ENSURE

Administrative Appeals Tribunal

DECISION AND REASONS FOR DECISION [2010] AATA 1058

ADMINISTRATIVE APPEALS TRIBUNAL	)	
	)	No 2008/6172
TAXATION APPEALS DIVISION	)	

Re **BARTERCARD AUSTRALIA PTY LTD**

Applicant

And **COMMISSIONER OF TAXATION**

Respondent

CORRIGENDUM

Tribunal Deputy President P E Hack SC

Date 10 March 2011

Place Brisbane

Decision The Tribunal directs the Registrar, pursuant to subsection 43AA(1) of the *Administrative Appeals Tribunal Act 1975*, to amend the reasons for decision by:

1. Deleting **Paragraph 22,** and inserting the following:

"22. A further agreement, described as "Internet Agreement", was executed by Bartercard Bermuda and Bartercard Australia on

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31 May 2002. The import of the Internet Agreement emerges sufficiently from this summary in clause 2 of the agreement:

'**2. Summary**

2.1 [Bartercard Bermuda] will develop for the benefit of [Bartercard Australia] two different types of technology from time to time:

(a) upgrades and new functionality for the Bartercard System ('System Applications'); and

(b) internet and eCommerce applications ('Internet Applications').

2.2 This Agreement covers only the development of Internet and eCommerce Applications. The development of Systems Applications is dealt with under the Contract of Service between [Bartercard Australia] and [Bartercard Bermuda].

2.3 Under this Agreement, [Bartercard Bermuda] will develop Internet Applications and license them to [Bartercard Australia] for use as part of its business.'

Clause 7.1 of the Internet Agreement contained an acknowledgment on the part of Bartercard Australia that all "Internet Applications" developed by it in connection with the operation of the Bartercard system shall become the property of Bartercard Bermuda unless the parties otherwise agreed in writing."

2. Amending **Paragraph 54(d)** to delete the words "Bartercard International" and inserting the words "Bartercard Bermuda".

....
Deputy President

Administrative Appeals Tribunal

DECISION AND REASONS FOR DECISION [2010] AATA 1058

ADMINISTRATIVE APPEALS TRIBUNAL)
) No 2008/6172
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Re BARTERCARD AUSTRALIA PTY LTD

Applicant

And COMMISSIONER OF TAXATION

Respondent

DECISION

Tribunal Deputy President P E Hack SC

Date 23 December 2010

Place Brisbane

Decision

1. The objection decision is set aside.
2. The matter is remitted to the respondent for reconsideration in accordance with the directions in paragraph 59 of these reasons.
3. It is certified that the proceedings have terminated in a manner favourable to the applicant.

.................[Sgd]....................
Deputy President

CATCHWORDS

TAXATION – income tax assessment – objections and appeals – terminating members' payments – research and development expenditure – "on behalf of any other person" – objection decision set aside – matter remitted for reconsideration in accordance with directions in paragraph 59 of reasons – proceedings terminated in manner favourable to applicant

Income Tax Assessment Act 1936 (Cth), ss 73B

Income Tax Assessment Act 1997 (Cth), ss 6-5, 8-1

Taxation Administration Act 1953 (Cth), s 14ZZK(b)

Bartercard Limited v Myallhurst Pty Ltd [2000] QCA 445

Federal Commissioner of Taxation v Dalco (1990) 168 CLR 614

Gaspet Ltd v Elliss (Inspector of Taxes) [1985] 1 WLR 1214

Gaspet Ltd v Elliss (Inspector of Taxes) [1987] 1 WLR 769 (C.A.)

Gauci v Federal Commissioner of Taxation (1975) 135 CLR 81

Industry Research and Development Board v Phai See Investments Pty Ltd [2001] FCA 532; (2001) 112 FCR 24

McCormack v Federal Commissioner of Taxation (1979) 143 CLR 284

Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd [2004] HCA 52; (2004) 219 CLR 165

REASONS FOR DECISION

23 December 2010 Deputy President P E Hack SC

INTRODUCTION

1. A reciprocal trade exchange program known as "Bartercard" operates in Australia and in a number of other countries. In Australia the program is operated by Bartercard Exchange Limited (Exchange) however the applicant in these proceedings, Bartercard Australia Pty Ltd (Bartercard Australia), has been appointed by Exchange to undertake the management of the affairs of Exchange and of the program.

2. Two matters remain in issue in these proceedings:

   (a) do payments received by Bartercard Australia from terminating Bartercard members constitute income of Bartercard Australia

according to ordinary concepts and thus assessable under s 6-5 of the *Income Tax Assessment Act 1997* (Cth) (ITAA 1997) in each of the 2002 and 2003 income years; and,

(b) is expenditure by Bartercard Australia on research and development deductible under the special rules in s 73B of the *Income Tax Assessment Act 1936* (Cth) (ITAA 1936).

FACTUAL BACKGROUND

3. The Bartercard program is a barter exchange system where members make and receive payments to and from other members in "Trade Dollars" (T$). It was established on the Gold Coast in 1991. There are, at present, in the order of 18,000 Bartercard members in Australia. Members join the program by acquiring one redeemable preference share in Exchange and agreeing to become bound by the rules of the Bartercard program (of which more will be said later). An account is established for each member and the member's "trades" i.e. a purchase from, or a sale to, another member, are recorded in T$. The members' accounts are also used to record dealings between members and Bartercard Australia.

4. Bartercard Australia is also a member of Exchange. It purchases goods and services from other members from time to time for use in its business. Bartercard Australia's trade account is debited, and the supplier's trade account is credited, when Bartercard Australia acquires goods or services from another member.

5. Members pay fees and commissions. For each trade under the program the buyer and the seller each pay a service fee of 5.5% in cash and 1% in T$. Additionally, monthly administration fees are payable by members. Fees are also payable on overdue accounts.

6. The relationships between Exchange, Bartercard Australia and members were governed, at all material times, by two documents. The first is a deed described as a "Deed of Management" and dated 16 April 2002 (the Deed) between Exchange and Bartercard. The other is the "Rules of the Trading Program) (the Rules) that were in

effect from 16 April 2002. An applicant for membership is required to complete and execute an application which includes the following:

> "**I APPLY** … for one redeemable preference share in [Exchange], carrying with it the right to participate as a Member in the Trading Program operated by [Exchange] under management by [Bartercard Australia] under a Deed of Management and **ACKNOWLEDGE** that I have read [Bartercard Australia's] Privacy Policy, the Rules of the Trading Program and this Application Form & Membership Agreement ("the documents') and I and all my additional cardholders **AGREE** upon acceptance of this Application by [Exchange] and/or [Bartercard Australia], to be bound by the terms and conditions contained in the Constitution of [Exchange] and the documents which shall be deemed to constitute the contract between myself, [Exchange] and [Bartercard Australia] …"

7. By virtue of Part III of the Deed, Bartercard Australia was "appointed to undertake the management of the affairs of [Exchange] and the Trading Program in accordance with the provisions of this Deed". Clause 4.2 provided:

> "[Bartercard Australia] shall during the continuance of this Deed and subject to the terms of this Deed have the full and unfettered management and control of the affairs of [Exchange] relating to the conduct and operation of the Trading Program".

8. The remuneration of Bartercard Australia by Exchange for undertaking the management of the affairs of Exchange was dealt with in clause 6 in these terms:

> "6 **MANAGER – REMUNERATION**
>
> 6.1 **Management fee payable.** [Exchange] shall pay to [Bartercard Australia] for the management of the affairs of [Exchange] pertaining to the conduct and operation of the Trading Program, a fee ('the Management Fee') equal to the total of:
>
> (a) all Application Fees;
>
> (b) all Transaction Fees;
>
> (c) all Directory Fees; and
>
> (d) all other fees, charges and other amounts payable to [Exchange] by Members under the Rules of the Trading Program excluding the Trade Dollar contribution to the Debt Reserve Fund.
>
> 6.2 **Timing of payment.** The Management Fee shall be due and payable to [Bartercard Australia] as and when it is collected from each Member.
>
> 6.3 **Members to pay [Bartercard Australia] direct.** To facilitate payment of the Management Fee [Exchange] irrevocably authorises [Bartercard Australia]

to direct Members to pay the fees charges and other amounts referred to in 6.1 direct to [Bartercard Australia]."

9. Some further explanation of the nature of T$ appears from the Rules. Clause 3 provides:

"3 **NATURE OF TRADE DOLLARS**

3.1 **Nature.** A 'Trade Dollar' is an accounting unit (notionally equivalent to one Australian Dollar) used to record the value of goods and services traded. Trade Dollars are not legal tender, securities, debentures or commodities. In these Rules, one Trade Dollar is the equivalent of one Australian Dollar and vice versa.

3.2 **Credit Balance an Asset of Member.** The Trade Dollars recorded in a Trade Account of a Member which has a credit balance, represents an asset of that Member. Such a Member is entitled to obtain goods or services from another Member to a value equivalent to that credit balance, in accordance with these Rules but not otherwise.

3.3 **Not a Liability of [Bartercard Australia] or [Exchange].** The Trade Dollars recorded in a Trade Account of a Member which has a credit balance, do not constitute a liability of a debt payable by [Bartercard Australia[or [Exchange] to any Member.

3.4 **Debit Balance a Liability of Member.** A Member whose Trade Account has a debit balance is liable, in accordance with these Rules, either:

(a) to supply goods or services to an equivalent value to another Member in accordance with these Rules but not otherwise; or

(b) if the Member has not discharged the Member's liability by supplying goods or services to another Member in accordance with these Rules, to pay to [Exchange] an amount in cash dollars equivalent to the amount in Trade Dollars of the debit balance in accordance with these Rules.

3.5 **No Obligation to Redeem or Convert.** Under no circumstances shall [Bartercard Australia] or [Exchange] be under any obligation to any Member to redeem or convert to cash or pay any amount for or in respect of Trade Dollars. [Bartercard Australia] and [Exchange] do not warrant the negotiability of Trade Dollars."

10. The notion of Bartercard Australia trading is dealt with by Rule 11.1. It reads:

"[Bartercard Australia] may participate in the Trading Program as if it was a Member and [Bartercard Australia] may debit or credit [Bartercard Australia's] Trade Account as the case may be and correspondingly credit or debit the Trade Account of the other Member participating in the Trade."

11. Amongst its other tasks Bartercard Australia was required to take all reasonable steps to monitor trade accounts with debit balances and, in the name of Exchange, pursue recovery of debit balances where the Rules make those balances recoverable.

12. The first issue in these proceedings concerns the treatment of amounts paid by members whose membership is terminated. The Rules permit a member to terminate membership by the giving of a notice in writing of an intention to cease to participate in the program. And Bartercard Australia might terminate a member's right to participate in the program under defined circumstances. The consequences of termination are dealt with in clause 20.5 in these terms:

> "20.5 **Consequences of Termination.** Upon the termination of a Member's right to participate in the Trading Program:
>
> (a) **(Return cards etc)** The Member must immediately return to [Bartercard Australia] all Member's Cards and used or unused Trade Transaction Vouchers, or other documents and property of [Exchange] or [Bartercard Australia];
>
> (b) **(Fees debited)** All cash and Trade Dollar Transaction/Services Fees, Directory Fees and any other fees and amounts payable by it under these Rules shall be immediately debited from the Member's Trade Account;
>
> (c) **(Where credit balance)** If after debiting the amounts referred to in Rule 20.5(b), the balance in the Member's Trade Account is a credit balance:
>
> (i) that Member must immediately pay to [Exchange] the amount of cash and Trade Dollar Transaction/Service Fees that would have become payable by it in the ordinary course of the Trading Program if that Member had entered into a Trade as a Buying Member in an amount sufficient to spend the amount of Trade Dollars standing to its credit;
>
> (ii) if the Member fails to pay the cash Transaction/Service Fees [Bartercard Australia], on behalf of [Exchange], may debit the Member's Trade Account with an amount of Trade Dollars equivalent to three times the cash Transaction Fees so payable;
>
> (iii) after receipt of the cash Transaction/Service Fees, (or if the fees are not paid in cash, the debiting of the Member's account) [Exchange] shall issue to the Member Gift Certificates expiring one hundred and twenty (120) days from the date of issue, having a Trade Dollar value equivalent to the remaining credit balance (if any) of the Member's Trade Account;

(d) **(Where debit balance)** if after debiting the amounts referred to in Rule 20.5(b), the balance in the Member's Trade Account is a debit balance:

(i) that Member must immediately pay to [Exchange] the amount of cash and Trade Dollar Transaction/Service Fees that would have become payable by it in the ordinary course of the Trading Program if that Member had entered into a Trade as a Selling Member in an amount sufficient to bring its Trade Account to a nil balance;

(ii) the Member has thirty (30) days within which to Trade as a Selling Member and in so doing reduce, so far as it can, the debit balance of its Trade Account;

(iii) at the expiration of the thirty (30) day period, the Member must immediately pay [Exchange] the amount of cash equivalent to the remaining debit balance in Trade Dollars of its Trade Account;

(e) **(No refund of fees)** No fees or charges paid to [Exchange] will under any circumstances be refunded."

13. In the year ended 30 June 2002 [Bartercard Australia] received payments from terminating members, made pursuant to clause 20.5(d), in the total sum of $711,053.31. For the year ended 30 June 2003 the total was $623,532.06.

14. The Commissioner contends that these amounts are assessable income of Bartercard Australia. The argument for the Commissioner is that these amounts formed part of the management fee payable by virtue of clause 6.1 of the Deed. On the Commissioner's case, the proper construction of clause 6.1 entitled Bartercard Australia to treat the moneys received from terminating members as a management fee and thus as its money rather than as monies received for the use and benefit of Exchange. It was not to the point, so the Commissioner says, that Bartercard Australia made debit entries in its account in Exchange's books of account increasing the debit balance of Bartercard Australia's T$ account because the Rules do not allow for such a transaction.

15. For its part, Bartercard Australia says that is received the monies from terminating members as agent for Exchange and not in its own right and that it accounted to Exchange by means of its T$ account. On the proper construction of the Deed monies paid by terminating members do not come within clause 6.1(d). Alternatively, if clause 6.1 does have the construction for which the Commissioner contends, the document does not reflect the agreement of the parties and a court of equity would rectify the agreement.

16. Some further background is necessary for a consideration of the second issue, that relating to s 73B of the ITAA 1936. For present purposes, it is a sufficient explanation of s 73B to say that it provides concessional deductions, at 125%, for expenditure incurred on research and development activities. However s 73B(9) of ITAA 1936 provides that a deduction is not allowable under the section for expenditure,

> "incurred by an eligible company for the purpose of carrying on research and development activities on behalf of any other person".

The issue here is whether the expenditure claimed by Bartercard Australia was expenditure "on behalf of any other person".

17. What follows is taken from the Commissioner's reasons for decision[1] which, relevantly, Bartercard Australia says "are accurate and should be accepted as being correct" [2].

18. Bartercard International Pty Ltd (Bartercard International) is an Australian company, incorporated in 1993. It and Bartercard Australia are wholly owned by two companies incorporated in the British Virgin Islands that are, in turn, wholly owned by Bartercard International Limited Company (Bartercard Bermuda), a company incorporated in Bermuda. The Bartercard website says of Bartercard Bermuda that it,

> "was incorporated in January 2000 and was formed to own all intellectual property related to the Bartercard business and to licence operators to use its systems globally. "

19. From 1999 Bartercard International acquired intellectual property relating to the Bartercard system from Bartercard Australia. Thereafter Bartercard Bermuda acquired the intellectual property of the Bartercard group. In September 1999 Bartercard International (as "Service Provider") and Bartercard Australia[3] (as "Service Receiver") executed a "Contract of Service". The recitals to that agreement noted that Bartercard International was,

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[1] Exhibit 1, page 13.
[2] Exhibit 5, paragraph 39.
[3] Then known as Bartercard Ltd.

> "the legal and beneficial owner of all of the material elements, industrial and intellectual property, systems, software, techniques and know-how of the Bartercard System".

By its operative parts, the agreement granted a licence to Bartercard Australia to use the intellectual property comprising the Bartercard program. By clause 6.17 Bartercard Australia acknowledged,

> "that all procedural, operational, computer software, sales, trading, training, marketing, promotional and other technical systems and/or procedures developed by [Bartercard Australia] or Sub-Licensees as a result of or in connection with the operation of outlets by [Bartercard Australia] or Sub-Licensees or the exercise by [Bartercard Australia] of its rights under this Contract of Service shall become the property of [Bartercard International].".

20. In December 1999 Bartercard International and Bartercard Australia[4] executed an agreement described as an "Internet Agreement" which, by clauses 1.1 and 1.3, notes that Bartercard International was to develop internet applications and license them to Bartercard Australia for use by it as part of its business. By clause 2.1(d) Bartercard International was made responsible "for all development, modification and enhancement costs associated with an Internet Application, including any payments to third parties …"

21. The September 1999 Contract of Service was assigned by Bartercard International to Bartercard Bermuda, with the consent of Bartercard Australia, in February 2000. On 14 January 2000 Bartercard Bermuda and Bartercard International executed a "Service Management Agreement". Clause A of the recitals to the agreement recorded that:

> "Bartercard Bermuda is the owner of all the material elements, industrial and intellectual property, systems, software, techniques and know-how of the Bartercard System"

By its operative parts, the agreement provided a mechanism whereby Bartercard Bermuda engaged Bartercard International to establish Bartercard trade exchanges around the world and sell licences to international franchisees to do so.

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[4] *Sub nom* Bartercard Ltd

22. A further agreement, described as "Internet Agreement", was executed by Bartercard Bermuda and Bartercard International on 31 May 2002. The import of the Internet Agreement emerges sufficiently from this summary in clause 2 of the agreement:

> "**2. Summary**
>
> 2.1 [Bartercard Australia] will develop for the benefit of [Bartercard International] two different types of technology from time to time:
>
> (a) upgrades and new functionality for the Bartercard System ('System Applications'); and
>
> (b) internet and eCommerce applications ('Internet Applications').
>
> 2.2 This Agreement covers only the development of Internet and eCommerce Applications. The development of Systems Applications is dealt with under the Contract of Service between [Bartercard International] and [Bartercard Australia].
>
> 2.3 Under this Agreement, [Bartercard Australia] will develop Internet Applications and license them to [Bartercard International] for use as part of its business."

Clause 7.1 of the Internet Agreement contained an acknowledgment on the part of Bartercard Australia that all "Internet Applications" developed by it in connection with the operation of the Bartercard system shall become the property of Bartercard International unless the parties otherwise agreed in writing.

23. In April and May 2003 Bartercard International and Bartercard Australia lodged applications for registration for research and development tax concessions. Bartercard International described its project as "Development of Trade Exchange Software"; Bartercard Australia described the project as "Development of the Bartercard Trade Exchange System". Each application sets out the same detailed description of the research and development activities to be undertaken[5]. Each company was registered under s 39J of the *Industry Research and Development Act 1986* (Cth) for the 2001/02 year. Similar applications were made by

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[5] Exhibit 1, pp 407-413 (Bartercard Australia) and pp 599-605) Bartercard International).

each of Bartercard Australia and Bartercard International in April 2004 for the 2003 income year and again the detail of the work undertaken is identical[6].

24. During the 2002 and 2003 income years Bartercard Australia paid a supplier $334,812 and $45,005 respectively for the development of a Wide Area Network (WAN) intranet for Bartercard Australia[7]. In its Statement of Facts and Contentions, lodged for the purpose of these proceedings[8], Bartercard Australia adopted the description of the project set out in its earlier application for registration. The project was described in this way in that document:

> "Bartercard is the largest and fastest growing barter network in the world. Today Bartercard operates in many major international markets and is continually opening in new countries. Bartercard is a business to business market place that facilitates transactions electronically via the internet, selected swipe cards facilities and telephone 'e-commerce', or by a transaction voucher similar to that used with a credit card. In order to cater to the current and predicted expansion of the network Bartercard has developed a unique administration system (BC Admin) which can be integrated with the both [sic] Bartercard's web based internet trading portal (used by members) and Bartercard's web trader operating system (used by brokerages)."

Descriptions of the Bartercard Administration System, Web Trader, Members' Trading Portal and Global Barter System follow together with a description of the manner in which those systems are integrated. The document shows that Bartercard Australia and Bartercard International were either partners or joint venturers in the research and development project albeit that Bartercard International had expended considerably more funds than Bartercard Australia.

25. The issue was given scant attention in the evidence of Mr Andersson. According to him, the purpose of the WAN and the benefits to Bartercard Australia of the WAN project were described in a strategic plan and a paper to the Bartercard Australia board that were both attached to his statement. The strategic plan appears to have been prepared by consultants in November 1999. The board paper appears to be from the same era. Mr Andersson exhibits the completed application for registration for 2001/2002 but does not affirm the accuracy of the information,

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[6] Exhibit 1, pp 419-420 (Bartercard Australia) and pp 611-612) Bartercard International).
[7] Exhibit 2, paragraph 23.
[8] Exhibit 5, paragraph 37.

presumably because he was not then employed by Bartercard Australia having commenced employment with it as Chief Financial Officer in February 2007. According to Mr Andersson, Bartercard International has not reimbursed, nor agreed to reimburse, Bartercard Australia for the expenditure incurred by Bartercard Australia on the WAN development[9] however I was told from the bar table, and counsel for the Commissioner accepted, that some part of this expenditure was recouped from franchisees[10].

26. The development of WAN ceased in 2003 as it "resulted in unsatisfactory operational speeds"[11]. The decision to cease the WAN development was made by the chief information officer of Bartercard International[12]. No explanation has been provided why the decision was made by Bartercard International rather than Bartercard Australia.

27. In January 2006 the directors of Bartercard Bermuda resolved "to document our approval of allocation of past, present and future expenses including operating costs, research and development costs, and fixed assets," as outlined in a document attached. By a further resolution the directors resolved that "all aforementioned expenses be paid by Bartercard International … on behalf of [Bartercard Bermuda] and be reimbursed accordingly". The "structure" attached to the resolutions described Bartercard Bermuda as owning all intellectual property of the group. I note that the Commissioner relied upon these resolutions in his Statement of Facts and Contentions[13]. No evidence was led by Bartercard Australia to deal with the matter.

28. The Commissioner has allowed Bartercard Australia a deduction (under s 8-1 of the ITAA 1997) for this expenditure but has refused the concessional element i.e. the extra 25%, under s 73B of the ITAA 1936 on the basis that the expenditure was for the purpose of carrying on research and development activities on behalf of another person. In the objection decision, the Statement of Facts and Contentions

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9 Exhibit 2, paragraph 23.
10 Transcript page 164.
11 Exhibit 1, page 25, adopted as correct by exhibit 5, paragraph 39.
12 Exhibit 1, page 302.
13 Exhibit 6, paragraphs 50 & 91(d).

and in written submissions the Commissioner nominated Bartercard Bermuda as the "another person".

THE PROCEDURAL BACKGROUND

29. Bartercard Australia's income tax return for the year ended 30 June 2002, when lodged, showed a loss of $1,057,692. Its return for the year ended 30 June 2003 showed nil taxable income. In 2006 and 2007 the Commissioner undertook an audit of the affairs of Bartercard Australia for those years. That audit increased the taxable income of Bartercard for the 2002 year by $911,407 to a loss of $146,285 and that for the 2003 year by $2,194,770 to $2,194,770. Each year involved a number of adjustments. The adjustments for the 2003 year were the subject of a notice of assessment dated 16 October 2007. On 19 October 2007 the Commissioner made an assessment of administrative penalty, calculated at 25% on the basis of a "lack of reasonable care".

30. Bartercard objected to both of those assessments by a notice of objection dated 14 December 2007. That objection put in issue four broad issues,

(a) the inclusion in Bartercard Australia's income of terminating members' payments of $710,853 in the 2002 income year and $737,025 in the 2003 income year;

(b) the Commissioner's refusal to allow concessional deductions of $183,229 for the 2002 income year and $532,055 for the 2003 income year for expenditure on research and development;

(c) the Commissioner's refusal to allow a deduction for corporate hospitality of $126,104 in the 2002 income year and $289,763 in the 2003 income year, and

(d) penalties.

The other adjustments made by the Commissioner were not objected to.

31. On 7 November 2008 the Commissioner disallowed the objections to the substantive assessment and allowed the objection to the penalty assessment to the extent of reducing the penalty to $50,585.04. On 24 December 2008 Bartercard lodged an application in the Tribunal seeking a review of the objection decisions.

32. It is only the terminating members' payments and the research and development expenditure that remain in issue. Bartercard no longer seeks a review of so much of the decision as disallowed the objection to the Commissioner's refusal to allow a deduction for corporate hospitality of $126,104 in the 2002 income year and $289,763 in the 2003 income year. And the issue of penalties has also been resolved on the footing that the Commissioner accepts that no shortfall penalties ought to have been imposed on that part of the shortfall that related to research and development expenditure and Bartercard accepts that the penalty objection decision ought to be otherwise affirmed.

33. One final matter of agreement need be noticed. The parties are agreed that the amount of terminating members' payments received in the years in question should be $711,053 (in lieu of $710,853) in the 2002 income year and $623,532 (in lieu of $737,025) in the 2003 income year.

THE LEGISLATION

34. A key feature of the income side of the ITAA 1997 is the concept of "assessable income". It will suffice for present purposes to say that, by virtue of s 6-5(1) of that Act, assessable income "includes income according to ordinary concepts". And assessable income is reduced by allowable deductions. What is deductible is explained in s 8-1 of the ITAA 1997 in these terms:

> **"8-1 General deductions**
> (1) 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; or
(b) it is a loss or outgoing of a private or domestic nature; or
(c) it is incurred in relation to gaining or producing your *exempt income or your *non-assessable non-exempt income; or
(d) a provision of this Act prevents you from deducting it.”

35. The other provision in issue in the proceedings is s 73B of the ITAA 1936. It is common ground that Bartercard Australia otherwise satisfied the requirements of that section provided that its claims for concessional deductions were not defeated by s 73B(9) of the ITAA 1936. That subsection, relevantly excerpted, provides,

> “(9) 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.”

TERMINATING MEMBERS’ PAYMENTS

36. The arguments of the parties have already been noted[14]. They do not turn upon any complicated notion of what constitutes “income according to ordinary concepts”, rather the arguments raise a factual enquiry about the party that received the benefit of the payments.

37. The starting point is the proper construction of clause 6.1(d) of the Deed. Mr Robertson, who appeared for Bartercard Australia, submitted that, on its proper construction, the clause did not have the effect that monies paid by terminating members came within the ambit of “all … other amounts payable to [Exchange] by Members under the Rules.” Alternatively, he submitted, if the construction argument was found against Bartercard Australia, the Deed was, to that extent, executed under a mutual mistake and that a court of equity would rectify Clause 6.1(d) to give effect to the basis on which the parties agreed which was that the terminating members’ payments did not form part of Bartercard Australia’s remuneration.

38. As it seems to me these submissions must be accepted.

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[14] See paragraph [14] and [15] above.

39. There is no doubt that the choice of words in clause 6.1(c) is poor. Construed literally and without reference to the wider context the words have the effect contended for by the Commissioner however it must now be regarded as well settled that the meaning of words in a contract,

> "is to be determined by what a reasonable person would have understood them to mean. That, normally, requires consideration not only of the text, but also of the surrounding circumstances known to the parties, and the purpose and object of the transaction."[15]

Here, the surrounding circumstances include the Rules which are expressly adopted, and form part of the Deed. In fact the Rules prevail over the Deed where there is conflict[16]. The surrounding circumstances include, as well, the fact that the parties are engaged in the conduct of a barter exchange and that, at least in theory, and until members terminate, the total of outstanding debit balances ought to be matched by the total of outstanding credit balances[17]. That is the premise of those Rules that deal with dissolution of the program. It is not Mr Andersson's evidence that leads me to that conclusion. What leads me to that conclusion is the very nature of the barter exchange, the notion of equilibrium. In reality, the evidence given by Mr Andersson was, in the main part, quite unhelpful, comprising a series of broad generalised conclusions without descending into the primary fact or logic that sustained the conclusions.

40. Moreover, clause 6.1(d), read as the Commissioner submits it ought to be read, would treat all monies received from members as remuneration to which Bartercard Australia was entitled. That would include, for example, debit balances recovered by Bartercard Australia pursuant to Rule 13.1. In my view, the proper construction of Clause 6.1(c) does not include terminating members' payments. Additionally, it is significant that the Rules, which detail the fees payable by members, make no reference to terminating members' payments being treated as fees payable to Bartercard Australia.

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[15] *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* [2004] HCA 52; (2004) 219 CLR 165, at [40].
[16] Clause 1.4, Deed.
[17] Cf *Bartercard Limited v Myallhurst Pty Ltd* [2000] QCA 445.

41. But even if that view were wrong, Bartercard's alternative submission relying on rectification is an answer to the Commissioner's contention. The parties, on the evidence, have conducted themselves on the basis that Bartercard Australia is obliged to account to Exchange for terminating members' payments. The Commissioner accepts[18] that an accounting entry was made in the account of Bartercard Australia in the books of Exchange; his point is only that the entry did not have the legal consequences that would otherwise flow from the entry.

42. I turn then to that point. The submission is that the entry, admittedly made, in the books of account of Exchange whereby Bartercard Australia accounts to Exchange for monies paid by terminating members,

> "does not reflect any transaction contemplated by the Trading Rules [and thus] it is not contemplated by clause 4.3(y) of the … Deed."[19]

The Commissioner's submissions analyse the accounting exercise when a terminating member makes a debit payment into two entries. The first entry involves crediting the member's T$ account with the amount of the payment to (hopefully) bring the account balance to zero. The second entry involves a debit of an equal amount to Bartercard Australia's T$ account in Exchange's books thereby increasing the debit balance of Bartercard Australia's T$ account.

43. The Commissioner says that the second entry involves the conversion of the liability to account to Exchange for the cash received from the terminating members into a T$ liability, a step not permitted under the Rules. I do not agree.

44. Bartercard Australia has a T$ account in the books of account of Exchange. Rule 5.2 requires Exchange to,

> "establish for each Member and for [Bartercard Australia], an account ('Trade Account') for recording Trades entered into by them <u>and other transactions in Trade Dollars which relate to them</u>." [emphasis added]

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[18] Transcript p 148.
[19] Commissioner's submissions, paragraph [31].

Bartercard Australia was entitled to participate in the program "as if it were a Member"[20]. It was thus entitled to "spend" any T$ it had by acquiring goods or services from other members. Mr Andersson gave the examples of Bartercard Australia acquiring stationery, printing, marketing and advertising from members. Thus a purchase by it would involve a credit in T$ to the seller's T$ account and an equivalent debit in T$ to the T$ account of Bartercard Australia.

45. On the other side of the ledger Bartercard Australia receives T$ (as well as cash) as part of its remuneration from Exchange when members paid to it, at the direction of Exchange, the various fees which, by virtue of Clause 6.1 of the Deed, became its remuneration from Exchange. To the extent those amounts were paid in T$ they amounted to the "other transactions" spoken of in Rule 5.2.

46. I do not accept the Commissioner's contention that the Rules do not contemplate the making of the "second entry". The Rules contemplate that Bartercard Australia will have a T$ account in the books of account of Exchange, that it may undertake "trades" and "other transactions" that will be accounted for by means of its T$ account and that a T$ is notionally equivalent to an Australian dollar. The Rules do not expressly authorise Bartercard Australia to account for cash received on the account of Exchange to a liability to T$ however I do not consider that to be necessary. Accounting in that way is not contrary to the Rules and is expressly authorised by clause 4.3 of the Deed. Clause 4.3 requires Bartercard Australia to,

> "do all things necessary and incidental to the proper and efficient management of the affairs of [Exchange], howsoever pertaining to the operation and conduct of the Trading Program, in accordance with the Rules of the Trading Program and, without limitation, in so doing:
>
> …
>
> (y) (**trade conversion)** will, exchange trade dollars for cash received by [Exchange] from a Member as payment of a Trade Dollar debt;
>
> …"

20 Rule 11.1.

47. I am then satisfied that the amounts of terminating members' payments received by Bartercard Australia did not constitute its income and thus do not come within the ambit of income according to ordinary concepts.

"ON BEHALF OF ANY OTHER PERSON"

48. It was submitted on behalf of Bartercard Australia that the expression "on behalf of" in the present context ought to be read no more widely than two situations – the relationship of principal and agent, and where monies are paid "under a contract of reimbursement". Reference was made to the decision of the Court of Appeal in *Gaspet Ltd v Elliss (Inspector of Taxes)*[21]. That case concerned claims by the taxpayer for capital allowances pursuant to the *Capital Allowances Act 1968* (UK). At first instance Peter Gibson J described the statutory background in this way[22]

> "A capital allowance authorised under the Capital Allowances Act 1968 is treated as a trading expense deductible from profits for corporation tax purposes: section 73 of the Act of 1968. Section 91(1) of that Act governs the right to a capital allowance in respect of expenditure on scientific research and the material part of that subsection is as follows: 'where a person – (a) while carrying on a trade, incurs expenditure of a capital nature on scientific research related to that trade and directly undertaken by him or on his behalf…' "

49. Kerr L J said[23]:

> "In the present case it is clear that the research was not directly undertaken by the taxpayer company. Was it, then, directly undertaken by someone else on behalf of the taxpayer company? As the judge said, the phrase 'on behalf of,' in particular in the context of the phrase 'by or on behalf of,' denotes the concept of agency. This is a perfectly straightforward concept, even if in a context such as the present it may require a wider interpretation than agency resulting from a direct contractual relationship."

and[24]

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[21] [1987] 1 WLR 769.
[22] [1985] 1 WLR 1214, 1216.
[23] [1987] 1 WLR 769, 775.
[24] [1987] 1 WLR 769, 776.

> "It is true, as Mr. Park reminded us, that the words 'on behalf of' can have a more extended meaning than agency, in the sense of 'for the benefit of' or 'in the interests of.' But I do not think that this is the sense in the present context."

Nicholls L J agreed that "to be within the phrase 'on behalf of' the relationship must be one of agency, or akin thereto…"

50. Reference was also made to the decision of Hely J in *Industry Research and Development Board v Phai See Investments Pty Ltd*[25]. The case concerned the *Industry Research and Development Act 1986* (Cth). Registration under that Act could be refused if activities "carried out by or on behalf of the company" did not include "research and development activities". His Honour said:

> "[19] The phrase 'on behalf of' is not an expression which has a strict legal meaning. It may be used in conjunction with a wide range of relationships, 'all however in some way concerned with the standing of one person as auxiliary to or representative of another person or thing': *R v Toohey; Ex parte The Attorney-General for the Northern Territory of Australia* (1980) 145 CLR 374 at 386. It is necessary to have regard to the context in which the expression 'on behalf of' is used in order to determine the scope of the relationships to which it applies: *R v Portus; Ex Parte Federated Clerks Union of Australia* (1949) 79 CLR 428 at 438.
>
> [20] In some contexts 'on behalf of' does contemplate a representative capacity or agency relationship, see eg, *Metropolitan Waste Disposal Authority v Willoughby Waste Disposals Pty Ltd* (1987) 9 NSWLR 7 at 10. In other contexts the phrase has a wider signification. Thus in *R v Portus* (supra), Qantas, a corporate entity, was held to act on behalf of the Commonwealth because its function was relevantly to act 'in the interests of' the Commonwealth. The authorities were reviewed by the NSW Court of Appeal in *Citizens Airport Environment Association Inc v Maritime Services Board* (1993) 30 NSWLR 207, but to borrow the words of Kirby J in his dissenting judgment, cases decided in a different statutory context 'cast only dim light' on the resolution of the instant problem."

51. On the view I take of the matter I need not determine the width of the expression. Even if I assume, favourably to Bartercard Australia, that the expression is confined to the two situations put forward I am of the view that Bartercard Australia

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[25] [2001] FCA 532; (2001) 112 FCR 24.

has not discharged its obligation to show that the assessment was excessive in this respect. Simply put, the material leaves me in a position where I am unable to make an affirmative finding that s 73B(9) of the ITAA 1936 does not operate to deny the concessional deduction.

52. The taxation decision in issue here is one concerning an assessment other than a franking assessment. Thus, by virtue of s 14ZZK(b) of the *Taxation Administration Act 1953* (Cth) "the applicant has the burden of proving that … the assessment is excessive". The assessment, in this respect, proceeds on the footing that s 73B(9) of the ITAA 1936 operated to deny the concessional deduction because the expenditure was on behalf of Bartercard Bermuda. The position, as I apprehend it, was expressed in this way by Mason J in *Gauci v Federal Commissioner of Taxation*[26]:

> "The Act does not place any onus on the Commissioner to show that the assessments were correctly made. Nor is there any statutory requirement that the assessments should be sustained or supported by evidence. The implication of such a requirement would be inconsistent with s. 190(b) for it is a consequence of that provision that unless the appellant shows by evidence that the assessment is incorrect, it will prevail."

His Honour's views, whilst in dissent in that case, are now accepted as the orthodox view[27].

53. The evidence from Bartercard Australia on this aspect of the matter is quite unsatisfactory. Mr Andersson, who gave evidence of these matters, was not employed by Bartercard Australia at the time in question. The Statement of Facts and Contentions of Bartercard Australia adopted as correct a lengthy extract from the Commissioner's reasons for decision that set out a summary of the factual background but no attempt was made to have Mr Andersson, or any other witness, affirm the accuracy of that material. Similarly, no attempt was made to explain the matters that the Commissioner had raised in the reasons for decision as pointing to the conclusion that the expenditure was on research for the benefit of Bartercard Bermuda nor the particular matters identified by the Commissioner in paragraph 94

[26] (1975) 135 CLR 81, 89.
[27] See *McCormack v FCT* (1979) 143 CLR 284; *FCT v Dalco* (1990) 168 CLR 614.

of his Statement of Facts and Contentions as leading to the inference that the research and development activities were carried on on behalf of Bartercard Bermuda.

54. Bartercard Australia accepts that it did not obtain the ownership of the intellectual property produced by the research and development expenditure[28]. Its submissions suggest that Bartercard International did so. It is not clear to me why that entity rather than Bartercard Bermuda became the owner however it is sufficient for present purposes to note that it was not Bartercard Australia. That aside, the documents establish, at least,

(a) that Bartercard Bermuda was formed to own all intellectual property of the Bartercard business;

(b) that throughout the period from 2000 to 2006 the affairs of the Bartercard group were arranged on the basis that Bartercard Bermuda held all intellectual property of the group of entities;

(c) that in December 1999 Bartercard International agreed to be responsible "for all development, modification and enhancement costs associated with an Internet Application, including any payments to third parties …", an obligation subsequently assigned to Bartercard Bermuda;

(d) that Bartercard Australia was to develop the types of technology specified in the 31 May 2002 agreement but that part, at least, of what was developed would become the property of Bartercard International;

(e) that Bartercard Australia and Bartercard International lodged relevantly identical applications for registration under the *Industry Research and Development Act* which described them as partners or joint venturers in the work being undertaken;

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[28] Written submissions, 11 October 2010 at paragraph 92.

(f) that the decision to abandon the development of the WAN was made by Bartercard Bermuda, not Bartercard Australia; and

(g) that, on one construction of the information available about the January 2006 resolution of the directors of Bartercard Bermuda, even then it was agreed that research and development costs, past, present and future, would be paid by Bartercard International on behalf of Bartercard Bermuda and reimbursed accordingly.

55. The Commissioner made reference to these matters in the Statement of Facts and Contentions and foreshadowed a contention that it ought to be inferred from these matters that Bartercard Bermuda was the other person on whose behalf the activities were carried out. The state of the evidence leaves me in a position where I am simply unable to find on whose behalf the research and development activities were undertaken.

56. In supplementary written submissions the Commissioner noted that Bartercard Australia had not lead any evidence that showed how it was expected to make any profits or gains from commercial exploitation of the results of the research and development activities to which the expenditure related. Bartercard Australia took issue with that submission in its written submissions, describing it as a “new proof point”. It said:

> “The respondent accepted that the expenditure met all the requirements for deductibility under s 8-1 and should not be allowed to go beyond his amended Statement of Facts Issues and Contentions, especially after the applicant had closed its case, because it takes the applicant by surprise and is procedurally unfair. If the Tribunal does allow the new point now to be raised, the applicant seeks leave to adduce fresh evidence to meet the point should the evidence already before it … not be considered satisfactory.”

57. I reject the argument and the application, if it be such, to re-open the case for Bartercard Australia. The Commissioner has made it plain from the outset that he relied upon s 14ZZK of the *Taxation Administration Act* and that Bartercard was to be put to proof of all facts on which it sought to rely. It is not for the Commissioner to tell a party the evidence that party ought to call to discharge that onus. In my judgment Bartercard Australia has failed to discharge its onus as I am left unable to

find on whose behalf the research and development activities were undertaken. The absence of the evidence to which the Commissioner's submissions drew attention was merely one of many aspects where I was left with no explanation or no adequate explanation of the evidence.

58. I would then affirm that part of the objection decision that rejected the claim for a concessional deduction under s 73B of the ITAA 1936.

CONCLUSION

59. I will give effect to these conclusions by,

(a) setting aside the objection decision of 7 November 2008;

(b) remitting the matter to the Commissioner for reconsideration in accordance with directions that,

(i) the amounts of $711,053 (in the 2002 income year) and $623,532 (in the 2003 income year) received by Bartercard Australia from terminating members are not assessable income of Bartercard Australia;

(ii) Bartercard Australia is not entitled to concessional deductions for research and development expenditure under s 73B of the ITAA 1936;

(iii) the shortfall penalty of $7,814.87 imposed in respect of the research and development adjustment is to be reduced to nil;

(iv) the objections be otherwise disallowed.

I certify that the preceding 59 paragraphs are a true copy of the reasons for the decision herein of Deputy President P E Hack SC

Signed: ....[Sgd]...

Associate

Date of Hearing	1 & 2 September 2010
Date of last submissions	11 October 2010
Date of Decision	23 December 2010
Counsel for the Applicant	Mr ML Robertson with Mr BL Jones
Solicitor for the Applicant	Grant Thornton
Counsel for the Respondent	Mr PA Looney
Solicitor for the Respondent	ATO Legal Services Branch