HIGH COURT OF AUSTRALIA

GLEESON CJ
GUMMOW, KIRBY, CALLINAN, HEYDON AND CRENNAN JJ

THE COMMISSIONER OF TAXATION OF THE COMMONWEALTH OF AUSTRALIA — APPELLANT

AND

CITYLINK MELBOURNE LIMITED (FORMERLY KNOWN AS TRANSURBAN CITY LINK LIMITED) — RESPONDENT

Commissioner of Taxation v Citylink Melbourne Limited [2006] HCA 35
20 July 2006
M49/2005

ORDER

Appeal dismissed with costs.

On appeal from the Federal Court of Australia

Representation

B J Shaw QC with I B Stewart for the appellant (instructed by Australian Government Solicitor)

A C Archibald QC with M M Gordon SC, M N Connock and S H Steward for the respondent (instructed by Freehills)

CATCHWORDS

Commissioner of Taxation v Citylink Melbourne Limited

Income tax – Allowable deductions – Respondent entered into contracts with the State of Victoria to design, construct, operate and maintain a major system of roads – The State conceded to the respondent rights to do all that was necessary to complete those tasks, with a view to transferring the infrastructure and all associated rights back to the State at the expiry of the concession period – Respondent paid concession fees as consideration for those rights – Whether concession fees were allowable deductions – Whether concession fees which accrued semi-annually were outgoings incurred in, and referable to, the relevant years of income, where the fees were "owing" but "not due for payment" – Whether payment was contingent or theoretical – Whether concession fees were on revenue or capital account – Whether concession fees were an outgoing in gaining or producing the taxpayer's assessable income – Whether the concession fees conferred a benefit on the taxpayer of an enduring nature – Whether acquisition of the benefit essential to the taxpayer's business – Whether concession fees were the purchase price paid for the road system as a capital asset – Whether concession fees were akin to a share of profits with the State or a dividend payable to a joint venturer – Whether payment of concession fees analogous to the payment of rent.

Words and phrases – "incurred", "referable".

Income Tax Assessment Act 1936 (Cth), s 51(1).
Income Tax Assessment Act 1997 (Cth), s 8-1.

1 GLEESON CJ. I agree with the orders proposed by Crennan J and with her reasons for those orders.

2 GUMMOW J. The appeal should be dismissed with costs.

3 I agree with the reasons of Crennan J.

4 KIRBY J. This appeal comes from a judgment of the Full Court of the Federal Court of Australia[1]. It involves questions that have provided a rich source of litigation in this Court concerning whether a claimed deduction from income tax liability arises on revenue account (and is thus *prima facie* deductible) or on capital account (and is thus not deductible). An additional question, if the classification on revenue account is upheld, is whether the obligation giving rise to the claimed deduction was "incurred" in the 1996 to 1998 years of income ("the income years") and was "properly referable" to income which the taxpayer derived in those years.

5 The answer to these questions is to be found, ultimately, in the operation of s 51(1) of the *Income Tax Assessment Act* 1936 (Cth) ("the 1936 Act")[2] and s 8-1 of the *Income Tax Assessment Act* 1997 (Cth) ("the 1997 Act")[3]. The appeal proceeded on the assumption that the respective provisions of the 1936 Act and the 1997 Act were identical in substance[4]. I agree with that assumption.

The facts

6 For the most part, the facts relevant to my reasons sufficiently appear in the reasons of Crennan J[5]. I incorporate and will not repeat them. In those reasons, her Honour describes the arrangements between Citylink Melbourne Limited (formerly known as Transurban City Link Limited) ("Transurban") and the State of Victoria ("the State") for the achievement of the City Link Project ("the Project"). She explains the contents of the Concession Deed[6], the issue of Concession Notes[7], the controlling operation of the Master Security Deed[8] and the terms of the Security Trust Deed[9]. I will not needlessly restate any of this material. I gratefully accept these descriptions. The facts at trial were complex. As Crennan J's reasons indicate, further details of the Project, to elaborate the

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1 *City Link Melbourne Ltd v Commissioner of Taxation* (2004) 141 FCR 69.

2 Referable to the 1996 and 1997 income tax years.

3 Referable to the 1998 income tax year.

4 (2004) 141 FCR 69 at 71 [2].

5 Reasons of Crennan J at [81]-[87].

6 Reasons of Crennan J at [100]-[110].

7 Reasons of Crennan J at [107]-[110].

8 Reasons of Crennan J at [111]-[114].

9 Reasons of Crennan J at [115]-[118].

relationship and arrangements between Transurban and the State, may be found in the reasons of the primary judge and of the Full Court[10].

The proceedings in the Federal Court

7 *Before the primary judge*: The primary judge[11] (Merkel J), whose orders were reversed by unanimous decision of the Full Court of the Federal Court of Australia[12], concluded that Transurban incurred a loss or outgoing in respect of the concession fees because the liability in respect of them arose unconditionally[13], and was satisfied by Transurban's electing to issue the Concession Notes, under which there was a present liability to pay the amounts due at a future time[14]. The primary judge also concluded that the fees were "referable to the period in respect of which the liability for the fees is incurred"[15]. However, he reached these conclusions notwithstanding an intuitive opinion, which he expressed, as to their artificiality and unreality. Indeed, he suggested that such an outcome could normally only be expected in "a taxpayers' heaven"[16].

8 Despite the foregoing findings, the primary judge held that the concession fees were not deductible because they were akin to a promised share of profits or payment of a dividend to the State in return for the advantage flowing to capital which the State had contributed to the Project[17]. The concession fees were thus outgoings expended "on the structure within which the profits were to be earned". They were not "part of the money earning process"[18]. They were outgoings on capital and not on revenue account[19].

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10 Reasons of Crennan J at [118]. See *Transurban City Link Ltd v Commissioner of Taxation* (2004) 135 FCR 356 at 361ff; (2004) 141 FCR 69 at 71ff.

11 (2004) 135 FCR 356.

12 (2004) 141 FCR 69 per Hill, Stone and Allsop JJ.

13 Under the Concession Deed, cl 3.1.

14 (2004) 135 FCR 356 at 378 [75].

15 (2004) 135 FCR 356 at 380 [81].

16 (2004) 135 FCR 356 at 381 [84].

17 (2004) 135 FCR 356 at 408 [188]-[189].

18 (2004) 135 FCR 356 at 409 [191] citing *BP Australia Ltd v Federal Commissioner of Taxation* (1965) 112 CLR 386 at 398, 403-404; [1966] AC 224 at 266, 271.

19 (2004) 135 FCR 356 at 409 [191].

9 It was on this basis that the primary judge rejected Transurban's "appeal" to the Federal Court against what it claimed was the erroneous decision of the Commissioner of Taxation ("the Commissioner") disallowing Transurban's objection to the Commissioner's disallowance of deductions claimed by Transurban in respect of concession fees for the income years.

10 *In the Full Court*: In allowing Transurban's appeal, the Full Court found that Transurban had incurred the concession fees in the income years although they were years during which the tollway was still under construction and therefore not generating (as it later did) substantial revenues from vehicular tolls. Moreover, the Full Court found that the concession fees were referable to the income years and that the State and Transurban were not joint venturers and did not, in any legal sense, share profits[20]. Finally, the Full Court concluded that the concession fees were payable for use and operation of, or the right to conduct, the Project. They were therefore a cost of conducting the business operation rather than a cost of acquiring a profit-making enterprise[21]. On this footing, the Full Court rejected the primary judge's conclusion that the concession fees were outgoings on capital account.

11 By special leave, this appeal is now brought to this Court to permit the Commissioner to propound his arguments defensive of the orders made by the primary judge.

<u>The applicable legislation</u>

12 *Primacy of the legislation*: Problems of income tax law, such as the present, cannot be resolved by generalities. In each case, it is the duty of the decision-maker to apply the relevant legislation to the facts as found. Income tax law is not a mystery unto itself, to be preserved separate from other parliamentary law as a legal canon reserved to a specialised priestly caste[22]. It is a law enacted by the Federal Parliament and, in its new form especially, it is intended to be generally understood by taxpayers, most of whom do not have ready access to countless decisions, many of them contradictory, written on the legislation these past seventy years.

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20 (2004) 141 FCR 69 at 85 [50].

21 (2004) 141 FCR 69 at 92-93 [70].

22 *Federal Commissioner of Taxation v Ryan* (2000) 201 CLR 109 at 146 [84]; cf *Steele v Deputy Federal Commissioner of Taxation* (1999) 197 CLR 459 at 477 [52].

13 In deriving the meaning and application of income tax law, as in other areas of the written law, wisdom lies in maintaining fidelity to the statutory text and the purpose of the legislation as found in its language and elucidated by authority and admissible material[23]. This has been a constant, and unanimous, theme of decisions of this Court, in many fields, in recent years[24]. Where the outcome is governed by legislation, the starting point is always the legislative text. Income tax law is no different. We sit here to apply the legislation, not judicial approximations of it.

14 *The legislation*: The applicable legislation, in its successive forms in the 1936 Act and the 1997 Act, is set out in Crennan J's reasons[25]. It is unnecessary for me to repeat the provisions. Effectively, both enactments allow the taxpayer to deduct from its assessable income any losses or outgoings to the extent that (relevantly) they were necessarily incurred in carrying on a business for the purpose of gaining or producing its assessable income. No such loss or outgoing may be deducted if (relevantly) it is a loss or outgoing of capital, or of a capital nature[26]. Here are the two sides of the legislative coin. In the case of the income of a business (such as Transurban) the statutes envisage a division of the world between losses or outgoings on revenue account and on capital account. In the case of revenue account, the deduction is available only to the extent that it is "incurred" in "gaining or producing … assessable income" or "necessarily incurred" in "carrying on a business for the purpose of gaining or producing" assessable income. The statutory language is relatively simple. It is expressed in ordinary, not technical, language. Courts should not burden it with undue elaboration. I say this whilst acknowledging that the application of the

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23 *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355 at 381-382 [69]-[71].

24 See, eg, *Roy Morgan Research Centre Pty Ltd v Commissioner of State Revenue (Vict)* (2001) 207 CLR 72 at 77 [9], 89 [46]; *Trust Company of Australia Ltd v Commissioner of State Revenue* (2003) 77 ALJR 1019 at 1033 [92]; 197 ALR 297 at 316; *Federal Commissioner of Taxation v Linter Textiles Australia Ltd (in liq)* (2005) 220 CLR 592 at 649-650 [181]; *Commissioner of Taxation v Stone* (2005) 79 ALJR 956 at 969 [79]; 215 ALR 61 at 78-79; *R v Lavender* (2005) 79 ALJR 1337 at 1357 [107]; 218 ALR 521 at 548; *Combet v Commonwealth* (2005) 80 ALJR 247 at 280 [135]; 221 ALR 621 at 660; *Neindorf v Junkovic* (2005) 80 ALJR 341 at 350-351 [42]; 222 ALR 631 at 641; *Weiss v The Queen* (2005) 80 ALJR 444 at 452 [31]; 223 ALR 662 at 671.

25 Reasons of Crennan J at [88]-[99].

26 See *Steele* (1999) 197 CLR 459 at 466-472 [19]-[35], 480-487 [64]-[78].

legislation will often require explanation and justification so as to make its meaning clear and to ensure a consistency and accuracy of approach[27].

15 From the remarks of successive judges, explaining the application of the legislation to particular facts, have come observations that have sometimes hardened into supposedly fixed rules[28]. Every now and again, it is necessary to pause and return to the legislation itself so as to ensure that decision-makers are applying its provisions as enacted by the Parliament. This is especially necessary where, as here, there are very complex commercial arrangements involving novel transactions for a major public-private infrastructure project.

<u>The issues</u>

16 The issues arising in this appeal are foreshadowed in the foregoing observations. Logically, the first question is whether Transurban's liability for the concession fees constituted outgoings on capital, rather than revenue, account. If this is so, that is the end of Transurban's entitlement to claim a deduction in respect of those fees. Further issues do not then arise. If, however, the fees are judged to be on revenue account, other, subsidiary questions arise.

17 The issues presented for decision are thus:

(1) *The capital characterisation issue*: Are the concession fees outgoings incurred in the performance of a promise given by Transurban as consideration for the acquisition of a capital asset, namely, the grant of the concession for the Project ("the Concession")? Are there circumstances where such payments are not of a capital nature, given the object and purpose for which the payments are made?

(2) *The incurring of the obligation issue*: If the first issue is determined against the Commissioner and the concession fees are characterised as being on revenue account, where the contract provides that an obligation may be satisfied by the issue of Concession Notes which are subject to identical conditions for presentation as the conditions which allow the deferral of payment, does the issue of such Notes mean that the obligation was "incurred" in the relevant income years or at some other time?

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27 See, eg, *Ronpibon Tin NL and Tongkah Compound NL v Federal Commissioner of Taxation* (1949) 78 CLR 47 at 55; cf *Steele* (1999) 197 CLR 459 at 481 [67].

28 cf Teo, "'Australia's Largest Tax Case' Revisited: A Nail in the Coffin for the Objective Approach to Determining the Deductibility of Expenses?", (2005) 8 *Journal of Australian Taxation* 328 at 330-331.

(3) *The proper referability issue*: If the first issue is determined adversely to the Commissioner and the second issue in favour of Transurban, where the outgoing is "incurred" in the income years but will not fall due for payment until some uncertain time in the future, can the full amount of the outgoing nevertheless be said to be "properly referable" to the income years, and thus deductible in respect of those years?

18 Other issues were presented at various stages in these proceedings[29]. Some of them are arguable and important. However, I agree with Crennan J that it is enough to decide the foregoing three issues.

The propounded deduction was an outgoing on capital account

19 *The applicable principles*: The primary question on the first issue is whether the concession fees are outgoings on capital account. What is the principle that distinguishes payments on capital account from payments on revenue account? The statutes alone do not answer this question.

20 Judges and commentators have been complaining about the income and capital dichotomy for more than a century. In *Inland Revenue Commissioners v British Salmson Aero Engines Ltd*[30], Sir Wilfrid Greene MR, after a review of much authority, observed:

> "There have been many cases which fall on the border-line. Indeed, in many cases it is almost true to say that the spin of a coin would decide the matter almost as satisfactorily as an attempt to find reasons. But that class of question is a notorious one, and has been so for many years."

The comments of Starke J in *Hallstroms Pty Ltd v Federal Commissioner of Taxation*[31] were to like effect. Despite these remarks, it is useful to turn to some of the judicial explanations.

21 The distinction between capital and revenue was examined in *BP Australia Ltd v Federal Commissioner of Taxation*[32]. There, Lord Pearce, delivering the reasons of the Privy Council in an Australian appeal involving a dispute over allowable deductions under s 51 of the 1936 Act, said:

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29 See reasons of Crennan J at [93]-[97].

30 [1938] 2 KB 482 at 498.

31 (1946) 72 CLR 634 at 644. See also *Steele* (1999) 197 CLR 459 at 482-483 [71].

32 (1965) 112 CLR 386 at 397; [1966] AC 224 at 264-265.

> "The solution to the problem is not to be found by any rigid test or description. It has to be derived from many aspects of the whole set of circumstances some of which may point in one direction, some in the other. One consideration may point so clearly that it dominates other and vaguer indications in the contrary direction. It is a commonsense appreciation of all the guiding features which must provide the ultimate answer. Although the categories of capital and income expenditure are distinct and easily ascertainable in obvious cases that lie far from the boundary, the line of distinction is often hard to draw in border line cases; and conflicting considerations may produce a situation where the answer turns on questions of emphasis and degree. That answer 'depends on what the expenditure is calculated to effect from a practical and business point of view, rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process' (per Dixon J in *Hallstrom's Case*[33]). As each new case comes to be argued felicitous phrases from earlier judgments are used in argument by one side and the other. But those phrases are not the deciding factor, nor are they of unlimited application. They merely crystallize particular factors which may incline the scale in a particular case after a balance of all the considerations has been taken."

22 In this Court, this analysis was taken a step further in *Federal Commissioner of Taxation v Energy Resources of Australia Ltd*[34]:

> "Where a taxpayer incurs loss or expense in raising funds by issuing promissory notes at a discount to their face value, its entitlement to a s 51 deduction for that loss or expense depends on the use to which the funds are to be put. If the funds are to be used as working capital, the cost of the discounts will be deductible as a revenue expense. If the funds are to be used to strengthen 'the business entity, structure, or organisation set up or established for the earning of profit', the cost of the discounts will generally not be deductible because they will be a capital, and not a revenue, expense. But sometimes the raising of capital may be such a recurrent event in the business life of a taxpayer that the cost of raising the capital will qualify as a revenue expense."

23 Yet these were not new thoughts. In *Sun Newspapers Ltd and Associated Newspapers Ltd v Federal Commissioner of Taxation*[35], Dixon J had observed:

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33 (1946) 72 CLR 634 at 648.

34 (1996) 185 CLR 66 at 73-74 (footnotes omitted).

35 (1938) 61 CLR 337 at 359.

> "The distinction between expenditure and outgoings on revenue account and on capital account corresponds with the distinction between the business entity, structure, or organization set up or established for the earning of profit and the process by which such an organization operates to obtain regular returns by means of regular outlay, the difference between the outlay and returns representing profit or loss."

24 Later in the same reasons, Dixon J made reference to what some would now call "guidelines" to which courts might refer in order to sharpen the foregoing distinction and to apply it to the facts of a particular case[36]:

> "There are, I think, three matters to be considered, (a) the character of the advantage sought, and in this its lasting qualities may play a part, (b) the manner in which it is to be used, relied upon or enjoyed, and in this and under the former head recurrence may play its part, and (c) the means adopted to obtain it; that is, by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payment so as to secure future use or enjoyment."

25 Nearly a decade later, Dixon J returned to this issue. In the passage cited by the Privy Council in *BP Australia*, he explained that the tests for distinguishing revenue and capital expenditures invoke a commercial rather than a strictly legal or jurisprudential approach. In *Hallstroms*[37], his Honour said:

> "What is an outgoing of capital and what is an outgoing on account of revenue depends on what the expenditure is calculated to effect from a practical and business point of view, rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process."

26 *Application to the facts*: The bundle of rights appearing in cl 2.8 of the Concession Deed were granted to Transurban once and for all. Such rights were a condition of Transurban's being able to establish and operate the Project. The promise to pay the concession fees was made in return for the grant of that bundle of rights. The defining feature of the Project (and an essential commercial condition of its viability) was its connection, at both ends, with the existing, publicly owned freeway infrastructure[38].

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36 (1938) 61 CLR 337 at 363. See also *British Insulated and Helsby Cables Ltd v Atherton* [1926] AC 205 at 213-214.

37 (1946) 72 CLR 634 at 648.

38 The relevant clause is set out in the reasons of Crennan J at [101].

27 Transurban, in this way, acquired the right to establish a profit-yielding venture. To perfect the grant of rights to Transurban, the State gave Transurban essential access to those portions of Crown land over which the tollway was to be constructed[39]. Transurban thereby acquired the right to place itself in a position to derive revenue for its business in the future. The advantages for which the concession fees were payable were expressed to be of a permanent and enduring character. The primary judge correctly so found[40].

28 For my approach, I would adopt the comprehensive analysis of the facts expressed by the primary judge, his application of the foregoing statements of authority as to the applicable *discrimen* for distinguishing payments on revenue from those on capital account and his consequent conclusion that the concession fees, by these criteria, were outgoings of a capital nature. This is what the primary judge concluded[41]:

> "[W]hen the matters stated by Dixon J in *Sun Newspapers*[42] are considered, the concession fees are of a capital nature. The advantages sought by the *payment* of the concession fees are to be characterised by reference to the services, facilities and entitlements contributed by the State. Those contributions … have lasting qualities, are of enduring benefit, are of a 'once and for all' nature and form part of the profit yielding structure of City Link. The services, facilities and entitlements contributed by the State, when considered cumulatively, are not contributed, and are not used, relied upon or enjoyed, on a periodic or recurrent basis. Rather they, and the advantages derived from them, are to be used, relied upon, enjoyed and not derogated from throughout the term of the Concession. Finally, the means adopted to obtain the services, facilities and entitlements (ie, *payment* of concession fees) is not a periodic reward or outlay for the use and enjoyment of City Link for periods commensurate with the payment. Rather, payment of the fees is in fixed amounts payable at the end of the Concession Period with provision for earlier payment if certain financial conditions are satisfied. In summary, the concession fees are outgoings expended 'on the structure within which the profits were to be earned' and were not 'part of the

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39 Concession Deed, cl 4.

40 (2004) 135 FCR 356 at 405 [173].

41 (2004) 135 FCR 356 at 408-409 [191] (emphasis in original).

42 (1938) 61 CLR 337 at 363.

money earning process'[43]. Accordingly, it must also follow that the concession fees are outgoings on capital, rather than revenue, account[44]."

29 The evidence shows that the advantages for which the concession fees were payable were clearly of a permanent and enduring character. Those advantages, secured by the obligation to pay the concession fees, comprised the grant of the Concession for a period of approximately 38 years. Clearly, that was a capital asset because it was the indispensable part of the profit-yielding structure of Transurban. The Concession was relied upon and enjoyed by Transurban in the building of the infrastructure and then in operating it, as intended, over the concession period. Transurban obtained the Concession by undertaking the obligations provided in the Concession Deed and in the other Project documents. Those obligations included the performance of Transurban's promise to build and operate the tollway and to collect tolls and other revenue and to make payments to the State, including (relevantly) the concession fees.

30 Self-evidently, Transurban acquired the Concession in order to generate profits for its business through the operation of the tollway. This was an important capital asset so long as the Concession operated. With respect, the Full Court erred in concluding that the concession fees were "ultimately payable"[45] for the right to operate the tollway. Rather, the concession fees were payable so as to secure the right to establish the essential business structure, which was a capital asset.

31 Unsurprisingly, the Full Court felt obliged to express the extent to which the concession fees were paid for the rights to design, construct and commission the tollway. The judges in the Full Court acknowledged that such rights "may be seen to confer an advantage of an enduring kind and therefore be capital"[46]. However, the Full Court ignored the significance of this conceded impression in reaching its conclusion on whether the concession fees were on income or capital account (or, perhaps, partly income and partly capital).

32 Without any supporting reasoning, the Full Court proceeded to conclude that "[t]he concession fee can *thus* be seen to be paid for the right to operate the ring road system to be constructed by Transurban and to impose and collect tolls

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43 *BP Australia* (1965) 112 CLR 386 at 398, 403-404; [1966] AC 224 at 266, 271.

44 cf *United Energy Ltd v Commissioner of Taxation* (1997) 78 FCR 169 at 182 per Lockhart J.

45 (2004) 141 FCR 69 at 92 [68].

46 (2004) 141 FCR 69 at 92 [65].

for the use of the system by motorists in accordance with the toll schedule"[47]. Obviously there is a missing link here in the Full Court's reasoning. Its use of the word "thus" was never explained or elaborated. With respect, the Full Court was also wrong to conclude that the obligation was not to be viewed as a single "concession fee", payable in instalments, as provided. Such, in my view, was the correct characterisation of the facts. These errors justify, and require, a fresh characterisation by this Court of the concession fees in substitution for that adopted by the Full Court. Performing that re-characterisation, I prefer the analysis of the primary judge. It adheres more closely to the *discrimen* explained by Dixon J in *Sun Newspapers* and *Hallstroms* and to the dichotomy expressed in the legislation.

33 This conclusion is still further reinforced by the nature of the Concession that Transurban secured under its agreements with the State. It is impossible to disaggregate those rights and to divide them up. Clearly, in composite, they were undifferentiated, both in their operation and in their character. The concession fees which Transurban was bound to pay to the State were paid "in consideration of the State granting the concession rights set out in clause 2.8"[48]. Those rights were to design, build and operate the tollway. They were not incurred in consideration of the right to operate the tollway separately from the other rights.

34 The recurrent concession fees payable by Transurban are thus no more than the method agreed upon by Transurban and the State for payment by Transurban for a significant capital asset indispensable to the Project. It follows that the fees constitute an outgoing of capital or of a capital nature.

35 *Expenditure necessary to the Project*: It is true that in *Cliffs International Inc v Federal Commissioner of Taxation*[49], Barwick CJ remarked that:

> "the fact that payments are made or received in performance of a promise given as part of the consideration for the acquisition of a capital asset does not necessarily mean that the payments are themselves of a capital nature".

36 However, Barwick CJ was dealing there with a case where the taxpayer, by its recurrent payments, "acquired nothing which it did not already have"[50]. The taxpayer in that case did not make those payments for the shares in issue.

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47 (2004) 141 FCR 69 at 92 [66] (emphasis added).

48 Concession Deed, cl 3.1(a).

49 (1979) 142 CLR 140 at 148.

50 (1979) 142 CLR 140 at 149.

By way of contrast, in the present proceedings, the concession fees were clearly paid for the acquisition of the Concession essential to the conduct of the Project.

37 The better view on this issue in *Cliffs International* was that stated by Gibbs J and Stephen J. In his reasons, Gibbs J[51] said:

> "the ... payments should properly be regarded as expenditure necessary for the acquisition of property or of rights of a permanent character, the possession of which was a condition of carrying on the business … at all".

Later, Gibbs J stated[52]:

> "In my opinion, if the expenditure can be truly characterized as the payment of consideration for a capital asset or advantage, it will be of a capital nature notwithstanding that the payments are recurrent and are continued for an indefinite period."

38 This approach is also consonant with that taken by Fullagar J in *Colonial Mutual Life Assurance Society Ltd v Federal Commissioner of Taxation*[53] where his Honour said:

> "It does not matter how they are calculated, or how they are payable, or when they are payable, or whether they may for a period cease to be payable. If they are paid as parts of the purchase price of an asset forming part of the fixed capital of the company, they are outgoings of capital or of a capital nature."

39 As in those cases, so in this. The payments of the concession fees formed part of the purchase price to secure an asset forming part of Transurban's fixed capital essential to the conduct on Crown land of the Project. As such, they were outgoings of capital or of a capital nature. The primary judge was correct to so hold.

40 *No analogy to rent*: The Full Court came to its conclusion that the concession fees represented outgoings on revenue account by suggesting that those fees were akin to rental payments, to be treated separately from the other elements in the Concession giving rise to Transurban's investment in the

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51 (1979) 142 CLR 140 at 153.

52 (1979) 142 CLR 140 at 156. See also at 162 per Stephen J.

53 (1953) 89 CLR 428 at 454.

Project[54]. In fact, an actual identified rent of $100 per annum was payable[55]. However, the question is whether the analogy to rent, which would normally be an outgoing on revenue account, was a valid one. Certainly, it played an important part in the Full Court's reasoning.

41 In my respectful view, the Full Court's rental analogy is unpersuasive. Transurban uses the tollway, designed, constructed, commissioned, operated, tolled, maintained and repaired by it, to raise revenue. It was also authorised by the Concession Deed to "raise revenues from other lawful uses of the Link approved by the State … until the end of the Concession Period, subject to and upon the terms of this Deed"[56]. The range of functions assigned to Transurban makes it clear that it was acquiring a distinct integrated intangible asset that did not, as such, attach to property (as does a lease to land).

42 Nor were the concession fees expressly payable only to allow Transurban possession of the land from time to time or to obtain an income flow from the use of the land. Clause 2.8 of the Concession Deed not only granted rights with commensurate obligations. It also ensured the support of the State for a project that included the many identified governmental acts necessary for its successful implementation. The State's control over the infrastructure denied to Transurban any right to use the asset constituting the Project in the same way as a lessee usually enjoys the use of property under a lease. Unlike in a lease, there was no pre-existing distinct property right held by the State that was made the subject of use or enjoyment by Transurban. The consideration given for the Concession was given for the conveyance of new rights and not merely for their use and enjoyment. Accordingly, on the facts, the analogy between the concession fees and rent is not sustained.

43 Additionally, an inherent feature of rent is that it typically involves a (generally regular) periodical payment. It is not a deferred payment payable over time. By way of contrast, the concession fees in the present case are, effectively, the deferred consideration payable by Transurban to secure the grant of the Concession essential to constituting the Project. The concession fees are not a series of periodic payments payable for the periodic use or enjoyment of the asset. It is true that periodic accrual, accounted for semi-annually and secured by the issue of Concession Notes, comprised the mechanism adopted for the quantification of the consideration given for the rights conferred. However, what Transurban acquired was a capital asset and an advantage of a capital nature.

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54 (2004) 141 FCR 69 at 93 [70].

55 (2004) 141 FCR 69 at 74 [12].

56 Concession Deed, cl 2.8(a). See reasons of Crennan J at [101].

The concession fees were thus to be classified as the instalment payments for securing that asset and advantage.

44 The Commissioner submitted that, if any analogy to an outgoing on revenue account was needed for the concession fees, a more accurate one was a promise by a lessee to pay a premium in instalments on entering into the lease. Such a payment has been described as "a cash payment made to the lessor, and representing, or supposed to represent, the capital value of the difference between the actual rent and the best rent that might otherwise be obtained"[57]. The Commissioner argued that, if a lease analogy were applicable, the consideration for the Concession (the concession fees) picked up the shortfall between the annual rent and a proper commercial rent for the land. On this view, the promise to pay concession fees fits comfortably with the concept of a premium.

45 I do not find it necessary to decide whether the payment of concession fees was analogous to some other form of payment incidental to a lease. It is enough to conclude that rent is fundamentally the consideration for the right to use property. The concession fees in this case were never payable simply for Transurban's right to use land. The integrated benefits acquired and the inter-related obligations assumed future payments by Transurban for the acquisition of the Concession, which was incontestably a capital asset. They themselves therefore displayed the character of capital. The analogy to rent generally, or to rent specifically payable for a parking station lease (as the Full Court thought[58]), is unpersuasive. It led the Full Court to its erroneous classification of the concession fees as being on revenue account.

46 *Conclusion: on capital account*: It follows that a correct application of the statutory provisions, explained in this Court's past authority, produces the conclusion that the characterisation adopted by the primary judge was the correct one.

47 I acknowledge that *dicta* can be found in the cases that appear to support Transurban's argument. On this issue, there have been so many judicial remarks that one feels embarrassed to add to them. Usually they are peppered with invocations as to how the expenditure can be "*truly* characterised". Characterisation, in every branch of the law, is problematic and usually disputable. Different minds categorise payments on different sides of the income and capital divide. That is why, in new and unusual circumstances such as the present case, it is necessary to return to the statutory text and to the novel means

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57 cf *King v Earl Cadogan* [1915] 3 KB 485 at 492 per Warrington LJ.

58 (2004) 141 FCR 69 at 93 [70].

adopted to acquire the Concession and thereby to secure, fund, establish, maintain and ultimately operate this major project of capital infrastructure.

48 To be accepted as the Project controller, Transurban had, at the one moment, to accept a series of interlocking agreements that represented an integrated payment for the capital asset it acquired for the designated period. Each part of the interlocking agreements was integral to, and dependent on, the others. The capital asset would not have been provided without the carrying out of each part. The concession fees are thus to be viewed, together, as the payment of consideration for this capital asset. This conclusion makes practical and business sense. And that is the approach proper to such questions, as this Court has repeatedly affirmed[59].

49 Therefore, whilst accepting that on such issues different minds may reach different conclusions, a return to the statutory language, and the differentiation it accepts, persuades me that the primary judge's conclusion was the better one. It disclosed no error on this point. The Full Court's analysis was faulty and unpersuasive. The primary judge's conclusion should be restored.

<u>Concession fees were not incurred in the income years</u>

50 *The remaining questions*: Having reached the foregoing conclusion, it is strictly unnecessary for me to consider the remaining issues in this appeal. They arise only if the concession fees are properly to be characterised as outgoings on revenue account. Nevertheless, out of respect for the parties' arguments, and in case I am wrong in the foregoing conclusion, I will offer my opinion on the chief remaining issues.

51 If one returns to the statutory language and the division it postulates between the income and capital accounts, there are serious factual oddities that militate against a conclusion that the concession fees, for which Transurban seeks deduction from its income tax obligations, were "incurred" in the income years. Transurban claimed a deduction for each year of income for which it incurred a liability to pay concession fees although no amount was actually paid to the State in respect of those fees in the relevant taxation years. During those years, the tollway was still being constructed. No tolls were collected. It was this feature of the evidence that led McHugh J, in the special leave hearing in relation to this appeal, to observe[60]:

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59 *Sun Newspapers* (1938) 61 CLR 337 at 359.

60 [2005] HCATrans 304 at 2.

> "[Y]ou have been allowed a deduction of $95 million which you do not pay until [2013 on the base case] …
>
> [T]he words of section 51 … talk[] about an outgoing …
>
> [A]rguably, this is a case of form triumphing over substance.
>
> ...
>
> [W]hen you talk about 'present liability' you are putting a gloss on the words of the section. … [H]ere you have a situation where you pay rent, $95 million, you discharge the liability by issuing a note, and the concession note, on one theoretical view, may never be payable at all."

52 These remarks were stated tentatively. They did not represent considered judicial conclusions and doubtless they reflect various imperfections. However, they highlight the intuitive oddity of the outcome upheld by the decision of the Full Court. They require this Court to scrutinise that outcome closely, to ensure that it accords with the text and purposes of the legislation. On the face of things, that seems unlikely. But have we, by judicial glossing of the legislation, reached such an outcome?

53 *The Commissioner's submissions*: On the assumption that liability for the concession fees was "incurred", the Commissioner submitted that nonetheless such fees were not outgoings incurred in the years of income, within the applicable provisions. He submitted, first, that the payments were not due until the conditions stated in cl 1.9 of the Master Security Deed and the conditions in Pt 3 of the Concession Notes were satisfied. He argued that these conditions had not been satisfied in the income years. He further submitted that the payments were not "properly referable" to the years of income. He also argued that for the concession fees to be deductible in full in the income years, long before they would fall due for payment, was truly an anomalous outcome. This was particularly so given the large discrepancy between the face value and the net present value of the concession fees in the respective years of income.

54 The Commissioner argued that this Court should hold that, where a contract provides that a contractual obligation to make a payment in the year of income is subject to conditions which *defer* payment indefinitely, or for a very long time in the future, at nil or negligible present cost, the obligation is not "incurred" in the relevant sense. He urged that the applicable statutory provisions contemplated that only the actual expenses of carrying on an income-earning activity in the year of income would be deductible in that year. This submission was made on the footing that the words "loss or outgoing" include debts but only if they have "come home" as a loss or outgoing and are "properly referable" to the income year. The concession fees, he suggested, did not answer to these descriptions.

55 Looking afresh at the language of the legislation and its apparent purpose and assuming, contrary to my primary conclusion, that the concession fees are to be characterised as payable on revenue account, I would accept these submissions and uphold the Commissioner's arguments.

56 *Concession fees were not incurred*: The trial judge, with apparent reluctance[61], and the Full Court with more enthusiasm[62], concluded that Transurban did "incur" a loss or outgoing in respect of the concession fees in the income years. Clause 3.1(a) of the Concession Deed arguably provides that the liability to pay the concession fees was unconditional. However, in fact, the obligation to pay was subject to conditions in cl 1.9 of the Master Security Deed and Pts 3 and 4(b) of the Concession Notes. While the Project Debt remains owing, the concession fees are owing but not due for payment, unless sufficient money is in the Distributions Account to meet the payment in full. The State thus had no absolute right to payment of the concession fees or to present the Concession Notes for payment.

57 The practical effect of these conditions was that the State's entitlement to demand payment was dependent upon the traffic levels, revenue and available cash flows arising from the operation of the tollway.

58 Transurban elected to issue Concession Notes with respect to the amounts of concession fees in the income years. However, the State can demand payment only when the conditions for presentation in Pt 3 of the Concession Notes are satisfied. In the absence of satisfaction of the conditions in Pt 3(b) or (c) of the Concession Notes, the State is entitled, under Pt 3(a), to present the Concession Notes within one year of the Expiry Date for payment on the Expiry Date. Like any claim for payment under Pt 3(b) and Pt 3(c)(ii), if the relevant conditions are satisfied, it is subject to cl 1.9 of the Master Security Deed. It is uncertain whether these conditions will be satisfied either by this time or before the end of the Concession (be that at the Expiry Date or another time).

59 In *New Zealand Flax Investments Ltd v Federal Commissioner of Taxation*[63], Dixon J said that the concept of loss or outgoing actually incurred "does not include a loss or expenditure which is no more than impending, threatened, or expected". By the application of this test, the conditions for payment in the present case indicate that any loss or outgoing in respect of the concession fees was at best "impending, threatened, or expected". It was not "actually incurred".

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61 (2004) 135 FCR 356 at 378 [75].

62 (2004) 141 FCR 69 at 83 [39].

63 (1938) 61 CLR 179 at 207.

60 In *Nilsen Development Laboratories Pty Ltd v Federal Commissioner of Taxation*[64], the question arose as to whether an employer's provision for employees' leave entitlements was deductible for income tax purposes from the employer's income. This Court held that such provisions were not deductible in that case because there was no liability to make the payment either due or payable by reference to the year of income. The Court concluded that, if at all, such liability did not arise until the time when the period of leave was entered upon by an employee. Until then, the amounts were not "incurred".

61 In his reasons in *Nilsen Development*, Gibbs J explained that an actual entitlement to payment was necessary to sustain the conclusion that an obligation was "incurred"[65]. His Honour said:

> "The employees were entitled to leave, but they were not entitled to payment. The entitlement to payment would not arise until the employees took leave (or died or left the employment). The event on which the entitlement … to payment depended had not occurred. There was a certainty that a liability to make payments in respect of leave would arise in the future, but it had not arisen. The present is not a case in which there was an immediate obligation to make payment in the future, or a defeasible obligation to pay, or a present obligation which as a matter of law was unenforceable – there was no accrued obligation to make any payment at all. There was no loss or outgoing 'incurred' within s 51(1)."

Similarly, Barwick CJ in *Nilsen Development* said[66]:

> "[T]here can be no warrant for treating a liability which has not 'come home' in the year of income, in the sense of a pecuniary obligation which has become due, as having been incurred in that year. Sir John Latham's language in *Emu Bay Railway Co Ltd v Federal Commissioner of Taxation*[67] clearly enough indicates that to satisfy the word 'incurred' in s 51(1) the liability must be 'presently incurred and due though not yet discharged'. The 'liability' of which Sir John speaks is of necessity a pecuniary liability and the word 'presently' refers to the year of income in respect of which a deduction is claimed. It may not disqualify the liability as a deduction that, though *due*, it may be *paid* in a later year. That part of

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64 (1981) 144 CLR 616.

65 (1981) 144 CLR 616 at 628.

66 (1981) 144 CLR 616 at 623-624 (emphasis added).

67 (1944) 71 CLR 596 at 606.

> Sir Owen Dixon's statement in *New Zealand Flax Investments*[68] which presently needs emphasis is that the word 'incurred' … 'does not include a loss or expenditure which is no more than pending, threatened or expected': and I would for myself add 'no matter how certain it is in the year of income that that loss or expenditure will occur in the future'."

62 *Conclusion: liability not incurred*: A deduction need not be referable to income actually derived in a specific tax year[69]. Deductibility is dependent on the fact that the taxpayer has become *liable* to pay a pecuniary sum[70]. The mere existence of a debt answering to that description does not necessarily mean that the loss or outgoing has been "incurred" in the year of income. As I explained in *Steele v Deputy Federal Commissioner of Taxation*[71]:

> "The words 'to the extent to which' contradict a complete divorce between [the assessable income and the incurring of 'losses and outgoings']. The word 'in' also suggests the necessity of a connection between the 'losses and outgoings' in question and the real possibility of 'assessable income'. Further, the very notion of 'allowable deductions', so described, suggests a relationship of some kind between the 'losses and outgoings' in question and 'the assessable income'."

63 It follows in the case of such a loss or outgoing, due in the year of income but payable in the future, that the liability must have "come home"[72]. This is a metaphor. Its utility was questioned during argument of this appeal. But income tax law is full of metaphors of this kind. Sometimes such expressions can help to explain what is meant by the language of the statute. So it is here.

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68 (1938) 61 CLR 179 at 207.

69 *Commissioner of Taxation (NSW) v Ash* (1938) 61 CLR 263 at 271; *John Fairfax & Sons Pty Ltd v Federal Commissioner of Taxation* (1959) 101 CLR 30 at 35, 46; *Commissioner of Taxation v Finn* (1961) 106 CLR 60 at 68; *AGC (Advances) Ltd v Federal Commissioner of Taxation* (1975) 132 CLR 175 at 185, 197; *Inglis v Federal Commissioner of Taxation* (1979) 28 ALR 425 at 427-428; *Fletcher v Federal Commissioner of Taxation* (1991) 173 CLR 1 at 16; *Steele* (1999) 197 CLR 459 at 467 [22], 481-482 [68].

70 *Coles Myer Finance Ltd v Federal Commissioner of Taxation* (1993) 176 CLR 640 at 676-677.

71 (1999) 197 CLR 459 at 482 [68].

72 *Nilsen Development* (1981) 144 CLR 616 at 623.

64 In the present case, Transurban's obligation had not "come home". The concession fees were "owing" in a notional sense. However, they were not "due for payment". This was because of the payment conditions. Transurban did not, therefore, "incur" an obligation to pay the concession fees until those conditions were satisfied. Until then, the obligation in respect of the concession fees remained "impending, threatened or expected". Accordingly, Transurban had only a "hope" or "expectation" of a loss or outgoing. No such loss or outgoing had actually been "incurred". The Commissioner was therefore correct, on this ground, to reject the deduction claimed by Transurban.

<u>The fees were not referable to the income years</u>

65 *Concession fees: a future expense*: In *Coles Myer Finance Ltd v Federal Commissioner of Taxation*[73], this Court held that the fact that a taxpayer has subjected itself in the year of income to a future liability does not necessarily compel the conclusion that the liability is "incurred", and is therefore deductible in full, in that year of income. For such a deduction, the liability, it was held, must be "properly referable to the year of income in question"[74].

66 Upon the present hypothesis, in the present case, the concession fees in issue are a future expense of Transurban's business operations. They actually fall to be met out of future assessable income[75]. That conclusion emerges from the terms governing the time when such payments fall due under the Concession Note arrangement, and the absence of any obligation to pay interest on amounts outstanding, in the context of the projections set out in the financial model received in evidence. To allow a deduction in the income years for the losses or outgoings when the burden of the liability only arises with the passage of time (possibly decades in the future) offends the principle of proper referability adopted by this Court in *Coles Myer*.

67 Before the primary judge, in reliance upon that authority, the Commissioner argued that the concession fees were "referable" to the years of income during which they would actually fall due for payment. In my opinion, that submission was correct. It postulates an approach which appears consistent with the language and purpose of the legislation. It is reinforced by the following observations of Dixon J in *Commissioner of Taxation (NSW) v Ash*[76] concerning the matching of deductions for expenses with income:

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73 (1993) 176 CLR 640 at 677.

74 *Coles Myer* (1993) 176 CLR 640 at 663.

75 See above these reasons at [26]-[29].

76 (1938) 61 CLR 263 at 282. See also *Coles Myer* (1993) 176 CLR 640 at 665-666.

"Where the reason for allowing a deduction is that it is a normal or recurrent expenditure or an expenditure which is fairly incident to the carrying on of the business, it is evident that it can seldom be associated with any particular item on the revenue side against which to set it, and, as the ground of its allowance is that it is an incident or accident, something concomitant to the conduct of the business, it follows that to deduct it in the year when it falls to be met is consistent with the reason for deducting it and conforms with business principles."

68 The primary judge rejected the Commissioner's submission in this respect. He did so because he considered that to allow deductions for concession fees in the year that they fall due for payment could potentially distort Transurban's operations on revenue account[77]. With respect, this conclusion was not correct. Payment of the concession fees was intended to be met out of later revenues rather than any revenues during the income years. It is therefore clear that distortion could arise if the outgoings are referable to years in which the liability is incurred.

69 Such distortions may be readily avoided by adopting the "reflex principle" which this Court explained in *Carden's Case*[78]. According to that principle, only so much of the loss or outgoing is reasonably referable to the income year in question as is calculated to give a substantially correct reflex of Transurban's true income position, each year over the life of the Project. In *Carden's Case*[79] Dixon J explained this concept in these words:

"In the present case we are concerned with rival methods of accounting directed to the same purpose, namely, the purpose of ascertaining the true income. Unless in the statute itself some definite direction is discoverable, I think that the admissibility of the method which in fact has been pursued must depend upon its actual appropriateness. In other words, the inquiry should be whether in the circumstances of the case it is calculated to give a substantially correct reflex of the taxpayer's true income … Speaking generally, in the assessment of income the object is to discover what gains have during the period of account come home to the taxpayer in a realized or immediately realizable form."

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77 (2004) 135 FCR 356 at 380 [82].

78 *Commissioner of Taxes (SA) v Executor Trustee and Agency Co of South Australia Ltd* (1938) 63 CLR 108.

79 (1938) 63 CLR 108 at 154-155.

70 *Conclusion: no correct reflex*: A correct reflex of Transurban's income was obliged to take into account the following facts:

(1) No amount would be derived through the operation of the Project until some time after the income years;

(2) The Concession Notes were not interest-bearing. The true cost to Transurban was thus far less than the face value of the Concession Notes. In fact, that cost decreased the longer the period of time for which they were to be held before being presented for payment. The Project documents forecast that the payment of Concession Notes would not be a demand on revenues in the income years because it would be many years before the preconditions for presentation of the Concession Notes would probably be satisfied;

(3) By contrast, the value of the benefits enjoyed by Transurban, from the grant of the Concession, was projected to increase in later years; and

(4) The expected source of funds for payment of the concession fees was the returns enjoyed by Transurban in the later years of the Project.

71 The anomaly of this result was recognised, and called to attention, by the primary judge. Obviously, it is a result having a considerable potential for tax avoidance. The primary judge was right to perceive the anomaly. He should have given effect to his intuition. As I have shown, it is supported by the authority of this Court.

72 A straight line apportionment was the approach taken by this Court in *Coles Myer* for allocating the discount on the accommodation bills and notes in issue there in each income year. If this approach is followed, no deductions would be allowable to Transurban in any of the income years because the trial judge held that the net present value of the concession fees, in those years, was nil, or negligible. In the trial, the Finance Director of Transurban, Mr Phillips, gave evidence that, if the concession fees were only deductible when payable (that is, when the Concession Notes were redeemed), their net present value was "nil"[80]. It was on the basis of that evidence that the primary judge concluded, correctly in my view, that from an accounting and economic point of view, the present value (rather than the nominal value) of the concession fees was the relevant value. It follows that the primary judge was correct to conclude that the present value of the concession fees payable in the income years was "nil or negligible"[81].

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80 Trial transcript before Merkel J, 3 October 2002 at 88.

81 (2004) 135 FCR 356 at 381 [84], 399 [150].

Outcome and orders

73 My conclusion is that the concession fees, on the assumption that they were incurred in the income years and were properly referable to those years, were not deductible because they were capital in nature. If, however, the concession fees were to be classified as an outgoing on revenue account they were not deductible because, on the evidence, they were not outgoings "incurred" in the income years. Any future obligation was neither satisfied in, nor properly referable to, those years.

74 On this basis, the conditions for deductibility stated in the applicable income tax legislation for the income years were not established. The Commissioner was therefore right to disallow the claims. The Full Court erred in upholding Transurban's objections to the Commissioner's assessments.

75 To give effect to these conclusions the following orders should be made. The appeal should be allowed with costs. The judgment of the Full Court of the Federal Court of Australia should be set aside. In place of that judgment, this Court should order that the appeal to the Full Court be dismissed with costs.

76 CALLINAN J. I agree with Crennan J.

77 HEYDON J. I agree with Crennan J.

78 CRENNAN J. Citylink Melbourne Limited (formerly Transurban City Link Limited) ("the respondent") is the concessionaire of the State of Victoria ("the State") pursuant to a concession agreement in respect of a major infrastructure project. The main issue in this appeal is whether concession fees paid by the respondent pursuant to that concession agreement are allowable deductions at their full face value under s 51 of the *Income Tax Assessment Act* 1936 (Cth) ("the 1936 Act"), applicable to the 1996 and 1997 years of income, and s 8-1 of the *Income Tax Assessment Act* 1997 (Cth) ("the 1997 Act"), applicable to the 1998 year of income (together "the sections").

79 Concession agreements are familiar in circumstances where a government, seeking to minimise public sector debt, retains private sector interests to build new infrastructure[82]. Charters or concessions to private sector interests, for the building and operating of infrastructure such as canals or railways, were common in nineteenth century Britain, as were municipal charters or franchises for similar purposes in the United States of America[83]. In Vinter, *Project Finance*[84], it is said:

> "In the context of project finance, [a concession] is usually granted by a governmental or quasi-governmental authority. The concession is the cornerstone of the 'BOT' ('build, operate, transfer') project finance model. In this model, a concession is granted to a concession holder who is required to build the relevant project facilities or piece of infrastructure, operate them or it for a fixed period and, at the end of such period, transfer them (or it) back to the person who originally granted the concession."

80 In broad terms, the common features of such commercial arrangements are: (i) the shared risks of a large project are allocated to the parties best able to incur the least cost in managing such risks[85], and (ii) consideration or priority is given to the repayment of lenders and to ensuring an adequate return to investors

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82 Gómez-Ibáñez, *Regulating Infrastructure: Monopoly, Contracts, and Discretion*, (2003) at 12 and 85-88; and also Grimsey and Lewis (eds), *The Economics of Public Private Partnerships*, (2005).

83 Linder, "Coming to Terms With the Public-Private Partnership", in Grimsey and Lewis (eds), *The Economics of Public Private Partnerships*, (2005) 75 at 85; and also Grimsey and Lewis, *Public Private Partnerships: The Worldwide Revolution in Infrastructure Provision and Project Finance*, (2004).

84 3rd ed (2006) at 85.

85 Victoria, Legislative Council, *Parliamentary Debates* (Hansard), 28 November 1995 at 841.

before any concession period expires[86]. The fiscal consequences of certain aspects of such commercial arrangements are the subject matter of this appeal.

The facts

81 The Melbourne City Link Project ("the Project") was a major infrastructure project. The State contracted with the respondent to design, construct and maintain a major system of roads ("the Link") which was to be operated using tolls. The respondent's tasks were to be undertaken during a period when the State conceded to the respondent the right to do all that was necessary to complete those tasks, with a view to ultimate transfer to the State of the completed infrastructure, and all other rights (including relevant intellectual property rights), at the expiry of the concession period. At the point of "surrender back"[87], the State will resume its right to operate the roads system, by tolling if it wishes.

82 After a competitive bidding process in 1995, the respondent, as part of the successful consortium, and the State entered into a suite of contracts ("the Project Documents") governing the Project, some of which are discussed in more detail in the judgment at first instance[88].

83 The *Melbourne City Link Authority Act* 1994 (Vic) and the *Melbourne City Link Act* 1995 (Vic) ratified relevant Project Documents. Thus the document central to this appeal, the Concession Deed, took effect as if enacted as law[89]. The legislation also empowered the State to contribute Crown land for the purposes of the Project, with the necessary planning approvals, and permitted the respondent to construct and maintain the infrastructure, and to impose tolls upon the users of the infrastructure[90].

84 The respondent (together with Perpetual Trustee Company Limited, the trustee of the Transurban City Link Unit Trust ("the Trustee")) was the special purpose corporate vehicle for the Project. The respondent, the Trustee, the State and City Link Management Limited (the manager of the Trust) signed the

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86 Vinter, *Project Finance*, 3rd ed (2006) at 86.

87 Victoria, Legislative Council, *Parliamentary Debates* (Hansard), 28 November 1995 at 841.

88 *Transurban City Link Ltd v Commissioner of Taxation* (2004) 135 FCR 356 at 361ff.

89 Section 14(1) of the *Melbourne City Link Act* 1995 (Vic).

90 Sections 1 and 4 of the *Melbourne City Link Act* 1995 (Vic).

Concession Deed on 20 October 1995. Between that date and 28 June 2002 there were 17 further deeds amending the Concession Deed[91].

85 As consideration for the rights conferred through the Concession Deed the respondent was required to pay concession fees to the State "from the date of the commencement of the Concession Period until the end of the twenty-fifth year after the date which [was] 6 months earlier than the Link Expected Completion Date"[92]. The base concession fee of $95.6m was payable semi-annually in arrears in June and December. The Link was first opened to traffic on 15 August 1999, with tolling commencing on 3 January 2000.

86 The Commissioner of Taxation ("the Commissioner") appeals from a unanimous decision of the Full Court of the Federal Court of Australia[93] allowing an appeal by the respondent from the decision at first instance[94]. The trial judge dismissed an appeal from the Commissioner's disallowance of deductions claimed in respect of the concession fees.

87 The respondent claimed concession fees paid by it as deductions in the financial years ending 30 June 1996, 1997 and 1998. These were amounts of $31.25m (said to have been incurred in the 1996 year of income) and $95.6m (said to have been incurred in each of the 1997 and 1998 years of income).

<u>The applicable legislation</u>

88 Section 51(1) of the 1936 Act (applicable to the income years ending 30 June 1996 and 1997) 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."

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91 (2004) 135 FCR 356 at 361 [11].

92 Clause 3.1(a)(i) of the Concession Deed.

93 *City Link Melbourne Ltd v Commissioner of Taxation* (2004) 141 FCR 69 (Hill, Stone and Allsop JJ).

94 (2004) 135 FCR 356 (Merkel J).

89 Section 8-1 of the 1997 Act (applicable to the income year ended 30 June 1998) provides that:

> "(1) You can deduct from your assessable income any loss or outgoing to the extent that:
>
> (a) it is incurred in gaining or producing your assessable income; or
>
> (b) it is necessarily incurred in carrying on a business for the purpose of gaining or producing your assessable income.
>
> (2) However, you cannot deduct a loss or outgoing under this section to the extent that:
>
> (a) it is a loss or outgoing of capital, or of a capital nature; or
>
> (b) it is a loss or outgoing of a private or domestic nature …"

90 As the Full Court observed, the difference between the sections is not material[95]. The same observation may be made about s 51(1) and its predecessor[96].

91 In *New Zealand Flax Investments Ltd v Federal Commissioner of Taxation*[97] Dixon J noted that the words of the income tax legislation give rise to particular difficulties when a transaction takes more than a year to complete, because it is the words of the section (which may not apply comfortably to certain economic or commercial practices), rather than general principles, which contain the test for deductibility[98]. The infinite variety[99] of factual situations which have fallen to be considered since *New Zealand Flax*[100] have led to continuing elucidation of the test for deductibility and how it applies to different facts.

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95 (2004) 141 FCR 69 at 71 [2].

96 Section 23(1)(a) of the *Income Tax Assessment Act* 1922 (Cth).

97 (1938) 61 CLR 179.

98 (1938) 61 CLR 179 at 199 and 206-207. See also *Federal Commissioner of Taxation v Orica Ltd* (1998) 194 CLR 500 at 555 [157] per Callinan J.

99 *Handley v Federal Commissioner of Taxation* (1981) 148 CLR 182 at 195 per Mason J.

100 (1938) 61 CLR 179.

92 In dealing with the positive limb of the test for deductibility, it is necessary to ask whether the concession fees were outgoings incurred in, and referable to, the relevant years of income. In dealing with the negative limb of the test, it is necessary to ask whether the concession fees are an expense on capital account having regard to the advantage they secure.

93 In summary, the Commissioner contended that the Full Court erred in holding that the concession fees represented outgoings which had been incurred in gaining or producing the taxpayer's assessable income in the respective years of income.

94 Alternatively, it was contended the Full Court should have held that if the concession fees were incurred in each of the years of income, they were incurred only to an extent to be ascertained by straight line apportionment over the concession period.

95 In the further alternative, it was contended that the net present value of the liability to pay the concession fees should be used to calculate allowable deductions. The Commissioner applied for leave to amend the grounds of appeal to raise this point. This was opposed, particularly as the Commissioner had not raised the point at trial (or in the Full Court) and, accordingly, there was no evidence of the full implications of adopting that accounting practice[101]. Leave to amend was refused. Present value discounting of outgoings, payable in the future, is currently under consideration, together with other methods for assessment and deduction, spread over the life of certain financial arrangements[102]. However, the accounting basis used to date in Australian tax law for the purposes of assessment and deductions has been historical cost accounting, rather than economic equivalents[103].

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101 cf *Coles Myer Finance Ltd v Federal Commissioner of Taxation* (1993) 176 CLR 640.

102 Australia, House of Representatives, Tax Laws Amendment (Taxation of Financial Arrangements) Bill 2006, Exposure Draft, December 2005.

103 *Burrill v Commissioner of Taxation* (1996) 67 FCR 519 at 524 per Jenkinson, Olney and Sundberg JJ. See also *J Rowe & Son Pty Ltd v Federal Commissioner of Taxation* (1971) 124 CLR 421 at 448-449 per Menzies J; *Federal Commissioner of Taxation v Myer Emporium Ltd* (1987) 163 CLR 199 at 216-217 per Mason ACJ, Wilson, Brennan, Deane and Dawson JJ; *Federal Commissioner of Taxation v Orica Ltd* (1998) 194 CLR 500 at 531-532 [72] per Gaudron, McHugh, Kirby and Hayne JJ.

96 Further, the Commissioner submitted that the Full Court, having held that the relevant outgoings had been incurred, erred in holding that the outgoings were on revenue account and that it should have held that each concession fee was an outgoing of a capital nature.

97 In brief, the respondent contended that each of the concession fees was an outgoing incurred in gaining or producing its assessable income. The basis of this argument was that the respondent was definitively committed to make payment of those concession fees as liability arose, and that they were referable to the relevant years of income. It was submitted that the Commissioner's claim for some apportionment in any deduction ran counter to established jurisprudence in respect of the sections. It was also submitted that in all the circumstances, the concession fees had the indicia of an outgoing on revenue account, rather than an outgoing of a capital nature.

98 The result in this matter is "peculiarly dependent upon the particular facts and circumstances"[104] of the concession agreement. Brief reference to certain Project Documents must be made to understand the context and the commercial and legal features[105] of the concession fees.

99 The primary determinants for the commercial arrangements for the Project, as embodied in the relevant Project Documents (including the Concession Deed), are the allocation of risk and the provision of finance primarily by loans, to be repaid out of revenues produced by the Project during the period of the concession.

<u>The Concession Deed</u>

100 The Concession Deed provided for the grant of certain rights during the concession period which commenced on 4 March 1996 and continued until "the date which is 33 years and 6 months after the Link Expected Completion Date" ("the Expiry Date"). The "Link Expected Completion Date" was 14 July 2000, so the concession period is due to continue until early 2034. While the fees accrued semi-annually, as explained in more detail below, the respondent was able to defer payment until some time before this date in 2034. However, the concession period could be ended earlier than the stated Expiry Date, or be extended, pursuant to cl 1 of the Concession Deed.

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104 *Cliffs International Inc v Federal Commissioner of Taxation* (1979) 142 CLR 140 at 148 per Barwick CJ.

105 *Coles Myer Finance Ltd v Federal Commissioner of Taxation* (1993) 176 CLR 640 at 660-661 per Mason CJ, Brennan, Dawson, Toohey and Gaudron JJ and 672-673 per Deane J.

101 Clause 2.8(a) of the Concession Deed specified the rights granted by the State to the respondent as the rights to:

> "(i) design;
>
> (ii) construct;
>
> (iii) Commission;
>
> (iv) operate;
>
> (v) impose and collect a toll for the use of Vehicles (within the meaning of the Toll Calculation Schedule) on;
>
> (vi) maintain and repair; and
>
> (vii) raise revenues from other lawful uses of the Link approved by the State under clause 9.4(c) and (d) in respect of,
>
> the Link until the end of the Concession Period, subject to and upon the terms of this Deed."

102 Clause 3.1(a)(i) of the Concession Deed provided:

> "The [respondent] shall (provided the Concession Period then continues), in consideration of the State granting the concession rights set out in clause 2.8, pay to the State in the period from the date of the commencement of the Concession Period until the end of the twenty-fifth year after the date which is 6 months earlier than the Link Expected Completion Date an annual concession fee of $95,600,000, payable in equal instalments semi-annually in arrears, on the last Business Day of each June and December in that period and on the date of termination of this Deed (should termination occur in that period) with each such payment being adjusted on a pro rata basis for any period of less than 6 months."

103 Clauses 3.1(a)(ii) and (iii) are expressed in similar terms to cl 3.1(a)(i) and provided for fees payable in equal instalments semi-annually in arrears of $45.2m per annum for years 26 to 34 of the scheduled operations, and of $1m per annum from the 35th year of the scheduled operations, if extended to this time.

104 Under the Concession Deed, only the respondent had the right to impose tolls upon the roads built as a part of the Project. No tolling of the Project roads occurred during the 1996, 1997 and 1998 years of income, as their construction was still in progress. Nonetheless, the concession fees were payable by the

respondent to the State during both the construction and the operation phases of the concession period.

105 If the deductions claimed are allowed, they will reduce to nil the respondent's taxable income under assessment for the relevant years of income[106].

106 The concession fee arrangements refer to a base concession fee determined by a "Base Case Financial Model", formulated in respect of projected traffic flows and tolling, as well as referring to the potential for a higher rate of return to the State by way of additional concession fees if the assumed projections are exceeded[107]. Under the Concession Deed, the respondent might, at its option, satisfy the obligation to pay the base concession fees by issuing to the State "Concession Notes"[108]. All outstanding Concession Notes are redeemable by the State within the concession period. Concession Notes can be factored, and are transferable. They do not bear interest and are not supported by letters of credit.

107 The respondent issued Concession Notes to the State for the base concession fees payable for the years of income ended 30 June 1996, 1997 and 1998. In the Base Case Financial Model it was anticipated, or assumed, that the State would commence redemption of the Concession Notes in the year 2013, and that this would continue until the end of the concession period.

108 Part 3 of each Concession Note provided that certain conditions precedent must be met before presentation of the Concession Note for payment. These were:

> "(i) the Equity Return (determined as at a date not earlier than 4 months before presentation of this Concession Note and as if the Concession Period ended on that date) must be 10% per annum or more; and
>
> (ii) the payment of the Payment Amount under this Concession Note must not result in the aggregate of the amounts paid by the [respondent] under the Concession Notes, and of the amount payable under this Concession Note, presented in the financial year

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106 (2004) 135 FCR 356 at 360 [5] per Merkel J.

107 Clause 3.1(d) of the Concession Deed.

108 As defined in cl 1.1 of the Concession Deed, as amended by a later Deed amending the Concession Deed dated 20 February 1996, in cl 3.1 and dealt with in cl 18.5 of the Master Security Deed.

in which this Concession Note is presented, exceeding 30% of the Distributable Cashflow for the preceding financial year."

109 Part 4 of each Concession Note provided that for so long as Project Debt was owing any payment to be made under the Concession Note was "owing" but "shall not be due for payment".

110 In addition to the concession fees, the respondent was also obliged to pay rent to the State for the use of the relevant land upon which the roads and infrastructure were to be built[109]. Further, certain other amounts were payable to the State by the respondent, where the State incurred costs; these were included, as explained shortly, as a part of defined "State's Priority Obligations".

<u>The Master Security Deed</u>

111 It was agreed that the terms of the Concession Deed prevailed over all other Project Documents, except the Master Security Deed. The Master Security Deed was signed ten days after the Concession Deed on 30 October 1995 by the State, the respondent, the Trustee, the agent of the lenders to the Project (Australia and New Zealand Banking Group Limited), and the Security Trustee (ANZ Capel Court Limited).

112 The Master Security Deed operated so that the order of priority of payments as between the lenders and the State was as follows: first, obligations defined as the "State's Priority Obligations" were to be met; then the lenders' "Project Debt" (defined in the Concession Deed so as to encompass money owed under the lending documents); followed by the other amounts owed to the State which included the concession fees and Concession Notes; and then finally any other securities.

113 The amended form of cl 1.9 of the Master Security Deed stated:

"For so long as any Project Debt is owing and notwithstanding the express terms of any Project Document to the contrary, any payment to be made by the [respondent] or the Trustee to the State under, or for breach of, any Project Document (other than payment of the State's Priority Amount) (the 'State Payment Amount') shall be owing to the State but shall not be due for payment until sufficient money is available for withdrawal from the Distributions Account (as defined in the Security Trust Deed) to meet that payment in full and each of the [respondent] and the Trustee undertakes not to apply any amounts held in the Distributions Account maintained in

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109 See cl 3.1(b) of the Concession Deed; however, the rent was set at an amount which would not provide a normal economic return for the use of that property.

> its name for any purpose other than payment of that State Payment Amount until the balance of the Distributions Account maintained in its name equals or exceeds that State Payment Amount to the extent that it is not in dispute and all or part of the balance has been applied by it to pay that State Payment Amount in full to the extent that it is not in dispute."

114 It can be noted that this provision is reflected in Part 4 of each of the Concession Notes as described above.

The Security Trust Deed

115 The Security Trust Deed established a number of accounts, including the special purpose Distributions Account referred to in cl 1.9 of the Master Security Deed, from which the entitlements of the State and the equity holders were to be paid[110].

116 The Security Trust Deed operated so that all the revenues of the Project were channelled through this framework of accounts, which was effectively controlled by the agent for the lenders. Clause 1.9 of the Master Security Deed had the effect that payments from the relevant Distributions Account could be made to the State only when the Project Debt owing to the lenders had been satisfied, and when there was sufficient money available to meet the payment of a Concession Note in full.

117 The respondent's ability to issue Concession Notes subordinated the payment of the concession fees to Project Debt owed to the lenders. This gave effect to the priorities dictated by the Project's commercial lending arrangements. The system of accounts described above, referred to in the hearing as "the waterfall of accounts", ensured conformity between the parties' contractual obligations and the subordination arrangements.

118 Further details of the Project are contained in the reasons of the trial judge[111] and in the reasons of the Full Court of the Federal Court[112].

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110 Clause 15 of the Security Trust Deed, referring to the "Borrower's Distributions Account" and the "Guarantor's Distributions Account", each encompassed by the definition of "Distributions Account" in cl 1.1.

111 (2004) 135 FCR 356 at 361ff.

112 (2004) 141 FCR 69 at 71ff.

<u>The decisions below</u>

119 The trial judge determined that the respondent had incurred an outgoing in respect of the concession fees in the years of income because the liability in each of those years of income arose unconditionally under cl 3.1 of the Concession Deed and was satisfied when the respondent elected to issue Concession Notes giving rise to a present liability to pay the amounts in the future[113]. His Honour also found that the fees were referable to the period in respect of which the liability for the fees was incurred. However, his Honour went on to find that the concession fees were outgoings of a capital nature rather than on revenue account[114].

120 The Full Court agreed with the trial judge's findings that the respondent had incurred an outgoing, namely the concession fees, in the years of income and that they were referable to those years[115]. However, the Full Court went on to find that the concession fees were payable for the right to conduct the business operations of the respondent in respect of the Project during the concession period[116]. The Full Court then concluded that the concession fees were characterised properly as an outgoing on revenue account rather than as an outgoing of a capital nature[117]. In my opinion, the Full Court was correct in the conclusions reached and in the orders which it made.

121 The commercial arrangements embodied in the relevant Project Documents are that the respondent encountered a liability for, and was definitely committed to, the payment of each concession fee as it became due, in each of the years of income. The terms concerning the time at which those liabilities are to be discharged do not affect the respondent's liability for concession fees in the years of income, nor do they render that liability, in any realistic or practical sense, contingent or uncertain. The subordination of the respondent's debt and the conditions precedent to commencement of the discharge of that debt were driven by the State's desire to have publicly accessible infrastructure for the Victorian community, without incurring new public sector debt, and not by any desire of the respondent's to avoid or postpone its liability to taxation. Each of the questions raised needs to be considered in more detail.

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113 (2004) 135 FCR 356 at 378 [75].

114 (2004) 135 FCR 356 at 408 [190].

115 (2004) 141 FCR 69 at 81 [31] and 82 [37].

116 (2004) 141 FCR 69 at 85 [50].

117 (2004) 141 FCR 69 at 92-93 [70].

Were the concession fees incurred in the years of income?

122 *New Zealand Flax*[118] concerned the deductibility of interest payments payable in the future. In considering the test for deductibility, Dixon J said[119]:

> "To come within [the] provision there must be a loss or outgoing actually incurred. 'Incurred' does not mean only defrayed, discharged, or borne, but rather it includes encountered, run into, or fallen upon. It is unsafe to attempt exhaustive definitions of a conception intended to have such a various or multifarious application. But it does not include a loss or expenditure which is no more than impending, threatened, or expected."

It has long been recognised that an outgoing may be "incurred", but not "discharged"[120], in the relevant year of income. In *Federal Commissioner of Taxation v James Flood Pty Ltd*[121] Dixon CJ, Webb, Fullagar, Kitto and Taylor JJ considered commercial and accounting practice and the test for deductibility and said of s 51(1)[122]:

> "The word 'outgoing' might suggest that there must be an actual disbursement. But partly because such an interpretation would produce very strange and anomalous results, and partly because of the use of the word 'incurred', the provision has been interpreted to cover outgoings to which the taxpayer is *definitively committed* in the year of income although there has been no actual disbursement." (emphasis added)

The Court went on to say "outgoings" could only have been "incurred" if "in the course of gaining or producing the assessable income or carrying on the business, the taxpayer has *completely subjected* himself to them"[123].

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118 (1938) 61 CLR 179.

119 (1938) 61 CLR 179 at 207.

120 *Federal Commissioner of Taxation v James Flood Pty Ltd* (1953) 88 CLR 492 at 506-507; *Coles Myer Finance Ltd v Federal Commissioner of Taxation* (1993) 176 CLR 640.

121 (1953) 88 CLR 492.

122 (1953) 88 CLR 492 at 506.

123 (1953) 88 CLR 492 at 506 (emphasis added).

123 In *Nilsen Development Laboratories Pty Ltd v Federal Commissioner of Taxation*[124], Barwick CJ said a liability could only be treated as having been "incurred" within the meaning of s 51(1) if it had "'come home' in the year of income"[125], yet his Honour recognised that a liability could be qualified as a deduction if it falls due in the year of income, but may be paid later[126].

124 In *Coles Myer Finance Ltd v Federal Commissioner of Taxation*[127] Deane J, agreeing with the majority[128], stated[129]:

> "[T]he weight of authority supports the conclusion that, depending upon the circumstances, a liability to pay money can constitute, or give rise to, a 'loss or outgoing' which is 'incurred' within the meaning of that sub-section notwithstanding that the money is not payable until a future time and that the obligation to pay it is theoretically defeasible or contingent in that it is subject to a condition which remains unfulfilled." (footnotes omitted)

125 Deane J considered that the critical question was whether the taxpayer was, as a practical matter, definitively committed or completely subjected to discharge of the liability in the future[130]. His Honour recognised that on some facts it would be apparent that a condition giving rise to a theoretical contingency could be treated, for practical purposes, as certain to be satisfied[131].

126 A Full Court of the Federal Court in *Federal Commissioner of Taxation v Australian Guarantee Corporation Ltd*[132] held that a liability in respect of interest on debentures to be paid (or credited) on maturity or earlier redemption was incurred in the year of income in which the taxpayer subjected itself to the

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124 (1981) 144 CLR 616.

125 (1981) 144 CLR 616 at 623.

126 (1981) 144 CLR 616 at 624.

127 (1993) 176 CLR 640.

128 Mason CJ, Brennan, Dawson, Toohey and Gaudron JJ.

129 (1993) 176 CLR 640 at 670.

130 (1993) 176 CLR 640 at 670-671.

131 (1993) 176 CLR 640 at 671-672.

132 (1984) 2 FCR 483.

liability to pay the interest, although actual payment was to occur at some uncertain time in the future.

127 It was against these examples of the application of the test for deductibility, and such propositions of general application as can be derived from those authorities, that the deductibility of the concession fees fell to be assessed. Hill J essayed a synthesis of these authorities in *Ogilvy and Mather Pty Ltd v Federal Commissioner of Taxation*[133], which was relied upon by the Full Court below[134]. The synthesis demonstrated that accruals based tax accounting and the jurisprudence in respect of the test for deductibility could not always be reconciled with a commercial or accounting approach.

128 The Commissioner submitted that the concession fees were not incurred within the meaning of the sections, because payment was not possible until cl 1.9 of the Master Security Deed and the conditions in Parts 3 and 4 of the Concession Notes were satisfied, none of which conditions had in fact been satisfied in the relevant years of income.

129 The Commissioner submitted that the effect of Part 3 of the Concession Notes and cl 1.9 of the Master Security Deed (reflected in Part 4 of the Concession Notes) is to render the liability of the respondent to the State contingent. It was argued that the practical effect of both sets of conditions was that the State's entitlement to demand payment depended on traffic levels, revenue and available cash flow. It was conceded that the concession fees were intended and meant to be paid, but it was argued that the conditions imposed on payment took the concession fees outside the scope of the sections because any loss or outgoing could at best only be "impending, threatened, or expected"[135] and that liability for concession fees had not "come home"[136] in the years of income.

130 The respondent characterised the terms of cl 1.9 of the Master Security Deed as subordinating the payment of the concession fees to the payment of the Project Debt owed to the lenders. The respondent identified the essential terms as providing that for so long as any Project Debt is owing any payment to be made by the respondent or the Trustee to the State shall be owing to the State, but shall not be due for payment until the relevant criterion is satisfied. It was

133 (1990) 95 ALR 663 at 700-701.

134 (2004) 141 FCR 69 at 79-80 [28].

135 *New Zealand Flax* (1938) 61 CLR 179 at 207 per Dixon J.

136 *Nilsen Development Laboratories Pty Ltd v Federal Commissioner of Taxation* (1981) 144 CLR 616 at 623.

submitted that this clause expressly confirms the existence of a liability which shall be owing, but that it alters the sequence in which payments would be made. The respondent contended that its promise to pay the State in accordance with the sequence of subordination, and to discharge preferentially liabilities to secured creditors, did not interfere with or diminish the certainty of its commitment to pay the concession fees.

131 Whilst there were no funds representing reserves allowing for future payment of concession fees, the accounts of the respondent refer to:

> "k) Non Interest Bearing Long Term Debt
>
> Non interest bearing long term debt represented by the Concession Notes has been included in the financial statements at the present value of expected future repayments. The present value of expected future repayments is determined using a discount rate applicable to the [respondent's] other borrowing arrangements. The present value of expected future repayments will be reassessed periodically."

132 The financial statements of the respondent also contain a section headed "Non-Current Liabilities" which is broken down to include "Borrowings − Non Current". An entry for "Concession fee[s]" is also recorded, as well as an entry accounting for the "Revaluation of Concession Note[s]".

133 In confirming the approach of the trial judge, the Full Court found that the respondent had completely subjected and definitively committed itself to paying the amount of the concession fees which accrued in each of the relevant years of income, and that the condition in cl 1.9 of the Master Security Deed that there be adequate funds in the Distributions Account did not lead to the conclusion that the liability to pay was not "incurred" within the meaning of the sections[137]. The Full Court went on to find that, in any event, the Concession Notes operated to satisfy the respondent's liability under the concession fees in the relevant years of income since the State could sue on the notes themselves[138].

134 The conclusion will be reached here that the concession fees were incurred in the years of income. On a semi-annual basis, the respondent was subjected to a contractual liability to pay the concession fees. The liability arose as and when each concession fee became due. That is when the outgoing was encountered or run into[139]. These facts exemplify a situation where a liability is

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137 (2004) 141 FCR 69 at 81 [31].

138 (2004) 141 FCR 69 at 81 [32].

139 *New Zealand Flax* (1938) 61 CLR 179 at 207 per Dixon J.

"incurred" in the year of income but not "discharged" in that same year[140]. The circumstances are distinguishable from those in *Nilsen Development Laboratories Pty Ltd v Federal Commissioner of Taxation*[141] and *Emu Bay Railway Co Ltd v Federal Commissioner of Taxation*[142]. In *Emu Bay* interest on debenture stock was only payable, in respect of any year, if a certain amount of net income was achieved. No debt or liability could arise in years when no net income was earned. Accordingly, no liability to make any outgoing had come into existence[143] in the relevant year of income. Clause 1.9 of the Master Security Deed is directed at conditions precedent to the timing of the discharge of the liability, not to the coming into existence of the liability. Here the liability comes into existence in the year of income. The deferral of the time for its discharge cannot alter this conclusion, nor can the length of time of the deferral[144].

135 An agreement, as here, between secured creditors to subordinate the rights of one to the other, does not alter the purposive character of a debt[145], nor does it render the liability, in respect of the debt, a liability which is merely impending, threatened, or expected[146]. The Concession Notes are a mechanism which satisfies the liability, but the liability is a contractual obligation irrespective of that mechanism.

136 The respondent's obligation to discharge the debt is not conditional on the commercial operating risks of the Project. Those risks do no more than affect the date on which the discharge of the liability begins and the speed with which it is discharged. The Concession Notes had to be paid no later than a certain date, namely 33 years and 6 months after July 2000[147]. They may be paid earlier if

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140 *Federal Commissioner of Taxation v James Flood Pty Ltd* (1953) 88 CLR 492 at 506-507; *Coles Myer Finance Ltd v Federal Commissioner of Taxation* (1993) 176 CLR 640.

141 (1981) 144 CLR 616.

142 (1944) 71 CLR 596.

143 (1944) 71 CLR 596 at 606 per Latham CJ.

144 *Federal Commissioner of Taxation v Australian Guarantee Corporation Ltd* (1984) 2 FCR 483.

145 *Federal Commissioner of Taxation v The Midland Railway Co of Western Australia Ltd* (1952) 85 CLR 306 at 318 per Dixon J.

146 *New Zealand Flax* (1938) 61 CLR 179 at 207 per Dixon J.

147 See Part 3(a) of the Concession Notes.

certain conditions are satisfied. If the last possible date for payment was extended, there would still be an equally certain date for payment. A liability can be encountered in the year of income without the taxpayer knowing the precise date for satisfaction of the liability[148]. The only sense in which it could be said the liability on the Concession Notes is contingent is in the abstract sense that all events in the future are conditional or contingent[149].

137 In the relevant years of income, the respondent was definitively committed and had completely subjected itself to the losses or outgoings which the concession fees represent. A condition affecting the timing of the discharge of a liability (but not the creation of the liability) does not render the liability contingent in any business or commercial sense[150].

Were the concession fees referable to the years of income?

138 In a joint judgment in *Coles Myer*[151], it is stated:

> "But it is not enough to establish the existence of a loss or outgoing actually incurred. It must be a loss or outgoing of a revenue character and it must be properly referable to the year of income in question." (footnote omitted)

139 The Commissioner submitted that the concession fees represented a future expense of the respondent's business operations because their payment fell to be met out of future assessable income. It was urged that the approach was consistent with observations made by Dixon J in *Commissioner of Taxation (NSW) v Ash*[152] to the effect that it conforms to business principles to match expenses and revenue. The Commissioner also contended that only so much of the concession fees should be referable to the relevant years of income as is

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148 *Federal Commissioner of Taxation v Australian Guarantee Corporation Ltd* (1984) 2 FCR 483.

149 *Commonwealth Aluminium Corporation Ltd v Federal Commissioner of Taxation* (1977) 32 FLR 210 at 224 per Newton J.

150 *Federal Commissioner of Taxation v Australian Guarantee Corporation Ltd* (1984) 2 FCR 483.

151 (1993) 176 CLR 640 at 663 per Mason CJ, Brennan, Dawson, Toohey and Gaudron JJ.

152 (1938) 61 CLR 263 at 282.

calculated to give a substantially "correct reflex"[153] of the respondent's income. The respondent submitted that the criterion of referability is the advantage secured by the liability in question, not the source of funds from which the liability will be discharged.

140 At trial and before the Full Court, it was found that the concession fees were the consideration for the respondent's entitlement to establish and operate the roads system. It was this entitlement which enabled the respondent to derive its assessable income during the relevant income years. Accordingly, there was no connection between each of the concession fees and the income expected to be derived in later years[154].

141 Clause 3.1 of the Concession Deed stipulates that each concession fee is an annual liability payable semi-annually. For periods less than six months, the amount of the fee is adjusted pro rata. The amount of the liability for concession fees corresponds precisely to the period to which a concession fee relates. Furthermore, while the concession fees represent a base fee, the additional concession fees[155] were calculated on the basis of additional revenue which was generated within the particular period.

142 These particular aspects of the concession fee arrangements make it clear that the advantages or gains referable to each concession fee "come home"[156] in the relevant income years.

143 In any event, the legislation does not require that the purposes of an outgoing be the gaining or production of income in the year in which the outgoing is claimed as a deduction[157]. Concession agreements are sufficiently

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153 *Commissioner of Taxes (SA) v Executor Trustee and Agency Co of South Australia Ltd* (1938) 63 CLR 108 at 154 per Dixon J.

154 (2004) 135 FCR 356 at 380 [81]; (2004) 141 FCR 69 at 82 [37].

155 Provided for in cl 3.1(d) of the Concession Deed.

156 *Nilsen Development Laboratories Pty Ltd v Federal Commissioner of Taxation* (1981) 144 CLR 616 at 623 per Barwick CJ.

157 *Amalgamated Zinc (De Bavay's) Ltd v Federal Commissioner of Taxation* (1935) 54 CLR 295 at 303 per Latham CJ, 306-307 per Starke J and 309 per Dixon J; *Ronpibon Tin NL and Tongkah Compound NL v Federal Commissioner of Taxation* (1949) 78 CLR 47 at 57 per Latham CJ, Rich, Dixon, McTiernan and Webb JJ; *Commissioner of Taxation v Finn* (1961) 106 CLR 60 at 68 per Dixon CJ; *Federal Commissioner of Taxation v Smith* (1981) 147 CLR 578 at 585 per Gibbs CJ, Stephen, Mason and Wilson JJ.

familiar not to require exploration by analogy. They are essentially licence agreements to use capital assets for the limited period of the concession. Here the capital assets of the Link are to be "surrendered" by the respondent to the State at the expiry of the concession period[158].

Apportionment

144 The Commissioner's alternative submission was that if the concession fee is incurred every year, the nominal amount of each concession fee should be spread over, or attributed to, the income years from the date when each fee was incurred until the date upon which it would fall due for payment.

145 The Commissioner accepted that, in general, deductions ought to be allowable at the face value of the loss or outgoing rather than at the discounted present value[159]. However, in reliance on *Coles Myer*[160], it was contended that the principle to be generally applied is not inconsistent with apportioning the face amount of an outgoing which is incurred over a number of years.

146 The facts here are distinguishable from *Coles Myer*[161], which concerned outgoings referable to an advantage spread over two years. The semi-annual liability for concession fees here does not secure the respondent's rights under the Concession Deed for future years. Each concession fee, like any periodic licence fee, is payable for its period. Other concession fees become due in each successive year. Accordingly, straight line apportionment is not an appropriate accounting basis for calculating the deductibility of the concession fees.

Were the concession fees on capital account having regard to the advantage they secured?

147 The starting point is the statement of Dixon J in *Sun Newspapers Ltd and Associated Newspapers Ltd v Federal Commissioner of Taxation*[162]:

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158 Australia, House of Representatives, Tax Laws Amendment (Taxation of Financial Arrangements) Bill 2006, Exposure Draft, December 2005; and cl 3.4 of the Concession Deed.

159 *Armco (Australia) Pty Ltd v Federal Commissioner of Taxation* (1948) 76 CLR 584 at 618 per Dixon J.

160 (1993) 176 CLR 640 at 661, 663 and 665-666 per Mason CJ, Brennan, Dawson, Toohey and Gaudron JJ and 673 per Deane J.

161 (1993) 176 CLR 640.

162 (1938) 61 CLR 337 at 363.

> "There are, I think, three matters to be considered, (a) the character of the advantage sought, and in this its lasting qualities may play a part, (b) the manner in which it is to be used, relied upon or enjoyed, and in this and under the former head recurrence may play its part, and (c) the means adopted to obtain it; that is, by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payment so as to secure future use or enjoyment."

148 The characterisation of an outgoing depends on what it "is calculated to effect", to be judged from "a practical and business point of view"[163]. The character of the advantage sought by the making of the expenditure is critical[164].

149 The trial judge found that the concession fees were referable to "advantages enuring to capital"[165] (in a form other than the provision of financial capital) and "akin to sharing profit"[166], with the State as a joint venturer being paid a dividend. As an alternative finding, the trial judge held that the concession fees were of a capital nature because they were properly characterised as outgoings expended "on the structure within which the profits were to be earned", and not outgoings expended in gaining or producing the respondent's assessable income as a "part of the money earning process"[167].

150 The trial judge also characterised the concession fee arrangements as analogous to a large lump sum fee payable in instalments, placing an emphasis on the total rights acquired by the respondent to design, construct and establish the roads and toll business[168].

151 The Full Court recognised the danger in arguing by analogy[169] because the arrangements here are sui generis commercial arrangements specific to

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163 *Hallstroms Pty Ltd v Federal Commissioner of Taxation* (1946) 72 CLR 634 at 648 per Dixon J.

164 *GP International Pipecoaters Pty Ltd v Federal Commissioner of Taxation* (1990) 170 CLR 124 at 137 per Brennan, Dawson, Toohey, Gaudron and McHugh JJ.

165 (2004) 135 FCR 356 at 405 [175].

166 (2004) 135 FCR 356 at 407 [182].

167 (2004) 135 FCR 356 at 389 [112] and 409 [191].

168 (2004) 135 FCR 356 at 405 [173].

169 (2004) 141 FCR 69 at 92 [67].

infrastructure projects. The Full Court also found the concession fees were a periodical and recurrent expense of conducting the respondent's business operations rather than an expense to acquire a profit-making enterprise[170].

152 The Commissioner contended that even if the concession fees were incurred in the years of income and were properly referable to those years of income, they were not deductible because they were capital in nature. The concession rights in cl 2.8 of the Concession Deed were characterised by the Commissioner as a bundle of rights necessary to establish a profit-yielding structure. Any analogy with lease payments was rejected.

153 Having regard to the criteria set out by Dixon J in *Sun Newspapers*[171], the respondent submitted that the concession fees do not secure for the respondent any enduring asset in terms of the roads built; rather, the grant of the concession resulted in the acquisition of the right to build, operate and earn a profit from the tolls charged for the use of those roads for the duration of the concession period.

154 The concession fees are only payable during the term of the concession period. The respondent does not acquire permanent ownership rights over the roads or lands used. All rights granted under the Concession Deed revert to the State at the expiry of the concession period[172]. Unlike periodic instalments paid on the purchase price of a capital asset, the concession fees are periodic licence fees in respect of the Link infrastructure assets, from which the respondent derives its income, but which are ultimately "surrendered back" to the State. Accordingly, they are on revenue account.

Conclusion

155 The concession fees satisfy the test for deductibility at their full face value in respect of each of the income years in which they are claimed as deductions. The appeal should be dismissed with costs.

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170 (2004) 141 FCR 69 at 93 [70].

171 (1938) 61 CLR 337 at 363.

172 cf *Cliffs International Inc v Federal Commissioner of Taxation* (1979) 142 CLR 140.