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Nickel Aust
Ltd v FCT
(1977) 137
CLR 347

[HIGH COURT OF AUSTRALIA.]

ARMCO (AUSTRALIA) PROPRIETARY LIMITED APPELLANT;

AND

FEDERAL COMMISSIONER OF TAXATION RESPONDENT.

H. C. OF A. 1947-1948.

SYDNEY, 1947. *June* 20.

Williams J.

SYDNEY, 1948. *April* 19, 20; *Aug.* 22.

Latham C.J., Starke, Dixon, and McTiernan JJ.

Income Tax (Cth.)—Assessable income—Deductions—Foreign parent company—Australian subsidiary company—Goods purchased by subsidiary company from parent company—Prices in foreign currency—Delay in payment—Current account with parent company for goods, plant and capital items—Loans by parent company to subsidiary company—Reasons therefor—Purchase by subsidiary company of shares in another Australian company—Shares sold to parent company—Promissory note given by subsidiary company to parent company—Satisfaction of debt—Discharge of promissory note—Amount required greater than contemplated—Increased rate of exchange—Loss on exchange in respect of payment—Capital or income—Income Tax Assessment Act 1936-1944 (*No.* 27 *of* 1936—*No.* 28 *of* 1944), *s.* 51 (1)—*Judiciary Act* 1903-1947 (*No.* 6 *of* 1903—*No.* 52 *of* 1947), 23 *s.* (2) (*a*).

The appellant company, which was incorporated and carried on business in Australia and which was a subsidiary of a company incorporated in the United States of America, purchased goods from the parent company for resale. Up to December 1937, the appellant paid cash in dollars, but thereafter purchased on credit. In addition, prior to September 1938, the parent company had lent sums amounting to $450,000 to the appellant, and had paid $75,536.90 in America on behalf of the appellant. In September 1938, the appellant's total liability to the parent company as shown by the latter's current account was $1,067,201.75 which had, from time to time, been entered in the appellant's books at the rate of exchange prevailing at the time of each purchase, loan or payment, and appeared therein as £A269,736 12s. 9d. The appellant purchased, by arrangement with the American Company, 250,000 £1 shares in another Australian company. In September 1938 the appellant executed a promissory note to the order of the parent company for $1,000,000 payable on demand with interest at 4½ per cent in the United States of America—this was part of the $1,067,201.75 but was not specifically appropriated to any of the component parts of that sum. The sum of £253,720 9s. 9d. was then transferred from the parent company's current account to an inter-company notes payable account, this sum being a conversion of $1,000,000 at $3.95694 to the £A, the average of the rates at which the liabilities had been taken into the appellant's books. The balance on the current account, $67,201.75, was repaid in the ordinary course of business, and the promissory note was discharged in October 1944 by sale to the parent company of the 250,000 shares at £1 each ($799,575) and a cash payment of £62,668 13s. ($200,425), these calculations being made at the then current rate of exchange of $3.1983 to the £A. Under s. 51 (1) of the *Income Tax Assessment Act* 1936-1944, the appellant claimed a deduction of £31,156 15s. 7d. as an "exchange loss," being the difference between £136,110 14s. 8d. (the value of goods purchased as appearing in its books) and the sum subsequently required in Australian currency to repay this portion of the promissory note.

Williams J. held that the promissory note was taken as complete satisfaction for the debt due at 15th September 1938, and that it was intended that the $1,000,000 should be lent to the appellant for the specific purpose of effecting a transaction on capital account, that is in investing its then approximate equivalent in Australian currency in acquiring and paying for the 250,000 shares, and, therefore, that the amount expended by the appellant to repay the $1,000,000 secured by the promissory note was an outgoing of a capital nature. On appeal to the Full Court.

Held, by *Dixon* and *McTiernan* JJ. (*Latham* C.J. and *Starke* J. *contra*), that the appeal should be dismissed.

The Court being evenly divided, the appeal, pursuant to the provisions of s. 23 (2) (*a*) of the *Judiciary Act* 1903-1947, was dismissed.

Appeal from *Williams* J.

Armco (Australia) Pty. Ltd. appealed to the High Court from a refusal by the Federal Commissioner of Taxation to allow the sum of £59,947 11s. 6d. as a deduction under s. 51 (1) of the *Income Tax Assessment Act* 1936-1944 from the assessable income of that company derived during the year of income ended 31st October 1944.

In the notice of objection it was stated that the grounds on which the company relied were :—1. that the said sum of £59,948 was an allowable deduction in calculating the taxable income of the company for the said accounting period, and 2., in view of the facts set out, and for the reasons stated in the memorandum which accompanied the company's income tax return, which memorandum was to be treated as part of the notice of objection, the company was entitled to a deduction to the extent provided by s. 51 (1) of the *Income Tax Assessment Act*.

The memorandum referred to was prepared by the company's secretary and was substantially as follows : Exchange loss—The exchange loss of £59,947 11s. 6d., was incurred in liquidating the

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debt to Armco International Corporation covered by the $1,000,000 note payable. The liquidation was effected by selling to A.I.C. 250,000 £1 fully paid shares in Commonwealth Rolling Mills Pty. Ltd. @ $3.1983 each (current rate $3.1982 to £A) and setting the amount involved $799,575 against the note payable.

The balance, $200,425, was paid in cash.

	$		£A		
Share transaction	799,575 @ 3.1983	..	250,000	0	0
Cash transaction	200,425 @ 3.1982	..	62,668	1	3
	1,000,000		£312,668	1	3

The $1,000,000 appeared in our books @ $3.95694 to £A, i.e. £252,720 9s. 9d. The loss was the difference between £312,668 1s. 3d. and £252,720 9s. 9d., £59,947 11s. 6d. of which £47,930 14s. was incurred on share transaction and £12,016 17s. 6d. on cash payment. As at October 31, 1938, we owed the Armco International Corporation approximately $1,550,000, $450,000 for cash advances and the balance for goods supplied us and used for resale, no capital items being included. This amount was shown in our accounts as £390,736 10s. 9d.

It was agreed to defer payment of portion of this account and the round sum of $1,000,000 was so deferred by the acceptance of the A.I.C. note.

It is claimed that the exchange loss was entirely incurred as a trading loss and as such is entirely allowable as a deduction for taxation purposes.

The appeal was heard before *Williams* J.

A statement of facts tendered in evidence on behalf of the appellant, and not objected to on behalf of the respondent, was substantially as follows :—

1. The appellant company was incorporated in Victoria under the *Companies Act* of that State in or about the month of August 1933 and has at all material times since that date carried on business in the States of Victoria, New South Wales, South Australia and Queensland as a steel merchant and fabricator. In the course of such business the appellant purchased from Armco International Corporation (duly incorporated under the laws of the United States of America) large quantities of steel sheets for resale in Australia, and in due course resold in Australia such steel sheets. The purchase price payable by the appellant to the American Corporation for such steel sheets was payable in dollars in America.

2. As at 15th September 1938 the appellant was indebted to the American Corporation on current account in the sum of $1,067,201.75 (shown in the books of the appellant in Australian currency at £269,736 12s. 9d.) which indebtedness was made up of the following items :—(*a*) unpaid purchase money for steel sheets $541,664.85 (shown in the books of the appellant in Australian currency at £136,110 14s. 8d.) ; (*b*) remittances received from the American Corporation $450,000 (shown in the books of the appellant in Australian currency at £113,922 0s. 3d.) ; and (*c*) debts incurred by the American Corporation for the appellant $75,536.90 (shown in the books of the appellant in Australian currency at £19,703 17s. 10d.).

3. The amount referred to in par. 2 (*a*) hereof represented the unpaid purchase price payable by the appellant to the American Corporation for steel sheets purchased by the appellant from the American Corporation during the years 1937 and 1938.

4. The amount referred to in par. 2 (*b*) hereof represented three amounts of $150,000 loaned by the American Corporation to the appellant in or about the months of May, July and August 1938 respectively, such loans having been remitted to the appellant in Australia and being repayable in dollars in America.

5. The amount referred to in par. 2 (*c*) hereof represented moneys paid by the American Corporation in America for and on behalf of the appellant during the year 1938 and repayable by the appellant to the American Corporation in dollars in America. No portion of the amount represented outgoings of the appellant of a revenue nature.

6. Prior to 15th September 1938 no interest was paid or payable by the appellant to the American Corporation in respect of the amount referred to in par. 2 hereof as owing on current account.

7. In arriving at the trading profit and the assessable income for Australian income tax purposes of the appellant the purchase price payable by the appellant to the American Corporation for steel sheets purchased by the appellant as aforesaid had been treated as outgoings of its business and deducted accordingly. In respect of the unpaid purchase price referred to in dollars in par. 2 (*a*) hereof the sum of £136,110 14s. 8d. had been charged to purchases account in the books of the appellant and treated as outgoings of its business as aforesaid, the liability in dollars having been translated into a liability in Australian currency at the exchange rate prevailing at the respective dates of receipt in Australia of steel sheets.

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8. On or about 15th September 1938 the appellant at the request of the American Corporation executed in Australia and forwarded to the American Corporation in United States of America a promissory note in the following form :—

" $1,000,000.00 September 15, 1938

On demand we promise to pay to the order of THE ARMCO INTERNATIONAL CORPORATION ONE MILLION DOLLARS with interest at $4\frac{1}{2}\%$ per annum

at MIDDLETOWN, OHIO, U.S.A.

Value received

ARMCO (AUSTRALIA) PTY. LTD.

A. J. Wenham Director

No. 1 Due on Demand J. H. Worsley Secretary ".

9. The sum of $1,000,000 referred to in the note represented portion of the sum of $1,067,201.75 referred to in par. 2 hereof but no specific appropriation to the note was made of the whole or any portion of the three amounts referred to in (*a*), (*b*) and (*c*) of par. 2.

10. On the execution by the appellant of the note the sum of £252,720 9s. 9d. was transferred in the books of the appellant from the American Corporation current account to an account styled " Inter-Company Notes Payable " account. This sum of £252,720 9s. 9d. was arrived at by converting the sum of $1,000,000 into Australian currency at an exchange rate of 3.95694 dollars to the Australian pound, being the average rate of exchange at which the dollars liability of the appellant to the American Corporation on current account had been taken into account in the books of the appellant. The rate of exchange as between Australia and United States of America as at 15th September 1938 was 3.8117 dollars to the Australian pound.

11. Subsequent to the execution of the note the appellant each month credited to the current account of the American Corporation interest at the rate of $4\frac{1}{2}$ per centum per annum on the sum of $1,000,000.

12. The liability of the appellant for principal under the note remained unchanged until October 1944 when it was satisfied and discharged in manner following :—(*a*) the appellant sold to the American Corporation 250,000 £1 shares owned by the appellant in the Commonwealth Rolling Mills Pty. Ltd. (which shares constituted half the share capital of that company and had been acquired by the appellant for the sum of £1 per share) at and for the price of £1 per share, the agreed rate of exchange being $3.1983 to the Australian pound (the then current rate of exchange being

\$3.1982 to the Australian pound) ; the indebtedness of the American Corporation to the appellant under this transaction, amounting to \$799.575, was set off against the liability of the appellant to the American Corporation under the note ; (*b*) the balance of the liability of the appellant under the note, amounting to \$200,425, was satisfied and discharged by a cash payment made by the appellant to the American Corporation. The cash payment was effected at the then current rate of exchange \$3.1982 to the Australian pound and involved the appellant in the expenditure in Australian currency of £62,668 13s.

13. The appellant in its return for income tax purposes for the year ended 31st October 1944 claimed as a loss or outgoing of its business under the heading " Exchange Loss " the sum of £59,947 11s. 6d. representing the difference between the amount required to discharge the note in October 1944, namely, £312,668 1s. 3d., and the amount in Australian currency at which the liability on the note was shown in the books of the appellant, namely, £252,720 9s. 9d.

In a letter dated 30th April 1940 to the Deputy Commissioner of Taxation the company's secretary stated : " In connection with our return of income derived during the year ended 31st October 1939, I would advise that the amount of £12,390 16s. 10d. shown as interest credited to Armco International Incorporated was a book entry and has not been actually paid. This interest was due on an amount of one million dollars which was loaned to the Australian Company by the American Company to enable the former to invest £250,000 in Commonwealth Rolling Mills Pty. Limited, this amount being 50% of the total authorised share capital of that company." In a further letter dated 9th October 1942 the company's public officer stated, *inter alia*, as follows : " The Notes Payable (Account) which stood at £252,720 9s. 9d. at the 31st October 1941 represent our indebtedness of \$1,000,000.00 which was converted to the Australian equivalent of £252,720 9s. 9d. at the 15th September 1938, which is the date of Demand Draft of \$1,000,000.00 accepted by us. These monies were to be allowed outstanding for an indefinite period and were lent to us to enable us to invest £250,000 in the Commonwealth Rolling Mills Pty. Ltd. this amount being 50% of the total authorised share capital of that company. Although our Principals hold the Demand Draft, it was mutually agreed that this Draft be withheld from presentation indefinitely."

The share capital of the appellant company consisted of 37,000 fully paid up £1 shares of which 36,996 shares were held by the Armco International Corporation referred to above, of Middletown, Ohio, United States of America. Two residents of Middletown,

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Ohio, held one share each, and one share each was held by a resident of New South Wales and a resident of Victoria respectively.

Barwick K.C. and *Hardie*, for the appellant.

A. R. Taylor K.C. and *A. C. Leslie*, for the respondent.

Cur. adv. vult.

Williams J. delivered the following written judgment :—

This is an appeal by Armco (Australia) Pty. Ltd. from a refusal by the respondent to allow the sum of £59,947 11s. 6d. as a deduction from the assessable income of the appellant derived during the year of income ended 31st October 1944. This year of income was adopted by the appellant and accepted by the respondent in lieu of the year ended 30th June 1944. The appellant claims that this sum should have been allowed as a deduction under the provisions of s. 51 (1) of the *Income Tax Assessment Act* 1936-1944. This section provides that :—

" All losses and outgoings to the extent to which they are incurred in gaining or producing the assessable income, or are necessarily incurred in carrying on a business for the purpose of gaining or producing such income, shall be allowable deductions except to the extent to which they are losses or outgoings of capital, or of a capital, private or domestic nature, or are incurred in relation to the gaining or production of exempt income."

In its income tax return for the year in question, the appellant claimed the whole of this sum as an allowable deduction, but at the hearing the appellant limited its claim to approximately one-half of this sum.

The appellant was incorporated in the State of Victoria in 1933, and carries on there and elsewhere in Australia the business of a steel merchant and fabricator. It has a nominal capital of 40,000 shares of £1 each of which 37,000 have been issued and are fully paid. It is a subsidiary of Armco International Corporation, a company incorporated in the U.S.A. which holds all the issued shares except two. For the purposes of its business the appellant purchases from the parent company large quantities of steel sheets for resale in Australia. The contracts of sale are made, and delivery of the goods takes place in the U.S.A. and the purchase money is payable in dollars there. Until towards the end of 1937 the appellant paid the purchase money in cash, and for that purpose bought the necessary dollars in the U.S.A. before or at the time of each transaction. But from 23rd December 1937 to 15th September 1938, the parent company gave the appellant credit for the goods it purchased from time to time. The indebtedness of the appellant to the parent company was converted in the books of the appellant from the price payable in dollars to Australian currency at the rate of exchange existing at the date of each shipment of the goods. The result was that on 15th September 1938 the appellant was indebted to the parent company on current account for unpaid purchase money for steel sheets in the sum of $541,664.85 (shown in the books of the appellant in Australian currency as £136,110 14s. 8d.).

In or about the months of May, July and August 1938 respectively, the parent company made three loans to the appellant each of $150,000 each repayable by the appellant to the parent company in dollars in the U.S.A. These loans were also converted into Australian currency in the books of the appellant at the rates of exchange existing at the date of each loan. The result was that on 15th September 1938 the appellant was indebted to the parent company on current account in respect of these loans for $450,000 (shown in the books of the appellant in Australian currency at £113,922 0s. 3d.). The appellant was also indebted to the parent company on current account on 15th August 1938 for $75,536.90 (shown in the books of the appellant in Australian currency at £19,703 17s. 10d.) for moneys paid by the parent company in the U.S.A. on behalf of the appellant during the year 1938, and repayable by the appellant to the parent company in dollars in the U.S.A.

On 15th September 1938 the total indebtedness of the appellant to the parent company on current account under these three headings was therefore $1,067,201.75 (shown in the books of the appellant in Australian currency at £269,736 12s. 9d.). On that date the appellant executed in Australia a promissory note to the order of the parent company for $1,000,000 payable on demand with interest at 4½ per cent at Middletown, Ohio, U.S.A.

The sum of $1,000,000 referred to in the promissory note represented portion of the sum of $1,067,201.75, but no specific appropriation to the promissory note was made of the whole or any portion of the amounts shown under the above three headings. On the execution by the appellant of the promissory note, the sum of £252,720 9s. 9d. was transferred in the books of the appellant from the current account to an account styled "Inter-Company Notes Payable" account. The sum of £252,720 9s. 9d. was arrived at by converting the $1,000,000 into Australian currency at an exchange rate of $3.95694 to the Australian pound, this being the

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average rate of exchange at which the dollars liability of the appellant to the parent company on current account had been taken into account in the books of the appellant. The rate of exchange between Australia and the U.S.A. on 15th September 1938 was \$3.8117 to the Australian pound. After the execution of the promissory note, the appellant each month credited to the current account of the parent company interest at the rate of $4\frac{1}{2}$ per cent per annum on the sum of \$1,000,000. The balance of the debt on current account, namely \$67,201.75, was repaid by the appellant to the parent company in the ordinary course of business.

The liability of the appellant to the parent company for principal under the promissory note remained unchanged until October 1944 when it was satisfied and discharged in the manner following. The appellant sold to the parent company 250,000 £1 shares owned by the appellant in an Australian company, the Commonwealth Rolling Mills Pty. Ltd. (which shares had been acquired by the appellant for the sum of £1 per share) at and for the price of £1 per share, the agreed rate of exchange being \$3.1983 to the Australian pound (the then current rate of exchange being \$3.1982 to the Australian pound). The indebtedness of the parent company to the appellant for the purchase of the shares amounting to \$799,575 was set off *pro tanto* against the liability of the appellant to the parent company on the promissory note. The balance of the liability on the promissory note amounting to \$200,425 was satisfied and discharged by a cash payment made by the appellant to the parent company. This cash payment was effected at the then current rate of exchange \$3.1982 to the Australian pound and involved the appellant in the expenditure in Australian currency of £62,668 13s.

The appellant in its return for income tax purposes for the year ended 31st October 1944 claimed as a loss or outgoing of its business under the heading " Exchange loss " the sum of £59,947 11s. 6d., representing the difference between the amount required to discharge the promissory note in October 1944, namely £312,668 13s., and the amount in Australian currency at which the liability on the promissory note was shown in the books of the appellant, namely £252,720 9s. 9d.

The appellant now admits that the amounts to the credit of the parent company on current account on 15th September 1938 under the second and third headings were outgoings of a capital nature, so that it is not entitled to deduct any difference between the amounts at which the items under these headings were then shown in its books in Australian currency, and the amounts of

Australian pounds which it had subsequently to expend in order to repay to the parent company in dollars such parts of these amounts as were represented in the promissory note for $1,000,000. But the appellant claims that it can trace the difference between the amount in Australian currency at which the sum of $541,664.85 stood in its books on 15th September 1938 to the extent to which this indebtedness is represented in the promissory note for $1,000,000, and the amount in Australian currency which it had subsequently to expend in order to repay this portion of the promissory note to the parent company, and that this difference is an allowable deduction under s. 51 (1) of the *Income Tax Assessment Act*.

The appellant relies upon the decision of this Court in *Texas Co. (Australasia) Ltd.* v. *Federal Commissioner of Taxation* (1). I think that it follows from this decision that if the indebtedness of the appellant to the parent company under the first heading had remained an indebtedness on current account, any difference between the amounts in Australian currency at which this indebtedness had been entered in the books of the appellant and the amount of Australian currency which the appellant had subsequently to expend in order to purchase the necessary dollars to discharge the debt would have been an allowable deduction in the year of income in which the debt was discharged within the meaning of s. 51 (1) of the *Income Tax Assessment Act*. Strictly speaking, the comparison would not have been between the part of the sum of £136,110 14s. 8d. represented in the promissory note and the amount of Australian currency subsequently expended to purchase the necessary dollars to repay this part of the debt of $1,000,000, but between the corresponding parts of the various sums in Australian currency into which the purchase moneys in dollars for each separate purchase had been converted and the amount of Australian currency required to buy the necessary dollars to pay the purchase money for those parts of each particular purchase. It may be said that this consideration is relevant to the form of the order if the appeal succeeds rather than to the success of the appeal.

But the difficulty of now tracing the extent to which the $541,664.85 was discharged by the repayment of the $67,201.75 in the ordinary course of business and by the subsequent payment of the promissory note illustrates the difficulty in the way of the appellant in proving that some part of the sum of £312,668 13s. which the appellant had to pay in October 1944 in order to discharge

(1) (1940) 63 C.L.R. 382.

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the promissory note was a loss or outgoing incurred in producing its assessable income.

It may be that the appellant could even now appropriate the whole of the indebtedness under the first heading to the amount secured by the promissory note and treat the indebtedness of $67,201.75 as part of the indebtedness under the second and third headings. But I need not pursue this inquiry because, in my opinion, the facts of the present case are altogether different to the facts in the *Texas Case* (1). It is true that in that case the Australian company purchased goods from an American company, the purchase money being payable in dollars in the U.S.A., and that the American company allowed the Australian company to postpone the payment of part of its current indebtedness so that the Australian company could accumulate capital for use in its business. It is also true that at a later date part of this indebtedness was funded and allowed to remain outstanding while the remaining part and any subsequent indebtedness for future purchases had to be repaid in the ordinary course of business. It is also true that the indebtedness of the Australian company to the American company on current account included items of a capital nature which led the Court to declare that only so much of the amount of the exchange as was found to be referable to expenditure incurred in or for the purpose of discharging or providing for liabilities on revenue or income account ought to be allowed as a deduction in ascertaining the taxable income of the company in the year in which the payments were made. But there the resemblance ends because in the *Texas Case* (1) nothing was done to alter the character of the funded debt. It still remained the same debt for the unpaid purchase money for goods which were or had been part of the stock in trade of the Australian company and for expenditure of a capital nature, whereas in the present case, on 15th September 1938, a radical alteration was made in the character of the indebtedness of the appellant to the parent company. This indebtedness was then wholly on current account and consisted roughly as to one half of expenditure to purchase stock in trade, and as to the other half of expenditure of a capital nature. But no distinction was made on 15th September 1938 between the component parts of the debt. The debt as a whole was subdivided into two portions. The portion of $1,000,000 the subject matter of the promissory note was to remain outstanding until demand but subject to a promise that no demand would be made for an indefinite period, while the balance of $67,201.75 was to be repaid in the ordinary

(1) (1940) 63 C.L.R. 382.

course of business. In *Allen* v. *Royal Bank of Canada* (1), Lord *Atkinson*, in delivering the judgment of the Privy Council, said: "Of course, a creditor may accept from his debtor a negotiable instrument either in absolute satisfaction of the debt due to him, or he may accept it as a conditional payment only. In the first case the creditor takes the instrument at the risk of its being dishonoured; which, if it be, he cannot sue the debtor on the original cause of action. . . . The result in the latter case is only this, that the remedies of the creditor to recover his original debt are suspended during the currency of the negotiable instrument" (2). It is a question of fact in each case whether the negotiable instrument is taken in complete satisfaction of the original debt, or merely as a conditional payment, the onus lying on the party alleging that the negotiable instrument operated as a complete satisfaction of the original debt (*Byles* on *Bills*, 20th ed. (1939), p. 311; *Halsbury*, *Laws of England*, 2nd ed., vol. 7, p. 241).

In the present case it is clear that for nine months prior to 15th September 1938 the debt on current account was allowed to accumulate and was even augmented by loans for the express purpose of supplying the appellant with the requisite funds to enable it to acquire and pay for a fixed capital asset, namely an investment in 250,000 shares of £1 each in the Commonwealth Rolling Mills Pty. Ltd. The debt secured by the promissory note was taken out of the appellant's current account and transferred to the inter-company notes payable account, the parent company being credited in that account with the sum of £252,720 9s. 9d. The debt became for the first time an interest-bearing debt. In April 1940 the appellant informed the respondent that this interest was due on an amount of $1,000,000 which was loaned to the appellant by the parent company to enable the former to invest £250,000 in the Commonwealth Rolling Mills Pty. Ltd. On 9th October 1942, the appellant informed the respondent that—"The Notes Payable which stood at £252,720 9s. 9d. at the 31st October 1941 represent our indebtedness of $1,000,000, which was converted to the Australian equivalent of £252,720 9s. 9d. at 15th September 1938, which is the date of demand draft for $1,000,000, accepted by us. These monies were to be allowed outstanding for an indefinite period and were lent to us to enable us to invest £250,000 in the Commonwealth Rolling Mills Pty. Ltd., this amount being 50 per cent of the total authorized share capital of that Company. Although our Principals hold the Demand Draft, it was mutually agreed that this Draft be withheld from presentation indefinitely."

(1) (1925) 134 L.T. 194. (2) (1925) 134 L.T. at p. 197.

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The relationship between the appellant and the parent company cannot be overlooked. They are in law separate entities so that the parent company, although it owned all but two of the shares in the appellant, did not in law acquire any proprietary interest in the shares in the Commonwealth Rolling Mills Pty. Ltd. But the purpose of the transaction was to obtain the benefit of a half share in the business of the Commonwealth Rolling Mills Pty. Ltd. for the parent company by the appellant in which it had a controlling interest acquiring half the shares. In this connection I venture to call attention to the citations which appear in *Associated Newspapers Ltd.* v. *Federal Commissioner of Taxation* (1). This purpose is sufficiently manifest from the relationship of the parent company and the appellant and the manner in which the necessary funds were provided by the parent company to enable the appellant to acquire the shares. There is also the fact that the appellant purchased the plant and equipment required by the Commonwealth Rolling Mills Pty. Ltd. for its undertaking from the parent company for $406,000, and then resold this plant and equipment to the Commonwealth Rolling Mills Pty. Ltd. at cost. Further it would appear from the balance sheet of the appellant annexed to its income tax return that it would have been unable to repay the $1,000,000 so long as it continued to hold the shares.

The inference I draw from these facts and admissions is that it was intended that the $1,000,000 should be lent to the appellant for the specific purpose of investing its then approximate equivalent in Australian currency in acquiring and paying for the shares in Commonwealth Rolling Mills Pty. Ltd. ; that this sum should no longer have any relation to any previous indebtedness on current account, and that the promissory note should be taken in substitution for and in full satisfaction of $1,000,000 of the total amount of this indebtedness. It seems to me that the $1,000,000 were borrowed just as specifically for the purpose of effecting a transaction on capital account in this case as the dollars were acquired specifically for the purpose of effecting transactions on revenue account in *Imperial Tobacco Co. (of Great Britain and Ireland) Ltd.* v. *Kelly* (2). After 15th September 1938 therefore there were two separate debts, one for $1,000,000 for money lent secured by the promissory note, and the other for $67,201.75 owing on current account.

For these reasons I am of opinion that the amount expended by the appellant to pay the $1,000,000 secured by the promissory note was an outgoing of a capital nature and that the appeal must be dismissed with costs.

(1) (1944) 69 C.L.R. 257 at p. 266. (2) (1943) 2 All. E.R. 119; 169 L.T. 133.

From that decision the appellant appealed to the Full Court.

During the course of argument on behalf of the appellant particulars in writing in respect of the appellant's claim were handed to the members of the Court and were referred to as Calculation A—as regards the claim for a deduction of £31,156 15s. 7d., and Calculation B—as regards a claim for a deduction £29,125 7s. 5d.

Calculation A was headed "Calculation of exchange loss incurred by the appellant in relation to the purchase of steel sheets" and was as follows :—

(1) As at 15th September 1938 the appellant was indebted to Armco International Corporation on current account in the sum of \$1,067,201.75 (taken into account in books of appellant at £269,736 12s. 9d.) made up as follows :—

	Dollar Liability	Taken into account in books at £A
Purchases of steel sheets for resale	\$541,664.85	£136,110 14s. 8d.
Loans and other capital liabilities	525,536.90	133,625 18s. 1d.
	\$1,067,201.75	£269,736 12s. 9d.

The \$1,000,000 for which the note was given represented part of the above amount of \$1,067,201.75 (par. 9 of Statement of Facts).

The amount of the liability for the purchase of steel sheets included in the note was \$507,556.01 calculated as under :—

$$\frac{541{,}664.85}{1{,}067{,}201.75} \text{ of } \$1{,}000{,}000 = \$507{,}556.01$$

(2) The \$1,000,000 note cost £312,668 1s. 3d. to discharge.

Therefore the liability for the purchase of steel sheets included in the note cost £158,696 11s. 1d. to discharge, calculated as under :—

$$\frac{507{,}556.01}{1{,}000{,}000} \text{ of } £312{,}668 \text{ 1s. 3d.} = £158{,}696 \text{ 11s. 1d.}$$

(3) The liability for the purchase of steel sheets included in the current account (i.e. \$541,664.85) was taken into account at £136,110 14s. 8d.

Therefore the liability for the purchase of steel sheets included in the note was taken into account at £127,539 15s. 6d., calculated as under :—

$$\frac{507{,}556.01}{541{,}664.85} \text{ of } £136{,}110 \text{ 14s. 8d.} = £127{,}539 \text{ 15s. 6d.}$$

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(4) Therefore the loss on exchange referable to the purchase of steel sheets was £31,156 15s. 7d. calculated as under :—

The liability of $507,556.01 included in the note in respect of the purchase of steel sheets—

Cost to discharge (see (2) above)	£158,696 11s. 1d.
Such liability had been taken into account at (see (3) above)	127,539 15s. 6d.
	£31,156 15s. 7d.

Calculation B was as follows :—

(1)	Goods purchased for resale	$541,664.85
	Less indebtedness for goods purchased for resale discharged in ordinary course of trade	67,201.75
(2)	Balance indebtedness for goods purchased for resale	$474,463.10
(3)	Capital purchases	525,536.90
(4)	*Promissory note given for*	$1,000,000.00
(5)	Converted in books at average rate of exchange	£A252,720 9s. 9d.
(6)	Cost to discharge Promissory note was	£A312,668 1s. 3d.
(7)	*Total loss on exchange*	£A 59,947 11s. 6d.

(8) Proportion of cost to discharge Promissory note applicable to goods purchased for resale :

$$\frac{474{,}463.10}{1{,}000{,}000.00} \text{ of £A312,668 1s. 3d.} = \text{£A148,349 9s. 2d.}$$

(9) Cost of goods purchased for resale, ($541,664.85) taken on charge in books was £A136,110 14s. 8d.

(10) Proportion of above cost of goods purchased for resale included in Postal Note :

$$\frac{474{,}463.10}{541{,}664.85} \text{ of £A136,110 14s. 8d.} = \text{£A119,224 1s. 9d.}$$

(11) Exchange loss applicable to goods purchased for resale = £A29,125 7s. 5d.

Summary

Exchange loss applicable to goods purchased for resale	£A29,125	7s.	5d.
Exchange loss applicable to capital purchases	30,822	4s.	1d.
Total loss on Exchange, as above ..	£A59,947	11s.	6d.

Barwick K.C. (with him *Hardie* K.C.), for the appellant. The claim is solely in respect of liability for stock-in-trade, that is to say steel sheets purchased from the American Corporation for re-sale in Australia by the appellant. On that item there was an exchange loss of £31,156 15s. 7d. It is a critical fact that a weighted average rate of exchange was taken at which the various items which went to make up the sum of $1,067,201.75 had been entered in the appellant's books. That sum included amounts for stock, money loaned and services rendered. Those three items were rateably taken into the $1,000,000. The force which should be given to the word " weighted " is that the appellant's secretary took, in ascertaining the average, the amounts of each individual conversion from dollars to pounds, so each item of debt was reflected in the ultimate average that was arrived at. He took the total amount of dollars and the total amount of pounds into which the dollars had been converted for bookkeeping purposes, divided one into the other and the result was 3.95654. It was not an actual rate prevailing at the day, but was a weighted average. It represented the actual rate which prevailed at the time the conversion was originally made. The fact that a weighted average was used is a complete answer to the respondent. The comparison to be made is between the estimates of liability and the final actual payment. Although the $67,201.75 went into current account they did not merely represent stock-in-trade. The difference by which the liabilities were under-estimated as compared with the actual payments should be allowed as a deduction. The appellant did not get any credit at any stage for the loss which at that time it must have suffered between the dates when the various shipments took place and 15th September 1938. If the view taken in the judgment appealed from be correct, that is, that the promissory note was taken in payment, then the exchange loss is not reflected anywhere. This case is indistinguishable from *Texas Co.* (*Australasia*) *Ltd.* v. *Federal Commissioner of Taxation* (1). That case determines the following propositions: (*a*) that the difference

(1) (1940) 63 C.L.R. 382.

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(attributable to exchange fluctuations) between the amount actually paid for the purchase of goods on revenue account and the estimated amount which has been debited in respect of their purchase in earlier profit and loss accounts (used for taxation purposes) is deductible as an outgoing in the year of actual payment for such goods (at least in the case of a continuing business) ; (*b*) that an agreement between debtor and creditor that the payment of the price of such goods should be deferred, whether to a fixed date or indefinitely, does not alter the taxpayer's position in regard to (*a*) ; and (*c*) that neither the reason which prompts such an agreement nor the use to which the debtor, whether because of such agreement or not, applies the money which he would or might otherwise have used in satisfaction of the price of such goods is relevant to (*a*) or (*b*). In other words, that case decided that one simply compares the estimated figure with the actual figure. The Court denied in that case that the reason which prompted the payment as between debtor and creditor was relevant and was sufficiently adequate to prevent the comparison being made between the estimate and the actual sum. Those three propositions apply to the facts in this case and are sufficient to dispose of it.

Latham C.J. Are those propositions challenged, Mr. *Taylor* ?

A. R. Taylor K.C. They are challenged as precise statements of the law. Proposition (*a*) is accurate. Proposition (*b*) is agreed to with the modification that the agreement in that case did not alter the taxpayer's position in regard to (*a*) but it is disputed that it can be said that no agreement can alter the relationship at all.

Barwick K.C. Calculation A as handed to the Court is in reality the comparison between the amount, at the exchange rate at the date of the various deliveries of the goods, and the amount that the appellant did in fact pay in liquidation of the debt so created. On any view, some part of the stock-in-trade was included in the $1,000,000, but nevertheless the appellant's claim has been wholly disallowed. The judgment appealed from amounts to a finding that the appellant made actual payment as at the date of the promissory note. There was no such payment. The very absence of a specific appropriation tells against the proposition that there was a satisfaction. It is clear from the evidence that the intention to buy the shares was not made at the time of the promissory note, but was formed as soon as payments by the appellant began to fall into arrear. It cannot be inferred from the facts that the promissory note was taken in absolute satisfaction (*Income Tax Commissioner* v. *Maharajadhiraja of Darbhanga* (1)). The amount of the indebtedness was not determined in any way. On 15th September 1938 $1,000,000 dollars were funded and a promissory note taken as an acknowledgment or as a collateral. At no time did the parties attempt to resolve the original indebtedness. The fact that the promissory note carried interest does not lead to the conclusion that the nature of the indebtedness was in any sense changed (*Inland Revenue Commissioners* v. *Oswald* (2)). Great emphasis is put on the method employed in determining the rate for conversion purposes. For that determination every dollar in the $1,067,201.75 was used, and, therefore, was reflected throughout the whole. It was truly a ratable distribution. This ratable method is in turn a submission rate.

[DIXON J. referred to *Commissioner of Stamp Duties* (*N.S.W.*) v. *Perpetual Trustee Co. Ltd.* (*Saxton's Case*) (3) ; *Resch* v. *Federal Commissioner of Taxation* (4) and *Federal Commissioner of Taxation* v. *Miller Anderson Ltd.* (5) on the " ratable " or " average " point, and to *Mackenzie* v. *Rees* (6) on the " satisfaction " point.]

This case is much more direct than *Resch* v. *Federal Commissioner of Taxation* (7).

A. R. Taylor K.C. (with him *A. C. Leslie*), for the respondent. The promissory note was given in satisfaction of $1,000,000 of the current account as it then stood. Any exchange loss which has been incurred merely in discharging that liability is a capital loss and not a revenue loss. The right conclusion must be a matter of inference from the facts. The only objection made was that the whole of the sum of £59,947 11s. 6d. was a deductible expense for the purpose of determining the appellant's taxable income for the relevant year. It was claimed that the whole of that sum was an exchange loss made on revenue account. No attempt was made to sever the amount of the loss. The claim for the deduction is a claim for a loss ascertained by reference to two dates. Even if there were a loss it has nothing to do with this appeal. It is not conceded that the appellant has not had the benefit of any such loss in the appropriate income tax year. The application of the artificial rate of exchange ascertained by calculations made by the appellant's secretary did not establish that any loss was made at that time, 15th September 1938, because no dollars were provided

(1) (1933) L.R. 60 Ind. App. 146, at p. 161.
(2) (1945) A.C. 360, at p. 373.
(3) (1929) 43 C.L.R. 247.
(4) (1942) 66 C.L.R. 198, at p. 231.
(5) (1946) 73 C.L.R. 341, at p. 379.
(6) (1941) 65 C.L.R. 1, at p. 14.
(7) (1942) 66 C.L.R. 198.

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at that stage, but it was quite open to the parties as between themselves to convert this account and convert this liability by discharging the goods account into a loan on capital account for a purpose which had been contemplated by both parties for nine or ten months previously. There was nothing in the transactions which required a conversion as between the parties. The loss claimed in *Texas Co. (Australasia) Ltd.* v. *Federal Commissioner of Taxation* (1) was a loss calculated by reference to the date of the incurring of the liability for goods supplied and the date of the discharge of that liability. That factor is not present in this case. In trying to apply the *Texas Case* (1) it is quite irrelevant to take an intermediate date from the original estimate and the date of the purchase of dollars for the final discharge of the debt. It is not conceded that any part of the $1,000,000 referred to in the promissory note is revenue. The true nature of the transaction between the appellant and the American Corporation must be determined as a matter of inference from the facts proved. Important facts are: (i) that the $1,000,000 were transferred to "Inter-Company Notes Payable Account" when the promissory note was issued, and treated in the appellant's books as a discharge of the current account to that extent at that time, and (ii) that at the end of 1938 the companies decided that the appellant should be put in funds to invest £250,000 in shares in another Australian company. The money was regarded as a loan by the American Corporation to the appellant for the purpose of making this capital investment. Unlike *Texas Co. (Australasia) Ltd.* v. *Federal Commissioner of Taxation* (1) the funds used were not the funds of the appellant, that is, the "local" company, but were the funds of the "parent" company, the American Corporation. The transaction took this form doubtless because the rate of exchange had moved against Australia. In the circumstances, particularly having regard to pars. 2, 2 (*b*), 11, 12 and 13 of the statement of facts, the whole of the $1,000,000 was just as real a loan as though the whole thereof had been forwarded to the appellant in one remittance. The American Corporation owns all but four of the shares in the appellant, therefore it is reasonable to suggest that the American Corporation dictates the policy of the appellant. The appellant has not yet elected to say whether the promissory note was given as a conditional payment or as some form of collateral security. To suggest that it was a conditional payment is not in accordance with the facts. No point was to be served by the appellant making a conditional payment to the American Corporation. The inference is irresistible

(1) (1940) 63 C.L.R. 382.

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that there was a complete substitution of a new liability of a capital nature for the old liability. The treating of it by the appellant as a discharge of the current account *pro tanto* was done, no doubt, on instructions from the American Corporation. The word "funding" as used in *Texas Co. (Australasia) Ltd.* v. *Federal Commissioner of Taxation* (1) is not appropriate to describe what happened in this case. Inasmuch as an apportionment was not made at the time, it is impossible to determine how much of the liability in respect of the steel sheets was included in the \$1,000,000. A proportion sum will not furnish the answer. The artificial rate of exchange adopted by the appellant was not warranted. If this is an attempt to claim an exchange loss calculated by reference to the artificial rate of exchange—which was applied at the time the appeal was taken—and an amount calculated by reference to the rate of exchange prevailing when the promissory note was discharged, then it is quite irrelevant because the rate when the promissory note was given was a completely irrelevant rate. The earlier rate of 3.95694 has nothing to do with it. The rate of exchange varies from day to day, therefore the only relevant dates are the dates when the goods were taken into the appellant's accounts and the date when the liability was discharged. The goods were taken into the appellant's accounts at a figure translated into Australian pounds at the appropriate rates of exchange prevailing when the goods were shipped or received. If there were to be an exchange loss in respect of these goods it would be the difference between those sums and the sum which it ultimately cost to discharge that liability. If, however, the appellant does claim a difference between the figure at which the goods were entered in its books and an amount, worked out on some proportionate basis, which it cost the appellant to discharge that liability, then the appellant goes far outside the notice of objection. That claim has never been made to the respondent and has never been considered. *Qua* the shares purchased there was no loss at all; the question of exchange does not arise. The real exchange loss is the difference in the exchange between the date of delivery and the promissory note in respect of the goods. It is submitted that the observations appearing in *Income Tax Commissioner* v. *Maharajadhiraja of Darbhanga* (2) were not intended as a general proposition on that particular aspect of the law.

Barwick K.C., in reply. The notice of objection covers precisely what is claimed by the appellant. As is shown by the memorandum

(1) (1940) 63 C.L.R. 382. (2) (1933) L.R. 60 Ind. App. at p. 161.

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the appellant claimed an exchange loss in respect of the whole of the account, portion of which was deferred. The submission made on behalf of the respondent in respect of the notice of objection is founded upon a misapprehension.

Cur. adv. vult.

The following written judgments were delivered :—

Latham C.J. Section 51 (1) of the *Income Tax Assessment Act* 1936-1944 is in the following terms :—" All losses and outgoings to the extent to which they are incurred in gaining or producing the assessable income, or are necessarily incurred in carrying on a business for the purpose of gaining or producing such income, shall be allowable deductions except to the extent to which they are losses or outgoings of capital, or of a capital, private or domestic nature, or are incurred in relation to the gaining or producing of exempt income."

The appellant company, Armco (Australia) Pty. Ltd., is an Australian company all the shares in which, except four, are owned by the Armco International Corporation, which is a company incorporated in the United States of America. The Australian company was therefore controlled by the American company. The company claims that an amount of £31,156 15s. 7d. is allowable as an " exchange loss " as a deduction for income tax purposes in respect of the year in which it was paid—the year ended 31st October 1944.

The Australian company purchased steel sheets from the American company in the ordinary course of business at dollar prices payable in the United States of America. The debts in respect of the steel sheets had been recorded in both dollars and Australian pounds in the books of the company. The profits of the company were ascertained and the company was assessed to income tax upon the basis that the amount required to discharge the dollar debts was truly represented by the amount in Australian pounds set down in the company's accounts. The movement in exchange against Australia made it ultimately necessary, when payment was actually made, to provide a larger sum in Australian pounds in order to discharge the dollar debts than had been recorded in the books of the company and allowed as a deduction in prior income tax assessments. The company calculates the increase in this amount at £31,156 15s. 7d. The company contends that the present case is governed by the decision in *Texas Co. (Australasia) Ltd.* v. *Federal Commissioner of Taxation* (1). In that case it was held that if the amount required in Australian money to discharge a

(1) (1940) 63 C.L.R. 382.

liability which was due in a foreign currency turned out to be greater than the amount which had already been estimated and allowed as a deduction for the purpose of ascertaining the business profits of a taxpayer, the increase above the estimate in the amount ultimately paid should be allowed as a deduction in the year in which the increased payment was made.

The Commissioner contends that the liability to pay the price for the steel sheets supplied was discharged on 15th September 1938, when a promissory note was given by the Australian company to the American company for an amount which included the amount owing for those goods; that the American company then lent the Australian company a sum of one million dollars for capital purposes; and that the repayment of that loan in 1944 was a payment of a capital nature, and therefore cannot be allowed as a deduction for purposes of assessment to income tax.

The Commissioner further submits that the liability in respect of the goods supplied cannot be traced into the substituted liability on the promissory note because that promissory note covered a payment on account of a total liability, including other items of indebtedness in addition to that for goods supplied, no appropriation of any part of the sum covered by the promissory note having been made to the liability for goods supplied.

It is further argued for the Commissioner that any deduction for exchange loss should have been claimed in relation to the income for the year in which the promissory note was given (1938), and not in relation to the income of the year 1944, in respect of which the deduction is now claimed.

The Commissioner disallowed the deduction and was upheld by *Williams* J. upon appeal. His Honour was of opinion that the liability for goods sold and delivered was discharged when the promissory note was given, and that the effect of the transaction which then took place between the two companies was that the American company made a loan of one million dollars to the Australian company, which loan was applied by the Australian company for capital purposes (the purchase of shares in another company), and that the repayment of the loan to the American company was a payment made on capital account. The company appeals from this decision.

There is no dispute about the facts. The Australian company from time to time bought large quantities of goods from the American company. The price of the goods was payable in dollars. Until about the end of 1937 the Australian company bought dollars in the United States of America and paid cash. But the American company proposed to make an investment in Australia in the shares of the Commonwealth Rolling Mills Pty. Ltd. In order to provide the necessary funds in Australia the account in respect of steel sheets supplied to the Australian company was allowed to run on. Accordingly, from the end of 1937 the Australian company did not pay as in the past for steel sheets soon after they were delivered, but merely recorded liability in its books in dollars and also in Australian pounds, converting dollars to pounds at the rate of exchange which happened to prevail at the time of the arrival of shipments in Australia. This procedure continued until September 1938, when the total of dollar liabilities in respect of goods supplied had grown to $541,664. The corresponding figure representing the same liability in Australian pounds, calculated in the manner stated, was shown at £136,110. (In stating figures I omit shillings and pence.) As the exchange rate between Australian pounds and dollars varied from time to time, the total figure of £136,110 bore no relation to the sum which would be necessary at any particular time to satisfy the dollar debt. The amount of that sum would be determined by the rate of exchange which obtained at the time when the debt was ultimately paid.

On 15th September 1938 the Australian company owed to the American company, not only the dollar sum stated in respect of the price of goods supplied, but also a further sum of $450,000 which had been lent to the Australian company by the American company in 1938, and a sum of $75,536, which represented moneys paid by the American company in the United States on behalf of the Australian company. The amounts of these two liabilities had been converted into Australian pounds and recorded in the books of account of the Australian company at the rates of exchange which happened to obtain at the date when the liabilities were incurred. The amount due for the loan mentioned and the last-mentioned amount were not chargeable as outgoings of a revenue nature. The total amount of these three classes of liabilities was $1,067,201. In Australian pounds this liability was shown in the books of the company at £269,736.

On 15th September 1938 the Australian company gave to the American company a promissory note in respect of this total liability for $1,000,000 payable on demand and carrying $4\frac{1}{2}$ per cent interest per annum. This transaction left outstanding a sum of $67,201, which was discharged in the ordinary course of current payments at the rates of exchange prevailing at the times when payment was made. The Court was informed that the Commissioner has allowed deductions on account of such payments to be made at those exchange rates, and no question arises as to them.

In the year 1944 the Australian company took up 250,000 £1 shares in the Commonwealth Rolling Mills Pty. Ltd. at £1 per share. The Australian company then sold the shares to the American company for $3.1983 per share. The current exchange rate when the sale was made was $3.1983 to one Australian pound. Thus the American company had a claim against the Australian company for $1,000,000 on the promissory note, but had become indebted to the Australian company for the price of the shares, viz. $799,575. The liability of the American company in respect of the shares calculated in dollars at the rate of exchange stated was set off against the debt of $1,000,000 owed by the Australian company. The balance of the liability upon the promissory note ($200,425) was discharged in cash in dollars.

The cost to the Australian company of meeting the promissory note in 1944 was £312,668. The company originally claimed as a deduction an amount of exchange loss calculated in relation to the whole sum of £312,668, but it is now conceded that no claim for deduction can be made in respect of the amounts due for the loan of $450,000 or for the other liability of $75,536. The claim of the company therefore is that £31,156 of the amount paid in satisfaction of the promissory note represents an exchange loss on account of the trading debt of $541,664.

The total amount owing by the Australian company to the American company was $1,067,201. It was shown in the books of the Australian company, as the result of conversions at varying rates of exchange, as a liability in Australian pounds of £269,736. This fact had no bearing upon the amount of the liability to the American company, which remained at $1,067,201. But the fact that the liability had been stated in the company's accounts at £269,736 was material in relation to income tax. The income of the company had been assessed to tax upon the basis that the liability for $1,067,201 was only £269,736. In fact it became necessary to pay £312,668 to meet the liability for $1,000,000, part of the sum of $1,067,201. Thus, if and so far as the payment on the promissory note represented a payment of trading debts, the company was entitled to an adjustment by way of deduction on account of exchange loss (*Texas Co. Case* (1)).

But the Commissioner contends that the trading debt was discharged in September 1938 when the promissory note was given, and that the satisfaction of the promissory note therefore did not

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include any payment on account of any trading debt. The promissory note was for \$1,000,000 and the debt owed was \$1,067,201. No appropriation of this sum was made between the three separate debts in respect of which the note was given. It was given "on account" of the total liability. The company contends that the amount of \$1,000,000 should be allocated ratably between these liabilities. The trading debt for goods supplied was \$541,664. Therefore $\frac{541,664}{1,067,201}$ of \$1,000,000, i.e. \$507,556, represented the part of the \$1,000,000 which was attributable to the trading debt. Where one payment is made on account of a number of liabilities without any appropriation, it should be taken as reducing them ratably (see cases cited in *Resch* v. *Federal Commissioner of Taxation* (1)). Thus \$507,556 of the \$1,000,000 should be appropriated to the trading debt. The expenditure incurred in paying off the \$1,000,000 at the rate of exchange actually current when the payment was made was £312,668. $\frac{507,556}{1,000,000}$ of that amount is £158,696. This sum represented the actual amount, part of the £312,668, which was provided in Australian money to meet the trading debt so far as the amount of that debt was included in the \$1,000,000.

But the total liability for the trading debt had been taken into account (as a matter of bookkeeping and as representing an estimate for income tax purposes) at only £136,110—the total of the liability calculated at varying exchange rates in the manner already explained. The total real liability was in dollars—\$541,664. Of that amount \$507,556 was included in the \$1,000,000. Therefore the amount attributable to the trading debt which was included in the amount of the note was $\frac{507,556}{541,664}$ of £136,110, i.e. £127,539. Thus the company reaches the result that it had been taxed upon the basis that a liability of \$507,556 represented, in Australian money, a liability of \$127,539 : in fact the company had to pay £158,696 to discharge the liability. It is the difference between these sums, £31,156, which the company claims as a deduction.

If part of the amount of \$1,000,000 is to be attributed to the trading debts, this method of making the appropriation is, in my opinion, correct. Unless a method of regarding the total amount paid or payable under the promissory note as apportionable among the three classes of debts is applied, the logical result would be that

(1) (1942) 66 C.L.R. 198, at p. 230.

the giving and payment of the promissory note produced no result whatever—in discharge or otherwise—in relation to any part of those debts. Such a result would be inconsistent with the intention of the parties.

The principal question in this case is whether the promissory note was accepted as in discharge of the antecedent three classes of liabilities so that there was an accord and satisfaction or whether it was accepted only as conditional payment. Was it the intention of the parties that those liabilities should be regarded as satisfied for once and for all by the making and delivery of the promissory note? Generally, when a negotiable instrument is accepted on account of a debt, it is taken as conditional payment only. Then remedies for the recovery of the debt are suspended until the negotiable instrument falls due and has been dishonoured (*Mackenzie* v. *Rees* (1)). In *Sayer* v. *Wagstaff* (2), a debtor delivered to his creditor a promissory note for the amount of the debt. It was held that the debts could be considered as actually paid if the creditor at the time of receiving the note agreed to take it in payment of the debts and to take upon himself the risk of the note being paid or if, from the conduct of the creditor in the circumstances of the case, such an agreement was legally to be implied. In the absence, however, of such an agreement or of such special circumstances, the delivery and receipt of the promissory note did not amount to a discharge of the debts but was merely an extension of credit. In *Price* v. *Price* (3), *Parke* B., dealing with a similar case, referred to the suspension of the rights of action of the creditor during the currency of the negotiable instrument. The law was laid down in the same terms in *La Neuville* v. *Nourse* (4), in *Maxwell* v. *Deare* (5) in the Privy Council, and in *Re the London, Birmingham and South Staffordshire Bank* (6)—" the remedy . . . is suspended till the instrument has attained to maturity." In *Ford* v. *Beech* (7), *Parke* B. said that it was " a very old and well established principle of law, that the right to bring a personal action, once existing and by act of the party suspended for ever so short a time, is extinguished and discharged, and can never revive " (8). But in that case itself he recognized that a party accepting a negotiable security payable in the future for and on account of an antecedent demand could not, until after such negotiable security had become due and

(1) (1941) 65 C.L.R. 1, at p. 25.
(2) (1844) 14 L.J. Ex. 116; 5 Beav. 415 [49 E.R. 639].
(3) (1847) 16 L.J. Ex. 99; 16 M. & W. 232 [153 E.R. 1174].
(4) (1813) 3 Camp. 35 [170 E.R. 1407].
(5) (1853) 8 Moo. P.C. 363 [14 E.R. 138].
(6) (1865) 34 L.J. Ch. 418, at p. 420.
(7) (1846) 11 Q.B. 842 [116 E.R. 689].
(8) (1846) 11 Q.B., at p. 867 [116 E.R., at p. 690].

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been disowned, sue for such antecedent demand (1). The law applicable to such a case was " grounded upon the peculiar nature of the negotiable instruments " which were deemed " to be necessary exceptions to the general rules of law in favour of the law merchant " (2).

In *Allen* v. *Royal Bank of Canada* (3), the Privy Council approved the following statement of the law in *Byles* on *Bills* 18th ed. (1923), p. 232 : " If a bill or note be taken on account of a debt and nothing be said at the time, the legal effect of the transaction is this—that the original debt still remains, but the remedy for it is suspended till maturity of the instrument in the hands of the creditor."

It is a question of fact whether a negotiable instrument has been taken as conditional or as absolute payment—*Day* v. *McLea* (4), and other cases cited in *Halsbury, Laws of England*, 2nd ed., vol. 7, p. 236.

In my opinion this is a case in which a note was taken on account of the debt and " nothing was said at the time."—i.e. nothing relevant to the question whether the note was taken as absolute satisfaction or as conditional payment. There was no agreement (express or implied) to take the promise contained in the promissory note as in discharge of the original liabilities in respect of which the note was given. The parties simply said nothing about such a matter. The position was that certain moneys were owing by the Australian company to the American company : it was decided that interest should be paid upon a part ($1,000,000) of the debt and that the rest should remain in current account. As in *Sayer* v. *Wagstaff* (5), there was simply an extension of credit. The Australian company opened a new account which removed the amount of $1,000,000 from the current account of the American corporation to a new account which was entitled " Inter-Company Notes Payable Account." This transfer involved the entry of a debit to the American corporation in a ledger account of $1,000,000 and a credit of the same amount in the new account. This was done by the Australian company as a matter of bookkeeping, not as a term of any agreement, and only recorded the fact that a promissory note had been given on account of the liability shown in the current account. There is no evidence that the American company agreed to accept the promise contained in the promissory note as in discharge of the original liability in the trading account.

(1) (1846) 11 Q.B., at p. 873 [116 E.R., at p. 700].
(2) (1846) 11 Q.B., at p. 873 [116 E.R., at p. 701].
(3) (1925) 134 L.T., at p. 196.
(4) (1889) 22 Q.B.D. 610.
(5) (1844) 14 L.J. Ex. 116 ; 5 Beav. 415 [49 E.R. 639].

The fact that the object of this transaction was to leave money in the hands of the Australian company for expenditure in buying shares in the Commonwealth Rolling Mills Pty. Ltd. does not, in my opinion, affect the particular matter with which the Court has to deal. The arrangement as to buying the shares and paying for them was an arrangement as to the use to be made by or on behalf of the American company of moneys payable to it by the Australian company when the moneys were paid. The use to which the American company put (or intended to put) its moneys, whether in Australia or elsewhere, cannot be a factor in determining whether that company accepted the note in discharge of prior liabilities or not. The American company could have spent the money as it thought fit—it was not bound to apply it in buying shares for itself. As between the parties the transaction was simply a case of a creditor taking a negotiable instrument for debts owing, charging the debtor interest, and asking the debtor to use the money in buying something to sell to the creditor. The fact that the creditor would thus acquire a capital asset cannot affect the character of the debt in respect of which the negotiable instrument was given—and, indeed, this has not been directly suggested. The debt remained a trading debt, with the remedy suspended during the currency of the promissory note, and did not become a debt of a different character because the creditor, when paid, proposed to spend the money in a particular manner.

There is no evidence that anything was said in or about September 1938 about the transaction being a loan of $1,000,000 to the Australian company. No one concerned appears to have thought of it as a loan until questions arose with respect to taxation. The Commissioner relied upon a statement in a letter sent by the taxpayer to the Deputy Commissioner on 30th April 1940 in which it was stated that certain interest was due on " an amount of one million dollars which was loaned to the Australian company by the American company to enable the former to invest £250,000 in Commonwealth Rolling Mills Pty. Ltd., this amount being 50 per cent of the total authorised share capital of that company." This appears to me to be an inaccurate description of the actual transaction. To take a cheque or other negotiable instrument payable on demand on account of a debt without any agreement that the promise therein contained is to discharge the debt cannot in my opinion accurately be described as (1) a transaction of absolute payment, followed by (2) a loan of the amount of the negotiable instrument. There simply is no lending of money in such a case.

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A creditor does not lend a debtor money when he allows a debt to remain outstanding on payment of interest.

I am therefore of opinion that the use to be made of the moneys when paid to or as directed by the American company is not relevant to any of the questions in this case, and that the transaction in September 1938 did not result in the discharge of the pre-existing debts. If there was no discharge of the trading debt in September 1938 then the contention that the " exchange loss " was suffered in 1938 and not in 1944 cannot be supported. The taxpayer is entitled to the deduction claimed because it was an outgoing incurred in gaining income, viz., the payment in 1944 of an ordinary trading debt incurred in earlier years.

Accordingly, in my opinion, the appeal should be allowed and the assessment remitted to the Commissioner with a direction that a deduction of £31,156 15s. 7d. should be allowed.

Starke J. This appeal concerns a claim by the appellant for a deduction from its assessment to income tax for the financial year 1944-1945 for exchange losses in connection with the purchase of steel sheets for the purposes of its business from the Armco International Corporation which is incorporated under the laws of the United States of America.

The Commissioner of Taxation disallowed the claim and on appeal to this Court in original jurisdiction the appeal was dismissed. Hence the present appeal.

In September of 1938 the appellant was indebted on current account to the American Corporation in the sum of $1,067,201.75, which converted into Australian currency amounted to £269,736 12s. 9d. This indebtedness represented—(*a*) unpaid purchase money for steel sheets $541,664.85 which, converted into Australian currency, amounted to £136,110 14s. 8d. ; (*b*) remittances by way of loan from the American Corporation $450,000 which, converted into Australian currency, amounted to £113,922 0s. 3d. ; (*c*) debts incurred by the American Corporation for the appellant $75,536.90 which, converted into Australian currency, amounted to £19,703 17s. 10d.

The appellant originally claimed an exchange loss by way of deduction in respect of these items of £59,947 11s. 6d., but abandoned its claim in respect of items (*b*) and (*c*) and confined its claim to item (*a*), the purchase of steel sheets amounting to either £31,156 15s. 7d. or £29,125 7s. 5d.

The last cash payment made to the American Corporation was in December 1937, and from that date the current account was allowed to run on for about nine months.

The appellant, it appears, had supplied plant and equipment to the Commonwealth Rolling Mills, which was or became a company limited by shares, for the establishment of its undertaking. This plant and equipment had been obtained from the American Corporation and had been recharged to the Rolling Mills at cost.

But it seems that the appellant had as early as February 1938 proposed to make an investment in the shares of the Rolling Mills. It did take up 250,000 shares of one pound in the Rolling Mills, which represented half its capital at a date which does not appear, but certainly after February 1938.

On 15th September 1938 the appellant, at the request of the American Corporation gave it a promissory note for $1,000,000 due on demand bearing interest at 4½ per cent per annum. This sum represented portion of the sum of $1,067,201.75 above mentioned, but no specific appropriation was made in respect of any items included in that amount.

The balance of $67,201.75 remained in the current account already mentioned. It was subsequently discharged and no claim in respect of exchange losses on the payment of that sum is made in these proceedings.

An account called the " Inter-Company Notes Payable " Account was opened.

The liability of the appellant on current account was reduced by $1,000,000, converted into Australian currency as £252,720 9s. 9d., and that amount was transferred to the credit of the American Corporation in the " Inter-Company Notes Payable " Account.

The rate of exchange adopted was $3.95694, which was obtained by dividing $1,067,201.75 by £269,736 12s. 9d. It was an artificial figure. The liability for steel sheets, $541,664.85 converted into Australian currency £136,110 14s. 8d. approximates, however, that rate.

The actual exchange rate on 15th September 1938 was $3.8117 to the pound, Australian currency.

The American Corporation was credited in the current account each month with interest at the rate of 4½ per cent per annum on $1,000,000.

So the matter stood until October 1944.

In that month the appellant sold to the American Corporation the 250,000 one pound shares in the Rolling Mills which the appellant had acquired. The price was one pound per share.

The indebtedness of the American Corporation to the appellant on the transaction amounted to £250,000 which, converted into

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American currency at an agreed rate of exchange, namely, \$3.1983, amounted to \$799,575.

The balance of the \$1,000,000, namely, \$200,425, was discharged by a cash payment of £62,668 13s. at the then current rate of exchange \$3.1982.

The total cost of discharging the promissory note was accordingly £312,668 13s.

The appellant claims a loss on exchange of £31,156 15s. 7d. if a proportion of the sum of \$67,201.75 above mentioned be attributed to the purchase of steel sheets, but £29,125 7s. 5d. if it be not so attributed. The calculations are as follows :—

Number (1) $\dfrac{541,664.85}{1,067,201.75}$ of \$1,000,000 = \$507,556.01

$\dfrac{507,556.01}{1,000,000}$ of £312,668 13s. = £158,696 in round figures

$\dfrac{507,556.01}{541,664.85}$ of £136,110 14s. 8d. = £127,539 in round figures

£31,157

Number (2) \$541,664.85 — 67,201.75 = \$474,463.10

$\dfrac{474,463.10}{1,000,000}$ of £312,668 13s. = £148,349 in round figures

$\dfrac{474,463.10}{541,664.85}$ of £136,110 14s. 8d. = £119, 224 in round figures

£29,125

The critical question is whether on these facts the appellant is entitled to any deduction.

Texas Co. (Australasia) Ltd. v. *Federal Commissioner of Taxation* (1) is authority for the proposition that exchange losses incurred by a taxpayer in carrying on business and trading operations are allowable as deductions under the *Income Tax Acts* except to the extent to which they are losses or outgoings referable to capital.

(1) (1940) 63 C.L.R. 382.

Thus in this case the appellant incurred obligations in American dollars for goods supplied to it in the carrying on of its business and trading operations. It entered the amount of those obligations in its books in dollars and also the corresponding liability in Australian currency at the rates of exchange then current. Exchange losses referable to transactions such as these are plainly not referable to capital and if to satisfy the dollar obligation, the appellant had to provide more in Australian currency than the sum originally calculated and entered in its books, owing to fluctuations in exchange, then the difference represents an exchange loss deductible as an outgoing.

And *Texas Co. (Australasia) Ltd.* v. *Federal Commissioner of Taxation* (1) is also an authority for the proposition that postponement in payment of dollar obligations does not affect the character of the deduction even though the postponement be made in order that the working capital of the business should not be employed in meeting trade obligations.

But here it is said that the dollar obligation for the goods supplied was satisfied by the giving of the promissory note for $1,000,000 which included the amount or a proportionate part of the amount of that obligation. It is immaterial, as it appears to me, whether the note be treated as an absolute or a conditional payment.

In fact, in the present case, the note was paid.

The obligation on the note was substituted for a pre-existing liability of the appellant but it was, nevertheless, incurred in connection with its business or trading operations. Payment of the note to the extent that it was not referable to capital was an outgoing of the business or trading operations of the appellant and allowable as a deduction. And the note, as appears, was given for an amount that included an item connected with the purchase of steel sheets, a transaction not referable to capital. If, therefore, it can be shown in respect of that item that more was paid in Australian currency than the sum originally calculated and entered in the books owing to fluctuations in exchange then the difference is an outgoing of the business deductible as a loss on exchange.

Another view of the facts was also relied upon in this case.

It was said that $1,000,000 were lent to the appellant by the American Corporation for the purpose of acquiring shares in the Rolling Mills. Accordingly, the appellant acquired 250,000 shares and subsequently sold them to the American Corporation. Such a transaction, it was said, was independent and apart from the dollar obligation in connection with the supply of goods to the

(1) (1940) 63 C.L.R. 382.

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appellant. Officers of the appellant stated that the moneys represented by the promissory note for $1,000,000 were allowed to stand over for an indefinite period and were lent to the appellant to enable it to invest £250,000 in the Rolling Mills which was fifty per cent of the authorized share capital of the Mills. But when the facts are examined the statements amount to no more than that payment of the dollar indebtedness was postponed so that the appellant might have sufficient funds to purchase Rolling Mill shares. Apart from the remittance of $450,000 by way of loan, already mentioned, no moneys were paid by the American Corporation to the appellant. The note was given on 15th September 1938. The liability of the appellant on current account was reduced by $1,000,000 but the same amount was transferred to the credit of the American Corporation in the " Inter-Company Notes Payable " Account. It does not appear when the Rolling Mills shares were acquired, certainly after February 1938; but the sale to the American Corporation was not effected until October 1944. Clause 12 of the statement of facts sets forth: " The liability of the appellant for principal under the said note remained unchanged until October 1944 when the same was satisfied and discharged in manner following:—(*a*) The appellant sold to the American Corporation 250,000 £1 shares owned by the appellant in the Commonwealth Rolling Mills Pty. Ltd. (which said shares had been acquired by the appellant for the sum of £1 per share) at and for the price of £1 per share, the agreed rate of exchange being $3.1983 to the Australian pound (the then current rate of exchange being $3.1982 to the Australian pound); the indebtedness of the American Corporation to the appellant under and by virtue of the said transaction amounting to $799,575 was set off against the liability of the appellant to the American Corporation under the said note. (*b*) The balance of the liability of the appellant under the said note amounting to $200,425 was satisfied and discharged by a cash payment made by the appellant to the American Corporation. Such cash payment was effected at the then current rate of exchange $3.1982 to the Australian pound and involved the appellant in the expenditure in Australian currency of £62,668 13s."

The transaction which resulted in the giving of the promissory note and the acquisition of the shares and the application of their value cannot be separated from the transactions that preceded it. They must be regarded as a whole. In the end an obligation in respect of a business or trading operation, which was not referable in part to capital, was satisfied and the appellant had to provide more in Australian currency than the sum originally calculated in respect thereof owing to fluctuations in currency. That, in my opinion, is a loss or outgoing incurred by the appellant in carrying on its business and trading operations and allowable as a deduction under the *Income Tax Acts*.

Another contention was that it was impossible to determine whether the deduction claimed by the appellant was referable to outgoings of a revenue or a capital nature because there had been no specific appropriation of the amount of the promissory note or the cash payment of \$67,201.75. But there is in the *Income Tax Acts* " nothing which prevents the division or apportionment between capital and income of an outgoing which is in part of a capital nature and in part of a revenue nature " (see *Texas Case* (1), per *Dixon* J.).

In my opinion, the calculation Number (2) already set forth appropriates the amounts in a manner that is substantially correct. An exchange loss of £29,125 in round figures thereby appears.

The appeal should be allowed, the assessment of the appellant to income tax should be reduced by that sum and the assessment remitted to the Commissioner of Income Tax to amend the assessment accordingly.

Dixon J. The taxpayer's claim is to deduct from its assessable income derived during the year ended 31st October 1944 a loss said to have been incurred during that year by reason of the discharge of a dollar indebtedness of some six or more years' standing. The loss consists in the increased number of £A required to obtain the necessary dollars, compared with the amount of £A represented by the dollars at the time when the indebtedness arose. The exchange rate applicable as at that time to the indebtedness in question may be taken to be \$3.8117 to the £A. The movement of the rate against Australia had brought it in the meantime to \$3.1982 to the £A. The taxpayer is a company incorporated in Australia, but its shares are held, except for the necessary nominees, by Armco International Corporation of Middletown, Ohio, United States of America, of which it is the Australian subsidiary. From the American Corporation the Australian company buys large quantities of steel sheets. The price is expressed in, and is payable in, dollars. The indebtedness in question represents, so it is claimed, the cost in dollars of steel sheets bought in this manner during the years 1937 and in 1938 before 15th September of that year. There is a difficulty, which I shall pass by, of attributing the payments ultimately made to specific items. But ignoring that, it may be

(1) (1940) 63 C.L.R., at p. 466.

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taken that, though perhaps transformed in character, the debt or its equivalent stood over until the year of income under assessment, when an amount to which it was traceable was satisfied by payment or accord and satisfaction. If there were no further facts there would be enough to afford a prima facie foundation for the claim that the increased amount required to purchase the exchange formed a trading loss or outgoing, which would be an allowable deduction from the assessable income of the accounting period in which it was incurred. But it is important to see how that result would be reached. It would arise from the fact that it is a continuing business, depending upon the purchase or manufacture of goods and their resale. The accounts are, of course, made up, not on a basis of receipts and disbursements, but upon the commercial basis of valuation and credit. Nevertheless in such a case actual expenditure in a later accounting period arising from a fortuitous increase in the amount of the liabilities taken into it from the prior period may form a proper debit in the later period, notwithstanding that the item relates to purchases or costs of manufacture included in an earlier accounting period.

The comparison made between the beginning and end of an accounting period means that stock in trade and purchases are taken into account not by reference to what is actually paid for them, but according to the value assigned to the one and the liability incurred in acquiring the other. That is done, of course, entirely independently of the period within which the actual disbursement of money is made to discharge the liability. If, as is commonly the case, the amount of the liability is fixed and incapable of subsequent variation, the disbursement itself whenever made could never matter for the purpose of computing profit or loss in that or any subsequent period. But if for any reason the amount is capable of changing, as is the case when the indebtedness is in a foreign currency and the rate of exchange may alter, a further question arises. If the change takes place in a subsequent period and actual payment is then made, is the increase or decrease, as the case may be, to be attributed to the prior period and the net profit or loss reassessed ? Obviously not. It is to be taken in as an item belonging to the subsequent period ; for the reason that, with continuing trading, when increases beyond the estimates by which assets and liabilities are carried out of one period into the next occur, they must be treated as incidents of the system and they must be regarded as belonging to the period in which they accrue or are realized.

Thus, if no further facts appeared, it might perhaps be assumed that, in spite of the long delay in payment, all that had happened was that, in a continuous course of trading and of accounting, the actual conversion rate at the time a dollar liability for stock had been discharged proved less favourable than the rate at which, at the close of the accounting period covering the purchase of stock, the dollars had been converted to £A for the purpose of ascertaining the profit or loss of that accounting period.

But more facts do appear; and upon them the Commissioner maintains that the exchange loss is in truth an outgoing of capital. It appears that in 1938, and perhaps 1937, the American Corporation considered it desirable that half the share capital should be acquired in an Australian company that had been formed or was in course of formation. To acquire half the share capital, it was necessary to subscribe for 250,000 shares of £1 each and to pay them up. It was decided that the taxpayer company should take up the shares and pay for them. But it was intended that afterwards they should be made over to the American Corporation. To put the taxpayer company in funds so that it could acquire the shares, the American Corporation decided that no money should be remitted for the steel sheets exported to Australia for the taxpayer company. The dollar liability for steel sheets bought by the taxpayer company was to be allowed to accumulate until, with the assistance of loans, sufficient funds were available in its hands to cover the investment.

The American Corporation made the advances necessary. By 15th September 1938 the indebtedness of the taxpayer company to the American Corporation on account of advances, steel sheets and other items amounted to $1,067,201. It was determined that of this sum a million dollars should stand over indefinitely. At the rates of exchange adopted, which were approximately those prevailing at that date, a million dollars were equivalent to £A252,720, very little over the £250,000 to be applied by the taxpayer in acquiring the shares. A promissory note for $1,000,000 payable on demand and bearing interest at 4½ per cent per annum was given to the American Corporation by the taxpayer company. The interest was paid. In 1944 it was decided that the shares should be transferred to the American Corporation and the note should be retired. Transfers were executed by the taxpayer company, three in number, comprising the whole 250,000 shares. The manner in which the consideration was expressed was the same in each and may be illustrated by a transfer for 150,000 shares, in which the statement of the consideration ran, "in consideration of the sum of $3.1983 per share U.S. of A. Currency (£150,000)

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paid . . . by Armco International Corporation." The current rate of exchange was $3.1983 to the £A. In a prepared statement of facts put in evidence on behalf of the taxpayer without objection the transaction is described as a sale of the shares " at and for the price of £1 per share, the agreed rate of exchange being $3.1983 to the Australian pound." The oral evidence of the secretary of the company put it, as the transfers do, as a sale at $3.1983 a share. But the difference is, I think, of little importance. The consideration in American currency amounted to $799,575, leaving a balance of $200,425 to make up the amount of the note for $1,000,000. That balance was remitted at the current rate of exchange of $3.1983 to the £A. The amount required to obtain the necessary dollars was £62,668. Of this sum it is said that a portion, namely, £31,156, can be traced to the liability allowed to accumulate up to 15th September 1938 for the purchase of steel sheets.

I attach little importance to the manner in which the transaction was recorded in the accounts of the taxpayer. But when the promissory note was given what was done was to debit the current account of the American Corporation in the taxpayer company's books with the Australian equivalent of the amount of the note, viz., £252,720, and credit the American Corporation with the like amount in what was called " The Inter-Company Notes Payable Account."

In my opinion the foregoing facts place an entirely different complexion upon the expenditure involved in finding the exchange. The purpose of allowing the liability for the steel sheets to stand over was simply to enable an investment to be made. One purpose in view when the goods were supplied was that of creating a fund in Australia, which, supplemented by the loans, would be applied for something outside trading altogether, viz., investment in the shares of another company, an operation exclusively of fixed capital. The giving of the promissory note is confirmatory of the intention that the amount representing the steel sheets and the loans made should together form a consolidated liability in the nature of an advance. It does not seem to be of importance even if, as between the parties, the promissory note was taken, not as absolute, but as conditional payment. The purpose in either event was the same, viz., to give a security covering a liability for moneys to be applied in acquiring the shares. I use the word " moneys " to mean an identifiable increase in credit capable of use in supporting specific expenditure. For income tax purposes the narrower legal

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conception is seldom important. We are here considering a commercial operation and the character of an expenditure arising from it. The reality of the transaction was that the American Corporation desired that its Australian subsidiary should take up shares at a cost of £250,000 and at a subsequent date transfer the shares to it at cost. For the purpose of putting its subsidiary in funds for the purpose it advanced money both by way of loan and by supplying goods and allowing the remission of the moneys representing the price to stand over.

In the wide sense properly belonging to the word "advance" (*M'Kune* v. *Joynson* (1); *London Financial Association* v. *Kelk* (2)), the American Corporation simply made an advance for a purpose in which it was interested. For that advance it took one negotiable instrument. The so-called loss on exchange arose in substance from two facts. One is that the transfer of the shares to the American Corporation was deferred for six years; and the other is that when it was done, not the dollars but the pounds used by the subsidiary company in effecting their purchase were taken as the basis of the consideration for the transfer. The consideration was ascertained by converting to dollars at the current unfavourable rate. The consequent loss or outgoing thus fell on the taxpayer company, not on the American Corporation. But it does not follow that it was a loss arising from a course of trading. And it does not follow that it is attributable simply to a discrepancy between the amount in £A at which purchases were taken into account and the amount of £A found subsequently to be necessary to meet the liability.

I think that *Texas Co. (Australasia) Ltd.* v. *Federal Commissioner of Taxation* (3) is a different case. There the purpose of allowing the fund to accumulate representing, among other things, unpaid purchases of stock, was that it should be employed in trading, not taken out of the business and invested. The use of the money as trading capital was not considered to exclude the view that variations in the exchange rate might result in gains or losses on revenue account.

In the course of stating at some length my own reasons for this view I said:—"The delay increased the chances of a loss expressed in pounds, but the fact that the reason for the delay related to capital does not make the outgoing a capital loss. It is rather a standing contingency representing the recurrent expenditure which must be incurred to obtain the use of the money and is much more

(1) (1858) 5 C.B. (N.S.) 218 [141 E.R. 87.]

(2) (1884) 26 Ch.D. 107, at p. 136.

(3) (1940) 63 C.L.R. 382.

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like annual outgoings to obtain the use of capital assets, such as rent, hire or interest " (1).

The passage indicates, I think, that the decision contemplated the use of the funds as part of the working capital and did not contemplate such a case as the present, where the parties agreed upon a course involving the creation of a fund to be used outside the business in the acquisition of an asset by one on terms that it should be transferred to the other at cost and the occasion of the loss consists in the variation of the exchange rate between the acquisition by the party put in funds and the transfer to the other party.

In my opinion the decision of *Williams* J. is correct and the appeal should be dismissed.

McTIERNAN J. I think that the judgment of *Williams* J. is right, and that the appeal should be dismissed.

The Court being evenly divided the appeal was, by virtue of the provisions of s. 23 (2) (*a*) *of Judiciary Act* 1903-1947, *dismissed with costs.*

Solicitors for the appellant, *Dibbs, Crowther & Osborne.*

Solicitor for the respondent, *H. F. E. Whitlam*, Crown Solicitor for the Commonwealth.

J. B.

(1) (1940) 63 C.L.R., at p. 469.