[HIGH COURT OF AUSTRALIA.]

'EDERAL COMMISSIONER OF TAXATION APPELLANT;

AND

SNOWDEN & WILLSON PROPRIETARY LIMITED . . . . . } RESPONDENT.

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MELBOURNE, *Mar.* 7, 11, 12; *May* 15.

Dixon C.J., Williams, Webb, Fullagar and Taylor JJ.

Income Tax (Cth.)—Assessment—Allowable deductions—" Outgoings . . . incurred in gaining . . . the assessable income or . . . necessarily incurred in carrying on a business for the purpose of gaining such income "—Interpretation—Meaning of " necessarily "—Company engaged in speculative building of houses for customers on terms—Attack in Parliament on integrity of those conducting business, fairness of transaction and sufficiency of disclosure—Advertising by company to counter allegations—Appointment of Royal Commission to inquire into allegations—Legal representation for company before commission—Whether money spent by company on advertising and on legal representation allowable deduction—Income Tax and Social Services Contribution Assessment Act 1936-1953 (*No.* 27 *of* 1936—*No.* 28 *of* 1953), *s.* 51 (1).

A company carried on a business which included the speculative building of houses for customers on terms. Complaints having been made in Parliament reflecting on the integrity of those conducting the company's business and upon the fairness of the transactions to the customers and the sufficiency of the disclosure to them of the operation of the terms, a Royal Commission was appointed to inquire into and report on the allegations. The ambit of the inquiry was wide and vague. The company expended money on advertising in the press to counter the effect of press reports concerning the allegations and incurred legal costs in appearing before the Royal Commission. It claimed to deduct these expenses and costs from its assessable income in the year in question.

Held, by *Dixon* C.J., *Williams*, *Fullagar* and *Taylor* JJ., *Webb* J. dissenting, that the expenditure in question was an outgoing necessarily incurred by the company in carrying on its business for the purpose of gaining or producing its assessable income and was an allowable deduction under s. 51 (1) of the *Income Tax and Social Services Contribution Assessment Act* 1936-1953.

Quaere whether the expenditure was not also allowable as an outgoing incurred in gaining or producing the assessable income.

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The meaning of " necessarily " in its context in the section, discussed.

Ronpibon Tin N.L. and Tongkah Compound N.L. v. *Federal Commissioner of Taxation* (1949) 78 C.L.R. 47, at pp. 55-57, referred to.

Held, further, by *Dixon* C.J., *Williams*, *Fullagar* and *Taylor* JJ., *Webb* J. expressing no opinion, that the outgoing was of a revenue and not a capital nature.

Morgan v. *Tate & Lyle Ltd.* (1955) A.C. 21, referred to.

CASE referred to the Full Court pursuant to s. 18 of the *Judiciary Act* 1903-1955.

In its return of income for the year ended 30th June 1953 Snowden & Willson Pty. Ltd. a company incorporated in the State of Western Australia claimed as a deduction the sum of £4,252 7s. 7d. being an outgoing incurred by it in connexion with an attack made on it in the Legislative Assembly of Western Australia on 17th September 1952 and the subsequent appointment of a Royal Commission to inquire into and report on the allegations. The allegations and the course of the proceedings appear more fully in the judgments hereunder. The claim for the deduction having been disallowed by the Commissioner of Taxation the company appealed to the Board of Review No. 2 which on 10th May 1957 by a majority, allowed the appeal.

From the decision of the Board of Review the Commissioner of Taxation appealed to the High Court. The appeal came on for hearing on 20th September 1957 before *Kitto* J. who, pursuant to s. 18 of the *Judiciary Act* 1903-1955 and with the concurrence of the parties, ordered that the appeal be heard before a Full Court of the High Court.

K. A. Aickin Q.C. (with him *M. N. O'Sullivan*), for the appellant. The expenditure was not incurred in gaining or producing assessable income or in carrying on a business for the purpose of gaining or producing such income. It is in the nature of a private expenditure unconnected with the business. The rebutting of charges of fraud is not a business outgoing. Alternatively the expense was of a capital nature, in that if the charges had been successfully refuted there would have been produced an enduring benefit to the business analagous to that produced in *Broken Hill Theatres Pty. Ltd.* v. *Federal Commissioner of Taxation* (1). If the respondent had been prosecuted for obtaining money by false pretences the costs of its defence would not have been an allowable deduction. The outgoing here is of the same nature. The Royal Commission did not purport to examine the respondent's current method of conducting its business but was examining specific transactions which were

(1) (1952) 85 C.L.R. 423.

completed. [He referred to *Strong & Co. Ltd.* v. *Woodifield* (1); *Ward & Co.* v. *Commissioner of Taxes* (2); *Toohey's Ltd.* v. *Commissioner of Taxation (N.S.W.)* (3); *W. Nevill & Co. Ltd.* v. *Federal Commissioner of Taxation* (4); *Inland Revenue Commissioners* v. *Warnes & Co.* (5); *Inland Revenue Commissioners* v. *von Glehn & Co. Ltd.* (6); *Fairrie* v. *Hall* (7); *Golder* v. *Great Boulder Proprietary Gold Mines Ltd.* (8); *Cattermole* v. *Borax & Chemicals Ltd.* (9); *Morgan* v. *Tate & Lyle Ltd.* (10).] On the capital or income aspect this case is governed by *Broken Hill Theatres Pty. Ltd.* v. *Federal Commissioner of Taxation* (11). The expenditure here was non-recurrent incurred for the purpose of gaining for the respondent a real and substantial advantage. The risk was one which affected the whole profit-earning structure of the company. [He referred to *Sun Newspapers Ltd. and Associated Newspapers Ltd.* v. *Federal Commissioner of Taxation* (12).]

[DIXON C.J. The passages you have read from that case are out of line with *Morgan* v. *Tate & Lyle Ltd.* (13), are they not?]

Yes. [He referred to *Federal Commissioner of Taxation* v. *Duro Travel Goods Pty. Ltd.* (14); *Sun Newspapers Ltd. and Associated Newspapers Ltd.* v. *Federal Commissioner of Taxation* (15); *W. Nevill & Co. Ltd.* v. *Federal Commissioner of Taxation* (16).]

J. McI. Young, for the respondent. The test on the authorities is not to look at the result of the expenditure. This Court has dealt with legal expenses as allowable deductions in *Hallstroms Pty. Ltd.* v. *Federal Commissioner of Taxation* (17). To determine whether the outgoing is of a capital or revenue nature it is necessary to look at the purpose with which the legal proceedings were undertaken. If any individual who made allegations before the Royal Commission had sued the company for relief based on the allegations the cost of resisting the proceedings would have been an allowable deduction. The analogy here is to civil, not criminal, proceedings. Applying the principles accepted by this Court since *Herald & Weekly Times Ltd.* v. *Federal Commissioner of Taxation* (18) the present problem can

(1) (1906) A.C. 448, at pp. 452, 453.
(2) (1923) A.C. 145, at p. 248.
(3) (1922) 22 S.R. (N.S.W.) 432; 39 W.N. 133.
(4) (1937) 56 C.L.R. 290, at p. 299.
(5) (1919) 2 K.B. 444.
(6) (1920) 2 K.B. 553, at pp. 564, 565.
(7) (1947) 177 L.T. 600, at p. 602.
(8) (1952) W.N. 50.
(9) (1949) 31 Tax Cas. 202.
(10) (1955) A.C. 21, at pp. 41, 43, 54, 66.
(11) (1952) 85 C.L.R. 423.
(12) (1938) 61 C.L.R. 337, at pp. 359-363.
(13) (1955) A.C. 21.
(14) (1953) 87 C.L.R. 524, at p. 528.
(15) (1938) 61 C.L.R., at pp. 354, 355.
(16) (1937) 56 C.L.R. 290, at p. 299.
(17) (1946) 72 C.L.R. 634, at pp. 646 et seq.
(18) (1932) 48 C.L.R. 113.

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be resolved without entering on the field covered by *Morgan* v. *Tate & Lyle Ltd.* (1). [He referred to *Herald & Weekly Times Ltd.* v. *Federal Commissioner of Taxation* (2); *Sun Newspapers Ltd. and Associated Newspapers Ltd.* v. *Federal Commissioner of Taxation* (3).] The character of the advantage sought here was no more than the immediate rebuttal of the allegations. No enduring advantage of any kind was expected. It was not to bring into existence a profit-earning asset. The only place from an accounting point of view for the present outgoing would be in the profit and loss account. That distinguishes this case from the *Broken Hill Theatres Case* (4). [He referred also to *Federal Commissioner of Taxation* v. *Duro Travel Goods Pty. Ltd.* (5); *Hannan's Principles of Income Taxation* (1946) pp. 436 et seq.; *In re Income Tax Acts No. 2* (6); *Toohey's Ltd.* v. *Commissioner of Taxation (N.S.W.)* (7); *Minister of National Revenue* v. *Kellogg Co. of Canada Ltd.* (8); *Minister of National Revenue* v. *Goldsmith Bros. Smelting & Refining Co. Ltd.* (9).] The reasoning of the House of Lords in *Morgan* v. *Tate & Lyle Ltd.* (1) shows that the expenditure here was for the purpose of the trade.

K. A. Aickin Q.C., in reply.

Cur. adv. vult.

May 15.

The following written judgments were delivered:—

DIXON C.J. The question for decision is whether the taxpayer is entitled to a deduction from its assessable income for the year of income ended 30th June 1953 of an amount expended by the company in an attempt to meet by advertisements certain attacks made in the Legislative Assembly of Western Australia upon the conduct of its business and in its appearance by counsel before a Royal Commission subsequently appointed to inquire into the charges and any further complaints or allegations made to the commissioner by persons who had dealt with the company.

The company carried on a business which included the speculative building of houses for customers on terms. The business covered the work of an estate agent, insurance agent and the kind of things associated with such enterprises. What, perhaps, is more material for present purposes is its business in building for its customers. The company would build for a customer owning the site or it would

(1) (1955) A.C. 21.
(2) (1932) 48 C.L.R., at pp. 118, 120.
(3) (1938) 61 C.L.R., at pp. 359-363.
(4) (1952) 85 C.L.R., at pp. 434, 436.
(5) (1953) 87 C.L.R., at p. 527.
(6) (1936) Q.S.R. 370.
(7) (1922) 22 S.R. (N.S.W.), at pp. 440 et. seq.; 39 W.N., at pp. 134-135.
(8) (1943) Can. S.C.R. 58.
(9) (1954) Can. S.C.R. 55.

contract to sell him the site and to build the house. The transaction would in each case be upon terms. It is unnecessary to enter upon the details of the complaints made in the Legislative Assembly, or elsewhere, of the company's methods. It is enough to say that they reflected on the integrity of those conducting the company's business and upon the fairness of the transactions to the customers and the sufficiency of the disclosure to them of the operation of the terms.

The company's methods were attacked in the Western Australian Assembly in September 1952, the Royal Commission was appointed in December 1952 and it sat for some thirty days in January, February and March 1953, and made its report (which was by no means favourable to the taxpayer company) on 27th April 1953. The taxpayer began by expending a sum on advertising to counter the effect produced by the reports in the press concerning the charges made. The cost of this was about £637. Then the taxpayer company proceeded to defend itself and its officers before the Royal Commission. This involved fees for counsel, solicitors, valuers, surveyor and accountants. The total cost, including the advertising, was £4,252. That amount the taxpayer sought to deduct from the assessable income in the assessment for the year in question. The deduction was disallowed by the commissioner but an appeal by the taxpayer was upheld by the majority of a board of review. An appeal was instituted to the High Court and referred to the Full Court by *Kitto* J.

This is the proceeding now before us.

The question whether this sum or any part of it may be deducted depends, of course, upon s. 51 (1) of the *Income Tax and Social Services Contribution Assessment Act* 1936-1953. In *Ronpibon Tin N. L. and Tongkah Compound N. L.* v. *Federal Commissioner of Taxation* (1) this Court discussed the provision pointing out the distinction between the manner in which it is constructed and the manner in which s. 23 (1) (*a*) and s. 25 (*b*) of the *Income Tax Assessment Act* 1922-1934 combined in operation. The judgment of the Court also distinguished between the two parts of the first limb of s. 51 (1). The first part deals with losses and outgoings to the extent to which they are incurred in gaining or producing the assessable income; the second deals with losses and outgoings to the extent to which they are necessarily incurred in carrying on a business for the purpose of gaining or producing such income.

It is suggested in the case mentioned (2) that the expression in the second part " in carrying on a business for the purpose of gaining or producing " lays down a test that is different from that implied

(1) (1949) 78 C.L.R. 47, at pp. 55-57. (2) (1949) 78 C.L.R., at p. 56.

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by the words " in gaining or producing ". The passage proceeds: " But these latter words have a very wide operation and will cover almost all the ground occupied by the alternative. The words ' such income ' mean ' income of that description or kind ' and perhaps they should be understood to refer not to the assessable income of the accounting period but to assessable income generally. If they were so interpreted, they would cover a case where the business had not yet produced or had failed to produce assessable income . . ." (1). This view, although expressed tentatively, appears to me to be right and to state the effect of that part of the provision correctly.

If it were not for the word " necessarily " there would be no difficulty, in my opinion, in treating the expenditure in the present case as coming within the conception expressed by this part of s. 51 (1). In saying this I am pronouncing upon a question of fact rather than of law. But, as it appears to me, the carrying on of the business of the nature described brought with it the attacks against which the taxpayer company sought to defend itself. The attacks touched its business nearly ; they disparaged the methods by which it was conducted ; they were calculated to deter intending or likely customers from dealing with it and to destroy the faith of existing customers in their current relations with the company. No doubt it would be instinctive in the business man or, perhaps, in any man, to defend himself and those associated with him in business against an attack of such a description on the manner in which they were pursuing their business activities. But the instinct is founded upon sound if intuitive conceptions of what must be done if they are not to suffer in their pursuit of custom and profit. Whether on the merits they were in a position to defend themselves successfully or whether, on the other hand, the attacks upon them lacked adequate foundation alike seem to me to be matters not to the point.

The case does not appear so far as the element now under consideration goes to depend upon case law or upon anything but an understanding of what in fact and according to the ordinary conduct of affairs is incidental to the conduct of a business. The word " necessarily " does, however, seem to me to require consideration. Clearly its operation is to place a qualification upon the degree of connexion between the expenditure and the carrying on of the business which might suffice in the absence of such a qualification. In *The Commonwealth and The Post-Master-General* v. *Progress Advertising & Press Agency Co. Pty. Ltd.* (2) *Higgins* J. supplied an

(1) (1949) 78 C.L.R., at p. 56. (2) (1910) 10 C.L.R. 457.

interpretation of " necessary " as not meaning essentially necessary but as meaning appropriate, plainly adapted to the needs of a department carrying out an Act (1). That was in another connexion but the phrase was availed of by the Court in the *Ronpibon Tin Case* (2) as throwing light on the use of the word " necessarily " in s. 51 (1). Clearly the expression is used in relation to business. Logical necessity is not a thing to be predicated of business expenditure. What is meant by the qualification is that the expenditure must be dictated by the business ends to which it is directed, those ends forming part of or being truly incidental to the business.

In the present case it appears to me that the taxpayer company could do nothing else but defend itself, if it was to sustain its business and continue carrying it on in anything like the same volume or according to the same plan. That seems to me to be enough.

There is no analogy here to cases in which fines or penalties are incurred. There the character of the expenditure and the reasons why the law imposes a fine or penalty separate the expenditure from the conduct of the business. It is not to the point that the conduct penalised found its motive in business considerations. Nothing of the kind can be said of the expenditure now under consideration nor is any principle of public policy affected by allowing the deduction.

There remains, however, the question whether the expenditure may not be considered to be of a capital nature and so subject to the express prohibition contained in s. 51 (1) against allowing losses and outgoings of a capital nature.

An examination of the facts does not support the view that the proceedings in Parliament and before the Royal Commission imperilled the existence of the business or the capital assets of the company. The proceedings were not necessarily directed at a winding-up of the company or a stoppage of the business. Precise definition or distinctions are difficult in such an affair. But what the company had most to fear was the embarrassments in the present and future conduct of its business and, no doubt, a decline in its custom.

There is no satisfactory ground for saying that the expenditure was an affair of capital.

The appeal from the decision of the board of review should be dismissed. The appellant commissioner should pay the costs, including the costs of the proceedings before *Kitto* J.

WILLIAMS J. I agree in the reasons for judgment of *Fullagar* J. I am of opinion that the appeal should be dismissed.

(1) (1910) 10 C.L.R., at p. 469. (2) (1949) 78 C.L.R., at p. 56.

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WEBB J. This is a reference by *Kitto* J. under s. 18 of the *Judiciary Act* 1903-1955 of an appeal to this Court by the appellant commissioner under s. 196 (1) of the *Income Tax and Social Services Contribution Assessment Act* 1936-1953 from a majority decision of a board of review. The board decided that legal and advertising expenses of the respondent taxpayer, amounting to £4,252, incurred in appearances before and in publishing part of the report of a Royal Commission were outgoings under s. 51 (1) of the Act in respect of the year ended 30th June 1953 and were not of a capital nature and so were allowable deductions.

The Royal Commission was appointed by the Government of Western Australia on 28th January 1953 to investigate and report on allegations made in the Parliament of that State suggesting what might well have appeared to be fraudulent conduct on the part of the managing director of the taxpayer in connexion with the sale of houses. The report is dated 27th April 1953 and was made after a hearing lasting thirty-two days. The findings were without exception unfavourable to the taxpayer.

From the statement of facts agreed upon by the parties in this Court it appears that for many years prior to 1953 the taxpayer had carried on the business *inter alia* of building houses for its customers on terms. Ordinarily the transaction took the form that the customer, who already owned the land or purchased it from the taxpayer, selected the design of house he required and paid a deposit varying according to whether or not the customer already owned the land. The contract fixed a price subject to adjustment for " extras," and contained a " rise and fall " clause. When the house was erected the amount owing by the customer to the taxpayer was ascertained, and on behalf of the customer the taxpayer raised a first mortgage over the property, usually from the Commonwealth Bank, and the taxpayer took a second mortgage for the balance owing to it. In September 1952 a member of the Legislative Assembly made charges against the taxpayer, more particularly in relation to abuse of the " extras " and " rise and fall " clauses and the Royal Commission was appointed. The terms of this appointment were to inquire into and report upon allegations against Snowden and Willson Proprietary Limited, that is the taxpayer, and Snowden and Willson (Housebuilders) Proprietary Limited, or either of them, or against any shareholders or employees of either, made in speeches in the Legislative Assembly, or made to the commission by any purchaser of land from or through the agency of either company in relation to any term in the contract of sale relating to the land, the circumstances leading to the making of the

contract or under which it was entered into or performed, including any inducement, representation, demand or request made to the purchaser, and money charged to the purchaser in connexion with the contract or land, including " extras ".

Eleven transactions with purchasers were referred to and investigated by the commission.

In giving evidence before the board of review the managing director of the taxpayer said, in explaining the reason for the expenditure claimed to be a deduction under s. 51 (1), that in the appointment of the Royal Commission there existed a threat both to the past revenue of the taxpayer and also to its goodwill and potential earning capacity ; that the taxpayer planned a defence based on the services of leading counsel and advertising ; and that advertising was resorted to because of abridged and presumably misleading newspaper versions of the report of the Royal Commission. This explanation appeared in a letter written by the managing director in February 1954, about ten months after the commission had made its report, but claimed by him to state the facts. The managing director added that the shareholders of the taxpayer were afraid that any adverse criticism, presumably by the commission, could seriously damage the taxpayer's goodwill and reputation and that the capital of the taxpayer would suffer.

As submitted by Mr. *Young* of counsel for the taxpayer we have first to decide for what purpose the money claimed as a deduction under s. 51 (1) was in fact expended : see *Morgan* v. *Tate & Lyle Ltd.* per Lord *Morton* (1). As to this purpose, I see no reason why we should not accept the evidence of the taxpayer that the goodwill, reputation and capital of the taxpayer would suffer if adverse criticism were indulged in. This was a reasonable, if not indeed a necessary conclusion, having regard to the nature of the allegations and the terms of the commission. It might be different if the commission had no further authority than to investigate the eleven individual transactions which were before it and to report its findings on them. But the commission was not confined to that. There was nothing to prevent it, if it felt obliged so to do by the evidence and its findings, from making recommendations which, if carried out, might well result in that prejudice to the taxpayer's goodwill, reputation and capital that the shareholders were said to fear. Accepting then the evidence for the taxpayer as stating the real purpose of the expenditure in question, and applying the reasoning in *Broken Hill Theatres Pty. Ltd.* v. *Federal Commissioner of Taxation* (2), I conclude that the expenditure was for the protection of

(1) (1955) A.C. 21, at p. 37. (2) (1952) 85 C.L.R. 423.

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the taxpayer's business as a whole, and was not *directly* incurred in gaining or producing the assessable income, or in carrying on a business for that purpose, and so was not an outgoing and deductible under s. 51 (1). Indeed this case is *a fortiori*.

For the contrary view the majority of the board of review relied upon the judgment of the House of Lords in *Morgan* v. *Tate & Lyle Ltd.* (1) in which it was held by a majority of their Lordships that expenditure " for the purposes of the trade " within r. 3 (*a*) of the rules applicable to Cases I and II of Schedule D of the English *Income Tax Act* 1918 included expenditure on propaganda to oppose the threatened nationalisation of the industry. Clearly that expenditure was to protect the business as a whole. However, Lord *Morton* who was one of the majority pointed out (2) that the words " for the production of assessable income " in s. 25 (*e*) of the Australian *Income Tax Assessment Act* 1922-1932 were narrower than the words " for the purpose of the trade " in the English Act. His Lordship also quoted (3), with apparent approval, Viscount *Cave's* observation in *Ward & Co. Ltd.* v. *Commissioner of Taxes* (4) in referring to the words " for the production of assessable income " in s. 86 (1) (*a*) of the New Zealand *Land and Income Tax Act* of 1916, that to be deductible the expenditure " must have been incurred for the *direct* purpose of producing profits ", and also with apparent approval (3), as I understand his Lordship, to Lord *Cave's* contrasting, but not inconsistent observation three years later in *British Insulated & Helsby Cables, Ltd.* v. *Atherton* (5), when referring to the words " for the purpose of the trade " in the English Act, that money expended " . . . in order *indirectly* to facilitate the carrying on of the business, may yet be expended . . . for the purpose of the trade ". Lord *Reid* in *Morgan* v. *Tate & Lyle Ltd.* (6) also quoted, with approval, these observations of Lord *Cave*. Such then is the difference between the English Act on the one hand and the Australian and New Zealand Acts on the other hand.

The expenditure in question here cannot be said to have been *directly* incurred in gaining or producing the assessable income or in carrying on a business for that purpose so as to be an outgoing and deduction under s. 51 (1).

It becomes unnecessary for me to deal with the other submissions for the appellant commissioner, including the submission that expenditure is not an allowable deduction under s. 51 (1) when made in the course of unsuccessfully refuting charges in the nature of

(1) (1955) A.C. 21.
(2) (1955) A.C., at p. 41.
(3) (1955) A.C., at p. 43.
(4) (1923) A.C. 145, at pp. 149, 150.
(5) (1926) A.C. 205, at pp. 211-212.
(6) (1955) A.C., at p. 50.

fraud, or otherwise of a criminal nature, even before a Royal Commission. It seems clear enough I think that an individual cannot claim as a deduction moneys spent in meeting a criminal or perhaps quasi criminal charge of which he has been convicted. But it is, I think, arguable that a company that spends money in the defence of its employees convicted of breaches of the law in the course of its work would, at least in some cases, be entitled to treat such expenditure as an outgoing deductible under s. 51 (1). Carelessness or inadvertence of employees is incidental to the conduct of many businesses and in some cases it could result in breaches of the law and fines. I have in mind more particularly traffic offences.

I would allow the appeal, set aside the decision of the board of review and affirm the appellant commissioner's assessment.

FULLAGAR J. This is an appeal by the Commissioner of Taxation against a decision of a taxation board of review. It has been referred to the Full Court by *Kitto* J. The question is whether the respondent company is entitled to deduct from its assessable income of the year ended 30th June 1953 the amount of certain expenditure incurred by it in consequence of certain allegations made against it and the appointment by the Government of Western Australia of a Royal Commission to inquire into those allegations.

The company carries on the businesses of " Builders and Contractors, Real Estate Agents, Sworn Valuers, Financial Agents, House-letting Specialists, and Mortgage and Insurance Brokers ". In 1949, in view of an acute housing shortage, the Western Australian Housing Commission decided to give to builders what were called " group permits " to build houses. The idea seems to have been that, by building houses in " groups " of from five to ten, the cost of construction would be reduced. Builders who obtained these permits built houses, and sold them either in the course of construction or after completion. There appears to have been no restriction on the price which a builder might charge. The respondent company appears to have obtained a number of group permits, under which it erected and sold a total of 92 houses. In September and October 1952, a Mr. Oldfield, a member of the Legislative Assembly of Western Australia, brought to the attention of the House certain complaints, which he said had been made to him by persons who had bought houses from the company. In the contract of sale signed by each purchaser there was a clause which has been referred to as a " rise and fall clause " (though it is really only a " rise clause "), and which provided for an increase in the contract price corresponding to any increase in the cost on which that price was based. The

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same clause also provided for the charging of " extras " in certain circumstances. The purchasers were complaining that the company had " represented " to them that any " rise " under the " rise clause " would not be more than £25 (or some other small named sum). In fact, it was alleged, considerably larger sums had been demanded as due under the " rise clause ", and exorbitant sums had been charged under the heading of " extras ".

In consequence of these complaints the Government, by proclamation published on 19th December 1952, appointed a stipendiary magistrate as a Royal Commission " to inquire into and report upon allegations " made against the company and another (presumably subsidiary) company named Snowden & Willson (Housebuilders) Pty. Ltd. The terms of the commission were wide, and were extended by proclamation published on 30th January 1953. The magistrate was to inquire into all allegations made by Mr. Oldfield in the House or by any person who had purchased land or obtained a loan from either company, relating to the terms of the contracts, the circumstances attending the making of the contracts, and the moneys (including " extras ") charged to the purchaser or borrower. The commission sat on a number of days in January, February and March 1953. It investigated the cases of nine purchasers, and its report was presented to the Governor on 27th April 1953. The report was in terms purporting to be very adverse to the company and to Messrs W. E. and C. H. Snowden. On its face, however, it seems open to more than one comment. For example, the finding that Mr. W. E. Snowden had " falsely represented " to some purchasers that not more than some such sum as £25 would become payable under the " rise clause " appears to have been based on a misapprehension on the part of the magistrate. Prima facie such a statement, if made, would amount to no more than an expression of opinion. Again, it is difficult to understand such a finding as that the company was " harsh and unconscionable in charging for extras at all ". The company did not stand in any fiduciary relation to purchasers, and it seems a strange idea that it ought not to have charged for extras actually provided. The question in the present case, however, does not, in my opinion, depend on whether the report of the commission was favourable or unfavourable to the company, and still less on whether that report ought to receive full faith and credit according to its tenor.

The proceedings in the Legislative Assembly and before the Royal Commission received, of course, much publicity, and the directors of the company took immediate steps to defend themselves and their companies against the attack made upon them. In doing so

they, of course, incurred expense. With regard to the allegations made in Parliament, they sought to have published in the press and through other channels their reply to the charges made. They found that they could not obtain the desired publicity for their reply except by paying advertising rates, and they expended £637 in advertising. With regard to the proceedings before the commission, they instructed solicitors and were represented by counsel. The conduct of the " defence " before the commission involved some incidental expenditure apart from solicitors' and counsel's fees. The total amount expended in advertising and in conducting a case before the commission was £4,252, of which about three-fourths represented legal costs. It is this sum that is in issue in this case. Is it an allowable deduction from the assessable income of the company derived in the year ended 30th June 1953 ? The question turns on s. 51 (1) of the *Assessment Act*, which, so far as material, 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 nature. A majority of the board of review has held that the expenditure in question is an allowable deduction under this provision.

The two categories mentioned in s. 51 (1) are not mutually exclusive. The interpretation of the first category which was adopted and explained in *Amalgamated Zinc (De Bavay's) Ltd.* v. *Federal Commissioner of Taxation* (1) and *W. Nevill & Co. Ltd.* v. *Federal Commissioner of Taxation* (2) has always been accepted without question, and it may well be right on that interpretation to say that the expenditure now in question falls within that first category. But, however this may be, that expenditure is, in my opinion, exactly the kind of expenditure that is covered by the second category of s. 51 (1). That category, as the late Dr. *Hannan* (*Principles of Income Taxation*, (1946), p. 291), observes, has not been the subject of detailed judicial examination. The learned author goes on to say : " The meaning of ' necessarily ' in that context is probably not limited to compulsion in a legal sense . . . , and may extend to business expenditure arising out of exigencies created by unusual or difficult circumstances." I would respectfully adopt that passage, omitting the word " probably " and substituting the word " does " for the word " may ". The interpretation of the word " necessarily " which is involved in this view is

(1) (1935) 54 C.L.R. 295, at pp. 303, 307, 309, 310.

(2) (1937) 56 C.L.R. 290, at p. 305.

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familiar in many similar contexts and in a variety of instruments: see, e.g., *The Commonwealth and the Post-Master-General* v. *Progress Advertising & Press Agency Co. Pty. Ltd.* (1) per *Higgins* J. It means for practical purposes that, within the limits of reasonable human conduct, the man who is carrying on the business must be the judge of what is "necessary". It accords with the general principle on which the *Assessment Act* is framed, and it leaves the revenue adequately safeguarded by the express exclusion of expenditure of a capital nature. In *Ronpibon Tin N.L. and Tongkah Compound N.L.* v. *Federal Commissioner of Taxation* (2) a Court consisting of *Latham* C.J. and *Rich*, *Dixon*, *McTiernan* and *Webb* JJ. said:—"The word 'necessarily' no doubt limits the operation of the alternative, but probably it is intended to mean no more than 'clearly appropriate or adapted for'" (3). The same view is, I think, implicit in the judgment of *McTiernan* J. in *Federal Commissioner of Taxation* v. *Robinson & Mitchell Pty. Ltd.* (4) where his Honour used the expression "*ex necessitate* the business" (5).

In the present case the company was carrying on a business for the purpose of gaining or producing assessable income. Attacks were made in Parliament and before the commission upon its conduct of that business—attacks which were capable of seriously affecting that business both directly and indirectly. It would naturally seem essential to the company's directors that a vigorous effort should be made to repel those attacks, and no defence could have any prospect of being effective which did not involve the expenditure of substantial sums of money. The relation between the expenditure and the carrying on of the business is clear. The expenditure was incidental to the carrying on of the business. It was incurred in carrying on the business, and it was necessarily incurred because the exigencies of the business imperatively demanded that it should be incurred.

The question remains whether the expenditure in question was an outgoing of a capital nature. This is a question which has given rise to difficulty in a large number of cases. The three most recent cases in this Court are *Broken Hill Theatres Pty. Ltd.* v. *Federal Commissioner of Taxation* (6), *Colonial Mutual Life Assurance Society Ltd.* v. *Federal Commissioner of Taxation* (7), and *Federal Commissioner of Taxation* v. *Duro Travel Goods Pty. Ltd.* (8). The first two are decisions of the Full Court, and the third is a decision of *Taylor* J.

(1) (1910) 10 C.L.R. 457, at p. 469.
(2) (1949) 78 C.L.R. 47.
(3) (1949) 78 C.L.R., at p. 56.
(4) (1941) 64 C.L.R. 612.
(5) (1941) 64 C.L.R., at p. 618.
(6) (1952) 85 C.L.R. 423.
(7) (1953) 89 C.L.R. 428.
(8) (1953) 87 C.L.R. 524.

In the *Broken Hill Theatres Case* (1) disapproval was expressed of the decision of *Lawrence* J. in *Southern* v. *Borax Consolidated Ltd.* (2). Since then in *Morgan* v. *Tate & Lyle Ltd.* (3), Lord *Morton* (4) has in effect expressed approval of the decision in the *Borax Case* (2), and both Lord *Reid* (5) and Lord *Tucker* (6) have referred to that decision with apparent approval. Lord *Keith* (7) expressly approved of the "first branch" of that decision. The case had previously received the apparent approval of the Court of Appeal in *Associated Portland Cement Manufacturers Ltd.* v. *Inland Revenue Commissioners* (8), and had been applied by *Croom-Johnson* J. in *Cooke* (*H.M. Inspector of Taxes*) v. *Quick Shoe Repair Service* (9). There is an article in the *Australian Law Journal* (10) by Mr. *R. E. O'Neill*, who observes that the English courts have been disposed to draw (as in the *Borax Case* (2)) a decisive distinction between (to put it very shortly) expenditure which adds to capital and expenditure which merely protects or preserves capital. Here the distinction has not been regarded as irrelevant, but it has not been treated generally as decisive. It is to be noted on the one hand that, although the relevant statutes differ in terms, the English courts, taking the view that capital expenditure is never deductible, have in many cases in substance addressed themselves to the question of what constitutes an outgoing of a capital nature, though often (the *Borax Case* (2) being a notable exception) subsuming it under the general question of what constitutes expenditure "wholly and exclusively" laid out in producing income. It is to be noted on the other hand that there is no essential inconsistency between the particular view discernible in recent English cases and the general principle expounded in *Sun Newspapers Ltd. and Associated Newspapers Ltd.* v. *Federal Commissioner of Taxation* (11), which has received acceptance in this Court ever since the decision in that case.

For present purposes I do not think that the general question need be pursued further. Whether or not the decision of *Lawrence* J. in the *Borax Case* (2) be accepted as correct, and whether or not the distinction above referred to ought to be regarded as decisive, I am quite unable to regard the expenditure now in question as being of a capital nature. It is true that the allegations against which the company was defending itself were calculated to affect adversely the goodwill of the company, and that fact was doubtless present to

(1) (1952) 85 C.L.R. 423.
(2) (1941) 1 K.B. 111.
(3) (1955) A.C. 21.
(4) (1955) A.C., at pp. 41, 46.
(5) (1955) A.C., at p. 51.
(6) (1955) A.C., at p. 62.
(7) (1955) A.C., at p. 69.
(8) (1945) 62 T.L.R. 115, at p. 117.
(9) (1949) 30 T.C. 460.
(10) (1956) 29 A.L.J. 561.
(11) (1938) 61 C.L.R. 337, at pp. 359 et seq.

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the minds of the directors. But that is very far from being the whole of the truth. The allegations were made in specific cases, and were capable of directly affecting the past present and future revenue of the company as such. They were made by persons who stood in an existing legal relationship to the company, either as contractors or as mortgagors. The object of those who made them can only have been to obtain ultimately some reduction in their obligations to the company—either by way of repayment of moneys paid or by way of partial cancellation of future indebtedness. If they had pursued this object in the courts, there could have been no doubt about the position. Expenditure incurred by the company in an action or suit to enforce a contract or a mortgage, or in resisting a claim for relief by a contractor or mortgagor, must have been deductible from the company's assessable income in the year in which it was incurred. It can surely make no difference that contractors or mortgagors chose a less direct (and perhaps in the long run less satisfactory) means of achieving the object they had in view. The expenditure was not recurrent, and it must be regarded as abnormal: it was not a continuing and unavoidable incident of the taxpayer's business, as was the expenditure in *Herald & Weekly Times Ltd.* v. *Federal Commissioner of Taxation* (1). But, on the other hand, the case appears to me to have nothing in common with the *Broken Hill Theatres Case* (2), where, as in the *Sun Newspapers Case* (3), a price was in effect paid for freedom from competition.

For the above reasons I find myself in agreement with the majority of the board of review. I do not agree with the dissenting member of the board that the present case bears any analogy to cases in which penalties and costs have been incurred in connexion with prosecutions for infringements of the law. The distinction between cases of that kind and such a case as the present was explained by *Gavan Duffy* C.J. and *Dixon* J. in *Herald & Weekly Times Ltd.* v. *Federal Commissioner of Taxation* (1) where their Honours referred to *Inland Revenue Commissioners* v. *von Glehn & Co. Ltd.* (4) and *Inland Revenue Commissioners* v. *Warnes & Co.* (5), and said:—"The penalty is imposed as a punishment of the offender considered as a responsible person owing obedience to the law. Its nature severs it from the expenses of trading. It is inflicted on the trader as a personal deterrent, and it is not incurred by him in his character of trader" (6).

The appeal should, in my opinion, be dismissed.

(1) (1932) 48 C.L.R. 113.
(2) (1952) 85 C.L.R. 423.
(3) (1938) 61 C.L.R. 337.
(4) (1920) 2 K.B. 553.
(5) (1919) 2 K.B. 444.
(6) (1932) 48 C.L.R., at p. 120.

TAYLOR J. In the income year ended 30th June 1953 the respondent company, which had then been engaged in Western Australia for a number of years in the building trade, expended the sum of £4,252 for legal and other costs incurred by it in connexion with its representation in proceedings before a Royal Commission which was appointed to inquire into some aspects of its trading activities. The precise ambit of the inquiry directed by the terms of the commission is of importance in the case but it would be out of place at this stage to endeavour to indicate in a few words the substance of the matters into which the commission was directed to inquire.

In its return of income for the relevant year the respondent sought to deduct the item of expenditure mentioned for the purpose of arriving at its taxable income but the deduction was disallowed by the appellant. Upon appeal to a board of review the respondent's objection to the commissioner's assessment was allowed and, by a majority, the appeal was upheld. The present appeal is now brought by the appellant in an attempt to restore his assessment.

The problem in the case arises in relation to the familiar words of s. 51 (1) of the *Income Tax and Social Services Contribution Assessment Act* 1936-1953 which, in broad terms, defines the general classes of expenditure which constitute allowable deductions for the purposes of the Act. In terms, the sub-section provides as follows : " (1) 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."

It will be seen that the majority decision of the board of review involved the twofold conclusion that the expenditure in question was incurred in gaining or producing the respondent's assessable income or necessarily incurred in carrying on its business for the purpose of gaining or producing that income and that the expenditure was not of a capital, private or domestic nature. Subject to one minor qualification to which reference will be made later there was no serious challenge to the relevance of the expenditure to the business operations of the respondent; indeed, those business activities and the manner in which they were conducted were, as the facts show, the very things which created the situation which led to the appointment of a Royal Commission and although the expenditure was not, by itself, calculated to produce assessable income (cf.

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Herald & Weekly Times Ltd. v. *Federal Commissioner of Taxation* (1)) it is readily recognisable as an expenditure which was " incidental and relevant to the operations or activities regularly carried on for the production of income ". (*Amalgamated Zinc (De Bavay's) Ltd.* v. *Federal Commissioner of Taxation* (2) ; and *W. Nevill & Co. Ltd.* v. *Federal Commissioner of Taxation* (3).) But this does not necessarily mean that the expenditure was not of a capital nature and the question whether or not it should be so regarded was the principal matter debated upon the appeal.

This question cannot, of course, be answered without an adequate appreciation of the circumstances in which the expenditure was incurred and it is convenient to turn to the facts of the case at once. The general nature of the company's business and the manner in which its activities were conducted are briefly described in the statement of facts agreed upon by the parties. It was, in fact, carrying on business in the manner described when on 12th December 1952, a Royal Commission was appointed " to inquire into and report upon allegations against Snowden & Willson (House-builders) Proprietary Limited "—" (1) made or referred to in the speeches, as reported in HANSARD, of Mr. E. P. Oldfield, M.L.A., in the Legislative Assembly on 17th September and 22nd October, 1952, or (2) made to the Commission by any purchaser of land from, or through the agency of either such Company in relation to—(a) any one or more of the terms of the contract of sale relating to the land ; (b) the circumstances leading to the making of the contract or under which the contract was entered into or performed, including any inducement, representation, demand or request made to the purchaser, whether concerning money, documents, papers or otherwise ; (c) money charged to the purchaser under, arising out of or connected with the contract or the land or any erection on or work done to the land, including ' extras '." Some weeks later the ambit of the inquiry was extended to include allegations against the respondent—" (3) made to the Commission by any person obtaining loans from or through the agency of such company for the purpose of financing the purchase of or erection on or work done to any land in relation to—(a) the moneys, costs and expenses charged to such person in respect thereof ; (b) the circumstances leading to the making of any such loan, including any inducement, promise, representation, demand or request made to such person, whether concerning money, documents, papers, or otherwise." Two things may be said at once concerning the terms of the Royal Commission.

(1) (1932) 48 C.L.R. 113.
(2) (1935) 54 C.L.R. 295, at pp. 307, 309, 310.
(3) (1937) 56 C.L.R. 290, at p. 305.

The first is that cl. (1) left much to be desired in the interests of precision and clarity and the second is that the remaining clauses left the ambit of the inquiry to be determined, in part, by the substance of any later allegations made to the commission itself. To say the least, the appointment of a commission to inquire into these matters produced a situation in which neither the commission nor the respondent could tell exactly what matters would be inquired into or where the inquiry would finish.

A perusal of the report in *Hansard* of Mr. Oldfield's speeches, who on 17th September 1952 moved for the appointment of a Select Committee, shows that he protested that he was " not making charges against the firm of Snowden & Willson but . . . merely placing before the House facts given " to him by persons who had had " business dealings and contractual relations with the firm in question ". The result was that no charges against the respondent were precisely formulated though the respondent was subjected to a considerable amount of criticism concerning the manner in which it had carried on its business. This criticism—or the " allegations "—touched the manner in which the respondent made its contracts with its clients, the prices charged for dwellings erected by it, the charges made in particular cases for extras, the time taken by it for the erection of particular dwellings, the arrangements and adjustments insisted upon by the respondent upon settlement with its clients and a number of other minor matters which seem to have found no place in the proceedings of the Royal Commission. All in all, Mr. Oldfield's speeches seemed to indicate a general *ex parte* disapproval of the manner in which the respondent conducted certain of its business activities. But the most important of the allegations made by him related to the use made by the respondent in certain cases of the " rise and fall " clause which appeared in its building contracts and it may be said that this constitutes the main topic of the inquiry before the Royal Commission. From what appears in the case it seems that, although it may not have been possible to specify its precise limits, the inquiry which was directed was substantially concerned with allegations that a number of clients of the company had been overcharged in particular instances. It was on this basis that the inquiry proceeded and the commission investigated, in all, thirteen cases. In each of seven of these cases the commission found that the secretary of the respondent, one W. E. Snowden, had falsely represented to the purchaser at the time of the execution of the relevant contract that the rise in costs of labour and material during the course of building operations would not exceed a few pounds, that in some cases this or some like representation had

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induced the purchaser to sign the contract and that, upon settlement, excessive amounts had been demanded and paid pursuant to the "rise and fall" clause. In two other cases it was found that excessive contract prices had been charged by the respondent whilst in the remaining four cases there were but minor matters for the consideration of the commission. It is unnecessary to refer in detail to the commission's findings in each particular case or to endeavour to indicate why it was thought that the prices charged by the respondent were excessive. Indeed, the findings themselves are of little consequence in this appeal; they are of importance only as an indication of the nature of the inquiry and its relation to the respondent's business activities. I also forbear to comment upon the commission's findings that the company "falsely represented" the extent to which labour and material costs would rise during particular building operations or concerning the recommendations which were finally made that "it should be made an offence for builders not to keep complete books and records" and that "the 'rise and fall' clause be abolished from contracts altogether". These are not matters for our consideration though, again, they may furnish some indication of the nature and substance of the inquiry.

This brief statement of the circumstances in which the Royal Commission was set up describes also the occasion for the expenditure which is now in question. For the appellant it is, of course, claimed that the circumstances indicate that the expenditure was of a capital nature. As I understand the argument it is asserted that the expenditure was incurred by the respondent, if not to preserve itself from extinction, then to protect the goodwill of its business and the "profit-making structure" from injury. No one would be concerned to deny that if the respondent had made no attempt to combat the allegations which had been made it would have been highly probable that its goodwill would have suffered. Indeed, the respondent conceded that this would have been so. But it is one thing to say that unless a particular expenditure is outlaid the goodwill of a business will or may suffer and another to assert that this very circumstance alone will brand the expenditure, when made, as an expenditure of a capital nature for it is not only capital expenditure which is ultimately reflected in the value of the goodwill of a business since every step in the day to day operations of a business may tend to enhance, preserve, or destroy it. It may, I think, be said that the true character of the expenditure in question in this case is to be sought in a consideration of its immediate purpose as revealed by an appreciation of the occasion which was thought to call for it and of the circumstances in which it was made.

In the course of argument the case of *Morgan* v. *Tate & Lyle Ltd.* (1) received some attention and it is as well to put that case aside before proceeding with our inquiry. In that case their Lordships were concerned with the question whether expenditure incurred by the taxpayer to combat the possibility of the seizure of its business by a process of what is called nationalisation was expenditure " wholly and exclusively laid out for the purposes of the company's trade ". A majority of their Lordships held that it was and the case is no more and no less than an authority for this proposition; it is of no assistance in applying the provisions of s. 51 (1). So much is clear from a comparison of the two statutory provisions and it is put beyond any question by the pointed distinction made by their Lordships between that case and the decision in *Ward & Company Ltd.* v. *Commissioner of Taxes* (2) where the critical words prohibited the deduction of expenditure " not exclusively incurred in the production of assessable income ". These, again, are words which differ from those contained in s. 51 (1) and neither case is of any real assistance in solving the problem before us.

If, however, the facts of the present case were analogous to those in *Ward's Case* (2) there could be little doubt that, upon authority, we would be bound to hold that the expenditure was of a capital nature. But they are not. On the contrary, an examination of the amorphous terms of the Royal Commission, reveals, at least, that the contemplated inquiry was concerned with complaints respecting particular trading activities of the respondent, with the possibility of affording relief to the so-called victims and, perhaps, with the desirability of placing restrictions upon some of the business practices employed by the respondent. There is nothing to suggest that the business of the respondent was faced with the prospect of annihilation either wholly or in part. Perhaps, it may be said that, at the most, it was faced with an inquiry into allegations which might have founded claims against it arising out of and in relation to certain dealings from which part of its income was derived. The cost of resisting such claims in the ordinary courts of law would, of course, constitute a revenue expense and it is difficult to see why any different conclusion should be reached merely because a special tribunal was empowered to investigate and report. The uncertainty of what might follow the report of the Royal Commission—either in the way of legislative action or judicial proceedings—led the appellant to suggest that the case was not unlike *Ward's Case* (2) that is to say, that the company was, in effect, " fighting for its existence ". But there is not the slightest

(1) (1955) A.C. 21.

(2) (1923) A.C. 145.

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reason to suppose that this was so; the inquiry, in substance, was an inquiry into more or less specific complaints by individuals that they had been unfairly treated in their business relations with the respondent and the ultimate goal could not have been said to lie beyond the provision to them of some form of relief and some regulation of trade practice to prevent possible abuses in the future. Upon this view of the facts the case is quite unlike *Ward's Case* (1) and clearly distinguishable from *Broken Hill Theatres Pty. Ltd.* v. *Federal Commissioner of Taxation* (2) where the purpose of the expenditure by the taxpayer was to secure for itself freedom from further competition in the locality where it carried on business. The case more closely resembles *Sydney Ferries Ltd.* v. *Commissioner of Taxation (N.S.W.)* (3) where the taxpayer incurred an expenditure for representation before a Royal Commission appointed to inquire into the constitution, business and operations of the company and to determine whether certain increases in fares were justified. In all the circumstances, I am of the opinion that the expenditure in question was not of a capital nature and that the deduction was rightly claimed.

The final observation which I wish to make is concerned with the argument that, as the expenditure was incurred in an endeavour to rebut the charges of fraud which were implicit in the allegations made by Mr. Oldfield, the company is not entitled to the deduction claimed. It was sought to support this argument by reference to cases concerned with legal costs and penalties incurred in criminal proceedings. It is, I think, sufficient to say that there is no analogy between the two classes of cases and, accordingly, that there is no substance in this submission. (See *Inland Revenue Commissioners* v. *Warnes & Co.* (4); *Commissioners of Inland Revenue* v. *von Glehn & Co. Ltd.* (5); *Minister of Finance* v. *Smith* (6).)

For the reasons given the appeal should be dismissed.

Appeal dismissed with costs including the costs of the proceedings before Kitto *J.*

Solicitor for the appellant, *H. E. Renfree*, Crown Solicitor for the Commonwealth of Australia.

Solicitors for the respondent, *Wheatley & Sons*, Perth by *Moule, Hamilton & Derham*.

R. D. B.

(1) (1923) A.C. 145.
(2) (1952) 85 C.L.R. 423.
(3) (1922) 22 S.R. (N.S.W.) 432.
(4) (1919) 2 K.B. 444.
(5) (1920) 2 K.B. 553.
(6) (1927) A.C. 193, at pp. 197, 198.