IN THE SUPREME COURT OF QUEENSLAND No. 1898 of 1996

Brisbane

BETWEEN:

RADAIR PTY LTD Appellant

AND:

COMMISSIONER OF PAY-ROLL TAX Respondent

REASONS FOR JUDGMENT - HELMAN J.

Judgment delivered 30 October 1998

1 This is an appeal by an employer under s. 33 of the *Pay-roll Tax Act* 1971 against a decision of the respondent. It raises the question whether an employer's contributions to an employee share ownership plan are liable to pay-roll tax in Queensland.

2 By an amended assessment issued on 10 February 1995 for the year ended 30 June 1994 the respondent included in the taxable wages which were the basis of the assessment $600,000.00 paid by the appellant to a company called John Shepherd Employees Pty Ltd, to which I shall refer as J.S.E., on or about 5 May 1994 under an employee share ownership plan called the John Shepherd Group Employee Share Ownership Plan. The plan enables an employer, in this instance the appellant, to offer selected employees the right to participate in a remuneration-based incentive scheme. Under s. 32 of the Act the appellant objected to the assessment, claiming that the tax should be reassessed to exclude the $600,000.00 from the taxable wages. The respondent determined on 28 July 1995 that the objection should be disallowed and so the appellant has pursued the matter in this court.

3 At all material times Messrs John Shepherd and John Pope were employees and directors of the appellant. They

were also the only directors of J.S.E., which was incorporated on 3 May 1994 with one employer share of $1.00 held by the appellant and one manager share of $1.00 held by Mr Michael Casey. I shall describe the classes of shares in J.S.E. later.

4 On or about 5 May 1994, four applications for the allotment of shares were made to J.S.E. The appellant applied for 600 employer shares of $1.00 each at a premium of $999.00 per share. The appellant tendered the $600,000.00 to J.S.E. The application shows $300,000.00 of the $600,000.00 was to be allocated under the plan to Mr Shepherd's account and the other $300,000.00 to Mr Pope's account. The default shareholder was specified as Mr Casey as trustee for the employees from time to time of the appellant. Messrs Shepherd and Pope each applied for 300 employee shares of $1.00 each and each tendered $300.00 to J.S.E. Mr Casey, as trustee for the employees from time to time of the appellant, applied for five default shares of $1.00 each and tendered $5.00 to J.S.E.

5 On 5 May 1994 J.S.E. accepted the applications and allotted the 600 employer shares, the 600 employee shares, and the five default shares on the terms and conditions contained in the applications. Under the share ownership plan the appellant participates by subscribing for employer shares in J.S.E. at a price of $1,000.00 per share: $1.00 par value and a premium of $999.00. Employees, who are selected by the appellant to participate in the plan, do so by subscribing for employee shares of $1.00. The appellant then specifies the incentive arrangements which will apply to the plan and in particular the conditions of eligibility which will apply. According to the document supplied to employees and describing the plan it was intended that J.S.E. would invest the money it receives from the appellant in accordance with an investment strategy which would be discussed and agreed with participating employees and which would emphasize capital security and growth as well as some income generation. Income from those investments might either be reinvested by J.S.E. or,

subject to the terms of the plan, distributed as dividends, usually franked. Subject to the plan, if an employee were permitted to surrender his interest in the plan that would be achieved by redemption of the employee shares in J.S.E., and perhaps by realization of some investments held by J.S.E., with the net proceeds of sale, after tax, being paid to the employee.

6 I shall now give a more detailed description of the plan, derived chiefly from the document supplied to employees.

7 There are four classes of shares in J.S.E.: employer shares, employee shares, manager shares, and default shares.

8 The rights attaching to employer shares are limited to a return of nominal capital on the winding-up of J.S.E., subject to the preferred rights attaching to employee shares. Employer shares carry no voting rights, no rights to receive dividends or other distributions of property from J.S.E., no right to participate in the management of J.S.E. or to appoint directors of J.S.E., and no right to share in surplus assets, if any, on a winding-up. Funds subscribed by the appellant in excess of the nominal capital are not recoverable by the appellant in any way and are available only to be used to fund benefits for employees. The appellant does, however, specify in advance the basis of an employee's involvement in the plan, in particular the qualifying and disqualifying events applicable to the employee shares and the circumstances in which employee shares may be redeemed.

9 Employee shares are redeemable preference shares of $1.00 each in the capital of J.S.E. Subject to the agreed conditions of the plan, including any qualifying and disqualifying events, employees will generally be entitled to:

1. The net income received and gains realized by J.S.E. on its investments calculated on a *pro rata* basis to

the amount standing for the benefit of employees in their incentive accounts. Whether or not J.S.E. declares dividends on a regular basis will depend on the terms and conditions of the plan. J.S.E. may declare dividends on one or more employee shares at the discretion of the directors; and

2. A *pro rata* share of the net proceeds received by J.S.E. upon sale of its investments. That amount is paid by J.S.E. upon redemption of employee shares, partly by way of dividend and partly by way of premium on redemption. When an employee is entitled to redeem employee shares will depend upon the conditions attaching to that employee's participation in the plan and in particular the conditions regarding the receipt of benefits.

Employee shares carry no voting rights and no rights to participate in the management of J.S.E. An employee's right to receive any dividends declared on employee shares and the payment on redemption of employee shares may be lost upon the occurrence of a disqualifying event, as agreed with the appellant. Moneys which would otherwise be payable to an employee may, on the happening of a disqualifying event, be reallocated to other participating employees or will be paid to the default shareholder.

10 Manager shares are ordinary shares of $1.00 each in the capital of J.S.E. and are the only voting shares in J.S.E. All manager shares are held by the appellant's accountant or other trusted adviser, or by a company wholly owned and controlled by such accountant or adviser. Manager shares carry the right to receive notice of, attend, and speak at, every meeting of members of J.S.E. and to vote on any resolution put to such a meeting. While manager shares are the only voting shares in J.S.E., they carry no rights to dividends or to participate in the profits or assets or in any capital surplus of J.S.E., other than the right to the return of nominal capital on a winding-up of J.S.E., which right is deferred to all other members of J.S.E. The

manager shareholder therefore has an effective right of control of J.S.E., but has no financial interest in its profits or assets by virtue of holding the manager shares. The manager is, however, entitled to certain fees and remuneration which are paid by J.S.E.

11 Default shares are redeemable preference shares of $1.00 each in the capital of J.S.E. They carry no right to participate in the assets or profits of J.S.E. except as I shall explain. Default shares may be held only by a trustee or nominee on behalf of, and for the benefit of, employees - e.g., the trustees of the appellant's group superannuation fund. Default shares are issued at their par value. If a contribution made by the appellant has not been used to fund or pay benefits to employees, the balance may be distributed to the default shareholder as a default recipient. Default shares carry no right to vote at, or to receive notices of meetings of, J.S.E., except a meeting convened to consider a resolution that J.S.E. be wound up. The default shareholder is entitled to be given notice of such a meeting and to speak at it, but not to vote. The rights of the default shareholder to dividends and other distributions are limited to such dividends as the directors of J.S.E. in their discretion may declare. The directors are appointed by the manager and would be unlikely to declare any such dividend unless there were no employees likely to be entitled to the income or assets derived from the contributions made by the appellant.

12 Once the appellant has decided which employees will be eligible to participate in the plan, the appellant discusses and agrees with those employees as to how their participation in the plan is to be funded, e.g., bonus, share of profit, salary packaging etc. They will also agree on the criteria which will result in employees' becoming entitled to benefits, and also on any events which can result in the loss of entitlements. The appellant and each employee then complete the necessary application forms for employer shares and employee shares respectively. The appellant pays for the appropriate number of employer

shares and also for employee shares on behalf of the participating employees. All subscription moneys are paid by the appellant and not by the participating employees. (The agreed statement of facts in this case, however, records, as I have related, that Messrs Shepherd and Pope paid for their employee shares.) The appellant cannot receive a refund of any money paid by it for employer shares. The premium of $999.00 paid by the appellant for an employer share is not repayable to the appellant under any circumstances and the appellant receives no income or gain on it. The premium is invested by J.S.E. and used to provide benefits to the participating employees or, to the extent not so used, becomes payable to the default shareholder, e.g., the trustee of the appellant's superannuation fund. Each employee is issued with an agreed number of employee shares by J.S.E. These employee shares give the employee the right to receive benefits resulting from the funding provided to J.S.E. by the appellant.

13 Employees can seek to withdraw from the plan at any time (subject to the conditions agreed with the appellant from time to time during the term of the employee's participation in the plan) by completing a redemption request form.

14 Each year an annual benefits statement is issued showing any dividends paid and the redemption value of employee shares as at the date of the statement. The plan allows the appellant to invest regularly by subscribing for more employer shares in J.S.E. As a general rule, income earned by J.S.E. will be reinvested to increase the value of J.S.E.'s investments. J.S.E. considers on a case-by-case basis requests from employees for dividends to be declared on their employee shares, but the directors retain a discretion as to whether or not to declare such dividends.

15 In the applications of Messrs Shepherd and Pope for employee shares the following appeared:

I further acknowledge and agree to be bound by the following Terms of Issue.

TERMS OF ISSUE OF EMPLOYEE SHARES

1. During the term of my employment with Radair Pty Ltd ('Employer') I will:

1.1 Work diligently in the Employer's business and affairs to the best of my ability and in the best interests of my Employer;

1.2 During my normal working hours as agreed from time to time with my Employer devote the whole of my time and attention and abilities to carrying out my duties unless prevented by ill health, holidays or other good reason;

1.3 Conform to such hours of work as may from time to time reasonably be required of me by my Employer and I acknowledge that in the absence of any agreement to the contrary, I shall not be entitled to receive any remuneration for work performed outside my normal hours;

1.4 Exercise such powers and perform such duties in relation to my Employer's business specified from time to time by my employer.

2. I agree to serve my Employer for a minimum term of three (3) years from the date upon which I am allotted shares in the Company and thereafter until my employment is validly terminated by either my Employer or myself.

3. I acknowledge that the following events are designated as 'disentitling events' in relation to my Employee Shares, namely if I:

3.1 Am guilty of any wilful or negligent misconduct in relation to the business or affairs of my Employer;

3.2 Fail to exercise reasonable diligence in my employment or act contrary to the interests of my Employer;

3.3 Do not serve my Employer for the minimum term referred to in paragraph 2 above (whether due to dismissal resignation incapacity or any other circumstances whether within or beyond my control);

3.4 Disclose (without the prior written consent of my Employer) any trade secret or secret information relating to my Employer's business or affairs;

3.5 Breach any of the terms contained herein.

4. I acknowledge that I may not redeem my Employee Shares without the consent of the Company.

The 'Company' referred to was of course J.S.E.

16 The definition of 'wages' in s. 3(1), the interpretation section, of the *Pay-roll Tax Act* at the relevant time was:

> **'wages'** means any wages, salary, commission, bonuses or allowances paid or payable (whether at piece work rates or otherwise and whether paid or payable in cash or in kind) to, or in relation to, an employee as an employee, or applied for the employee's benefit, and, without limiting the generality of the foregoing, includes -
>
> (a) any amount paid or payable by way of remuneration to a person holding office under the Crown in right of the State of Queensland or in the service of the Crown in right of the State of Queensland;
>
> (b) any amount paid or payable under any prescribed classes of contracts to the extent to which that payment is attributable to labour;
>
> (c) any amount paid or payable by a company by way of remuneration to a director or member of the governing body of that company;

(d) any amount paid or payable by way of commission to an insurance or time-payment canvasser or collector;

(e) the provision by the employer of meals or sustenance or the use of premises or quarters as consideration or part consideration for the employee's services;

(f) any amount paid or payable by way of remuneration by a person (in this paragraph referred to as the employment agent) to a person (in this paragraph referred to as the worker) who was engaged by the employment agent to provide services for a client of the employment agent and as a result of the engagement -

(i) the worker does not become the employee of either the employment agent or the client but does carry out duties of a similar nature to those of an employee;

(ii) remuneration is paid directly or indirectly by the employment agent to the worker or to some other person in respect of the services provided by the worker; and

(iii) the employment agent receives directly or indirectly payment, whether by way of a lump sum or an ongoing fee, during or in respect of the period when the services are provided by the worker to the client; and

(g) fringe benefits.

That definition had been amended by the *Revenue Laws Amendment Act* 1993 by inserting the words 'to, or in relation to, an employee as an employee, or applied for the employee's benefit' in lieu of the words 'to an employee as such', and by inserting '(g) fringe benefits'. New definitions in s. 3(1) of 'fringe benefit', 'Fringe Benefits Assessment Act', 'paid or payable', and 'pay', and a new s. 8A, were inserted by the 1993 Act:

'fringe benefit' means -

(a) a benefit that, in relation to an employee, or an employer of an employee, is a fringe benefit under the Fringe Benefits Assessment Act; or

(b) anything prescribed by regulation to be a fringe benefit;

but does not include -

(c) a car parking fringe benefit within the meaning of that Act; or

(d) anything prescribed by regulation not to be a fringe benefit;

'Fringe Benefits Assessment Act' means the *Fringe Benefits Tax Assessment Act* 1986 (Cwlth);

'paid or payable' in relation to wages that are fringe benefits, means -

(a) paid;

(b) if another meaning is prescribed by regulation - that meaning;

'pay', in relation to wages, includes provide, confer and assign;

Value of taxable wages

8A.(1) The value of taxable wages that are paid or payable in kind (other than fringe benefits under the Fringe Benefits Assessment Act) is the value under the regulations.

(2) The value of taxable wages that are fringe benefits under the Fringe Benefits Assessment Act is the value that would be the taxable value of the benefits as fringe benefits under that Act, unless otherwise prescribed by regulation under this Act.

All of those amendments came into force on 1 January 1994.

17 On behalf of the appellant, Mr Russell Q.C. submitted that the appellant's contributions to the plan did not fall within any of the categories of taxable wages.

18 Mr Dorney Q.C., on behalf of the respondent, conceded that $600.00 of the $600,000.00 could not be

supported as taxable wages because it was payment for the par value of the employer shares to the return of which the appellant would be entitled on a winding-up of J.S.E. as I have explained. The remaining $599,400.00 consisted of, he submitted, bonuses paid - i.e., provided, conferred, or assigned - in relation to, employees as employees. That was the only basis on which the respondent sought to resist the appeal. It was conceded that, as Mr Russell argued, the respondent could not rely on the category of 'fringe benefits' in paragraph (g) of the definition of 'wages'. There was no suggestion - nor could there be - that paragraphs (a) to (f) of that definition have any application to this case.

19 Pay-roll tax was first imposed in 1941 by the Commonwealth. In 1971 it ceased to be a Commonwealth tax and became a State tax. In Queensland the *Pay-roll Tax Act* 1971 was enacted. Taxable wages which made up the 'pay-roll' - as Dixon J. observed in *Mutual Acceptance Co. Ltd. v. Federal Commissioner of Taxation* (1994) 69 C.L.R. 389 at p. 403, a figure of speech - did not include all benefits that may be conferred on an employee in the course of his employment. An example of a case in which the distinction was drawn between the pay-roll and a benefit not part of the pay-roll is *Commissioner of Pay-Roll Tax v. Reserve Bank of Australia* [1987] V.R. 241 in which the benefit of a low-interest loan made by an employer to an employee was held not to be part of the 'wages' of the employee. Nathan J. observed:

> Not every benefit provided by an employer to its workers, even if quantifiable, comprises an ingredient of its payroll. For example, an employer providing squash courts or holiday homes at subsidized rates would be astounded if the provision of these amenities comprised part of its payroll and thus became taxable in its hand. There are many such conditions of employment commonly referred to as 'perks' which do not form part of the payroll. (p. 253)

20 A further example comes from New South Wales. In *Terry Shields Pty Ltd v. Chief Commissioner of Pay-roll Tax*

(1989) 17 N.S.W.L.R. 493, the provision by an employer of a motor vehicle for the use by an employee for his own purposes was held by Lee C.J. at Common Law not to be subject to pay-roll tax. Referring to an amendment to the New South Wales Act which inserted a definition of the word 'pay' as 'in relation to wages, salary, commission, bonuses or allowances, includes provide, confer and assign' his Honour said:

> It was contended on behalf of the Commissioner that the amendment operated to make clear that the various components in the overall expression 'wages means ...' are not required to be considered as representing amounts of money and thus the word 'allowances' would catch the case of use of a car made available by the employer to the employee. The word 'allowances' it is said - like all the words before it - includes anything of a value whether certain or uncertain, that is allowed to or conferred upon, the employee by the employer. In my view the amendment does not bear that meaning. It does not alter the meaning of the words 'wages, salary, commission, bonuses or allowances paid ...' but merely enlarges the meaning of the word 'pay' to cover circumstances in which what are ordinarily understood as 'wages, salary, commission, bonuses or allowances' are made available to employees; they still remain wages, salary etc as ordinarily understood in our community.
>
> To give the words the meaning contended by the Commissioner would be to alter the whole nature of pay-roll tax. At present it is a tax payable upon wages, salaries, commission, bonuses and allowances and upon one further feature often found in the case of employer and employee, that is, meals and quarters provided by an employer: it would become a tax upon wages paid to and benefits, monetary or otherwise, received by the employee. In other words it would introduce into the *Pay-roll Tax Act* the scheme behind the *Fringe Benefits Tax Assessment Act* 1986 (Cth). Such a radical change, in my view, should not be held to result merely from the definition given to the word 'pay' in the amending Act of 1988. If the legislature proposes to tax benefits received by employees over and above wages paid there would need to be defined with some degree of precision, as in the *Fringe Benefits Tax Assessment Act* (Cth), the circumstances in which the tax is to operate beyond the

> concept of wages, salary etc as ordinarily understood. In this regard one may note that the word 'pay' as defined in the Act of 1988 in using the words 'provide, confer and assign' is using words introduced into the *Pay-roll Tax Act* 1971 (Vic) by amendments made by Act No 9440 of 1980. A significant amendment was made by that Act to the definition of 'wages' by adding after 'allowances' the words 'or other benefits'. The Act required that the words 'wages, salary' be read as 'wages, remuneration, salary'. In addition the principal Act was amended by inserting a new s 3A which made taxable 'a benefit received by an employee in respect of the terms of repayment of a loan provided by the employer to or in relation the employee'. None of these extensions to the operation of the Act are to be found in the New South Wales Act, but the Commissioner nonetheless claims that Act in its present form is to be so understood. (pp. 502-503)

21 Another Victorian case, *T.W. Morris & Son Pty. Ltd. v. Accident Compensation Commission; T.W. Morris & Son Pty. Ltd. v. Commissioner of Pay-roll Tax* [1994] 1 V.R. 98, demonstrates the point made by Lee C.J., because in that case contributions by an employer to a fund established to provide redundancy payments to persons working in the building industry were held to be taxable wages under the *Pay-roll Tax Act* 1971 (Vic.), which defined wages as 'any wages, *remuneration*, salary, commission, bonuses, allowances *or other benefits* paid or payable ... to or in relation to an employé as such'. (my emphasis). McDonald and J.D. Phillips JJ., with whom Brooking J. agreed, concluded that any part of the reward allowed by an employer to employees for their services in the course of their employment with the employer could be regarded as taxable wages (p. 103). The provisions of the Queensland Act, like those of the New South Wales Act considered by Lee C.J., are not as wide as that.

22 The Queensland Act before the amendments made by the 1993 Act confined the tax to wages, salary, etc., as ordinarily understood - to adopt Lee C.J.'s phrase - together with some specified benefits. In my view, the scheme of the Act remained after those amendments as it had

been before: pay-roll tax remained a tax on wages, salary, etc., as ordinarily understood and some specified benefits. Specified benefits added in 1993 were 'fringe benefits' as defined - not all fringe benefits that could be enjoyed by an employee but only those that came within the definition. It was, as I have mentioned, conceded on behalf of the respondent that the payment in question on this appeal did not fall within the definition of 'fringe benefit': it clearly did not come within paragraph (c) of the definition, it was not suggested it was within paragraph (d), but it was common ground that it was not within paragraphs (a) or (b). The substitution of the words 'to ... an employee as an employee' for 'to an employee as such' brought about no change of substance in the definition of 'wages', and the introduction of the words 'or in relation to' and 'or applied for the employee's benefit' in that definition, and the new definition of 'pay' did not enlarge the meaning of wages, salary, etc., as ordinarily understood, in my view.

23 There can, I think, be little doubt that the selection process resulting in the acquisition of employee shares by Messrs Shepherd and Pope led to their having conferred on them at least the possibility of their acquiring benefits as employees of the appellant. They were permitted to buy shares which, it is reasonable to conclude, could have produced financial rewards to them, provided they were not disqualified. (Mr Pope was disqualified this year, but that is irrelevant to the issues on the appeal, as is the fact that no moneys have been distributed to, or applied for the benefit of, either Mr Shepherd or Mr Pope by J.S.E.) If they were disqualified other employees would acquire the benefits. The contribution by the appellant of the $599,400.00 was at the heart of the implementation of the plan, but that payment was not a payment of wages, salary, etc., as ordinarily understood. It was in my view something distinct and remote from that, something which may properly be described as being done to provide for contingent fringe benefits, but not fringe benefits subject to pay-roll tax.

24 The word 'bonus', probably originally stock exchange slang, has as a primary meaning '[m]oney or its equivalent, given as a premium, or as an extra or a irregular remuneration, in consideration of offices performed, or to encourage their performance': *The Oxford English Dictionary*, 2nd ed., 1989, Volume II, p. 390. Although, as I shall mention, a bonus may be contracted for, the usual reference in ordinary usage is to a 'gratuity paid to workmen, masters of vessels, etc., over and above their stated salary': *ibid.*

25 In *Murdoch v. Commissioner of Pay-roll Tax (Victoria)* (1980) 143 C.L.R. 629, Mason, Murphy and Wilson JJ. accepted the following description of a bonus:

> A bonus imports, in the case of an employee or agent, something given or paid over and above what is due and payable for his services. Often it is paid out of profit realised, in reward to those whose services have contributed to the making of the profit. ... in the case of an employee the payment of a bonus is ordinarily made as a voluntary gift, ex gratia, in recognition of the extent to which the services of that employee have contributed to the making of the profit. (p. 642)

Clearly enough the $599,400.00 could not properly be regarded as comprising gifts to Messrs Shepherd and Pope, but a bonus may be contracted for: in *Mutual Acceptance Co. Ltd. v. Federal Commissioner of Taxation*, again at p. 403, Dixon J. described bonuses as 'occasional or periodical additions whether contracted for or voluntary'. But when a bonus is contracted for the contract comes first and the bonus afterwards. So it would be in this case, in my view: if any payments to employees under the share ownership plan could properly be regarded as bonuses - and in my view none could - they would be the payments to the employees under the plan by way of dividends, payments on redemption, etc. The payment of the $599,400.00 the conferred the possibility of the acquisition of benefits on employees - Messrs Shepherd and Pope in the first instance and, if they were disqualified, other participating employees or those on behalf of whom shares are held - but not bonuses.

26 Mr Russell advanced an argument in reliance on s. 8A of the Act, but it is unnecessary for me to consider it further.

27 For those reasons I conclude that the payment of the $599,400.00 did not come within the definition of 'wages' in the *Pay-roll Tax Act* 1971, and therefore the appeal should be allowed in respect of all of the $600,000.00. I shall invite further submissions on the form of the orders to be made, and costs.