

BLAKE DAWSON WALDRON

LAWYERS

221 ST GEORGE'S TERRACE, PERTH, WA, 6000

CONFIDENTIAL

Mr Denis Smith
16 St Pauls Crescent
JOONDALUP WA 6027

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221 St George's Terrace
Perth WA 6000
ABN: 75 304 286 095

Our Ref: AOD:09-1345-2270
Bill No: 90020656
Date of Issue: 25 September 2003

TAX INVOICE

Employment Issues - City of Joondalup

For our professional services in this matter for the period from 4 September 2003 to 24 September 2003 as per schedule attached.

\$ 6,000.00

DISBURSEMENTS

Communications-Fax - Local	\$ 10.00	
Document Production-Document Production - Internal	\$ 6.89	\$ 16.89

Total for this Bill \$ 6,016.89

G.S.T. \$ 601.69

Total Amount Payable (Inclusive of G.S.T.) \$ 6,618.58

**Indicates not subject to G.S.T.*

This account is payable within 14 days of the date hereof. Within 30 days of the receipt of this account you may require the firm by notice in writing to provide you an itemised account of the costs the subject of this account. Within 30 days of receiving an itemised account, you may require the firm by notice in writing to submit the account to the taxing officer of the Supreme Court of Western Australia for review of the account of costs charged to you, the subject of this account.

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Our Ref: AOD:09-1345-2270
Bill No: 90020452
Date of Issue: 05 September 2003

TAX INVOICE

Employment Issues - City of Joondalup

For our professional services in this matter for the period from 26 August 2003 to 3 September 2003 as per schedule attached.

\$ 1,314.60

DISBURSEMENTS

Communications-Fax - Local

\$ 14.00

Document Production

\$ 4.77 \$ 18.77

Total for this Bill \$ 1,333.37

G.S.T. \$ 133.34

Total Amount Payable (Inclusive of G.S.T.) \$ 1,466.71

**Indicates not subject to G.S.T.*

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Our Ref: AOD:09-1345-2270
Bill No: 90020338
Date of Issue: 28 August 2003

TAX INVOICE

Employment Issues - City of Joondalup

For our professional services in this matter for the period from 22 July 2003 to 23 August 2003 as per schedule attached.

\$ 3,600.00

DISBURSEMENTS

Rene Le Miere - Counsel Fees	\$ 1,680.00	
Communications-Fax - Local	\$ 50.00	
Document Production-Document Production - Internal	\$ 42.40	\$ 1,772.40

Total for this Bill \$ 5,372.40

G.S.T. \$ 537.24

Total Amount Payable (Inclusive of G.S.T.) \$ 5,909.64

**Indicates not subject to G.S.T.*

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24 September 2003

Mr Peter Schneider
Director Corporate Services and Resource Management
City of Joondalup
PO Box 21
Joondalup WA 6919

Dear Peter

**CITY OF JOONDALUP ("Council")
FRINGE BENEFIT TAX AND LEGAL EXPENSES**

Based on discussions with Ross Atkins, please find below our advice on the Fringe Benefit Tax ("FBT") implications of legal expenses paid by the Council on behalf of one of its employees.

1. Background

Our understanding of the facts are:

- The CEO of the Council is taking legal action against a Councilor who he has alleged has defamed him in relation to his employment with the Council;
- The CEO is also the subject of an investigation as to the validity of his employment contract. In particular, whether he has falsely represented his qualifications for the position;
- No formal qualifications are required for the position held by the CEO;
- The CEO is taking legal advice to protect his reputation and employment position;
- The issues, the subject of the legal action, have not been resolved; and
- The City of Joondalup is reimbursing the CEO for the costs of his legal expenses. These costs are paid direct by Council to the law firm.

2. Issues to be considered

- Is the payment an expense payment fringe benefit?
- Would the expenditure be deductible in the CEO's hands?
- What is the taxable value for FBT purposes?

3. Our Advice

The payment of the legal expenses by the Council is an expense payment fringe benefit as defined in subsection 136(1) of the *Fringe Benefits Tax Assessment Act 1986* ("FBTAA"). Consequently, any payments made by the Council will create an FBT liability.

However, we believe that it is reasonably arguable that the legal expenses related to all matters would have been deductible in the hands of the CEO if he had incurred the expenses. Consequently, the taxable value for fringe benefits tax purposes would be reduced to nil.

4. Detailed Analysis

In general terms fringe benefits tax is payable where a benefit is provided by an employer to an employee. There is no question that the CEO of a Council would be an employee of that Council. Thus, any benefit provided by the Council would fall for consideration under the FBTAA.

The FBTAA provides that where a person reimburses another person (the recipient), in whole or in part, in respect of an amount of expenditure incurred by the recipient, the reimbursement shall be taken to constitute the provisions of a benefit by the provider to the recipient.

It is clear from this that the legal expenses incurred by the CEO and subsequently reimbursed by the Council would be an expense payment fringe benefit.

4.1. What is the taxable value of the fringe benefit?

The taxable value of the fringe benefit is the value of the expense paid less any amount that would have been tax deductible if the employee had incurred the expense. Thus, to determine the taxable value for FBT purposes we must look at whether the legal expenses would be deductible to the CEO if he had incurred them.

4.2 Deductibility of Legal Expenses

The deductibility of legal expenses is a very complex area. There have been numerous cases on the tax deductibility of legal expenses incurred in protecting a person employment position, and subsequently their income stream. There is no set of rules established that would be applicable to all circumstances. Each case must be considered based on its own facts.

In determining whether a deduction for legal expenses is allowed under section 8-1 of the *Income Tax Assessment Act 1997* ("ITAA97"), the nature of the expenditure must be considered (*Hallstroms Pty Ltd v FC of T* (1946) 72 CLR 634; (1946) 3 AITR 436; (1946) 8 ATD 190). The nature or character of the legal expenses follows the advantage that is sought to be gained by incurring the expenses. If the advantage to be gained is of a capital nature, then the expenses incurred in gaining the advantage will also be of a capital nature. The question which needs to be address is if the advantage to be obtained by the CEO in taking the legal advice can be said to have the character of revenue, then the expenses incurred would be deductible.

For the legal expenses to have the character of revenue, there must be an evident connection between the expenditure in instituting the proceedings and the taxpayer's earning activities. Legal expenses may be capital or private in nature where the legal action is to protect the taxpayer's personal good name and reputation (*Case U102 87 ATC 621; AAT Case 72 (1987) 18 ATR 3515*).

In *FC of T v Rowe* (1995) 60 FCR 99; (1995) 31 ATR 392; 95 TC 4691, the Full Court of the Federal Court accepted that legal expenses incurred in defending the manner in which a taxpayer performed his employment duties were allowable. No significance was placed by the court on the taxpayer's status as an employee.

In order for the legal expenses of the CEO to be deductible we must consider what the CEO is protecting by the taking of the action. If the action is related to his personal reputation, then no deduction would be allowable for the expenses. However, where the legal expenses were directly related to his capacity for performing his duties as a CEO, we believe that the legal expenses are deductible.

In determining this issue we believe that *Rowe's Case* provides sufficient support to conclude that the legal expenses of the CEO would be deductible. In *Rowe's Case* the respondent was suspended from his employment as the shire engineer for the Livingstone Shire Council and was required by the council to show cause why he should not be dismissed by reason of several complaints made against him. The Director of Local Government, acting at the direction of the minister, requested that an inquiry be conducted into the suspension in accordance with the Local Government Act.

In *Rowe's Case* the Federal Court made the following statement in summing up:

"The respondent's cost of legal representation at the inquiry comprised an outgoing incurred by him in gaining assessable income with the first limb of subsection 51(1). The council would have immediately terminated the respondent's services had he not been successful at the inquiry. Incurring his legal costs contributed to his success. Incurring the costs was sufficiently closely connected with the production of income for the costs to be deductible."

We believe that a similar conclusion can be reached in the CEO's case. The legal expenses have been taken by the CEO in order to protect his employment and, thus his future income stream. This analogy can apply equally to the defamation action, as to the investigation into the validity of his employment contract. We do not believe that it is his reputation that is being defamed but it is an alleged attack against his abilities to properly perform his duties.

Case X42, 90 ATC 352 also provides support for our argument. In this case the taxpayer had been employed since 1973 in an administrative capacity by an organisation. In July 1986, when he was aged 60, he became aware that his employment was under threat. The taxpayer engaged a firm of solicitors to try and ensure his continued employment with the organisation. After protracted negotiations, the organisation agreed to employ him for another 5 years. The AAT held that if the taxpayer had not instructed solicitors to act on his behalf, his employment would have been terminated and he would not have earned assessable income. In all circumstances, the legal expenses incurred by the taxpayer were outgoings incurred in gaining or producing assessable income. As the expenses were not of a private or domestic nature, nor of a capital nature, they were deductible.

Once again we can take comfort in this analysis. The CEO has taken legal action to maintain his employment position.

It should be borne in mind that the ultimate success or failure of the taxpayer's purpose or action is not related to the revenue or capital nature of the legal expenses incurred [*Case B31 70 ATC 148*]. That a taxpayer has nothing to show for having incurred the expenses does not preclude a finding that the expense is deductible.

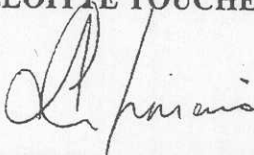
5. Structure of invoices

Irrespective of the fact that we believe the Council will have no FBT to pay in relation to the reimbursement of the legal expenses of the CEO, we would recommend that the Council seek to have the invoices categorized into each activity that is being undertaken. This will allow the Council to clearly determine the costs associated with defending each action.

We trust the above addresses the matters raised. Please do not hesitate to contact Ross Atkins on 9365 7188 if you have any further queries.

Yours sincerely

DELOITTE TOUCHE TOHMATSU LTD



ANTHONY CIPRIANO
Director – Deloitte Tax Services