IN THE HIGH COURT OF AUSTRALIA
MELBOURNE REGISTRY **No. M52 OF 2019**

ON APPEAL FROM THE FULL COURT OF THE FEDERAL COURT OF AUSTRALIA

BETWEEN: **COMMISSIONER OF TAXATION OF THE COMMONWEALTH OF AUSTRALIA**
Appellant

and

SHARPCAN PTY LTD
Respondent

APPELLANT'S SUBMISSIONS

Part I: CERTIFICATION

1. I certify that this submission is in a form suitable for publication on the internet.

Part II: CONCISE STATEMENT OF THE ISSUES

2. Whether the outgoing of $600,300 (**GME Expenditure**) incurred by the Trustee of the Daylesford Royal Hotel Trust (**the Trustee**) in the year ended 30 June 2010 for the acquisition of 18 Gaming Machine Entitlements (**GMEs**) was capital or in the nature of capital and for that reason was not deductible under s 8-1 of the *Income Tax Assessment Act 1997* (**ITAA**).

3. Whether the GME Expenditure, if capital in nature, was deductible over five years pursuant to s 40-880(2) of the ITAA. In dispute is whether the exception to s 40-880(2) deductibility, contained in s 40-880(5)(f), does not apply because s 40-880(6) applies. Section 40-880(6) applies if both of the following were satisfied:

   (1) the GME Expenditure was expenditure which the Trustee incurred to preserve (but not enhance) the value of goodwill; and

   (2) the value to the Trustee of the GMEs was solely attributable to the effect that the GMEs had on goodwill.

4. The Commissioner respectfully submits that the GME Expenditure was not deductible pursuant to s 8-1 by reason of being capital or in the nature of capital, and was not deductible pursuant to s 40-880(2) by reason of s 40-880(5)(f) because either

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one or both of the requirements set out in [3] above for the application of s 40-880(6) were not met.

Part III: SECTION 78B NOTICES

5. No notice is required under s 78B of the *Judiciary Act 1903* (Cth).

Part IV: CITATION

6. Administrative Appeals Tribunal (**Tribunal**): *Sharpcan Pty Ltd and Commissioner of Taxation (Taxation)* [2017] AATA 2948.

7. Full Federal Court (**Full Court**): *Commissioner of Taxation v Sharpcan Pty Ltd* [2018] FCAFC 163.

Part V: NARRATIVE STATEMENT OF FACTS

8. On 8 August 2005 the Trustee acquired a business trading as a hotel (the **Royal Hotel**) for $1,025,000. The business derived revenue from accommodation, sales of meals and alcohol, gaming on 18 electronic gaming machines onsite, and wagering. (Tribunal Reasons, [6] **[AB11]**; Full Court Reasons, [1] **[AB43]**, [3] **[AB43]**)

9. In 2005, gaming in Victoria was regulated by the *Gambling Regulation Act 2003* (Vic) (**Gambling Act**) which provided for the issue of both a venue operator's licence and a gaming operator's licence. In relation to the Royal Hotel:

   (1) The Trustee obtained a venue operator's licence.

   (2) Tattersalls Gaming Pty Ltd (**Tattersalls**) held a gaming operator's licence and so was permitted to own and operate gaming machines at the Royal Hotel: s 3.4.2(d) of the Gambling Act. This licence was due to expire in 2012.

   (3) The Trustee and Tattersalls entered into an agreement pursuant to which Tattersalls owned and operated 18 gaming machines at the Royal Hotel.

   (4) Tattersalls as the gaming operator derived revenue from conducting gaming on 18 gaming machines. Tattersalls paid a percentage of its net revenue from conducting gaming (that is, gross receipts less returns (payouts) to those persons playing the 18 machines) by way of a fee to the Trustee.

   (5) Tattersalls was required by s 3.6.6 of the Gambling Act to pay amounts from the gaming machine income to the Trustee and to the Victorian Commission for Gambling Regulation (**Commission**).

(Tribunal Reasons, [6] **[AB11]**, [7] **[AB11]**, [8] **[AB11]**; Full Court Reasons, [4]-[8] **[AB43]**-**[AB44]**)

10. In 2008, the Victorian government announced a new regime to apply from 2012 for gaming in Victoria, as a result of which a new Part 4A of Chapter 3 was introduced into the Gambling Act to provide for GMEs to be allocated to gaming venue operators. (Tribunal Reasons, [8] **[AB11]**; Full Court Reasons, [56] **[AB56]**)

11. Each GME permitted the holder to acquire and conduct gaming on one machine. The GMEs had a duration of 10 years from August 2012, extendable for two further years under s 3.4A.7 of the Gambling Act. GMEs could be traded and transferred under s 3.4A.3 of the Gambling Act. (Tribunal Reasons, [8] **[AB11]**, [9] **[AB12]**; Full Court Reasons, [73] **[AB61]**)

12. The Trustee acquired 18 GMEs for $33,350 each as a result of a competitive auction process held on 10 May 2010. The Trustee elected to pay for the GMEs in instalments between May 2010 and 31 August 2016. The first instalment was paid in May 2010. The remaining instalments were paid quarterly between 16 August 2012 and 31 August 2016.[1] (Tribunal Reasons, [2] **[AB8]**; Full Court Reasons, [30] **[AB50]**)

13. The new arrangements resulted in the following changes for the Trustee:

    (1) By the acquisition of the GMEs the Trustee secured for itself the right, which it did not previously have, to itself conduct gaming at its hotel for a period of ten years on and after 16 August 2012. (Tribunal Reasons, [8] **[AB11]**, [9] **[AB12]**, [10] **[AB12]**)

    (2) On and after 16 August 2012, the Trustee instead of Tattersalls derived the income from the gaming machines. Tattersalls ceased to conduct gaming at the hotel and to derive income therefrom, and ceased to pay commissions to the Trustee. (Tribunal Reasons, [9] **[AB12]**; Full Court Reasons, [19] **[AB47]**, [22] **[AB48]**)

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[1] The evidence as to payment was that $10,000 paid by the Trustee to the State to participate in the auction was credited to the amount payable for the GMEs. A further $50,030 was paid in May 2010, $60,030 was paid on 16 August 2012 and further amounts of $30,015 were payable quarterly until 31 August 2016. The Trustee sold the Royal Hotel on 9 November 2015 and pursuant to the contract of sale, the purchaser assumed responsibility for paying the instalments after 9 November 2015. The Tribunal and the majority in the Full Court inaccurately recite the amounts of the May 2012 and 16 August 2012 instalments. (Tribunal Reasons, [2] **[AB8]**; Full Court Reasons, [30] **[AB50]**; cf Full Court Reasons, [268] **[AB107]**, [271] **[AB108]** per Thawley J). Nothing turns on the inaccuracy.

(3) The Trustee engaged PVS Australia Pty Ltd (**PVS**) to administer the gaming operations at the Royal Hotel pursuant to an agreement dated March 2012 in consideration for a fee per gaming machine. This required PVS to provide 18 gaming machines (which PVS acquired from Tattersalls), and to undertake audit and other compliance activities. (Tribunal Reasons, [9] **[AB12]**; Full Court Reasons, [20] **[AB47]**, [270(3)] **[AB108]**)

(4) The Trustee was obliged to make monthly payments of tax to the Commission pursuant to s 3.6.6A of the Gambling Act. The payments were calculated by reference to the average revenue per GME: s 3.6.6A(7). (Full Court Reasons, [22] **[AB48]**, [270(2)] **[AB107]**)

(5) The Trustee made the payments for the GMEs under the deferred payment terms until November 2015.

14. On 9 November 2015, the Trustee sold the Royal Hotel business, including the GMEs, for consideration of $2,453,000 plus $40,000 for stock, to Jamcoe Pty Ltd (**Jamcoe**). Jamcoe assumed liability to make the remaining quarterly payments owing to the State of Victoria in respect of the GMEs. (Full Court Reasons, [271] **[AB108]**)

15. The Respondent is a beneficiary of the Daylesford Royal Hotel Trust (the **Trust**) and was presently entitled to 100% of the net income of the Trust for the 2012 income year. The Commissioner disallowed the Respondent's objection for the 2012 income year and included in the Respondent's taxable income the net income of the Trust, being $139,901. If the GME expenditure was deductible either in full under s 8-1 when incurred in 2010, or over five years under s 40-880, the net income of the Trust for the 2012 year will be nil. (Tribunal Reasons, [1] **[AB7]**; Full Court Reasons, [39] **[AB52]**)

16. The above facts were not in dispute between the parties.

Part VI: ARGUMENT

First Issue: Submission – the majority of the Full Court erred in holding that the GME Expenditure was an outgoing on revenue account. The Full Court ought to have held that the GME Expenditure was an outgoing of capital or of a capital nature and

therefore not deductible under 8-1 of the ITAA[2]

17. The basis of the decision of the majority of the Full Court that the GME Expenditure was on revenue account involves a departure from accepted doctrine. The consideration by the majority of the need for the outgoing to be met out of or recouped from the daily earnings of the business as the, or the substantive, factor for determining that the character of the outgoing is on revenue account is a fundamental error of general principle. Their Honour's reliance upon *BP Australia v FCT* (1965) 112 CLR 386 involves a misapplication of that decision. It is submitted that the dissenting judgment of Thawley J is correct.

10 *Application of established principles*

18. The test for determining the characterisation of an outgoing is set out in *Sun Newspapers Limited v Federal Commissioner of Taxation* (1939) 61 CLR 337 at 359 and 363 per Dixon J:

> "The distinction between expenditure and outgoings on revenue account and on capital account corresponds with the distinction between the business entity, structure, or organization set up or established for the earning of profit and the process by which such an organization operates to obtain regular returns by means of regular outlay, the difference between the outlay and the returns representing profit or loss. ...
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> 20 There are ... three matters to be considered, (a) the character of the advantage sought, and in this its lasting qualities may play a part, (b) the manner in which it is to be used, relied upon or enjoyed, and in this and under the former head recurrence may play its part, and (c) the means adopted to obtain it; that is, by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payment so as to secure future use or enjoyment."

19. In *Hallstroms Proprietary Limited v Federal Commissioner of Taxation* (1946) 72 CLR 634 at 648, Dixon J stated:

> "What is an outgoing on account of capital and what is an outgoing on
> 30 account of revenue depends on what the expenditure is calculated to effect from a practical and business point of view, rather than upon the juristic

[2] Notice of Appeal, grounds 1 and 2

classification of the legal rights, if any, secured, employed or exhausted in the process."

20. It is submitted that on the application of the principles set out in *Sun Newspapers* and *Hallstroms* to the facts ([8] - [14] above), the GME Expenditure was an outgoing of capital or of a capital nature.

21. In respect of the first of the three considerations identified by Dixon J in *Sun Newspapers*, from a practical and business point of view, the advantage sought and achieved by the GME Expenditure was the acquisition of GMEs which were created and allocated to the Trustee pursuant to Part 4A of the Gambling Act. The GMEs authorised the holder to acquire and operate gaming on gaming machines in an approved venue: s 3.4A.2 of the Gambling Act. They were capable of being assigned and were for a period of 10 years with a right to be extended for a further 2 years: s 3.4A.7(1) in Division 3 of Part 4A of the Gambling Act. Their acquisition by the Trustee secured for it one of the statutory requirements necessary for it to conduct a gaming business: s 3.4A.1 of the Gambling Act. The character of the advantage sought and achieved by the GME Expenditure was one of capital. The GMEs formed part of the structure through which the Trustee carried on its business.[3] Their acquisition did not occur as part of the process by which the business was operated to obtain regular returns by means of regular outlay.

22. In respect of the second of the three considerations identified by Dixon J in *Sun Newspapers*, the GMEs were used, relied upon and enjoyed by the Trustee as providing one of the statutory authorities it required in order to operate a gaming machine business. The statutory authority which the GMEs conferred could be enjoyed by the Trustee for a minimum period of 10 years. The manner of use and reliance upon the GMEs by the Trustee was as an enduring component of the structure of its gaming business, and not as a part of the process by which the gaming machines and other regular business activities were operated or undertaken to generate the income of the business.

23. In respect of the third of the three considerations identified by Dixon J in *Sun Newspapers*, the means by which the GMEs were obtained was by a one-off acquisition for a fixed price, payable upon election by the Trustee in instalments.[4]

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[3] Cf *AusNet Transmission Group Pty Ltd v FCT* (2015) 255 CLR 439 at 474 [73] per Gageler J
[4] Greenwood ACJ, Full Court Reasons, [30] **[AB50]**; Thawley J at [268]-[269] **[AB107]**

There was no regularity by which the Trustee incurred the GME Expenditure.[5]

24. It follows that the GME Expenditure was capital or in the nature of capital. The relevant business of the Trustee was a hotel business which generated revenue from providing accommodation, selling meals and alcohol, conducting gaming on gaming machines, and wagering. The GME Expenditure did not occur as part of the regular process by which that business operated to produce income. It was a one-off outgoing, albeit payable in instalments, that was incurred in order to acquire GMEs, which on and after 16 August 2012 were a necessary component of the profit making structure of the Trustee's business: Thawley J, Full Court Reasons, [280]-[286] **[AB111]-[AB114]**; cf Greenwood ACJ at [137]-[140] **[AB76]-[AB77]**. Without the GMEs the Trustee was not authorised to conduct gaming on gaming machines. The GMEs were intangible assets, capable of being bought and sold, that conferred required statutory entitlements in relation to the conduct of gaming on gaming machines for a minimum period of 10 years. The GMEs were not acquired by the Trustee as part of any process which it operated to obtain regular returns from regular outlays. The income earning activities of the Trustee did not involve the sale of GMEs. The GMEs were acquired and held by the Trustee as part of its capital. In the circumstances the GME Expenditure, which secured the GMEs for the Trustee, was an affair of capital and therefore not deductible under s 8-1(1) by reason of 8-1(2).

Erroneous conclusions at law by the majority of the Full Court

25. Greenwood ACJ, with whom McKerracher J agreed, accepted that there were factors which pointed in the direction of the GME Expenditure being a capital outgoing: Full Court Reasons, [139] **[AB77]**. However, Greenwood ACJ relied substantially upon two seemingly related and overlapping matters to agree with the conclusion of the Tribunal and to find that the GME Expenditure was on revenue account:

(1) first, there was a relationship between the "threshold of earnings" and the GME Expenditure and its quantification[6] in that there was "relativity between the *cost* of the GME and the *capacity* of the business undertaking to fund the acquisition out of future revenue (cash flows), while maintaining an acceptable rate of return in the business";[7]

[5] Cf *BP Australia v FCT* (1965) 112 CLR 386 at 400

[6] Full Court Reasons, [152] **[AB80]**; see also [146]-[151] **[AB78]-[AB80]**

[7] Full Court Reasons, [146] **[AB78]**

(2) second, the cost of securing future earnings for the going concern of the hotel business would need to be, and was, recouped out of, in effect, every day's trading across all facets of the integrated business and especially out of gaming revenues: Full Court Reasons, [145] **[AB78]**, [154] **[AB80]**, [176]-[178] **[AB86]**.

It is submitted that Greenwood ACJ erred.

26. The reasoning by Greenwood ACJ involves a fundamental error of principle. The character of an outgoing is not revealed by a consideration of the manner in which the outgoing is to be met or how it is to be funded. Nor is the character of an outgoing revealed by whether there is relativity between the amount of the outgoing and the capacity of the business undertaking to fund the outgoing out of future revenue. The decision to undertake capital expenditure in the course of a business undertaking will, at least in the case of the prudent decision maker, invariably involve considerations as to whether the cost of the outgoing may be expected to be met out of future revenues and otherwise how the outgoing may be funded.

27. It is the character of the advantage sought by the making of the expenditure that is "the chief, if not the critical, factor in determining the character of what is paid': *GP International Pipecoaters Pty Ltd v Federal Commissioner of Taxation* (1990) 170 CLR 124 at 137; *Mount Isa Mines Ltd v Commissioner of Taxation* (1992) 176 CLR 141. The "character of expenditure is ordinarily determined by reference to the nature of the asset acquired ...": *GP International Pipecoaters*, ibid.

28. The advantage sought and obtained by the GME Expenditure was the Trustee's acquisition of the GMEs. The GMEs were intangible assets, created pursuant to statute, that were capable of being bought and sold. Materially, they conferred on the Trustee the right, which it did not otherwise have, to conduct gaming at its hotel for a period of 10 years after 2012. The GMEs were not purchased by the Trustee, and the GME Expenditure was not incurred, for the purpose of on-selling or otherwise trading in GMEs. The GMEs were purchased to be held by the Trustee for as long as it sought to conduct gaming, which the GMEs authorised, as part of its hotel business. It is the character of the GMEs which the GME Expenditure secured which determines the character of the expenditure. That character was capital.

29. The reliance by Greenwood ACJ upon the need for the GME Expenditure to be met out of daily earnings wrongly conflates the character of the advantage sought by the

making of the expenditure with the manner in which the expenditure is to be funded. His Honour's reasoning represents a departure from established authority and does not properly address the issue of characterisation raised by s 8-1(2) which requires a conclusion to be drawn as to the character of the advantage sought by the expenditure. Here the GME Expenditure acquired for the Trustee the statutory entitlements which it required to conduct its trading activities of gaming for a period of 10 years. The fact that the expenditure is to be met or recouped out of daily earnings does not reveal the character of the assets acquired by the expenditure.

30. A consequence of Greenwood ACJ's incorrect reliance upon the two matters referred to above was the failure to properly characterise the GME Expenditure by reference to the character of the GMEs in the hands of the Trustee, the acquisition of which was the advantage sought and obtained by the expenditure: Full Court Reasons, [150] **[AB79]**, cf [139] **[AB77]**. The reasoning of Greenwood ACJ at Full Court Reasons, [179]-[191] **[AB86]-[AB89]** wrongly ignored the statutory rights secured by the expenditure and the relationship of those rights to the profit-making structure of the Trustee's hotel business.

31. So far as Greenwood ACJ[8] sought to rely upon *BP Australia*, his Honour's reliance involves a misapplication of the decision. On the facts of that case the particular agreements pursuant to which the relevant outgoings were incurred "merged in and became part of the ordinary process of selling": 112 CLR at 405. "The advantage which BP sought was to promote sales and obtain orders for petrol …": 112 CLR at 397-8. The "payments [were] made to particular customers to secure their particular custom": 112 CLR at 402. The payments occurred in the ordinary course of BP Australia marketing its product. In contrast, the GME Expenditure did not occur as part of or in the ordinary course of the Trustee's trading activities. The expenditure acquired for the Trustee the statutory entitlements it required to enable it to conduct its gaming activities for a period of 10 years: cf Thawley J, Full Court Reasons, [296]-[299] **[AB117]-[AB118]**.

32. Greenwood ACJ at Full Court Reasons, [185]-[191] **[AB87]-[AB89]** refers further to three particular considerations. However, his Honour erred in concluding that those considerations support the conclusion that the character of the GME Expenditure was on revenue account.

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[8] Full Court Reasons, [154]-[175] **[AB80]-[AB85]**

33. In relation to the first consideration, Greenwood ACJ at Full Court Reasons, [185] **[AB87]** found that the GME Expenditure was an outgoing incurred in relation to an integrated hotel business which included gaming activities. However, that fact does not reveal the character of the outgoing. The advantage sought by the expenditure was to acquire statutory entitlements without which the Trustee could not conduct gaming activities. The GMEs provided the Trustee with a component of its profit-making structure that was required to carry on gaming activities for a period of 10 years.

34. In relation to the second consideration, Greenwood ACJ at Full Court Reasons, [186] **[AB87]** noted that if the Trustee did not acquire the GMEs it would not have any income from gaming after 16 August 2012. His Honour further noted that the "loss of profit contribution from gaming would have imperilled the total undertaking" of the Trustee. Those facts do not support the conclusion that the expenditure was on revenue account. To the contrary, they reveal the character of the outgoing as one of capital incurred to secure the right to carry on business activities in the nature of gaming for a period of 10 years. The mere fact that an asset is required of a business to maintain the income upon which it derives and relies, does not render the outlay for that asset an outgoing of revenue. A tradesman might require a new truck because his existing vehicle ceases to operate; notwithstanding the new truck is required to maintain existing streams of income, the acquisition of that vehicle is clearly an affair of capital as it goes to the profit-making structure of the business.[9]

35. At Full Court Reasons, [187] **[AB88]** Greenwood ACJ stated that the "Trustee incurred the outgoing to preserve the hotel business as a going concern." However, the Trustee achieved the preservation of its business as a going concern by acquiring statutory rights to conduct gaming for a period of ten years, which but for the acquisition it did not have. In those circumstances the outgoing is an affair of capital: cf. *Hallstroms Proprietary Limited* at 641-2; see also *Broken Hill Theatres Pty Ltd v Federal Commissioner of Taxation* (1952) 85 CLR 423 at 433-434.

36. In addition, Greenwood ACJ inaccurately described the Trustee as having incurred the outgoing "to preserve revenue from gaming and to preserve the contribution the gaming activities made to the derivation of revenue". However, prior to the outgoing the Trustee could only receive income, through Tattersalls, from gaming at its hotel

[9] *AusNet Transmission Group Pty Ltd v Commissioner of Taxation* (2015) 255 CLR 439 at 450 [15]

until 16 August 2012. The outgoing did not preserve an existing state of affairs. It acquired for the Trustee new rights which but for the outgoing would not have existed. It secured for the Trustee new entitlements pursuant to which it (and not Tattersalls) would be able to conduct gaming for a 10 year period.

37. The GMEs provided the Trustee with a right to derive income from gaming, just as the licence in *Henriksen v Grafton Hotel Ltd* [1942] 2 K.B. 184 (cited with approval in *BP Australia*) permitted the taxpayer to retail liquor.[10] Absent a licence the taxpayer in that case would be unable to trade and unable to derive income. That fact did not point to the licence fee in question being on revenue account. Nor, it follows, does the prospect of being unable to derive income from gaming absent the GREs point to the conclusion that the GME expenditure is revenue in nature.

38. In relation to the third consideration, at Full Court Reasons, [191] **[AB89]** Greenwood ACJ stated that "the Trustee could not afford to find itself in the position where it could no longer carry on gaming activities" and that the "interdependence of gaming activities with other activities conducted in the business of the hotel was critical to the revenues and ultimately to profitability." However, the GME Expenditure secured for the Trustee the statutory entitlements it required to carry on gaming activities for 10 years. The entitlements were assets that were added to and formed part of the profit making structure of the Trustee's business. On the tests set out in *Sun Newspapers Limited* and *Hallstroms Proprietary Limited* the outgoing which secured those assets for the Trustee are on capital account.

39. It is respectfully submitted that the reasoning and conclusion of Thawley J at Full Court Reasons, [280]-[302] **[AB112]-[AB119]** were correct.

Second Issue: Submission – the majority of the Full Court erred in finding that if the GME Expenditure was an outgoing of capital or of a capital nature s 40-880(6) applied and that the expenditure was deductible under s 40-880(2). The Full Court ought to have held that the requirements for the application of s 40-880(6) were not satisfied and accordingly by reason of s 40-880(5)(f) no deduction was allowable under s 40-880(2)[11]

40. In the event that the GME Expenditure is capital and therefore not deductible under

[10] See also *AusNet Transmission Group Pty Ltd v FCT* (2015) 255 CLR 439 at 451 [16]; Thawley J, Full Court Reasons, [293] **[AB116]**
[11] Notice of Appeal, grounds 4-6

s 8-1, the respondent seeks a deduction under 40-880(2). The issue as to the application of s 40-880(6) arises because the GME Expenditure, if capital, formed part of the cost base of the GMEs which were acquired by reason of the expenditure. The GMEs were CGT assets: s 108-5 of the ITAA. The GME Expenditure, if capital, was required to be taken into account to determine the amount of a capital gain or a capital loss from the happening of a CGT event in respect of the GMEs, such as upon their sale or expiry: ss 104-10 and 104-25(1)(c) of ITAA. In fact they were disposed of by the Trustee as part of the sale of the hotel by the Trustee on 9 November 2015. In those circumstances, no deduction could arise under s 40-880(2) in respect of the GME Expenditure because of s 40-880(5)(f), unless s 40-880(6) applied.

41. In finding that s 40-880(6) applied, Greenwood ACJ (with whom McKerracher J agreed) misconstrued the meaning of goodwill. Materially his Honour found the "Trustee incurred the outgoing to preserve the hotel business as a going concern", and further that the "value to the Trustee...of the right to conduct gaming (the critical right attached to a GME), was solely attributable to the effect the right had on the custom, patronage, revenue and profits of the hotel business": Full Court Reasons, [187] **[AB88]**, [242] **[AB99]**]; see also [254] **[AB102]**. On those findings the majority ought to have held that s 40-880(6) did not apply.

42. Goodwill is a separate and distinct concept from the trading income and profits of a business. Further, it is not a reference to a business as a going concern. Goodwill is "the attractive force that brings in custom and adds to the value of the business": *Federal Commissioner of Taxation v Murry* (1998) 193 CLR 605 (at [68]; see also [4], [20] and [22]); *CSR v Placer Done Inc* [2018] HCA 59 at [70], [91].

43. In *Placer Dome* [2018] HCA 59 at [97]-[98], the plurality stated:

> "Goodwill for legal purposes is different from, and is not to be confused with, the "going value" or the going concern value of a business. These terms are not separate methods of valuing the same intangible. The distinction between them is clear and, in the context of this appeal, important. As seen earlier, goodwill represents a pre-existing relationship arising from a continuous course of business – to which the "attractive force which brings in custom" is central. Without an established business, there is no goodwill because there is no custom.
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> Going concern value, on the other hand, is the ability of a business to generate

income without interruption even where there has been a change in ownership"[12]

44. The finding of Greenwood ACJ that the GME Expenditure was incurred by the Trustee to preserve the business as a going concern, involving as it must the derivation of trading income and profits, has the consequence that the expenditure did not answer the statutory description of being incurred "to preserve (but not enhance) the value of goodwill". Further, the finding that the value to the Trustee of the GMEs acquired by the expenditure was attributable to, amongst other things, revenue and profits necessarily excludes the conclusion that the value was solely attributable to any effect the GMEs may have had on goodwill. In the circumstances, s 40-880(6) did not apply. The error of law made by Greenwood ACJ in relation to the meaning of goodwill is manifest in his Honour's reasons at [242] **[AB99]** in which his Honour treated both the effect of the right to conduct gaming on "custom, patronage, revenue and profits of the hotel business" and "the effect on the goodwill of the integrated hotel business undertaking" as the one and the same: see also Full Court Reasons, [254] **[AB102]**.

45. For the reasons set out below it is submitted that the dissenting judgment of Thawley J in relation to s 40-880(6) was correct.

Issue 2a: submission – the GME Expenditure was not incurred by the Trustee to preserve (but not enhance) the value of goodwill within the meaning of s 40-880(6)

46. Section 40-880(6) applies only to a very limited category of expenditure. The category is delineated by three requisite characteristics. The first is that the expenditure is incurred by the taxpayer "to preserve (but not enhance) the value of goodwill". There are three matters to be noted about the statutory meaning of that first requirement.

47. First, the expression "you incur to preserve (but not enhance) the value of goodwill" refers to the purpose of the taxpayer ("you") in incurring the expenditure. The relevant enquiry is to ascertain the purpose of the taxpayer rather than an objective purpose of the expenditure: *Starr v FCT* (2007) 164 FCR 436 at 443-446, [32]-[56].

48. So far as the taxpayer's purpose is revealed by its subjective state of mind, its purpose is the result it seeks to achieve by the expenditure, not the reason why it seeks to

[12] See also Gageler J at [176]

achieve that purpose. The taxpayer's motivation for expenditure does not answer the statutory enquiry under s 40-880(6). In *News Limited v South Sydney District Rugby League Football Club Limited* (2003) 215 CLR 563 at 573 [18], Gleeson CJ stated:

> "Purpose is to be distinguished from motive. The purpose of conduct is the end sought to be accomplished by the conduct. The motive for conduct is the reason for seeking that end. The appropriate description or characterisation of the end sought to be accomplished (purpose), as distinct from the reason for seeking that end (motive), may depend upon the legislative or other context in which the task is undertaken. Thus, for example, in describing, for the application of a law relating to tax avoidance, the purpose of an individual, or of an arrangement, it will be necessary to look at what is sought to be achieved that is of fiscal consequence, not at a more remote, but fiscally irrelevant, object, such as increasing a taxpayer's disposable income."

49. Further, evidence as to objective facts, including what is achieved by the expenditure, may be relevant to ascertaining the taxpayer's relevant state of mind: Thawley J, Full Court Reasons, [324] **[AB125]**. In *Starr v Commissioner of Taxation* [2007] FCA 23, 65 ATR 86 (upheld on appeal),[13] French J referred to the question of purpose as an issue of "state of mind" and stated:

> "The finding of a mental state as a fact referred to in a statute may be a traditional process of inference based on objective and subjective evidence." (at [28])
>
> "The debate in this case was joined as a debate between a construction of s 224(2) which says that the "purpose" to which it referred is to be subjectively determined and the construction which says it is to be objectively determined. In my opinion however, the relevant dichotomy is between a mental state *inferred* by reference to subjective and objective evidence and a mental state *attributed* on the basis of objective evidence which excludes consideration of the actual mental states of those behind or entering into the scheme." (at [29])
>
> "...even though it is the subjective mental state of a person that is to be attributed, objective evidence about the likely effect of the person's conduct may be the best evidence." (at [38])

[13] *Commissioner of Taxation v Starr* (2007) 164 FCR 436

50. The second matter to note about the statutory construction of the first requirement is that s 40-880(6) describes the expenditure to which it applies by reference to only one purpose, namely "to preserve (but not enhance) the value of goodwill". The subsection is not expressed in terms of the relevant expenditure being incurred for a number of purposes that include a purpose of preserving (but not enhancing) the value of goodwill: cf s 80B(5)(c) of the *Income Tax Assessment Act 1936* and *FCT v Students World (Australia) Pty Ltd* (1978) 138 CLR 251 at 265 per Mason J.

51. The final matter to note about the statutory construction of the first requirement is that it is a further express requirement for the application of s 40-880(6) that the value to the taxpayer of the right in respect of which the expenditure is incurred "is solely attributable to the effect that the right has on goodwill". Accordingly, the focus of the subsection is upon expenditure, the requisite purpose and effect of which are both prescribed by reference to goodwill.

52. It is submitted, having regard to the matters of construction referred to above, that it is likely that the purpose "to preserve (but not enhance) the value of goodwill" which is required by s 40-880(6) is the sole, dominant or main purpose for which the taxpayer incurs the expenditure. It would not be sufficient to enliven s 40-880(6) if the requisite purpose was simply one of a number of purposes of the taxpayer in incurring the expenditure.

53. However, whether or not the requisite purpose referred to by s 40-880(6) is required to be the sole, dominant or main purpose, it is submitted that s 40-880(6) does not refer to a purpose of preserving (but not enhancing) the value of goodwill that is merely incidental to another purpose. The statutory enquiry required by the language of s 40-880(6) is to categorise the expenditure to which the subsection applies by reference to purpose and effect. There is no apparent statutory purpose for concluding that the process of characterisation may or ought to be achieved by reference to a purpose that is merely incidental to another purpose that does not answer the statutory description of "to preserve (but not enhance) the value of goodwill": cf Thawley J, Full Court Reasons, [339] **[AB129]**.

54. It is not necessary in this case to determine whether the purpose of preserving but not enhancing the value of goodwill is required by section 40-880(6) to be the sole, dominant or main purpose of the taxpayer in incurring the expenditure. On the facts, the Trustee incurred the GME Expenditure with the intention and object of acquiring

the GMEs, which would authorise it to conduct gaming as part of its hotel business and to derive income therefrom for a specified period of ten years. The expenditure achieved the object sought. That was not the purpose to preserve (but not enhance) the value of goodwill. The GMEs, the right to conduct gaming which they authorised, and the income generated from the conduct of gaming were distinct and separate from goodwill. Accordingly, the expenditure does not satisfy the statutory requirement that it be incurred by the Taxpayer to preserve (but not enhance) the value of goodwill within the meaning of s 40-880(6): cf Thawley J at [339] **[AB129]**.

55. The decision to the contrary by the majority of the Full Court involved a fundamental error as to the meaning of goodwill. The majority incorrectly equated the purpose of obtaining the right to conduct gaming and to derive income therefrom with the purpose of preserving goodwill: see Full Court Reasons [242]-[245] **[AB99]-[AB100]**. The object of preserving the value of goodwill may have been a motivation for seeking to obtain the right to conduct gaming, but the purpose of incurring the GME expenditure was to secure that right and to enable gaming to be conducted for the production of income.

56. At [26] **[AB23]** of its reasons, the Tribunal found that the "evidence in this case was that the purpose for incurring the expenditure was to secure entitlements for the trustee to continue gaming activities which had previously been carried on by Tattersalls at the trustee's premises". It further found that the "expenditure on the gaming machine entitlements was to enable the trustee to derive directly the income from gaming activities...". The Tribunal incorrectly concluded that "[t]hat purpose of the expenditure ... was, from a practical and business point of view, to preserve the value of goodwill and was also reflected in the trustee's goodwill." At [245] **[AB100]** Greenwood ACJ accepted and relied upon that conclusion. For the reasons stated above, the Tribunal's conclusion and Greenwood ACJ's acceptance of it are erroneous and are premised on a misconception as to the meaning of goodwill.

57. The purpose of the taxpayer in this case is revealed by what the GME Expenditure was designed to achieve and what it in fact achieved, namely the acquisition of the statutory entitlements necessary for the Trustee to conduct gaming on gaming machines for reward at its hotel on and after 16 August 2012. Without the GMEs the Trustee could not carry on gaming as part of its hotel business. The Trustee's purpose of incurring the GME Expenditure was to obtain the necessary statutory rights to conduct gaming and to derive income therefrom for reward as part of its business.

The Tribunal and the majority of the Full Court erred in equating that purpose with a purpose of preserving the value of goodwill: cf Thawley J at [325]-[341] **[AB125]-[AB129]**.

Issue 2b: Submission – the value to the Trustee of the GMEs was not solely attributable to the effect they had on goodwill within the meaning of s 40-880(6)

58. The second requirement for the application of s 40-880(6) is that the expenditure is incurred "in relation to a legal or equitable right." The requirement was satisfied. The GMEs, for which the GME Expenditure was outlaid, are the relevant "legal rights".

59. The third requirement for the application of s 40-880(6) is that the value to the taxpayer of the right, in relation to which the expenditure is incurred, is solely attributable to the effect the right has on goodwill. The expression "attributable to" connotes a causal connection between the subject matters to which the expression is applied: *FCT v Sun Alliance Investments Pty Ltd* (2005) 225 CLR 488 at 514 [80]. Under s 40-880(6), the required causal connection in this case is between the value to the Trustee of the GMEs and any effect the GMEs had on goodwill. The word "solely" requires that there is no other independent or collateral cause of the value of the GMEs to the Trustee apart from their effect on goodwill: *Ryder Municipal Council v Macquarie University* (1978) 139 CLR 633 at 644.

60. The third requirement is not satisfied. The GMEs had value to the Trustee separate and independent from any effect they may have had on goodwill. They conferred on the Trustee the right to conduct gaming for reward. The gaming conducted by the Trustee pursuant to the GMEs resulted in substantial income. Without the GMEs no gaming income would have been earnt by the Trustee after 16 August 2012. The GMEs were intangible assets with inherent value. They were sold by the Trustee as part of the hotel business in November 2015: Thawley J at [343] **[AB129]**.

61. In finding to the contrary the majority of the Full Court misconceived the meaning of goodwill. The income stream produced from the gaming activities which the GMEs authorised was a substantial financial benefit to the Trustee separate and distinct from any consequence on goodwill. As stated above, having found that the "*value* to the Trustee…of the *right* to conduct gaming (the critical right attached to a GME), was solely attributable to the effect the right had on the custom, patronage, revenue and profits of the hotel business" Greenwood ACJ ought to have held that the third requirement of section 40-880(6) was not satisfied: [41]-[43] above.

62. At [254] **[AB100]** of the Full Court Reasons, Greenwood ACJ stated:

> "…. the value to the Trustee of the right was to preserve the gross revenue and net profit of the hotel business which, absent the expenditure, would have been, at the very least, significantly diminished on the financial information in evidence. It is difficult to see how the business undertaking of the Royal Hotel could have survived *at all* without the gross contribution to revenue and the net contribution to profit from gaming, an activity entirely dependent upon "the right"."

63. It follows from the above findings that, contrary to the conclusion of Greenwood ACJ, the value to the Trustee of the GMEs was not solely attributable to any effect they may have had on goodwill. Their value to the Trustee was at least substantially attributable to the income generated from the gaming activities which they authorised: cf Thawley J at Full Court Reasons, [343] **[AB129]**.

64. The value of the GMEs lay in their earning power as assets of the business. Without the GMEs no gaming could be conducted and no gaming income could be derived on and after 16 August 2012. In *Murry* 193 CLR at 625 [51] the High Court stated:

> "Where the goodwill of a business largely derives from using an identifiable asset or assets, the goodwill of the business, as such, when correctly identified, may be of small value. That is because the earning power of the business will be largely commensurate with the earning power of the asset or assets. If the goodwill of a business largely depends on a trade mark, for example, and the trade mark is fully valued, the real value of goodwill can only reflect a value that is similar to the difference between the business as a going concern and the true value of the net assets of the business including the trade mark. A purchaser of the business will not pay twice for the same source of earning power."

65. Accordingly, s 40-880(6) is not enlivened and the GME Expenditure is not deductible under s 40-880(2).

Legislative background to s 40-880(6)

66. The conclusion that the GME Expenditure is not expenditure to which s 40-880(6) applies is supported by the background and purpose of s 40-880 generally, and s 40-

880(6) in particular.[14] The legislative history of s 40-880 is set out in the dissenting judgment of Thawley J at [306]-[313] **[AB120]-[AB122]**. Section 40-880 was enacted in its current form[15] with effect from 1 July 2005 by the *Tax Laws Amendment (2006 Measures No 1) Act 2006* (Cth). The explanatory memorandum to the Tax Laws Amendment (2006 Measures No 1) Bill 2006 (**Explanatory Memorandum**) explained that s 40-880 was to be a "provision of last resort" for "certain business capital expenditure" that was not "taken into account in some way elsewhere in the income tax law",[16] for example "capital expenditure … not included in the cost base of a CGT asset or in the cost of a depreciating asset".[17]

10 67. In relation to s 40-880(6) specifically, the Explanatory Memorandum provides:

> "2.70 Expenditure is deductible where it is incurred in relation to a lease or other legal or equitable right, and the value of the expenditure to the taxpayer arises solely from the effect that the right has in preserving, but not enhancing, the value of goodwill. For example, capital expenditure may be incurred in relation to a right that is both unlimited in duration, and which merely prevents goodwill from being damaged. Such a right has no distinct value in itself. Its value lies in the effect its existence has upon the value of the goodwill. Such expense represents in substance a blackhole expense even though it is in relation to an asset. [Schedule 2, item 30, subsection 40-880(6)]
>
> 20 2.71 Where a taxpayer incurs an expense in relation to a right and that right enhances the value of the goodwill, or has an inherent value in itself then it would not be appropriate to allow a deduction as a business related cost as the expenditure does not represent a loss to the taxpayer."

68. The Explanatory Memorandum at [2.70], while directed at the exclusion in paragraph (d) of s 40-880(5) rather than the exclusion in paragraph (f) (the relevant paragraph in these proceedings[18]), is instructive of the purpose of s 40-880(6) which is to deal

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[14] Interpretation of a provision requires that regard be had to the grammatic meaning of the text, its context, and the legislative purpose: *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355 at [78]; *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue* (2009) 239 CLR 27 at 46 [47], *Thiess v Collector of Customs* (2014) 250 CLR 664 at 672 [22], *FCT v Consolidated Media Holdings Ltd* (2012) 250 CLR 503 at [39]; *Military Rehabilitation and Compensation Commission v May* (2016) 257 CLR 468 at [10] and the cases therein cited.

[15] Apart from some minor amendments that are not relevant for present purposes.

[16] Explanatory Memorandum at [2.7], [2.61]

[17] Explanatory Memorandum at [2.2]

[18] The parties do not dispute that the s 40-880(5)(d) exclusion does not apply to the GME expenditure.

with rights that have no inherent value in themselves. The GMEs do have inherent value because they entitle the holder to conduct gaming and so derive gaming income, and can be exchanged for value. In this way GMEs can be contrasted with, for example, a restrictive covenant imposed on a departing employee which has no value apart from its effect upon the attraction of custom.[19] It is apparent s 40-880(6) was intended to have limited application, where a legal or equitable right *only* has value in relation to goodwill (the attraction of custom[20]). The GMEs are not such a right.

Part VII: ORDERS

69. The Court should make the following orders:

(1) The Appeal be allowed.

(2) Order 1 of the Full Court of the Federal Court of Australia be set aside and in lieu thereof the following orders be made:

a. the appeal be allowed;

b. the decision of the Tribunal be set aside;

c. the appellant's objection decision be affirmed.

(3) There be no order as to costs of the Appeal.

Part VIII: ESTIMATE FOR HEARING

70. It is estimated that 3 hours will be required for the appellant's oral argument.

Dated: 8 May 2019

G J DAVIES
J E JAQUES
L J S MOLESWORTH

.....
Lee Benjamin
for and on behalf of the Australian Government Solicitor
Solicitor for the Appellant

[19] See *Box v Commissioner of Taxation* (1952) 86 CLR 387 where a payment in relation to a restrictive covenant was found to be paid in connection with the goodwill of the business, and approved in *Commissioner of State Revenue v Placer Dome Inc* [2018] HCA 59 at [61], [64], [87].
[20] *Placer Dome* at [91]