

FCT v Murry: The Federal Court takes licence with goodwill

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1. Introduction

This paper focuses on the nature of goodwill, particularly for the purposes of Part IIIA of the *Income Tax Assessment Act* 1936 (Cth)¹ (the Act), with reference to both the majority and dissenting judgments of the Full Court of the Federal Court in *FCT v. Murry*.² The issue in this case concerned whether a capital gain on sale of a taxi licence was subject to the 50% exemption provided for in s. 160ZZR(1) of Part IIIA.³ That is, did the sale

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¹ References to legislative provisions will be references to this Act unless otherwise indicated. The relevant legislative provisions are contained mainly in Part IIIA (ss. 160AX - 160ZZU) of the Act, but provisions outside that Part may also have relevance in the definition of terms. The purpose of Part IIIA is to include in assessable income certain realized capital gains accruing to the taxpayer on the disposal of assets acquired on or after 20 September 1985. Goodwill is defined as an asset in s. 160A for the purposes of Part IIIA. A capital gain on disposal of goodwill may be subject to concessional treatment in the form of a 50% reduction pursuant to s. 160ZZR(1). To qualify for this concession, s. 160ZZR(1) requires that the taxpayer dispose of a business, or an interest in a business, that includes goodwill, or an interest in goodwill, and that the net value of the business, or the interest in the business, be less than the exemption threshold for the year in question. The exemption threshold is calculated in accordance with s. 160ZZRAA which sets the threshold at \$2,000,000 before 1993-94 and indexes it from that year onwards. Earlier, for disposals before 27 February 1992, the s. 160ZZR threshold was set at \$1,000,000 without indexation and the reduction in the capital gain was 20%. This earlier legislation was applicable in *Case 11/96* (see fn. 3), but nothing turns on these differences for the purposes of this paper.

² 96 ATC 4703 (*Murry*).

³ A similar question was considered by the Administrative Appeals Tribunal (AAT) in *Case 11/96*, 96 ATC 199. Senior Member Fayle held that s. 160ZZR(1) did not apply because he determined on the facts of the case that the taxpayer had not disposed of a business as required by that subsection. He also held *obiter* that there could be no goodwill attached to a taxi in the circumstances of the case. Refer to fn. 5 for further consideration of this case.

of the licence constitute the disposal of goodwill for the purpose of that section? The majority held in the affirmative in separate judgments. It is contended in this paper that the judgments of the majority confuse goodwill itself with what contributes to goodwill. Goodwill, it is contended, is an asset separate from any other identifiable assets which may contribute to its value in a business. Consequently, it is recommended that the accounting concept of goodwill should be adopted for legal purposes, and particularly in the context of Part IIIA.

2. FCT v. Murry

This case resulted from an appeal by the Federal Commissioner of Taxation (the Commissioner) from the decision of the Administrative Appeals Tribunal (AAT), reported as *Case 59/95*,⁴ wherein Deputy President Gerber allowed the taxpayer's objection against the disallowance of the s. 160ZZR concession in relation to the sale of her interest in a taxi licence. The Federal Court dismissed the appeal by a majority comprising Beaumont and Drummond JJ, with Kiefel J dissenting.

The facts

The facts were agreed between the parties and are taken from the judgment of Beaumont J. In 1987 the respondent taxpayer acquired in partnership with her husband what was described in evidence as a 'taxi business' comprising: (1) a licence to hire issued by the Queensland Department of Transport in accordance with the *State Transport Act 1960-1981* (Qld); and (2) shares in a taxi co-operative company operating within a defined area on the Sunshine Coast. Membership of the company was necessary to operate a taxi in this area and about 43 taxi operators were involved. The taxpayer and her husband did not operate this business themselves, but instead they purported to 'lease' the taxi licence to a Mr Gower, the owner of the licensed vehicle, for a fixed monthly fee.⁵

⁴ 95 ATC 473.

⁵ At this point, Beaumont J stated 'for our purposes, nothing turns on the arrangement with Mr Gower' (fn. 2 at 4704). Given this statement, it is interesting to note that a similar leasing arrangement in *Case 11/96* (see fn. 3) led the AAT to decide that the taxpayer had not disposed of a business as required by s. 160ZZR(1) and therefore the exemption under that subsection was not available to the taxpayer. It was held that the leasing arrangement meant that the taxpayer was not carrying on a business, but instead was receiving passive income in the form of rent. However, while that finding was probably correct

In March 1992, the partnership entered into an agreement to sell the 'business' consisting of the licence and the shares in the co-operative company. At the same time, Mr Gower agreed to sell his taxi vehicle to the purchasers and the assets of both vendors were entered on to the one sale form provided by the Department of Transport. In summary, the form contained details of the vehicle for a sale price of \$6,000, the shares for \$25,000 and the licence for \$189,000. The reference to the licence was part of the printed form and was described as 'GOODWILL (Licence Value)'.

State Transport Legislation⁶

Beaumont J went on to consider the legislative provisions regarding the regulation of taxis in Queensland. Relevant provisions require the holding of a licence to hire in order to operate a taxi and permit the lease or transfer of this licence to another person, subject to written approval from the Commissioner of Transport.

AAT decision and Commissioner's grounds of appeal

Before the AAT the Commissioner argued that the payment of \$189,000 for the licence was a 'premium' to enter the taxi market rather than goodwill. But Dr Gerber, Deputy President, in upholding the taxpayer's objection, found that this amount constituted goodwill and thus she was entitled to the s. 160ZZR exemption. In his notice of appeal to the Federal Court, the Commissioner contended that the AAT had erred in law in its interpretation of goodwill and that the amount paid was consideration for the licence,

(and could apply to the facts in *Murry* also), it is submitted that s. 160ZZR(1) does not require that the business, of which the goodwill forms a part, must have been carried on by the taxpayer disposing of it. What is required is the disposal of a business, including goodwill, by the taxpayer. It is quite conceivable that the owner of a business can dispose of it as a going concern without having carried it on himself, but rather having leased the relevant business assets to another person to carry on the business for the term of the lease agreement. Consequently, it is submitted that the AAT decision is ill-founded on this point. Nonetheless, for other reasons which are canvassed in this paper, the decision is still considered to be correct. That is, the taxi licence, or any other identifiable asset of the business, could not constitute goodwill for the purpose of s. 160ZZR. In fact, the AAT recognised this view in *obiter dictum* in stating that '... there could be no part of the sum paid for or received for the acquisition and disposal of the taxi licence which could reasonably be regarded as anything other than the going market price for a taxi licence' (96 ATC 199 at 203).

⁶ *State Transport Act* 1960-1981 (Qld); *State Transport Regulations* 1987.

rather than for goodwill, and thus the taxpayer was not entitled to the s. 160ZZR exemption.

Beaumont J's decision

His Honour opened his deliberations in the following interesting way:

If the present matter were free from authority, there would, in my view, be much to be said for the Commissioner's contentions. That is to say, there is much to be said for making the following assumptions: (1) That a statutory licence of the present kind is property ... and assignable, subject to departmental approval, as a chose in action, and thus an 'asset' within s. 160A. (2) That in s. 160ZZR(1), the noun "goodwill" was intended to have its ordinary, dictionary meaning, as for instance, defined in the *Macquarie*, 2nd ed.:

3. Comm. an intangible, saleable asset arising from the reputation of a business and its relations with its customers, distinct from the value of its stock etc.

But, as the transfer form here itself indicates, *there is a settled line of authority which, I think, compels the conclusion that the licence value is itself a form of goodwill*, expressed as a monopoly or quasi-monopoly (or oligopoly) goodwill; and that it should be accepted that those drafting s. 160ZZR(1) must have been aware that, technically, 'goodwill' could extend to pick up the licence value itself, even if no commercial reputation (in the dictionary sense⁷) were involved.⁸ (Emphasis added.)

⁷ It is interesting to note that *The CCH Macquarie Dictionary of Law*, 2nd edn, defines 'goodwill' thus: 'an intangible property right constituted by the value of the reputation of a business, its technical know-how, good location, market penetration, effective advertising and management, and good relations with its suppliers, customers and employees. It is distinct from other intangible industrial property rights (eg patents, designs and trademarks).' This definition, from a dictionary of law, gives no indication that a separate asset can constitute goodwill and indeed specifically states that it is separate from other industrial property rights, at least. It does not specifically state that it is distinct from other types of intangible property such as licences, but the tenor of the definition indicates that this is how it should be viewed.

⁸ Fn. 2 at 4709.

Thus Beaumont J felt that he was compelled by 'a settled line of authority' to find that the licence, although an asset in its own right, was in this case goodwill for the purpose of s. 160ZZR. This finding raises the interesting and fundamentally important question whether there is 'a settled line of authority' regarding the nature of goodwill and, particularly, one which compels this conclusion. At the heart of his Honour's finding was the view that identifiable assets which contribute to the value of goodwill (an unidentifiable asset) may be taken to be part of goodwill itself, based on the purported settled line of authority. So do the authorities support this view as he contended?

Beaumont J located the starting point of the settled line of authority in a reference to an 'agreed absence from competition' by Lord Lindley in *IRC v. Muller & Co's Margarine Ltd.*⁹ From this point, his Honour stated that this observation was cited 'with apparent approval' by Dixon CJ, Williams, Fullagar and Kitto JJ in *Box v. FCT*,¹⁰ wherein an earlier High Court decision in *Phillips v. FCT*¹¹ was also cited. At issue in *Box* was whether an amount received as consideration for a restrictive covenant was a premium in terms of s. 83(1) (as then enacted) such that it would be included in assessable income under s. 84(1). The appellant taxpayer had held an exclusive personal statutory licence to conduct a bakery in a designated zone, thus having a monopoly in that zone. He entered into an agreement to sell his business, involving the lease of the premises to the purchaser, the sale of plant and utensils and goodwill for an agreed amount, and for a further amount (the amount in question) he entered into the restrictive covenant not to compete with the purchaser. Section 83(1) provided that 'premium' meant *inter alia* 'any consideration ... for or in connection with any goodwill ... attached to or connected with land a lease of which is granted assigned or surrendered'. The High Court held that in this case the goodwill was not attached to or connected with the leased land in terms of s. 83(1) and thus was not an assessable premium under s. 84(1). The Court found that the goodwill was not connected with the situation of the business, but rather was connected with the licence which provided the monopoly and accordingly added value to the business. In his judgment,

⁹ [1901] AC 217 (*Muller*).

¹⁰ (1952) 86 CLR 387 (*Box*).

¹¹ (1947) 75 CLR 332, (1945-49) 8 ATD 297 (*Phillips*).

Beaumont J referred to the following passage from the joint judgment of Dixon CJ, Williams, Fullagar and Kitto JJ in *Box*:

In the case of a monopoly such as letters patent, or an exclusive licence to sell a commodity only obtainable from the licensor, such as a newspaper, in a particular area, the real value of the goodwill would lie in the fact of sole ownership and, so far as it has a locality, would be situated in the area over which the monopoly extended ...¹²

This passage formed part of the *ratio* in *Box* which led to the conclusion that the goodwill was connected with the licence rather than the land. That is, it was the licence, not the land, which contributed to the value of the goodwill of the business in this particular case. It is submitted that there is nothing in their Honours' judgment to support the proposition that the licence itself was goodwill. Many assets of a business may contribute to the value of goodwill without being part of goodwill; in *Box* the statutory licence was found to be the asset which was the major contributor.

In *Phillips* the issue was similar to that of *Box* and involved the sale of a newsagency comprising *inter alia* the newspaper agencies and goodwill, together with the assignment of the lease of the premises.¹³ Williams J found that the goodwill was not connected with the premises because the shop could have been situated at any convenient location in the area where the agency applied. In the passage cited by Beaumont J, Williams J went on to say:

... the real value of the goodwill of such a business lies in the appointment of the proprietor as the exclusive agent of the newspaper companies ... in the words of Lord *Eldon* in *Kennedy v. Lee* - 'the goodwill of a trade follows from, and is connected with, the fact of sole ownership'.¹⁴

Here, it is submitted, Williams J was saying that the goodwill derived its value from the existence of an exclusive agency, but he did not say that the goodwill was the property comprising the agency rights. Rather, the value

¹² Fn. 10 at 397.

¹³ In fact, there was an arrangement made that the landlord would accept the purchaser as the new tenant, but nothing turned on this point for the purpose of s. 84(1).

¹⁴ (1945-49) 8 ATD 297 at 299.

follows from the fact of sole ownership. However, it must be conceded that this interpretation is not free from doubt because later his Honour said in respect of the goodwill payment:

It was a payment made by [the purchaser] to the appellant because he and not the landlord owned what was of real value, namely the personal right to carry on business as the exclusive agent of the newspaper companies in a certain area and to transfer that right to a purchaser whom and at a price which they approved.¹⁵

At this point, his Honour appeared to be treating the agency and the goodwill as one and the same, or at least that interpretation could be put on this statement. What this apparent confusion serves to do, is to illustrate the general confusion about the nature of goodwill which seems to prevail in many of the authorities.

Next, Beaumont J cited passages from the separate judgments of Dawson, Toohey and McHugh JJ in the High Court's decision in *Hepples v. FCT*.¹⁶ But these passages were cited without any direct attempt to invoke their support for his conclusion. And, with respect, it is difficult to find clear and unambiguous support for such a conclusion. Indeed, it is possible to find support for the opposite conclusion that an asset, while contributing to goodwill, is separate from the goodwill. For example, Dawson J said in part:

The trade secrets and the special processes may also have constituted knowledge with a value apart from goodwill and therefore might be regarded as assets separate from Hunter Douglas's goodwill, but the covenants not to divulge or use them undoubtedly protected Hunter Douglas against competition and in so doing assisted in generating goodwill. I do not think that it can be doubted that a covenant in restraint of trade may enhance the value of goodwill of a business ...¹⁷

Such a statement may easily be adduced in support of a 'separate assets' viewpoint. In addition, the passage quoted from McHugh J's judgment contained the following statement:

¹⁵ Id at 300.

¹⁶ 91 ATC 4808 (*Hepples*).

¹⁷ Id at 4823.

It will be seen from the statements in *IRC v. Muller* that goodwill is the collective name for various intangible sources of the earnings of a business which are not able to be individually quantified and recorded in the accounts as assets of the business.¹⁸

Contrary to the conclusion of Beaumont J, this statement also may be used to support a case for treating goodwill as something apart from those things which contribute to it, that is its sources.

As a matter of interest, Beaumont J cited the case of *Duncan v. Ridd*¹⁹ without comment on its relevance to his reasoning. However, it must be said that this case does not lend real support to his Honour's view. Indeed, in *Duncan* Yeldham J held that he did not have to decide the question, but adopted the view of the Court of Appeal in *Rutter v. Daniel*²⁰ that an asset essential for a business, such as a statutory licence, and goodwill 'were not precisely one and the same thing'.²¹ Furthermore, Yeldham J had earlier made an even more pertinent comment that:

... to say that the purchaser of goodwill is in general entitled to receive an assignment of licences permitting the business to be conducted is not necessarily to equate such licences with the goodwill itself. Indeed, upon one view, it points to the distinction between them, even though, at the same time, indicating their close relationship.²²

¹⁸ Fn. 16 at 4837.

¹⁹ [1976] 2 NSWLR 105 (*Duncan*).

²⁰ (1882) 30 WR 724.

²¹ *Id* at 123.

²² *Id* at 117. Previously, in *Appleby v. Attard* (1974) 48 ALJR 430, the High Court had been called upon to consider the entitlement of the purchasers of a poultry farm to a hen quota licence granted under the *Egg Industry Stabilisation Act* 1971 (NSW), the same legislation that was under consideration in *Duncan v. Ridd*. Mason J stated (at 431): 'An agreement to sell the goodwill of a business will in general import an obligation to assign to the buyer any existing licence relating to the business held by the vendor' This statement tends to suggest also that a licence and goodwill '[are] not precisely one and the same thing', notwithstanding a close relationship. If the licence were to constitute the goodwill, then there could be no question of the sale of one (the goodwill) importing an obligation to assign the other (the licence); all that would be required would be the sale of the licence.

Finally, his Honour referred to Hill J who gave the leading judgment of the Full Court of the Federal Court in *FCT v. Krakos Investments Pty Ltd.*²³ In discussing a kind of goodwill which he labelled 'monopoly goodwill', Hill J said:

A process may be so unique that the mere ownership of a patent brings with it custom. In such a case the attractive force of the custom attaches to the patent. Similarly, where a statutory licence or monopoly has been conferred, that licence may come to have attached to it a type of goodwill, in the sense that it is the holding of the licence which attracts custom. For example, a crown monopoly to sell a commodity such as salt may come to have a special value to its holder over and above the cost of obtaining the monopoly.²⁴

Again, it is submitted that this passage does not make it clear that the licence should be treated as goodwill. Rather, it is stated that the licence has goodwill attached to it; that is, the licence is a source of the goodwill. Furthermore, Hill J's deliberations on goodwill, albeit that they may be of judicial significance, are nonetheless *dicta*. Notwithstanding that they are *dicta*, however, a close examination of them does not lead one easily to the conclusion that other identifiable assets should be treated as goodwill. On the contrary, in a passage not quoted by Beaumont J, Hill J said:

Monopoly goodwill attaches to the statutory monopoly right. Having regard to the disparate nature of these rights which together make up the goodwill of a particular business and which to some extent can be dealt with separately, I do not think it can be correct to say that although comprised of separate elements goodwill is to be treated as inseverable. It is, however, correct to say that to the extent that the goodwill attaches to a species of property it may only be dealt with together with that property. But this is not to say that it is not capable of being dealt with as a separate species of property or as being the subject of a bargain and sale at a price.²⁵

²³ 96 ATC 4063 (*Krakos*).

²⁴ *Id* at 4069-70.

²⁵ *Id* at 4073.

This passage, it is submitted, could be used to support an argument for treating goodwill as an asset separate from what contributes to it in the form of other assets such as statutory licences.

Nevertheless, Beaumont J concluded:

... as a legal concept, it is established that an element of a particular form of 'goodwill' is the degree of competition permissible, specifically, that allowed under a licensing system. It must ... follow, in my opinion, that the description in the transfer application form ('GOODWILL (Licence Value)') should, in the light of the settled course of authority, be treated as appropriate in the present case to describe an element of goodwill ... for the purposes of s. 160ZZR. ... the partial absence of competition arising from the limited form of monopoly granted under the licensing system meant that the partnership should be regarded as possessing, and then disposing of, a form of goodwill.²⁶

Drummond J's decision

Drummond J noted that the Commissioner's arguments were grounded on three bases: (1) that a licensed taxi business of the kind in question can have no goodwill; (2) that s. 160ZZR only applies where the goodwill of a business represents a value separate from the values of all other assets of the business subject to sale; and (3) that if a taxi business can have goodwill, contrary to (1), then the sale of a specific asset like a licence is not the sale of goodwill but the sale of an asset that contributes to goodwill.

His Honour's decision may be distilled into arguments based around four main propositions: (1) that the assurance of custom which a taxi licence gives is capable of being described as goodwill; (2) that lack of differentiation between services in the taxi market does not preclude the existence of goodwill; (3) that goodwill cannot be transferred separately from a business; and (4) that the rule that goodwill only attaches to an established business is not an inflexible one.

²⁶ Fn. 2 at 4711.

(i) Proposition (1)

Drummond J reached back to *Muller* and Lord Macnaghten's definition of goodwill as 'the attractive force which brings in custom'²⁷ and referred to a similar view expressed by Rich J in *FCT v. Williamson*.²⁸ This his Honour saw as the 'essence of business goodwill'.²⁹ He then went on to say:

It is not uncommon for a business to have a monopoly or semi-monopoly in providing the goods or services it supplies to the market; this can comprise an element of the business' goodwill, additional to all other elements of the particular business' goodwill, which may include site and personal and name goodwill. ... There is no reason why a business cannot have a goodwill comprised solely of monopoly goodwill: if a business has a monopoly on the supply of particular goods or services that are in demand, customers have to patronise it, irrespective of its location and the personality of the proprietor and ... what trading name it adopts. That the goodwill of a particular business can consist solely of monopoly goodwill was accepted in *Box v. FCT* (1952) 10 ATD 71 at 75; (1952) 86 CLR 387 at 397.

... The only customer connection the respondent's business had was the assurance that it would share in the demand for cab services in the relevant area, which flowed from the semi-monopoly in meeting that demand that possession of the licence conferred.

In my opinion, the only thing that gives a taxicab licence its commercial value is the assurance of sharing in the available custom which it confers on the holder: a cab licence confers no other benefit on the licensee. ... It is no misuse of language to say that the benefit comprising the semi-monopoly rights created and conferred by a licence of the kind here in question comprises the goodwill of the licensed business: see *Box v. FCT*, supra, at ATD 75; CLR 397 where the High Court observed: 'Goodwill includes whatever adds value to a business, and different businesses derive their value from different considerations'.³⁰

²⁷ Fn. 9 at 224.

²⁸ (1943) 67 CLR 561.

²⁹ Fn. 2 at 4714.

³⁰ Ibid.

However, as in regard to Beaumont J's decision, it is submitted with respect that there is nothing in the cases referred to that lends unequivocal support to the proposition that a licence, albeit an essential and valuable asset, is itself goodwill.

(ii) Proposition (2)

His Honour made reference to the fact that '[a] cab licensee cannot differentiate his service from that provided by other cab licensees operating in his area'.³¹ He then went on to say that 'without being able to do that, his cab licence still commands substantial value in the market because of the peculiar nature of the semi-monopoly ...'.³² His Honour's intention was to rebut the Commissioner's contention that a taxi business of this kind cannot have goodwill by saying that, notwithstanding lack of differentiation, the semi-monopoly nature of the licence is valuable in the market, thus implying that this value constituted goodwill. But, it may be argued, this lack of differentiation could be seen to support the Commissioner's contention, rather than rebut it. An important feature of goodwill, it is submitted, is that set of attributes of a business which attracts custom to it rather than to a competitor. For example, see Lord Lindley's reference to the 'agreed absence from competition' in *Muller*, cited above. In a situation such as this, the competition would be the other licensed taxis in the area. This argument depends on the view that those excluded from the taxi market by not holding a licence could not in any realistic sense be seen as competitors. Admittedly, one should be careful not to dismiss out of hand the counter argument that the statutory prevention of others from entering the market does in fact lead to an absence of (unlicensed) competition. However, it is submitted that, on balance, lack of differentiation in a taxi market such as this one tends to support the contention that no goodwill attaches to the taxi business. This view, in fact, was expressed by Kiefel J in dissent as *obiter dictum*.³³

(iii) Proposition (3)

As Drummond J has indicated, there is good authority for the proposition that goodwill cannot exist independently of the business and thus it cannot

³¹ Fn. 2 at 4715.

³² *Ibid.*

³³ The same view was also expressed *obiter* by the AAT in *Case 11/96*, 96 ATC 199.

be transferred separately from the business.³⁴ In the case of the taxi business in question, his Honour found that it was not possible under the governing legislation to transfer the licence without transferring the entire business. From this he argued that 'therefore [there was] no impediment to this taxicab licence being identified as the source of the whole of the goodwill of the licensee's business'.³⁵ While it is agreed that this proposition does not impose any such impediment, it is obvious that of itself it does not make a case for treating the licence as goodwill.

(iv) Proposition (4)

It was submitted by the Commissioner that there could be no goodwill associated with the licence because at the time of its acquisition as a newly issued licence it was not associated with any business. He cited *Muller* as authority for the rule that goodwill arises from business activity and 'is the one thing which distinguishes an old-established business from a new business at its start'.³⁶ On this basis, the Commissioner argued that any amount held to be goodwill on disposal would constitute the whole capital gain because there would have been no purchase of goodwill to constitute a cost base. However, Drummond J countered by citing McHugh J in *Hepples* in saying that this is not an inflexible rule as 'goodwill may exist in the case of some kinds of new business before they ever start to trade'.³⁷ He cited, as an example, the inherent value of a particular site as an attraction to customers at the outset of a business. As a consequence, Drummond J was able to find that the whole of the purchase price of the licence was a purchase of goodwill in the form of monopoly goodwill.

As did Beaumont J, his Honour made a case for finding that the licence may be associated with, or be the source of, any goodwill of this business, on the assumption that this kind of business can have goodwill in the first place. But, with respect, it is submitted that he did not make an entirely cogent case for a conclusion that the licence itself was goodwill. As argued

³⁴ In *Murry*, fn. 2 at 4715, Drummond J cited as authority for this proposition: *IRC v. Muller*; *Geraghty v Minter* (1979) 142 CLR 177 at 181; *FCT v. Just Jeans Pty Ltd* 87 ATC 4373 at 4382. At the same time, his Honour recognised in parentheses that a differing view had been suggested in *Krakos*; a view with which Kiefel J disagreed in *Murry*.

³⁵ Fn. 2 at 4716.

³⁶ *Ibid.*

³⁷ *Ibid.*

elsewhere in this paper, the fact that a separate asset is the source of goodwill does not make that asset goodwill. That a distinction between goodwill and its source must be made is, in effect, the primary thesis of this paper.

Kiefel J's decision

Kiefel J dissented from her fellow judges in delivering her decision; a decision which, in the opinion of this writer, is the one to be preferred. Her Honour found that the licence did not constitute goodwill, and it is noteworthy that she reached this decision by reference largely to the same authorities as those used by the majority, thus tending to cast doubt on Beaumont J's 'settled line of authority'. At the outset, her Honour identified two essential features in her understanding of the goodwill of a business: (1) goodwill is an asset which has no existence independent of the business to which it relates; and (2) it is an asset which comprises a number of elements, thus it would not include a singular asset as a distinct item of property.

It is submitted that the first of these features may be considered settled in that there is clear and compelling authority for the view that goodwill cannot exist apart from the business. It may be severable from certain assets of the business, however, such as in the case of *Rosehill Racecourse Company v. The Commissioner of Stamp Duties (NSW)*³⁸ where the

³⁸ (1906) 3 CLR 393. This was an important early High Court decision which determined that, for stamp duties purposes, goodwill could be treated as separate from the land in circumstances where a club's right to hold race meetings conferred by the Australian Jockey Club was found to be the critical element in building the goodwill, rather than the land itself. O'Connor J said (at 409): '... it is clear that the racecourse, with appointments and buildings and goodwill, is valueless as a racecourse unless used under the right given by the registration of its racing fixtures under the rules of the Australian Jockey Club. So the most important element in the goodwill of this business is the right of registration and the right to fixtures appointing the days of the race meetings.' His Honour then went on to say that he thought the right of registration was 'an element of what constitutes goodwill' (at 410). But he did not make it clear whether he meant by this that the right of registration was the goodwill or that it contributed to the goodwill. This doubt was given expression by Griffiths CJ where he said (at 398): '... goodwill may *perhaps* comprise licences to exercise patents, and contracts with various persons and other rights of that nature.' (Emphasis added.) This statement could perhaps lend some support to the views of Beaumont and

goodwill was found to be severable from the land, while remaining with the business itself, that is, the racing club. To the extent that Hill J in *Krakos* suggested that goodwill might be severable from the business, Kiefel J was prepared to demur in saying that such a view did not accord with the authorities and, in any event, was not part of the *ratio* in that case. On this theme, her Honour later said:

There is no doubt that some assets ... may be sold separately. But in my view, one is not then talking of a sale of 'goodwill', even if the removal of one asset central to the business and its goodwill may be largely destructive of it. What one is speaking of is the sale of a distinct asset, separate from the goodwill, to which it contributes as one might speak, for instance, of the sale of essential plant and machinery.³⁹

The second feature concerning the composite nature of goodwill was held by her Honour to follow from the first:

The conclusion that goodwill cannot be separated from the business also reflects the concept of goodwill as a composite of a number of factors or elements working together, rather than as representing an income producing item of property which may be quite separately valued and dealt with.⁴⁰

Her Honour supported this view by reference to *Hepples* where McHugh J said that 'goodwill is the collective name for various intangible sources of the earnings of a business'.⁴¹ The essence of McHugh J's view, it is submitted, is that goodwill is generated from within the business and is inseverable from it. This view, of course, does not preclude the possibility of one or more identifiable assets of the business being the source of the goodwill. However, this does not make any such assets goodwill. As her Honour said, 'the fact that an asset be important, indeed essential, to a business and its income, does not render it goodwill'.⁴²

Drummond JJ, but its equivocal nature would tend to render that support rather weak. (In fact, it was not used in this way by either judge.)

³⁹ Fn. 2 at 4720.

⁴⁰ Id at 4718.

⁴¹ Ibid.

⁴² Id at 4719.

With specific reference to the issue before her, her Honour invoked the concepts of goodwill of Lords Lindley and Macnaghten in *Muller* and then opined that a licence could not exert 'attractive force' in terms of Lord Macnaghten's description. She said:

By reference to one aspect of Lord Macnaghten's description, it might be said that a statutory licence could never **attract** customers, in the sense of operating to draw them to a business. (Emphasis given.) It operates to the holder's advantage by simply ensuring that, by lack of choice, a number of people will have to use the taxi to which it is connected. ... In this connexion one might compare it with a restrictive covenant given by a seller of a business which has been said to "enhance" the level of custom already built up by preventing the seller engaging in competition, and in that sense is taken to be part of goodwill ...⁴³

Thus Kiefel J questioned whether a taxi business of the sort in this case could have any goodwill in the first place. However, the *ratio* of her judgment was that, even if this were possible, there was no authority for treating the licence as goodwill.

3. The Concept of Goodwill

The legal concept of goodwill has proved to be somewhat elusive and confusing. The conflicting decisions in *Murry* bear testimony to this conclusion. The concept has developed in the courts over the years in response to the need to understand and apply the term 'goodwill' as used in various statutes, but without having to pay strict attention to its inherent nature.⁴⁴ Now the need to clarify its meaning in the context of Part IIIA has arisen and, it is submitted, this must be done with due attention to the need to give proper effect to the s. 160ZZR exemption. In this regard, goodwill's inherent nature assumes critical importance.

It needs to be said, however, that the very nature of goodwill makes it difficult to pin down in legal terms. Therefore, it is submitted that the accounting approach to goodwill has much to offer to the legal

⁴³ Id at 4718.

⁴⁴ See, for example, *FCT v. Williamson*, fn. 28 where Rich J said: '... in the present case the Court has little concern with the inherent nature of goodwill.'

understanding. And, furthermore, as goodwill is after all a creature of commerce, there is much to recommend this approach. *Statement of Accounting Standards AAS 18*⁴⁵ 'Accounting for Goodwill' states in para. 4 that 'goodwill comprises the future benefits from unidentifiable assets which, because of their nature, are not normally recorded individually in the accounts'. *AAS 18* then goes on to state later in the same paragraph that:

[Goodwill] would exclude assets of an intangible nature which are capable of being both individually identified and specifically recorded, as may be the case with patents, licences, rights and copyrights.

Thus for accounting purposes goodwill is an unidentifiable asset, or a benefit from unidentifiable assets, such that it is not to be confused with any identifiable assets, tangible or intangible. Accordingly, this view is in direct conflict with the majority's view in *Murry* that an identifiable asset, such as a licence, may be treated as goodwill. To further underline this conflict, Henderson and Peirson state:

In accounting, goodwill is measured as the difference between the price paid for a business and the fair market value of the identifiable net assets acquired. Goodwill, therefore, is not an asset with a separate existence, it is simply the difference between two amounts. Goodwill can only be sold or purchased as a part of the firm as a whole. It is not a separate vendible asset.⁴⁶ (Emphasis added.)

It is part of the major submission of this paper that, contrary to the majority in *Murry*, the balance of legal authority is not inimical to the accounting view of goodwill, even if not unequivocally supportive of it. Any

⁴⁵ *Statements of Accounting Standards* are issued by the Accounting Standards Board of the Australian Accounting Research Foundation, a body jointly sponsored by the *Australian Society of CPAs* and *The Institute of Chartered Accountants in Australia*. *AAS 18* is one of a series of *Standards*, designated *AAS*, that apply to the non-corporate sector and set down 'generally accepted accounting principles' applicable to entities in that sector. For companies, on the other hand, the applicable *Standards*, designated *AASB*, have the force of law pursuant to the *Corporations Law* and companies are required to comply with them in the preparation of financial statements. The company goodwill *Standard* is *AASB 1013* (revised June 1996) which contains definitions and rules largely consistent with *AAS 18*.

⁴⁶ Henderson, S. & Peirson, G. 1991, *Issues in Financial Accounting*, 4th edn, Longman Cheshire, Melbourne, 379.

equivocation, however, would appear to result from a lack of precision in the principles necessary to enunciate clearly the nature of the asset called goodwill, particularly in terms of whether or not it has an identity separate from other assets of a business. Therefore, it is submitted that the courts should adopt the accounting concept of goodwill. As indicated above, this concept is not necessarily at odds with the legal concept and, furthermore, there is sound authority for the courts to take into account relevant commercial or accounting concepts where a term is not defined in legislation. For example, in *Brent v. FCT*, Gibbs J of the High Court was called upon to consider the meaning of income derived in terms of s. 25(1) and said:

It has become well established that unless the Act makes some specific provision on the point the amount of income derived is to be determined by the application of ordinary business and commercial principles ...⁴⁷

Earlier, in similar vein, the Full High Court in *Arthur Murray (NSW) Pty Ltd v. FCT* said:

In so far as the Act lays down a test for the inclusion of particular kinds of receipts in assessable income it is ... true that commercial and accounting practice cannot be substituted for the test. But the Act lays down no test for such a case as the present. The word 'income', being used without relevant definition is left to be understood in the sense which it has in the vocabulary of business affairs.⁴⁸

Is goodwill property?

Judicial recognition of goodwill as property has a long pedigree⁴⁹ and now seems firmly enshrined in the law. For example, in *Muller* Lord Macnaghten commented that '[i]t is very difficult ... to say that goodwill is not property'.⁵⁰ And in *Krakos*, Hill J noted the argument that goodwill is not property and opined that '[i]t is probably now too late in the day for such

⁴⁷ 71 ATC 4195 at 4200.

⁴⁸ (1965) 114 CLR 314 at 320

⁴⁹ For example, goodwill was recognised as property in *England v. Downs* (1842) 6 BEAV 269; (1842) 49 ER 829.

⁵⁰ Fn. 9 at 223.

an argument to succeed'.⁵¹ Nonetheless, learned commentators continue to cast doubt on goodwill as property.⁵² Further, it is noteworthy that in the important 'goodwill' cases of *Williamson*, *Phillips* and *Box* the High Court was not required to resolve this question as it was not directly concerned with it in reaching its decisions.⁵³

Notwithstanding the question of goodwill as property, for the purposes of Part IIIA at least goodwill is an 'asset' as defined in s. 160A(aa)⁵⁴ and is further recognised as an asset capable of disposal in s. 160ZZR(1). Thus this question is rendered redundant in the context of Part IIIA, a point noted by Hill J in *Krakos*. Furthermore, accounting also recognises goodwill as an asset, as indicated earlier.

The real issue is the legal recognition of goodwill as an asset separate from those other assets that may contribute to its existence; which existence being evidenced by an amount that a purchaser is willing to pay above the market values of the identifiable assets. This amounts to a recognition of the commercial reality of goodwill and its accounting form as an amount apart from other assets of a business. As argued above, there is no impediment to the courts taking this approach.

4. Goodwill and Part IIIA

In *Murry*, Beaumont J expressed the view 'that those drafting s. 160ZZR(1) must have been aware that, technically, "goodwill" could extend to pick up the licence value itself ...'.⁵⁵ This view was based on his Honour's finding of the 'settled line of authority' which compelled his conclusion that the licence could be considered goodwill. But, as argued in this paper, there is no settled line of authority which necessarily compels this conclusion.

⁵¹ Fn. 23 at 4067

⁵² See, for example, Inglis, M. W., 'Inglis on CGT', *Charter*, November 1995, ICAA at 44, and Slater, T., 'The Nature of Goodwill', *1994 NSW Intensive Seminar - Capital Gains Tax*, 18-19 November 1994, TIA at 3. Slater argues that goodwill is not property, but rather a quality or attribute resulting from assets or other properties of a business, none of which in itself is goodwill.

⁵³ However, in *Box* the Court made an indirect reference to goodwill as property by way of citing a reference to this characteristic by Lord Lindley in *Muller*.

⁵⁴ Moreover, the construction of para. (aa) indicates that it was drafted on the premise that goodwill is a form of incorporeal property.

⁵⁵ Fn. 2 at 4709.

Accordingly, the imputed intention on the part of the drafters to give goodwill this meaning in s. 160ZZR must be called into question.

Kiefel J, on the other hand, took a different view of s. 160ZZR, based naturally enough on her view that goodwill is a separate asset. Her Honour said:

Nor does the section, or the Part within which it is contained, convey any legislative intent 'including any policy which may be discerned from those provisions' which would permit or require a departure from the ordinary meaning of the word 'goodwill' see *Cooper Brookes (Wollongong) Pty Limited v. FC of T* 81 ATC 4292.⁵⁶

It is submitted that Kiefel J's view is logical and correct. There is no warrant for giving goodwill other than its normal meaning, which should be held to encompass the accounting concept of a separate asset. There is nothing in the *Explanatory Memorandum* which indicates any special meaning to be given to goodwill. In fact, the goodwill exemption in s. 160ZZR was introduced as a concession to small business (announced by Press Release on 28 November 1985). It might be proposed, therefore, that the accounting or commercial concept of goodwill was the one in the minds of the legislators at the time.

Furthermore, the operation of Part IIIA involves rendering assessable capital gains realised on the disposal of assets. If goodwill were considered to be no more than the asset or assets which may contribute to its value, then there would hardly be any need to define it specifically as an asset in s. 160A. But given that goodwill is both specifically defined as an asset and is a common component of business sales, it is reasonable to suppose that it was intended to be treated as a separate asset in the scheme of the Part.

The allocation of amounts between goodwill and other assets in the sale of a business would remain an issue, but no more so than it has been before. For example, if the goodwill of a business is protected by the vendor's entering into a restrictive covenant not to compete with the purchaser and no amount of consideration is attributed to it, then the question could arise whether some of the amount for the goodwill should be allocated to the covenant on

⁵⁶ Id at 4720.

the basis that the rights under it constitute an asset which has a value. The Commissioner takes the view in *Taxation Ruling* TR 95/3 that such a restrictive covenant has value as an asset⁵⁷ separate from the goodwill and states that whether he would assign any consideration to it where none was assigned would depend on the facts of the case. However, if the sale agreement were not a sham and the parties were at arm's length, it is submitted that there would be a good case for accepting the amounts of consideration in the agreement. In *Krakos*, no consideration was allocated to a restrictive covenant to protect the goodwill of a hotel, but the issue under consideration here was not an issue before the Federal Court in that case. Nevertheless, Hill J made the relevant comment that an agreement should be accepted unless there was satisfactory evidence to the contrary. Furthermore, in the recent *Taxation Ruling* 96/24,⁵⁸ the Commissioner has indicated that he will accept that an amount agreed to as (site) goodwill will not be treated as a lease premium in the normal case where the agreement is not a sham and arm's length market values apply. This would appear to indicate that the Commissioner is now generally prepared to accept arm's length agreements of this type. On a final note, the sale agreement in *Murry* described the licence value as goodwill,⁵⁹ but the commercial and legal reality of that description was, of course, at issue in this case. The simple labelling of something as something else on a sale document cannot be expected to be acceptable in this matter.

5. Conclusion

At the time of writing, the Commissioner has made application to the High Court for special leave to appeal the decision in *Murry*. It is hoped that the High Court will assent to this application in order to clarify the law in this important and contentious area of income tax.⁶⁰ The potential to label or classify other distinct assets as goodwill has significant implications for taxpayers and the revenue in the light of the 50% exemption applicable to goodwill. The resultant tendency would be to undermine the integrity of Part IIIA. It is the theme of this paper that goodwill should be seen as an

⁵⁷ That the rights or benefit under a restrictive covenant may constitute an asset as defined in s. 160A is stated in this *Ruling* without reference to authority, but it is submitted that the definition could encompass them given its current breadth.

⁵⁸ This *Ruling* replaces the earlier *Taxation Ruling* IT 2535 in which site goodwill was automatically treated as a lease premium.

⁵⁹ This was referred to in the facts of the case at the beginning of this paper.

asset separate from whatever contributes to it in accordance with accounting practice and that there is nothing in the authorities to preclude such an interpretation. Clarifying the issue by legislative amendment may be an option, but there seems to be a firmly entrenched aversion to defining common commercial terms in legislation. As a consequence, the responsibility for deciding the question must be taken to rest with the High Court.

⁶⁰ The High Court has since granted special leave to appeal.