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[1514] Work-in-progress and the *McGowan* case: beyond stamp duty?

by David W Marks, Barrister-at-Law

McGowan & Roche v Comr of Stamp Duties (2001) 47 ATR 357 (reported at 2001 WTB 27 [1116]) raised the issue of how work-in-progress (WIP) of a professional firm ought be treated for stamp duty purposes. There are questions now as to how that decision might be generalised for other revenue and tax purposes.

It has been put to me that the decision has significance in terms of the calculation of assets under the proposed Thin Capitalisation measures, or even in terms of the development of the Tax Value Method. Any such significance might be doubted. However, before making that kind of quantum leap, it assists to have some background about the issue actually decided.

As will appear, the reasons for judgment in *McGowan* do not permit an easy conclusion as to the matters actually decided, nor as to the *ratio decidendi*. It is difficult to reconcile the leading judgment of McPherson JA, with the "concurrence" of Williams JA. Helman J simply concurs with *both* McPherson and Williams JJA.

I concentrate on the leading judgment of McPherson JA. With respect, it is difficult to follow the initial step taken by Williams JA. Williams JA appears to say that a solicitor's retainer is assignable, and that he agrees with McPherson JA on this point. McPherson JA, in the published reasons, says no such thing, and is (with respect) correct to deny assignability of the retainers. The reasons are therefore irreconcilable, and those of McPherson JA must (with respect) be preferred.

Qld Stamp Act

I turn first to the legislation considered by the Court. According to McPherson JA (para [3] at 47 ATR 360), the assessment was raised in reliance upon the *Conveyance or Transfer* heading, read with (amongst other things) s 54(1) of the *Stamp Act 1894* (Qld).

Section 54(1) taxes certain contracts as if they were transfers. Specifically, it catches a "contract or agreement whereby a person becomes entitled or may, provided the terms and conditions thereof are met, become entitled to the conveyance or transfer of any property".

McPherson JA (para [5] at 47 ATR 361) summarises the contentious point as follows:

"The point at issue on this appeal is the Commissioner's action in including as part of the unencumbered value of the partnership interest transferred on which duty was assessed the two items described in the balance sheet as representing 'work in progress'".

The road to his Honour's conclusion in favour of the Commissioner was not as straightforward as that summary might suggest. As this note focuses on generalising the conclusions from the decision, I do not deal with the particular facts and documents involved.

I make these preliminary observations.

How *McGowan* stands with income tax cases

First, *McGowan* stands with the existing income tax decisions concerning derivation of income of a professional firm. An item might be booked only for management purposes as WIP, and it might still not be derived as assessable income: yet the stamp duty law asks a different question.

Accounting

Secondly, accounting standards, and the duties of accountants in recording work-in-progress, were never in issue. McPherson JA says (para [7] at 47 ATR 362):

"Here the question is not whether 'work in progress' is to be included in arriving at the taxable profit of a solicitors' partnership as representing income 'earned' or 'derived' in a particular year before completion of the work; but whether it correctly finds a place as an asset in a balance sheet, whose function it is to ascertain the net worth or value of an enterprise at a particular date ..."

With respect, the above passage might lead some to confuse the real issue, to which I will come in a moment. Understandably, certain in the accounting community are concerned about that passage, and about a subsequent passage. Some might read that subsequent passage (para [8] at 47 ATR 362) as requiring WIP to be included in the balance sheet.

On the face of the Court's record, a balance sheet including WIP had been submitted to the Commissioner in the course of the assessing process. In the peculiar circumstances of an appeal by way of case stated, there could be no real issue about the value of WIP, nor about whether it ought have been included in the balance sheet.

The key

Thirdly, the real key to the decision must be seen in the discussion of the ability to assign a right or expectation to future payment under a contract not yet performed or completed (at paras [13] and [14] at 47 ATR 364). This issue arises acutely where stamp duty depends on there being "property", and on there being an assignment or agreement to assign.

A solicitor's retainer is a contract for personal services, and not assignable: McPherson JA at para [14]. A purported present assignment for value of the retainers would operate in equity as an agreement to assign the fruits of the retainers as and when the fruits came in.

There could have been no present assignment of the retainers. However, that was not the end of the matter. Section 54(1) brought to duty a contract "whereby a person may become entitled to a conveyance or transfer of property". According to McPherson JA, s 54(1) was apt to catch an instrument operating as an agreement to assign the fruits of the retainers as they fell in.

McPherson JA says that, under the particular Deed, there was a clause assigning rights to all contracts related to the partnership, and that this included the retainers. What had been assigned included the benefit or fruits of current retainers with clients of the firm, for the performance of professional work not yet completed. His Honour continued (para [17] at 47 ATR 365):

"In the case of the partnership of Shine Roche & McGowan, the benefit of those contracts is the 'work in progress' to which the balance sheet of the firm referred. It was, in my opinion, rightly treated by the Commissioner as a component of the partnership property assigned, and so conveyed or transferred, in assessing the stamp duty payable on the Deed of Assignment".

Again, that passage must be read in light of s 54(1), which, according to his Honour's earlier reasoning, extended to a contract under which future property was agreed to be assigned. The Deed of Assignment might, on face, have purported to assign the non-assignable retainers. It operated in equity in such a way as to attract s 54(1), which taxed an agreement to assign the fruits of a retainer. Section 54(1) then treated such an "agreement" as if it were an assignment of property.

Fourthly, the non-assignability of a retainer did not, according to his Honour, mean that the retainer was not "property". The Crown was not assisted by that conclusion. Non-assignability meant that the retainers did not move in the transaction. That is why I have concentrated above on whether s 54(1) could pick up a contract, which operated in equity as an agreement to assign the fruits of the non-assignable retainer.

Generalising the results

McGowan is undoubtedly a difficult case to generalise into the income tax and CGT fields. The following conclusions can be drawn:

1. The case was about particular provisions of the Queensland Stamp Act.
2. Section 54(1) of that Act caught an agreement to assign the fruits of a retainer. Ultimately, McPherson JA characterised the WIP in the case as comprising those fruits.
3. Incontrovertibly, the fruits of such an unperformed contract are not themselves property until they fall in.
4. The Crown sought to support an assessment of conveyance duty. An assessment of conveyance duty relied on there being something capable (at some stage) of conveyance.
5. For that reason, *McGowan* does not focus on the non-assignable retainers. It focuses on something that was ***not*** present property, but which would be property when it came in - that is, the fruit of the retainers.
6. Nevertheless, McPherson JA points out that a non-assignable retainer for personal services might yet be property, citing the United Kingdom CGT decision *O'Brien v Benson's Hosiery (Holdings) Ltd* [1980] AC 562.

If the concept of "asset" in other legislation relies on there being present property, *McGowan* does not provide direct assistance in relation to WIP. The case decides something quite different. However, what I note at point 6 above may be of relevance.

I know that the above does not represent the only interpretation of *McGowan*. Those anxious to disagree with my approach will find ample material in McPherson JA's judgment, not to mention the judgment of Williams JA.

However, I trust this contribution will at least illuminate the statutory background to the decision, and thus inform the ensuing debate.

I understand that the taxpayer did not seek special leave to appeal to the High Court of Australia. I conclude by noting that the above does not represent the views of a party to the proceedings, and that (so far as I have recounted the facts of the case) factual material is simply that apparent on the face of the reasons for decision.

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