent concludes in paragraph 25 that the "overall effect" of these provisions was that the applicant did not bear any financial risk, or at least any material financial risk, associated with the R&D.

37 The Commissioner may be right or wrong in reaching this conclusion but, to my mind, it is a clear enough exposition of his view at the time of the appeal statements. The respondent submits that the applicant could discharge the onus of proof in relation to this issue by "adducing evidence or advancing submissions to show that, by proper alternative construction of the agreements, the Applicant was at risk in relation to the expenditure". It may be, as the respondent concedes, that further particulars would assist the applicant in challenging the Commissioner's conclusion however, in my view, there is no basis here for declaring that the respondent has failed to discharge his obligation to provide appeal statements within the meaning of the *Federal Court Rules*.

Conclusion

38 I do not accept that the applicant has established that the Court should order the Commissioner to provide amended appeal statements, much less has it made out a case for ordering that the statements be removed from the files. It seems to me that had the Commissioner responded appropriately to the applicant's request for further particulars much, if not all, of the present dispute could have been avoided. The efficient preparation of an appeal from the Commissioner's rejection of the taxpayer's objection to an amended

assessment of income tax requires that the parties co-operate on procedural matters. The requirement of an appeal statement is directed to this end as is the obligation to provide particulars in response to a proper request for particulars, that is particulars of fact not of argument. An appropriate response would have been for the Commissioner either to provide the particulars requested or, if he regarded the request as seeking information that does not fall within a proper request for particulars, to take issue with the details of the request. For the reasons I have given the applicant's motions must be dismissed however in all the circumstances it seems to me that the costs of the motions should be costs in the cause.

I certify that the preceding thirty-eight (38) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justice Stone.

Associate:

Dated: 5 February 2008

Counsel for the Applicant:	T Bathurst QC, M Richmond
Solicitor for the Applicant:	Allens Arthur Robinson
Counsel for the Respondent:	D McGovern SC, K Stern
Solicitor for the Respondent:	Australian Government Solicitor
Date of Hearing:	11 December 2007
Date of Judgment:	5 February 2008