IN THE HIGH COURT OF AUSTRALIA
MELBOURNE REGISTRY

No M139 of 2014

BETWEEN:

AUSNET TRANSMISSION GROUP PTY LTD (ACN 079 798 173)

Appellant

and

THE COMMISSIONER OF TAXATION OF THE COMMONWEALTH OF AUSTRALIA

Respondent

APPELLANT'S REPLY

Part I – Publication

1. The Appellant certifies that these submissions in reply are in a form suitable for publication on the internet.

Part II – Reply to the Argument of the Respondent

A. The Negative Limb of s 8-1

2. The s 163AA imposts were not paid "for" the acquisition of the "transmission system" including the Transmission Licence: RS [11]. These assets were acquired by paying the "Total Purchase Price", being the "fixed" sum of $2,502,600,000.

3. *First*, the s 163AA imposts did not form part of the "Total Purchase Price": RS [12]. This wholly new argument contradicts the reasons of the majority upon whom the Respondent relies.[1] It also misconceives the Asset Sale Agreement. The "Total Purchase Price" simply "means $2,502,600,000", which was "fixed" and payable at Completion.[2] As the recitals make clear,[3] the obligation to pay the imposts was *in addition to* the Total Purchase Price.[4]

4. Moreover, the Appellant could not have assumed a liability to pay the s 163AA imposts under cl 7 AB 2/408 (cl 2.1(b)(2) AB 2/402 is descriptive of this assumption of liabilities). By its terms, the Appellant agreed to "assume with effect from Completion all liablities of the Seller to the Creditors". The clause must be taken to refer to liabilities of PNV that are capable of assumption from Completion, viz present liabilities. At Completion, there was no liablity *of the Seller* to pay the imposts which

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[1] FC [13] AB 3/1029 and [35] AB 3/1036
[2] Definition of "Total Purchase Price" AB 2/400 and Clause 4.4(a) AB 2/405
[3] Recitals E and F AB 2/395
[4] TJ [88] AB 3/1003; FC [13], [37] AB 3/1029, 1037

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was capable of being "assumed" by the Buyer. The Order in Council did not create a present liablity of PNV only to be performed in the future, but rather a future liability contingent upon PNV retaining the transmission licence at the times set out in the Order. And after Completion, by the terms of the Asset Sale Agreement, PNV ceased to be the holder of the Transmission Licence, and could thus never become liable to pay the imposts.[5]

5. *Secondly*, the Respondent contends that if the s 163AA imposts were not part of the "price" for the assets, they were nonetheless a "cost" of their acquisition: see RS [14]. With respect, the artificial distinction sought to be made here between "price" and "cost" conflicts with the employment of a "practical and business point of view". Moreover it seeks impermissably to capture outgoings which are merely connected with the acquisition of capital assets: RS 14(a) and (b). The contention that *any* payment which has a causal connection to, or contributes to the acquisition of a capital asset, is of a capital nature[6] is not supported by authority. As this Court decided in *Morgan*, the question posited by s 8-1 is not answered by seeking to identify from the terms of a contract of sale whether a payment is "an item of the total payment which the purchaser must make in order to obtain a transfer of the property".[7] As submitted in chief, that is an enquiry sometimes mandated by state Duties Acts.

6. The remaining factors in RS[14] do not support the proposition that the imposts were a cost of acquiring "the transmission system assets". *First,* the fact that the payments were fixed and payable over a limited period[8] reflected the underlying rationale for the imposition of the imposts, which was that during a limited transition period the "x factor" could not be reset to reduce the Appellant's MAR.[9] *Second,* the fact that the buyer may have taken into account the future imposts in determining its bid price, does not mean that those imposts are an affair of capital when incurred. A buyer, acting rationally, will take into account all future cash inflows and outgoings ~ whether they be on revenue or on capital account ~ in determining the amount it will spend to acquire that business.[10] *Third,* this is not a case of disguised consideration: the Respondent has never suggested, nor has any judge found below, that the sum paid of $2,502,600,000 did not represent the market value of the business. *Fourth,* the accounting treatment adopted by the buyer is of no assistance. Here, the Australian Accounting standards for the capitalisation of expenditure do not ask the questions

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[5] Even if the State of Victoria was a "Creditor" (as defined) AB 2/397, any obligation the Seller had to pay the s 163AA imposts prior to Completion terminated upon the Seller ceasing to be the holder of the licence. Thereafter, the obligation of the buyer was a fresh obligation arising under s 163AA.

[6] RS [14(c), (d), (e), (f)]

[7] *Morgan* at 520

[8] Also referred to at RS [20], [21] and [28]

[9] Information Memorandum pages 27 and 28 AB 1/102-103

[10] In that respect, the Respondent's attempt to invoke isolated statements from witnesses not called for cross examination does not advance his case: RS [14(g)] and [14(h)] referring to Cohen [23] Keller [20(a)]. The Respondent also seeks to rely (at fn 22) upon an internal record of the State that was not before the Full Court. The Trial Judge had found that documents neither in the possession of, nor available to, the Appellant could not form part of the matrix of circumstances: TJ [47] AB 3/990. The document casts no light on the purpose of the outgoing from the taxpayer's perspective.

posed by s 8-1.[11] In any event, the correct accounting treatment was a matter of dispute which the trial judge found unnecessary to resolve.[12]

7. The Respondent's continued reliance upon the decision in *Tata* is, with resepct, misconceived. The issue in that case was whether certain payments could be said to be incurred "for the purposes of earning profits" under the *Indian Income Tax Act* 1922. As submitted in chief, that is not the test under s 8-1(1). As this Court decided in *Steele v DCT* (1999) 197 CLR 459 at [27]: "[the] distinction ... drawn between a sum expended in order to earn profits, which formed a valid deduction in arriving at the profits, and a sum expended to obtain capital...has never been the critical distinction in Australia."

8. *Thirdly*, if the imposts were *neither* part of the price for the transmission business *nor* a cost of acquiring it, they were not also "for" the profit-yielding structure of the business, although they were incurred "in connection with" it: RS [17]. As to the first proposition, the Appellant repeats the foregoing. As to the second, it is not the correct test. Many revenue outgoings exhibit an obvious connection with the capital structure of a business: interest incurred on a loan entered into to fund the development of a motel (*Steele*) and payments made to obtain a concession to operate a tollway (*CityLink*) are but two examples.

9. The further contentions at RS [17] are incorrect or fail to address the question posited by s 8-1: what is the money really paid for? Moreover, they are not supported by any findings made below. Plainly, the s 163AA imposts were paid "as part of" a "regulatory framework.[13] But nothing follows from this. After all, the great majority of the Appellant's earnings – its assessable income – was derived as "part of" that same framework. Moreover, as the primary judge found, the relevant part of that "regulatory framework" was directed at capping the Appellant's MAR and not at securing an advantage for the Appellant: TJ [86] AB 3/1002. That framework did not secure to the Appellant any freedom from competition: the transmission licence was not exclusive.[14] Nor were the imposts referable either to the benefit of an exclusive customer base (which did not exist) or a statutory right to exclusive supply (which also did not exist).[15] In contrast, any benefit to the Appellant from conducting a regulated business – such as predictable revenue streams – was conferred by reason of it holding the transmission licence, not by reason of the payment of the imposts: FC [108] AB 3/1057.

10. *Fourthly*, the contention that the liability to pay the imposts was "incurred" upon entry into the Asset Sale Agreement – raised here for the first time – is not consistent with the terms of the Order in Council or s 163AA of the EIA. For the reaons given in chief, no present liability existed unless and until the Appellant was the holder of the

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[11] TJ [99] AB 3/1006. Moreover, here what was capitalised was the present value of the liability, and not – as required by the Act – its historical cost. The present value of the outstanding imposts was included in the provisions disclosed in the balance sheet and a "discount on the transmission licence fee" was expensed in the profit and loss statement: see for example AB 1/303 and 311; *CityLink* at [95]

[12] TJ [99] AB 3/1006

[13] TJ [86] AB 3/1002

[14] Information Memorandum page 135 AB 1/210. The Respondent's fn 29 – intended to buttress the allegation that monopoly rights were obtained – is unsupported by any evidentiary references.

[15] Cf ss 162(2B) and s 163A the subject of the decision of the Full Court in *United Energy*

transmission licence at the time when the imposts became payable.[16] The Respondent's contention that the imposts were nonetheless "referable to" the years of income in which they were claimed,[17] rather than with the year in which the business was acquired (1997), undermines his primary case that the imposts were really "for" that acquisition. If they were, they would be more referable to 1997 than any other year of income.

B. The Positive Limb

11. The submissions of the Respondent in support of his notice of contention are based on a fundamental error as to the applicable legal principle. There is no rule that a payment "out of profits" or that represents "a share of profits"[18] is precluded from deductibility under s 8-1(1). The principle is as stated by Dixon J in *Commissioner of Taxation v The Midland Railway Co of Western Australia*[19] at 312-3: "it is not decisive of the issue under [s 8-1] that it was paid or payable out of profits so long as it was not payable out of the precise fund called by the Act taxable income."[20] The reason for this is plain: an amount conditional on the existence of, and calculated by reference to, "taxable income" – which is the amount remaining after allowable deductions are subtracted from assessable income[21] – cannot, as a matter of logic, be an amount incurred in gaining or producing assessable income.[22]

12. Even if the relevant principle is that deductibility is denied for a payment that is a "share of profits", the Respondent's argument on the notice of contention must fail:

    (a) the imposts do not take the legal form of sharing profits. There was no joint venture between the Appellant and the State of Victoria, and the State was neither a partner nor shareholder of the Appellant.[23] Nor was there a disposal of a share in profits to a purchaser as a quid pro quo for some benefit given to the Appellant;[24]

    (b) the imposts, calculated as the forecast difference between the actual MAR under the tariff order and the adjusted MAR, could not be said to have "represented profits",[25]

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[16] *Coles Myer Finance* at [27]-[28]. A distinction is drawn between those contingencies that affect the timing of the discharge of a liability and those which affect the coming into existence of the liability. It is a contingency of the latter kind which prevents the incurrence of a liability: *CityLink* at [134]

[17] RS [32]

[18] RS [45], [46], [48], [49], [50]

[19] (1952) 85 CLR 306

[20] See also *The Midland Railway Co of Western Australia v FCT* (1950) 81 CLR 384 at 393 per Kitto J. Dixon J's expression "payable out of taxable income" is not to be taken to refer to a physical fund called "taxable income" out of which an amount is payable. The actual *source* of the payment of the imposts is irrelevant: Davies J at FC[96]-[97] AB 3/1053-4; Edmonds J at FC[7] AB 3/1026-7. RS[47] misinterprets what fell from Edmonds J; in fact his Honour found at FC[7] precisely the opposite of what the Respondent records.

[21] Section 4-15 of the 1997 Act

[22] TJ[67] AB 3/997, FC[96] AB 3/1053

[23] Cf *CityLink Melbourne* FFC at [48]-[49]

[24] *Midland Railway* at 318 per Dixon J

[25] RS[50]

nor be "akin" to a payment out of profits[26] nor be "pretty nearly" the taxable income of the Appellant.[27] *First*, the MAR calculation was based upon gross revenue.[28] It did not cap profits.[29] It reduced gross income. *Second*, the MAR was calculated to reflect three matters,[30] none of which reflect the computation of taxable income, or actual profits. *Third*, the imposts were payable irrespective of the existence of actual profits or taxable income.[31]

13. The submission that the impost was "on profits" should not be accepted[32], for the reasons given above. Further, it is the quality of the payment that matters here, not its admeasurement: *Midland Railway* at 317.

14. The impost here finds no analogy to the franchise fee for the grant of a statutory right of exclusivity in *United Energy*.[33] The Respondent's reliance on the reasoning of Lockhart J[34] is also flawed: that judgment proceeded without reference to the dictum of Dixon J in *Midland Railway*, and for that reason, was given *per incuriam*. It thus does not state the correct test, and should, with respect, not be followed. The judgment of the plurality in *United Energy* is to be preferred for the reasons given below by Edmonds and McKerracher JJ.

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[26] RS[45],[47]

[27] RS[48], [50]

[28] In any case, the imposts were calculated based on forecast regulated revenue from the provision of prescribed services: TJ[18] AB 3/980; Information Memorandum at page 27 AB 1/102. The Appellant derived other revenues: Keller [31] AB 1/65.

[29] FC[97] per Davies J; the Information Memorandum states: "the CPI-X regulatory regime applies to PowerNet's revenue not its profits" (page 5) AB 1/80 and on pages 4, 86 and 90 AB 1/79, 161, 165 the "licence fee" is shown as a reduction of operating revenue.

[30] TJ [19] AB 3/980-1; FC[97] AB 3/1054

[31] FC[98] AB 3/1054 per Davies J, TJ[77] AB 3/1000. Disregarding the imposts, the Appellant's tax return for the year ended 30 June 1999 disclosed nil taxable income and a tax loss of $3,301,637 AB 1/30-31. Nonetheless, imposts of $62,500,000 were paid in that tax year: TJ[37] AB 3/987

[32] RS[51]. The cases cited by the Respondent at fn 101 concern the English and Irish tax system, which unlike our Act, impose tax on the profits of a taxpayer. Those cases are of no assistance.

[33] *United Energy v FCT* (1997) 78 FCR 169 at 193 C-D

[34] RS[43], [45]-[47]