HIGH COURT OF AUSTRALIA

FRENCH CJ,
KIEFEL, BELL, GAGELER AND NETTLE JJ

AUSNET TRANSMISSION GROUP PTY LTD APPELLANT

AND

THE COMMISSIONER OF TAXATION OF THE COMMONWEALTH OF AUSTRALIA RESPONDENT

AusNet Transmission Group Pty Ltd v Federal Commissioner of Taxation
[2015] HCA 25
5 August 2015
M139/2014

ORDER

Appeal dismissed with costs.

On appeal from the Federal Court of Australia

Representation

S H Steward QC with L A Hespe and K J Deards for the appellant (instructed by Deloitte Lawyers Pty Ltd)

H M Symon QC with E F Wheelahan for the respondent (instructed by Australian Government Solicitor)

CATCHWORDS

AusNet Transmission Group Pty Ltd v Federal Commissioner of Taxation

Taxation – Income tax – Allowable deductions – Charges were imposed on holder of electricity transmission licence pursuant to State regulatory framework – Taxpayer purchased assets of electricity transmission business including electricity transmission licence – Taxpayer required to pay charges to State of Victoria under asset sale agreement – Whether payments of charges were outgoings "of capital, or of a capital nature" and therefore not tax deductible.

Words and phrases – "capital", "capital account", "of a capital nature", "revenue account".

Electricity Industry Act 1993 (Vic), ss 163A, 163AA.
Income Tax Assessment Act 1997 (Cth), s 8-1(2)(a).

FRENCH CJ, KIEFEL AND BELL JJ.

Introduction

1 In 1993, the State of Victoria embarked upon the privatisation of its publicly owned electricity supply industry. On 12 October 1997, a State-owned electricity transmission company, Power Net Victoria ("PNV"), which was incorporated under the *Electricity Industry Act* 1993 (Vic) ("the Electricity Act"), sold its assets to the appellant, then known as Australian Transmission Corporation Pty Ltd ("ATC"), under an "Asset Sale Agreement". The assets included a transmission licence held by PNV under the Act ("the Transmission Licence"). ATC changed its name to GPU PowerNet Pty Ltd on 30 October 1997 and again changed its name to SPI PowerNet Pty Ltd ("SPI") on 2 July 2000 following the acquisition of its issued capital by SPI Australia Holdings Pty Limited. SPI changed its name to AusNet Transmission Group Pty Ltd ("AusNet") on 4 August 2014. The name AusNet, as used throughout these reasons, may be taken to include the company under its earlier names.

2 The central question in this appeal is whether the payments by AusNet of certain statutory charges imposed on PNV as holder of the Transmission Licence transferred to AusNet, and thereafter payable by AusNet, were deductible expenditures under s 8-1 of the *Income Tax Assessment Act* 1997 (Cth) ("the ITAA") and in particular whether they were payments of capital or of a capital nature within the meaning of s 8-1(2)(a). Section 8-1 relevantly provides:

> "(1) You can ***deduct*** from your assessable income any loss or outgoing to the extent that:
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> (a) it is incurred in gaining or producing your assessable income; or
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> (b) it is necessarily incurred in carrying on a business for the purpose of gaining or producing your assessable income.
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> (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".

As appears from subs (2) and as Dixon CJ observed of the analogous s 51(1) of the *Income Tax and Social Services Contribution Assessment Act* 1936 (Cth)[1]:

> "a loss or outgoing incurred in gaining or producing the assessable income or in carrying on a business for that purpose may nevertheless be a loss or outgoing of capital".

3 The charges were imposed by an Order in Council made pursuant to s 163AA of the Electricity Act. They amounted to $177,500,000 and were payable by force of the Electricity Act[2]. They were also the subject of a contractual promise by AusNet under the Asset Sale Agreement to pay them to the State, in addition to a "Total Purchase Price" of $2,502,600,000 to be paid to PNV for its assets. For the reasons that follow, the primary judge and the majority in the Full Court of the Federal Court were correct to hold that the payments of the charges by AusNet were of a capital nature and therefore, pursuant to s 8-1(2)(a) of the ITAA, were not deductible. They were paid by AusNet as part of the price of acquiring the assets of PNV, including the Transmission Licence, which was an essential element of the transmission business. The licence was essential because s 159 of the Electricity Act provided that a person must not engage in the transmission of electricity unless the person was the holder of a licence authorising that activity or was exempted from the requirement to obtain a licence in respect of that activity[3].

4 These reasons consider the following sequence of topics:

(i) The procedural history.

(ii) The decision of the primary judge.

(iii) The decision of the Full Court.

(iv) The issues on the appeal.

(v) Capital or revenue account — general principles.

(vi) The Office of the Regulator-General.

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1 *John Fairfax & Sons Pty Ltd v Federal Commissioner of Taxation* (1959) 101 CLR 30 at 34; [1959] HCA 4.

2 Electricity Act, s 163AA(2).

3 Electricity Act, s 159(1).

(vii) The Transmission Licence and its conditions.

(viii) Section 163AA of the Electricity Act.

(ix) Section 163A of the Electricity Act and the decision of the Full Court of the Federal Court in *United Energy Ltd v Commissioner of Taxation*[4], which characterised payments of franchise fees under that provision as capital in character.

(x) The Order in Council under which the charges under s 163AA were imposed.

(xi) The Asset Sale Agreement.

(xii) The rationale of the Order in Council.

(xiii) The characterisation of the AusNet payments.

(xiv) Conclusion.

The procedural history

5 AusNet did not claim income tax deductions for the s 163AA charges in its incarnation as ATC. After ATC became SPI, SPI self-amended its tax returns for the 1999 and 2000 income tax years, and claimed deductions for the payment of the charges in those years, and also claimed the deduction in its tax return for the 2001 tax year. Each of the 1999, 2000 and 2001 tax years was a "Loss Year"[5]. However, SPI claimed deductions in subsequent years with respect to losses referable to the Loss Years. Following the formation of the SP Australia Networks (Transmission) Ltd ("SPANT") tax consolidated group, SPI recalculated its taxable income for the substituted accounting period ended 31 March 2006. In doing so, it utilised a tax loss referable to the Loss Years[6].

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4 (1997) 78 FCR 169.

5 A "loss year" for a company is an income year where it has a "tax loss": ITAA, ss 165-70(5), 175-35(5). There will be a "tax loss" if certain deductions exceed certain incomes for the company for the income year: ITAA, ss 165-70(1)–(5), 175-35(1)–(5).

6 *SPI PowerNet Pty Ltd v Federal Commissioner of Taxation* 2013 ATC ¶20-416 at 15,492 [37].

6 The Commissioner of Taxation began an audit of the SPANT tax consolidated group on or about 15 December 2008 and issued amended assessments disallowing the deductions claimed or carried forward losses used by SPI for the 2001 to 2006 income tax years. SPI objected to the assessments but its objections were disallowed by a notice from the Commissioner dated 15 August 2012[7]. AusNet, as SPI, subsequently filed notices of "appeal" in the original jurisdiction of the Federal Court against the Commissioner's objection decisions pursuant to s 14ZZ of the *Taxation Administration Act* 1953 (Cth) ("the Taxation Administration Act").

7 On 19 September 2013, the primary judge (Gordon J) dismissed each of the applications instituted pursuant to the notices of appeal under the Taxation Administration Act and directed that AusNet pay the Commissioner's costs, to be taxed unless agreed. AusNet then appealed to the Full Court of the Federal Court. On 7 April 2014 the Full Court (Edmonds and McKerracher JJ, Davies J dissenting) ordered that the appeal be dismissed with costs. On 12 December 2014, this Court (Crennan, Kiefel and Bell JJ) granted special leave to AusNet to appeal from the judgment of the Full Court of the Federal Court[8]. In the same order, the Court directed that the appellant's name on this Court's record be changed to AusNet Transmission Group Pty Ltd.

The decision of the primary judge

8 The primary judge held that the payments of the s 163AA charges were payments made by AusNet out of its profits after the calculation of its taxable income[9]. They were not an outgoing incurred in gaining or producing its assessable income or necessarily incurred in carrying on a business for the purpose of gaining or producing such assessable income. They therefore did not satisfy either limb of s 8-1(1).

9 Her Honour went on to consider whether the payments constituted a loss or outgoing of capital or of a capital nature within the meaning of s 8-1(2). Her Honour observed that the obligation to make the payments was specifically included in the Asset Sale Agreement as an element of the acquisition of the transmission business, although it was not part of the purchase price[10]. The fact

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7 *SPI PowerNet Pty Ltd v Federal Commissioner of Taxation* 2013 ATC ¶20-416 at 15,492–15,493 [38]–[39].

8 [2014] HCATrans 288.

9 2013 ATC ¶20-416 at 15,500 [79]–[80].

10 2013 ATC ¶20-416 at 15,502 [88].

that the payments were of charges imposed on the holder of the Transmission Licence did not confer upon them a revenue character. They were not related to the process of derivation of income after privatisation, and they were not a "working expense"[11]. They were an outgoing of capital or of a capital nature[12].

The decision of the Full Court

10 Edmonds J disagreed with the primary judge's conclusion that the payments did not fall within s 8-1(1) of the ITAA. In particular, he did not accept that there was a basis for her Honour's finding that the payment of the imposts came out of profits after the calculation of taxable income[13]. On the other hand, his Honour agreed that the outgoings were of capital or capital in nature[14]. They were part of the cost to AusNet of acquiring the Transmission Licence, which was unarguably a capital asset[15].

11 McKerracher J, like Edmonds J, accepted AusNet's submission that the imposts would have qualified for general deduction as an outgoing necessarily incurred for the purpose of gaining assessable income[16]. However, like Edmonds J and the primary judge, he took the view that they were capital payments incurred in order to acquire an asset.

12 Davies J dissented, taking the view that the payments were deductible under s 8-1(1) of the ITAA and that they were not of a capital nature[17].

The issues on the appeal

13 AusNet's Notice of Appeal to this Court was directed to the characterisation of the payments of the charges imposed pursuant to s 163AA as

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11 2013 ATC ¶20-416 at 15,502 [92].

12 2013 ATC ¶20-416 at 15,503 [93].

13 *SPI PowerNet Pty Ltd v Federal Commissioner of Taxation* (2014) 220 FCR 355 at 357–358 [6]–[7].

14 (2014) 220 FCR 355 at 359 [11].

15 (2014) 220 FCR 355 at 359 [12].

16 (2014) 220 FCR 355 at 363 [29].

17 (2014) 220 FCR 355 at 372 [80]–[81].

payments of capital or of a capital nature. By Notice of Contention, the Commissioner asserted that the decision of the Full Court should be affirmed on the basis that the payments did not satisfy the positive requirements of s 8-1(1) of the ITAA. The answer to the first question is determinative and the Notice of Contention is not reached.

Capital or revenue account — general principles

14 The evaluative judgment required to distinguish between expenditure on capital or revenue account is made under the guidance of approaches developed in decisions of this Court over many years. Those approaches have necessarily been expressed with a degree of generality sometimes criticised for unpredictability in the outcomes they yield[18]. However, as Dixon J observed in *Hallstroms Pty Ltd v Federal Commissioner of Taxation*[19], the courts, having been given by the income tax law "a very general conception of accountancy, perhaps of economics", have proceeded with the task "in the traditional way of stating what positive factor or factors in each given case led to a decision assigning the expenditure to capital or to income as the case might be".

15 The distinction between capital and revenue expenditure is readily discerned in cases close to the core of each of those concepts. A once and for all payment for the acquisition of business premises would be treated as an outlay of capital. A rental payment under a lease of the same premises would be treated as an outgoing on revenue account. The distinction is not so readily apparent in penumbral cases. They may require a weighing of factors including the form, purpose and effect of the expenditure, the benefit derived from it and its relationship to the structure, as distinct from the conduct, of a business. Some of those factors may point in one direction and some in another[20]. Definitive and specific criteria are not, and never have been, in abundance in Australia, nor in the decisions of the courts of the United Kingdom in the late 19th century and the first half of the 20th century which have been referred to from time to time in this Court's decisions. Lord Dunedin suggested in 1910 that a distinction between a

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18 In *Inland Revenue Commissioners v British Salmson Aero Engines Ltd* [1938] 2 KB 482 at 498 Sir Wilfrid Greene MR equated the process to "the spin of a coin". The late Professor Julius Stone relegated the distinction to a legal category of meaningless reference: Stone, *Legal System and Lawyers' Reasonings*, (1964) at 340.

19 (1946) 72 CLR 634 at 646; [1946] HCA 34.

20 *BP Australia Ltd v Federal Commissioner of Taxation* (1965) 112 CLR 386 at 397; [1966] AC 224 at 264.

once and for all payment and a recurrent payment may be "in a rough way ... not a bad criterion of what is capital expenditure ... as against what is income expenditure"[21]. Viscount Cave LC in *British Insulated and Helsby Cables v Atherton*[22] cautioned that this criterion is not decisive in every case[23]. In that case, the "once and for all" character of an expenditure was treated as an indicator that it was in the nature of a capital outlay, a fortiori, when made "with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade"[24]. Even then there might be "special circumstances" leading to an opposite conclusion[25]. *British Insulated and Helsby Cables* was long treated in this Court as "the leading case on the subject"[26].

16 The fact that a payment is recurrent is not determinative of its character. The payment by instalments of a charge, imposed as a condition upon the grant of a liquor licence reflecting its monopoly value, was held by the Court of Appeal in *Henriksen v Grafton Hotel Ltd*[27] to be a capital outlay. Du Parcq LJ, citing Viscount Cave LC, said[28]:

> "Here each sum in question was part of a total amount paid to acquire the right to trade for a period of years. At the date when that period began the possession of that right was essential before trading could be begun. In these circumstances, I am of opinion that each sum paid must be considered part of a capital outlay."

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21 *Vallambrosa Rubber Co Ltd v Inland Revenue* 1910 SC 519 at 525.

22 [1926] AC 205.

23 [1926] AC 205 at 213.

24 [1926] AC 205 at 213–214 per Viscount Cave LC.

25 [1926] AC 205 at 213–214 per Viscount Cave LC.

26 *Broken Hill Theatres Pty Ltd v Federal Commissioner of Taxation* (1952) 85 CLR 423 at 434 per Dixon CJ, McTiernan, Fullagar and Kitto JJ; [1952] HCA 75.

27 [1942] 2 KB 184.

28 [1942] 2 KB 184 at 195, citing *British Insulated and Helsby Cables v Atherton* [1926] AC 205 at 213–214.

Referring to that decision, the Privy Council in *BP Australia Ltd v Federal Commissioner of Taxation*[29] observed that:

> "Without the license the business could not be carried on. There was also an element of monopoly."

The term "an element of monopoly" might today be understood in terms of enhanced market power where the requirement for a licence, not freely given to all comers, constitutes a barrier to entry for potential competitors into the relevant market.

17 The need for Viscount Cave LC's caution about Lord Dunedin's "rough" criterion was illustrated in *Royal Insurance Co v Watson*[30]. The purchaser of an insurance business agreed, as part of the purchase arrangements, to pay a fixed salary to a continuing employee with an election to commute the salary to a gross sum and terminate the employment. The salary, whether or not commuted, was found to be part of the consideration for the purchase of the business and thereby an outgoing of a capital nature. Lord Halsbury LC put it thus[31]:

> "The result is that one of the companies sells to the other, and part of the consideration which was contemplated by both parties, and in respect of which the bargain was made, and without which it would not have been made, was the manager, and all that was incident to the manager, in respect of the payments to be made to him, whether made at once or made in this form of commutation."

The key factor in characterisation in that case, which is of considerable significance in the present appeal, was that the contested payment was part of the consideration for the acquisition of the business[32]. In the ordinary course, a lump sum paid to an employee to procure his or her resignation would be on revenue

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29 (1965) 112 CLR 386 at 405; [1966] AC 224 at 273.

30 [1897] AC 1.

31 [1897] AC 1 at 7.

32 [1897] AC 1 at 7 per Lord Halsbury LC, 8 per Lord Herschell, 9 per Lord Macnaghten, 10 per Lord Shand, 10–11 per Lord Davey.

account "made for the purpose of organizing the staff and as part of the necessary expenses of conducting the business"[33].

18 The significance attached to the purchase price of a business by the Privy Council in *Tata Hydro-Electric Agencies, Bombay v Income-tax Commissioner, Bombay Presidency and Aden*[34] was debated in the submissions on this appeal. The contested outlay in that case was a payment by the assignees of an agency business of a percentage of certain commissions, in discharge of an obligation owed by the assignor to certain third parties. The statutory test of deductibility under s 10(2)(ix) of the *Indian Income-tax Act* 1922 required that the "expenditure (not being in the nature of capital expenditure) [was made] solely for the purpose of earning such profits or gains". In holding that the payments were not deductible, the Privy Council, in a passage quoted by the primary judge, said[35]:

> "the obligation to make these payments was undertaken by the appellants in consideration of their acquisition of the right and opportunity to earn profits, that is, of the right to conduct the business, and not for the purpose of producing profits in the conduct of the business".

AusNet pointed out that the question considered by the Privy Council was the positive question posed by s 10(2), not the negative question relating to capital expenditure. The negative question was not reached because the positive question was answered adversely to the taxpayer. Nevertheless, the passage quoted was consistent with the approach adopted in this Court to the characterisation of expenditure as being "of a capital nature". So much appears from the discussion below of the judgment of Fullagar J in *Colonial Mutual Life Assurance Society Ltd v Federal Commissioner of Taxation*[36], which referred to *Tata Hydro-Electric*[37]. The fact that a payment can be viewed as part of the consideration for the acquisition of a business or capital asset weighs heavily in

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33 *W Nevill & Co Ltd v Federal Commissioner of Taxation* (1937) 56 CLR 290 at 306 per Dixon J, see also at 302 per Latham CJ, 304 per Rich J, 308 per McTiernan J; [1937] HCA 9.

34 [1937] AC 685.

35 [1937] AC 685 at 695, quoted at 2013 ATC ¶20-416 at 15,502 [90].

36 (1953) 89 CLR 428; [1953] HCA 68: see (2014) 220 FCR 355 at 359 [12], 362 [25] per Edmonds J, 368–369 [56]–[59] per McKerracher J.

37 (1953) 89 CLR 428 at 455.

favour of its character as a capital outlay. However, as also appears from *Cliffs International Inc v Federal Commissioner of Taxation*[38], the question must always be asked — was the payment made "for" the acquisition?

19 The proposition is well established that expenditure of a kind ordinarily treated as being on revenue account in one set of circumstances may be treated as on capital account in another set of circumstances. An example is found in the decision of the Scottish Court of Session in *Law Shipping Co v Inland Revenue*[39]. The expenditure of substantial sums on repairs to a ship which had been necessary at the time of its purchase was treated as capital[40]. The need for repairs meant that the ship when purchased was a less valuable asset than if it had been in repair[41]. Absent the need for repairs, the sellers could have demanded a higher price[42]. Analogical reasoning suggests that the Transmission Licence, bringing with it as it did the burden of the charges imposed under s 163AA, was on that account a less valuable asset than it would have been if PNV had paid the charges before transfer.

20 Both parties in this appeal relied upon well-known passages about the characterisation of capital and revenue outlays in the judgment of Dixon J in *Sun Newspapers Ltd v Federal Commissioner of Taxation*[43]. The contested expenditure by Sun Newspapers secured, from its potential competitor, a non-compete covenant which was limited in duration and spatial coverage. Although, as Rich J held at first instance, it was a wasting asset, that did not deprive it of its capital character[44]. Its purpose was "to buy out opposition and secure so far as

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38 (1979) 142 CLR 140; [1979] HCA 8.

39 1924 SC 74.

40 1924 SC 74 at 79–80 per Lord Clyde, 80–81 per Lord Skerrington, 81 per Lord Cullen, 81–82 per Lord Sands.

41 1924 SC 74 at 79 per Lord Clyde.

42 1924 SC 74 at 79 per Lord Clyde.

43 (1938) 61 CLR 337; [1938] HCA 73, described in *BP Australia Ltd v Federal Commissioner of Taxation* (1965) 112 CLR 386 at 394; [1966] AC 224 at 261 as a "valuable guide to the traveller in these regions".

44 See Parsons, *Income Taxation in Australia*, (1985) at 431–432 [7.10] for a discussion of wasting assets as structural capital assets, the costs of which are on capital account and non-deductible.

possible a monopoly"[45]. As Latham CJ said, the payment obtained "a very real benefit or advantage ... namely, the exclusion of what might have been serious competition"[46].

21 Dixon J said that the distinction between capital and revenue account expenditure corresponded with the distinction between the business entity, structure or organisation set up or established for the earning of profit and the process by which such an organisation operates to obtain regular returns by means of regular outlay[47]. Acknowledging the infinite variety of business structures, his Honour said that some might comprise little more than the intangible elements constituting goodwill[48]. Implicit in that observation was the uncontroversial proposition that an intangible asset might, according to its nature and function in the conduct of the business, be properly characterised as forming part of the structure of the business and the cost of its acquisition as a capital cost. As Starke J said in *Hallstroms Pty Ltd v Federal Commissioner of Taxation*[49] after quoting Dixon J in *Sun Newspapers*:

> "The asset or advantage need not have a tangible existence: thus the acquisition of the goodwill of a business or of restrictive covenants not to compete in business and the promotion of Parliamentary bills and so forth may all involve expenditure of capital or of a capital nature." (citation omitted)

As in the case of *Henriksen v Grafton Hotel Ltd*, mentioned earlier, a licence, essential to the conduct of the business, may fall within that description.

22 Dixon J in *Sun Newspapers* analysed the question of characterisation by consideration of three factors[50]:

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45 (1938) 61 CLR 337 at 347.

46 (1938) 61 CLR 337 at 355.

47 (1938) 61 CLR 337 at 359.

48 (1938) 61 CLR 337 at 359–360.

49 (1946) 72 CLR 634 at 644. See also *British Insulated and Helsby Cables v Atherton* [1926] AC 205 at 222 per Lord Atkinson; *Van den Berghs Ltd v Clark* [1935] AC 431 at 439–440 per Lord Macmillan.

50 (1938) 61 CLR 337 at 363.

> "*(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."

He later observed in *Hallstroms Pty Ltd v Federal Commissioner of Taxation* that the distinction also depends upon "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"[51]. The advantage may not comprise any "rights" at all. In holding in *John Fairfax & Sons Pty Ltd v Federal Commissioner of Taxation*[52] that the corporate taxpayer's legal costs in a contest over control of another company were of a capital nature, Dixon CJ said[53]:

> "It is not in my opinion right to say that because you obtain nothing positive, nothing of an enduring nature, for an expenditure it cannot be an outgoing on account of capital."

The competition in that case, as Fullagar J put it, was "for a capital gain or advantage"[54]. It should be added, however, that the emphasis placed by Dixon J on the "practical and business point of view" does not mean that it is unnecessary to examine the legal rights (if any) obtained by the expenditure[55].

23 The real question, as Gibbs ACJ identified it in *Federal Commissioner of Taxation v South Australian Battery Makers Pty Ltd*[56], may be "not to determine the character of the advantage sought, once it has been identified, but to decide

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51 (1946) 72 CLR 634 at 648.

52 (1959) 101 CLR 30.

53 (1959) 101 CLR 30 at 36, Kitto J agreeing at 43.

54 (1959) 101 CLR 30 at 42.

55 *Federal Commissioner of Taxation v South Australian Battery Makers Pty Ltd* (1978) 140 CLR 645 at 662 per Stephen and Aickin JJ; [1978] HCA 32.

56 (1978) 140 CLR 645.

what was the advantage sought by the taxpayer by making the payments"[57]. If one advantage for the acquisition of a capital asset was "the fact that the payments were called 'rent', and were made periodically, [that] would not necessarily prevent them from being in part outgoings of a capital nature"[58]. It might be thought that that observation has considerable relevance to the present case. The assumption by AusNet of liability to pay the s 163AA charges by operation of law upon the transfer of the licence to it and by the contractual promise to pay the charges was, as appears later in these reasons, an integral part of the consideration it had to provide in order to acquire the assets of the transmission business, which necessarily included the Transmission Licence. The observation of Gibbs ACJ was reflected in *GP International Pipecoaters Pty Ltd v Federal Commissioner of Taxation*[59], in which the Court said "the chief, if not the critical, factor" is the character of the advantage sought by the expenditure[60]. That factor had been the focus of consideration in *Colonial Mutual Life*, which was relied upon by the Commissioner in this case.

24 In *Colonial Mutual Life*, payments by the purchaser of an income producing property of a percentage of the rents derived from it, made as part of the consideration for the acquisition of the property, were held to be on capital account. The parties to this appeal focussed upon the observation of Fullagar J, with whom Kitto and Taylor JJ agreed[61], that the payments were made in order to acquire a capital asset and that they constituted the price payable on the purchase of the land. How they were calculated, how and when they were payable and whether they might cease to be payable for a time, did not matter. Fullagar J said[62]:

> "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."

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57 (1978) 140 CLR 645 at 655.

58 (1978) 140 CLR 645 at 655.

59 (1990) 170 CLR 124; [1990] HCA 25.

60 (1990) 170 CLR 124 at 137.

61 (1953) 89 CLR 428 at 460.

62 (1953) 89 CLR 428 at 454.

His Honour formulated the questions commonly arising in such cases as[63]:

> "(1) What is the money really paid *for*?—and (2) Is what it is really paid for, in truth and in substance, a capital asset?" (emphasis in original)

25 Williams ACJ treated the case as indistinguishable from *Tata Hydro-Electric* and applied what Dixon J had said in *Sun Newspapers*. His Honour adopted as the relevant question[64]:

> "Are the sums in question ... capital outlays, are they expenditure necessary for the acquisition of property or of rights of a permanent character the possession of which is a condition of carrying on the trade at all?"

Webb J also treated the outgoings as "expenditure for the acquisition of a capital asset ... and not expenditure in the working of that or any other asset with a view to making it income-producing, although this asset is to be used for rent-production"[65]. The thrust of the reasoning in each of the three separate judgments of Williams ACJ, Webb and Fullagar JJ was to the same effect.

26 AusNet questioned reliance upon the proposition, taken in isolation from the judgment of Fullagar J, that payments, however calculated or payable and whenever payable, if made as part of the purchase price for an asset forming part of the fixed capital of the taxpayer were outgoings of capital or of a capital nature. As AusNet pointed out, the proposition directs attention to the question then formulated by Fullagar J — "what is the money really paid for?"

27 AusNet accepted that in the usual case an outgoing which forms part of the consideration for the acquisition of a capital asset will be "for" the advantage of securing that asset on an enduring basis. The usual case, however, is not every case. AusNet pointed to the treatment by this Court, in *Commissioner of Taxation v Morgan*[66], of the apportionment of municipal and water rates reimbursed by a purchaser of land to the vendors, who had paid the annual levy covering a period beyond the date of transfer of the land to the purchaser. The

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63 (1953) 89 CLR 428 at 454.

64 (1953) 89 CLR 428 at 448, derived from the test applied by Lord Clyde in *Robert Addie & Sons' Collieries v Inland Revenue* 1924 SC 231 at 235.

65 (1953) 89 CLR 428 at 448–449.

66 (1961) 106 CLR 517; [1961] HCA 64.

apportionment was treated as paid on revenue account. It is important, however, to note the factors upon which the Court focussed in that case, including the separateness of the payment from the purchase price and, importantly, its variability dependent upon the time of settlement. That variability reflected its treatment between vendor and purchaser as part of the "flow" of outgoings characteristic of expenditure on revenue account[67]. The time-dependent and variable character of the outgoing and its place in the contract of sale put it in a different category from the fixed liability assumed by AusNet upon transfer to it of the Transmission Licence, both by force of the statute and, as will be seen, pursuant to its contractual promise to pay the charges.

28 AusNet also relied upon *Cliffs International*, in which *Colonial Mutual Life* was distinguished[68]. The contested expenditures in that case were royalty payments on iron ore mined by the taxpayer which were paid to the vendors of shares acquired by the taxpayer in a mining company which held certain tenements. The payments were held to be on revenue account and thereby deductible. Barwick CJ said that the fact that the promise to make the payments was part of the consideration for the acquisition of the capital asset did not necessarily mean that they were of a capital nature[69]. The promise to make the payments was part of the consideration given for the purchase of the shares[70]:

> "[b]ut they were acquired without making the payments in question. The recurrent payments were not made for the shares though it might properly be said that they were payable as a consequence of the purchase of the shares."

The Chief Justice did not find the facts in *Colonial Mutual Life* analogous although he did not say why and expressly left open the correctness of that decision[71]. As appears from the passage quoted, he effectively found that the payments were not made "for" the shares. Jacobs J, also in the majority, acknowledged that in *Colonial Mutual Life* the recurrent payments could hardly

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67 (1961) 106 CLR 517 at 521 per Dixon CJ, Kitto and Windeyer JJ.

68 (1979) 142 CLR 140 at 151 per Barwick CJ, 175 per Jacobs J.

69 (1979) 142 CLR 140 at 148, citing *Egerton-Warburton v Deputy Federal Commissioner of Taxation* (1934) 51 CLR 568 at 572–573; [1934] HCA 40.

70 (1979) 142 CLR 140 at 149.

71 (1979) 142 CLR 140 at 151.

be regarded otherwise than as part of the cost of the acquisition of the freehold[72]. Accepting that each case turned on its own facts and circumstances, he said of the case before him[73]:

> "The preponderating factors are that the payments were in respect of a depreciating asset, that they were recurrent over the life of the asset if the asset was used throughout its life and that the amount of the payments were proportioned to the use made of the asset. These factors in my opinion clearly outweigh the other factors which might support a contrary view."

Murphy J, who formed the third member of the majority, found that there was a strong analogy with an agreement to pay rent as part of the consideration for acquisition of a lease[74]. Gibbs and Stephen JJ dissented, holding that the case was covered by the principle on which *Colonial Mutual Life* was decided[75]. The majority judgments do not disclose a common proposition applicable to this case.

29 More recently, in *Federal Commissioner of Taxation v Citylink Melbourne Ltd*[76], payment of a fixed annual "base concession fee" as part of the consideration given by the taxpayer to the State of Victoria for the concession to construct and operate a toll road system was held to be deductible. In rejecting the proposition that the payment was on capital account, Crennan J, with whom Gleeson CJ, Gummow, Callinan and Heydon JJ agreed[77], observed that the taxpayer did not acquire permanent ownership of the roads or associated land. Her Honour said[78]:

> "Unlike periodic instalments paid on the purchase price of a capital asset, the concession fees are periodic licence fees in respect of the Link

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72 (1979) 142 CLR 140 at 175.

73 (1979) 142 CLR 140 at 175.

74 (1979) 142 CLR 140 at 176.

75 (1979) 142 CLR 140 at 156 per Gibbs J, 161 per Stephen J.

76 (2006) 228 CLR 1; [2006] HCA 35.

77 (2006) 228 CLR 1 at 8 [1] per Gleeson CJ, 8 [2] per Gummow J, 27 [76] per Callinan J, 27 [77] per Heydon J.

78 (2006) 228 CLR 1 at 44 [154].

> infrastructure assets, from which the [taxpayer] derives its income, but which are ultimately 'surrendered back' to the State. Accordingly, they are on revenue account."

As appears below, the charges imposed under s 163AA, being of an ad hoc character imposed for a time-limited purpose, could not be described as "periodic licence fees". Periodic fees were payable in respect of the Transmission Licence but pursuant to a separate provision of the Electricity Act.

30 Against that background it is now convenient to turn to the legislative framework.

The Office of the Regulator-General

31 It is necessary, in order to understand the relevant regulatory provisions of the Electricity Act and the provisions of the Transmission Licence, to say something about the Office of the Regulator-General. That Office was established under the *Office of the Regulator-General Act* 1994 (Vic) ("the Regulator-General Act"). The Office is empowered to act as regulator of any industry specified as a "regulated industry" by the legislation under which the industry operates or by an Order in Council[79]. Its involvement in the electricity industry came from Pt 12 of the Electricity Act, introduced into the Act in 1994[80], and conferred regulatory functions on the Office[81]. The Office was given the power under Pt 12 to regulate charges for connection to, and the use of, the transmission system[82]. It was also responsible for approving the grant[83],

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79 Regulator-General Act, s 8, read with the definition of "regulated industry" in s 3(1).

80 *Electricity Industry (Amendment) Act* 1994 (Vic), s 25.

81 Electricity Act, s 155.

82 See eg Electricity Act, s 158(1)(b)(iii).

83 Electricity Act, s 162(1).

transfer[84] and revocation[85] of licences under the Electricity Act, including transmission licences[86].

The Transmission Licence and its conditions

32 A transmission licence granted pursuant to s 162 of the Electricity Act could be granted for such term (if any)[87] and on such conditions[88] as were determined by the Office of the Regulator-General. A non-exhaustive list of conditions which could be imposed upon a licence was set out in s 163(3), including the requirement in s 163(3)(a) that:

> "the licensee ... pay specified fees and charges in respect of the licence to the Office".

Section 163(4) required that the fees and charges so specified be determined by the Minister having regard to the proportion of the total cost of the Office incurred in the administration of Pt 12. The Office could also determine conditions specifying procedures for the variation or revocation of the licence[89]. The Office was empowered under s 164(3) to revoke the licence in accordance with the procedures specified in the licence conditions.

33 Clause 2 of the Transmission Licence granted to PNV and transferred to AusNet pursuant to the Asset Sale Agreement on 6 November 1997 provided:

> "The Office, in exercise of the powers conferred by section 162 and section 168 of the Act, licenses the Licensee to transmit electricity and to supply electricity using the Licensee's electricity transmission system, subject to the conditions set out in this licence."

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84 Electricity Act, s 167(5).

85 Electricity Act, s 164(3).

86 Electricity Act, s 161(1)(b).

87 Electricity Act, s 163(1).

88 Electricity Act, s 163(2).

89 Electricity Act, s 163(3)(h).

The licence took effect on and from 3 October 1994[90].

34 It was a condition of the licence that the licensee pay the fees and charges determined by the Minister under s 163(4) of the Electricity Act[91]. Clause 18 of the Transmission Licence provided:

> "COMPLIANCE WITH LAWS
>
> The Licensee must comply with all applicable laws including but not limited to the Tariff Order."

It may be taken, although it was not argued, that cl 18 applied to the statutory obligation to pay charges imposed under s 163AA. Non-compliance with cl 18, or any other condition, did not automatically lead to loss of the licence. There was a process for its revocation.

35 Clause 3.2 provided for revocation of the licence by the Office of the Regulator-General in accordance with cll 3.3 and 3.4. Clause 3.4 empowered the Office to give a notice of revocation to the licensee if the licensee did not comply with an "enforcement order" or an undertaking, and the Office decided that it was necessary or desirable to revoke the licence in order to achieve certain policy objectives[92], in which case the term of the licence would end, subject to cl 3.5, on the expiration of the period of the notice. The term "enforcement order" refers to an enforcement order served under s 35 of the Regulator-General Act. Section 35 applied where the Office was, as in this case, responsible under relevant legislation for licensing, and a person was contravening, or in the opinion of the Office was likely to contravene, the conditions of a licence, and the Office considered that the contravention or likely contravention was not of a trivial nature[93]. The Office could serve an order on the person (which might be

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90 Transmission Licence, cl 3.1.

91 Transmission Licence, cl 16.1. There was no condition relating to the charges imposed under s 163AA, as that provision had not been enacted at the time that the licence issued.

92 The objectives specified in s 157 of the Electricity Act and s 7 of the Regulator-General Act and, to the extent context requires, in a statement of government policy under s 10 of the Regulator-General Act: Transmission Licence, Schedule, cl 1, definition of "policy objectives".

93 Regulator-General Act, s 35(1).

provisional or final) requiring the person to comply with the licence condition[94]. It was an offence for a person not to comply with such an order[95]. Importantly, failure to pay a charge imposed under s 163AA, while placing the licensee at risk of revocation, did not necessarily lead to revocation of the licence. The State could simply take action in such a case to recover the charge as a debt when it became due and payable.

36 It is convenient now to consider s 163AA of the Electricity Act, under which the Order in Council was made which imposed the charges on PNV, as holder of the Transmission Licence, which were ultimately paid by AusNet.

Section 163AA of the *Electricity Industry Act* 1993

37 Section 163AA of the Electricity Act was inserted in that Act in 1995[96]. As at October 1997 it provided:

> "***Charges payable to Treasurer***
>
> (1) The Governor in Council, on the recommendation of the Treasurer, may, by Order published in the Government Gazette, declare that specified charges, or charges calculated in a specified manner, are payable as an impost by the holder of a licence at such times and in such manner as are so specified.
>
> (2) The holder of a licence must pay to the Treasurer for payment into the Consolidated Fund the charges determined under sub-section (1) and applicable to the licence at the times and in the manner so determined.
>
> (3) An Order made under this section does not apply to a distribution company, a transmission company or a generation company that ceased to be a public distribution company, public transmission company or public generation company before the Order was made.

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94 Regulator-General Act, s 35(2).

95 Regulator-General Act, s 35(8).

96 *Electricity Industry (Further Amendment) Act* 1995 (Vic), s 13.

(4) Nothing in this section or in an Order under this section prevents a charge being paid, or the payment of a charge being received, before the due date for payment."

Section 163AA(3) had been amended, with effect from 3 June 1997, to include references to "a transmission company" and "public transmission company"[97].

38 "[T]ransmission company" meant[98]:

"(a) Power Net Victoria while it continues to hold a licence to transmit electricity issued under Part 12;

(b) a person who is the holder of a licence to transmit electricity issued under Part 12, being a person declared by Order of the Governor in Council published in the Government Gazette to be a transmission company for the purposes of this Act".

"[P]ublic transmission company" meant a transmission company which was[99]:

"(a) a statutory authority; or

(b) a company all the shares in which are held by, or on behalf of, the State or a statutory authority".

Other provisions of Pt 12 gave content to the definitions. Section 161(1) provided that a person could apply to the Office of the Regulator-General for the issue of a licence authorising one or more of a number of certain activities where specified in the licence, including "to transmit electricity"[100]. The term "licence" was defined in s 154 as "a licence specified in section 161(1)".

39 It follows from the definitions of "transmission company" and "public transmission company" that PNV would cease to be a public transmission company for the purposes of s 163AA(3) if it ceased to be a licence holder or if it

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97 *Electricity Industry (Miscellaneous Amendment) Act* 1997 (Vic), s 24(b).

98 Electricity Act, s 3(1), inserted by *Electricity Industry (Miscellaneous Amendment) Act* 1997 (Vic), s 18(b).

99 Electricity Act, s 3(1), inserted by *Electricity Industry (Miscellaneous Amendment) Act* 1997 (Vic), s 18(a).

100 Electricity Act, s 161(1)(b).

ceased to be a State-owned company. It followed that no charge could be imposed on PNV under s 163AA after it had transferred the licence to AusNet.

40 As appears below, the Asset Sale Agreement included a provision that AusNet would not challenge the validity of the charges imposed on PNV pursuant to s 163AA which AusNet was to pay post-transfer. The imposition of the charges on PNV, which was in effect an instrumentality of the State of Victoria, may have been calculated to avoid characterisation of the charges as an excise[101]. However, the liability to pay the charges, in this case, was extended by the Order in Council to transferees of the licence from PNV. Although it was acknowledged by counsel for AusNet that characterisation of the charges as an excise may have been a continuing concern, no submissions were made on the question whether they were, and it is neither necessary nor desirable to express a view on that matter, which, in any event, would involve a question arising under the Constitution. It is sufficient for present purposes to observe that, as appears from the Asset Sale Agreement, the possibility of a challenge by AusNet to the validity of the charges was contractually precluded. There is no suggestion that the contractual provision was unnecessary or unenforceable. It was an element of the consideration moving from AusNet under the agreement.

41 It is necessary next to refer to s 163A of the Electricity Act, which provided for the imposition, by Order in Council, of franchise fees on distribution companies. The Full Court of the Federal Court in *United Energy* held that the payment of the franchise fees was on capital account. Its reasoning has significance for this case.

Section 163A of the *Electricity Industry Act* 1993 — an analogous provision?

42 As part of the process leading from State ownership of the electricity industry to full privatisation, five entities known as "Municipal Electricity Undertakings" were restructured into five regionally based distribution companies each with a retail arm and a regulated geographic distribution area. That process took place in 1994. Each distribution company was, until December 2000, to be the sole retailer of electricity for what were designated as "franchise customers" in a "franchise area". In effect, the distribution companies, which were privatised on 31 January 1995, had exclusive licences in respect of their areas.

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101 See *Queanbeyan City Council v ACTEW Corporation Ltd* (2011) 244 CLR 530 at 541–542 [19]–[22] per French CJ, Gummow, Hayne, Crennan, Kiefel and Bell JJ; [2011] HCA 40.

43 Section 163A[102] provided that a distribution company which was the holder of an exclusive licence under Pt 12 of the Act was to[103]:

> "pay to the Treasurer, in respect of each financial year during which it holds, or held, such a licence the impost determined in respect of that year by Order of the Governor in Council, on the recommendation of the Treasurer, applying to that company and published in the Government Gazette".

The Treasurer, in recommending the amount of an impost for each financial year, was required to be satisfied that the amount reasonably represented the amount by which the income of the company derived from the sale of electricity to franchise customers in that year was likely to exceed the sum of the costs of deriving the income, taxes payable in deriving that income and a reasonable return on the capital of the company used in deriving that income[104].

44 The payments of franchise fees by distribution companies under s 163A were held by the Full Court of the Federal Court in *United Energy* to be not deductible because they were payments of a capital nature[105]. Lockhart J asked the questions posed by Fullagar J in the *Colonial Mutual Life* decision — "what is the money really paid for and is what it is really paid for in truth and in substance, a capital asset?"[106] Their answers required a practical examination of the facts concerning "what the expenditure is calculated to effect from a practical and business point of view"[107]. His Honour concluded that the payments could be viewed in substance as a purchase price for a business which the distribution

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102 Introduced by s 29 of the *Electricity Industry (Further Amendment) Act* 1994 (Vic) and substituted by s 30 of the *Electricity Industry (Amendment) Act* 1995 (Vic).

103 Electricity Act, s 163A(1).

104 Electricity Act, s 163A(2)(a)–(c).

105 (1997) 78 FCR 169 at 181 per Lockhart J, 196 per Sundberg and Merkel JJ. Special leave to appeal from that decision was refused by this Court on 13 February 1998: [1998] HCATrans 41.

106 (1997) 78 FCR 169 at 181.

107 (1997) 78 FCR 169 at 182, quoting *BP Australia Ltd v Federal Commissioner of Taxation* (1965) 112 CLR 386 at 397; [1966] AC 224 at 264.

company had acquired for nothing and which conferred on it monopoly power in a specific geographic area[108]:

> "In return for obtaining the exclusive right to conduct its business in Melbourne, the applicant makes payment of franchise fee until the monopoly runs out in the year 2001; it receives the monopoly right to distribute and sell electricity in its defined area and in return makes payment of the associated monopoly rent."

Sundberg and Merkel JJ characterised the franchise fee as benefiting "the business entity, structure, or organisation set up or established for the earning of profit"[109]. They also invoked the joint judgment in *Broken Hill Theatres Pty Ltd v Federal Commissioner of Taxation*[110], observing that[111]:

> "'the advantage of being free from ... competition' in the sale of electricity for the period for which the franchise fee is payable is 'just the very kind of thing which has been held in many cases to give to moneys expended in obtaining [that advantage] the character of capital outlay'".

The payments of the fees, as a monopoly rent for freedom from competition in respect of a substantial body of retail customers in the taxpayer's licence area, were held to be qualitatively different from payments of the annual licence fees payable under the licence to sell electricity in Victoria[112].

45 AusNet submitted that the charges under s 163AA of the Electricity Act were a tax. It suffices to say that those charges, and those imposed on distribution companies under s 163A, were compulsory exactions of money by a public authority for a public purpose and were not a payment for services

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108 (1997) 78 FCR 169 at 182. His Honour also held that the fees did not fall within either limb of deductibility in s 51(1) of the *Income Tax Assessment Act* 1936 (Cth), and in that respect differed from Sundberg and Merkel JJ, but the difference was not material for present purposes.

109 (1997) 78 FCR 169 at 194, quoting *Sun Newspapers Ltd v Federal Commissioner of Taxation* (1938) 61 CLR 337 at 359 per Dixon J.

110 (1952) 85 CLR 423 at 434 per Dixon CJ, McTiernan, Fullagar and Kitto JJ.

111 (1997) 78 FCR 169 at 194.

112 (1997) 78 FCR 169 at 196, evidently a reference to the licence fees chargeable pursuant to s 163 of the Electricity Act.

rendered. Those attributes may support their characterisation as a tax[113], at least with respect to privately owned licence holders[114]. However, they may not always be determinative[115]. The charges under s 163A were characterised by the Full Court of the Federal Court in *United Energy* as the price paid by the distribution companies for a geographic monopoly right[116]. That characterisation involved the application of orthodox approaches to a particular set of facts. It did not rest upon the proposition that recurrent periodic licence fees paid as a condition of a right to carry on a business activity must always be treated as an affair of capital.

46 As appears later in these reasons, the rationale for the imposition of the charges under s 163A, which included the limitation of the distribution companies to a reasonable return on their capital, was not dissimilar to the rationale for the charges imposed under s 163AA, which were directed to a restriction on the return of capital earned by PNV and its successors in title. Despite the emphasis which AusNet placed upon the purpose of the charges in its submissions, its identification is not determinative and to some extent distracts from the proper approach to characterisation. The critical question must always be — what was the expenditure calculated to effect from the taxpayer's point of view? What was the taxpayer paying the money for? Neither the distribution company in *United Energy* nor AusNet paid the charges under s 163A and s 163AA respectively in order to limit their return on capital. They paid the charges to secure rights to carry on their respective businesses of the distribution and transmission of electricity.

47 It is now necessary to consider the particulars of the charges imposed on PNV by the Order in Council.

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113 See *Matthews v Chicory Marketing Board (Vict)* (1938) 60 CLR 263 at 276 per Latham CJ, 290 per Dixon J; [1938] HCA 38; *Parton v Milk Board (Vict)* (1949) 80 CLR 229 at 258 per Dixon J; [1949] HCA 67.

114 cf *Queanbeyan City Council v ACTEW Corporation Ltd* (2011) 244 CLR 530 at 542 [20]–[22] per French CJ, Gummow, Hayne, Crennan, Kiefel and Bell JJ.

115 *Air Caledonie International v The Commonwealth* (1988) 165 CLR 462 at 467; [1988] HCA 61; *Harper v Minister for Sea Fisheries* (1989) 168 CLR 314 at 336 per Dawson, Toohey and McHugh JJ; [1989] HCA 47.

116 (1997) 78 FCR 169 at 182 per Lockhart J, 196 per Sundberg and Merkel JJ. See also *Browns Transport Pty Ltd v Kropp* (1958) 100 CLR 117 at 129–130; [1958] HCA 49, concerning licence fees imposed on road transport operators in Queensland.

The Order in Council

48 On 30 October 1997, there was published in the Victorian Government Gazette an Order in Council under s 163AA(1) of the Electricity Act in the following terms:

> "The Governor in Council acting on the recommendation of the Treasurer under Section 163AA(1) of the **Electricity Industry Act 1993** declares that the amounts payable as an impost by Power Net Victoria, as the holder of a licence (the 'Transmission Licence') to transmit electricity issued under Part 12 of the **Electricity Industry Act 1993**, to the Treasurer for payment into the Consolidated Fund under Section 163AA(2) of the **Electricity Industry Act 1993**, are as follows:
>
> (a) $37,500,000 in respect of the financial year ending 30 June 1998, payable in arrears in two instalments, being $25,000,000 on 31 March 1998 and $12,500,000 payable on 30 June 1998;
>
> (b) $50,000,000 in respect of each of the financial years ending 30 June 1999 and 30 June 2000, payable in arrears in four equal instalments on 30 September, 31 December, 31 March and 30 June in each relevant financial year; and
>
> (c) $40,000,000 in respect of the 6 months ending on 31 December 2000, payable in arrears in two equal instalments on 30 September 2000 and 31 December 2000.
>
> This Order applies to any person or persons (jointly and severally) to whom the Transmission Licence is transferred or any subsequent holder of the Transmission Licence or any person or persons (jointly and severally) who acquire all or substantially all the business of Power Net Victoria and who is or are issued with a licence to transmit electricity under Part 12 of the **Electricity Industry Act 1993**."

There is nothing in s 163AA, nor the Order in Council, to suggest that the charges were imposed as any kind of fee for service. They were not licence fees of the kind imposed pursuant to s 163(3)(a). They did not require for their determination consideration of criteria like those required to be considered in determining fees under s 163(4). Nor did they require, for their determination, that the Treasurer have regard to matters of the kind specified in respect of franchise fees by s 163A(2).

49 In the light of that background, the terms of the Asset Sale Agreement can be examined.

The Asset Sale Agreement

50 The parties to the Asset Sale Agreement were the Treasurer of the State of Victoria, designated as "State"; PNV, designated as "Seller"; and AusNet (then known as ATC), designated as "Buyer"[117].

51 The recitals to the agreement included:

> "B. The Seller agrees to sell and the Buyer agrees to buy the Assets (excluding the Land which will be allocated from the Seller to the Buyer) on the terms and conditions set out in this agreement.
>
> ...
>
> E. The total value attributed by the parties to the sale of Assets (net of Creditors and Contract Liabilities) the subject of this agreement is $2,555,000,000 made up of:
>
> | | |
> |---|---|
> | Total Purchase Price | $2,502,600,000 |
> | Estimated Duty | $ 52,400,000 |
> | | $2,555,000,000 |
>
> F. The parties agree that the total payments to the State in connection with the privatisation of the Seller are $2,732,500,000 (including future licence fees of $177,500,000 payable by the Buyer, which the State values in net present value terms at approximately $161,000,000)."

52 The term "Assets" was defined to include "the Licences", a category which, in turn, was defined to include the "Transmission Licence". "Transmission Licence" was defined as:

> "the transmission licence issued to the Seller under Part 12 of the Electricity Act by the Office of the Regulator-General on 3 October 1994 as amended on 7 August 1995 and 1 March 1996 and to be amended in accordance with the draft amendments included in the Data Room Documentation".

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117 GPU Inc, a United States company, became the holding company for ATC at the time, and was designated as guarantor, but plays no role in the determination of this appeal.

53 The term "Total Purchase Price" mentioned in recital E was defined as:

> "$2,502,600,000 being the sum of the price of the Assets (including the Land) net of Contract Liabilities and Creditors (excluding Specified Creditors) assumed under this agreement and, for the avoidance of doubt, does not include the Estimated Duty. The sum of $2,502,600,000 is fixed, notwithstanding that the components referred to above may be shown collectively to have a different value."

54 Clause 2.1 of the Asset Sale Agreement required that, subject to the terms of the agreement, on the "Completion Date", a date not earlier than 6 November 1997, the Seller was required to sell the Assets (excluding the Land) and the Buyer was required to:

> "(1) buy the Assets (excluding the Land);
>
> (2) assume the Creditors (except the Specified Creditors) and the Contract Liabilities;
>
> (3) pay the Total Purchase Price to the Seller".

The term "Creditors" was defined expansively. It included "all persons to whom are owed amounts, debts, obligations and liabilities, whether currently owed or prospectively or contingently owing by the Seller".

55 Under cl 4.2(c)(1), at completion[118] the Seller was required to deliver to the Buyer the Transmission Licence, transferred so that the Buyer replaced the Seller as the licensee. If any party were to fail to pay any sum payable by it under the agreement at the time and otherwise in the manner provided in the agreement, that party was required to pay interest on that sum at a "Base Rate" plus two per cent.

56 It was a condition precedent to completion that the State, the Seller and the Buyer would procure that the Office of the Regulator-General approve the transfer of the Transmission Licence from the Seller to the Buyer with effect from completion[119]. It was also a condition precedent that the State would procure the publication in the Government Gazette of an Order in Council declaring that the Buyer was a transmission company for the purposes of the

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118 Defined to mean "completion of the sale and purchase of the Assets and the assumption of Creditors and Contract Liabilities under clause 2".

119 Asset Sale Agreement, cl 4.3(a).

Electricity Act, to take effect when the Buyer held a licence to transmit electricity issued under Pt 12 of the Electricity Act[120]. The term "Licence Fee Order" was defined as "the order in substantially the form set out in annexure G", which reflected the terms of the Order in Council made following the execution of the agreement. It was a further condition precedent to completion that the State would procure publication in the Government Gazette of the Licence Fee Order[121].

57 An important clause in the agreement was cl 7, which provided under the heading "ASSUMPTION OF LIABILITIES AND CREDITORS":

> "Following Completion, the Buyer assumes with effect from Completion all liabilities of the Seller to the Creditors, including without limitation the Contract Liabilities, other than the Specified Creditors and agrees to pay all Creditors other than the Specified Creditors in the normal course of business for obligations of the Seller existing before or after Completion."

Given the definition of "Creditors" in the Asset Sale Agreement, the obligation thus assumed embraced PNV's contingent liability, which existed when the agreement was signed, to pay the charges imposed by the Order in Council when they fell due. AusNet's submissions to the contrary should be rejected, as should its submission that the Asset Sale Agreement did not otherwise impose upon it a contractual liability to pay the charges under the Order in Council. The contractual liability was imposed by cl 13.3(d) of the agreement.

58 Clause 13.3(d) provided that the Buyer acknowledged and agreed with the State and the Seller that:

> "(1) the amounts to be payable by the Buyer pursuant to the Licence Fee Order are an integral part of the regulatory framework of the industry and the Buyer accepts that it must pay the amounts set out in the Licence Fee Order in order to carry on the Business transferred from the Seller;
>
> (2) the Buyer must not challenge the validity of the Licence Fee Order or the amounts, or the basis of calculating the amounts, specified in the Licence Fee Order;

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120 Asset Sale Agreement, cl 4.3(b).

121 Asset Sale Agreement, cl 4.3(d).

(3) the Buyer agrees to pay to the Treasurer the amounts specified in the Licence Fee Order in accordance with the terms of, and at the times specified in, the Licence Fee Order, whether or not the Licence Fee Order is valid or enforceable; and

(4) the Buyer may not transfer the Transmission Licence or allow any person to become a licensee under the Transmission Licence unless the proposed licensee has first delivered to the State a covenant (in form and substance satisfactory to the State) agreeing to be bound by this clause 13.3(d) as if it were the Buyer."

59 AusNet submitted that cl 13.3(d) confirmed that the Order in Council was the source of its liability to pay the charges which it imposed. The promise in cl 13.3(d)(3) to pay the charges "whether or not the Licence Fee Order is valid or enforceable" was said to be operative only if the Order in Council were found to be invalid or unenforceable. That submission cannot be accepted. The promise was unconditional. Its effect and evident purpose was to provide to PNV and the State certainty that the charges would be paid even if they turned out not to have been validly imposed. The promise was consideration moving from AusNet under the Asset Sale Agreement and was necessary to secure not only the Transmission Licence but the other assets that were the subject of the sale.

60 Central to AusNet's case on characterisation was its proposition that the Total Purchase Price, which did not include the s 163AA charges, was the amount expended by AusNet in order to acquire the Assets. It was said the licence fees were not described in recital E of the agreement as forming part of the total value to be attributed to the Assets. They were described in recital F as "future licence fees ... payable by the Buyer". Invoking the language of *Commissioner of Taxation v Morgan*, AusNet said "[t]he price remains fixed. The payment of the [s 163AA imposts] is separate". *Commissioner of Taxation v Morgan*, however, is not apposite. The charges imposed under s 163AA cannot be viewed in the same way as an adjustment of municipal and water rates on the sale of land. Such rates are recurrent charges connected with the provision of public services. Their adjustment as between vendor and purchaser is time dependent. The imposts under s 163AA were significant liabilities not inherently recurrent and able to be imposed at such times and in such manner as are "specified" in the exercise of power conferred by that provision. They were a significant part of the consideration moving from AusNet for the acquisition of the Assets. The designation of an amount as the Total Purchase Price to be paid to PNV, as distinct from the licence charges to be paid to the State, does not relegate the payment of those charges to some lesser, incidental purpose. From the perspective of AusNet, "from a practical and business point of view", they were part of the consideration moving from it for the acquisition of the Assets.

61 Submissions by AusNet about the characterisation of the charges made reference to their purpose, as set out in the reasons for judgment of the primary judge. That rationale is explained in the following section.

The rationale of the Order in Council

62 Section 158A(1)(c) of the Electricity Act provided for the making of Orders in Council to "regulate, in such manner as the Governor in Council thinks fit ... charges for connection to, and the use of, the transmission system". A Tariff Order, made pursuant to s 158A on 20 June 1995, prescribed charges to be levied by PNV for certain network and connection services. It also imposed a cap on the revenue which PNV could derive from the provision of defined network and connection services and augmentation to the system and connection facilities. The cap on PNV's gross revenue for each financial year was designated the Maximum Allowable Revenue ("MAR"). That figure was the product of a specified Maximum Allowable Charge and forecast Summer Maximum Demand. The MAR was calculated by reference to efficient levels of operating and maintenance costs, a return on capital and straight line depreciation at rates reflecting estimated useful lives on a Current Cost Accounting asset base. The charges were fixed so that PNV would recover the cost of its assets over time and its operating and maintenance costs and would gain a return on its capital[122]. The tariff fixed in each year after the first was to be adjusted by reference to the Consumer Price Index less a factor designated "X", which was a proxy for the expected real rate of improvement in efficiency.

63 Between the making of the Tariff Order on 20 June 1995 and the time that PNV was privatised in 1997, the State Government decided to extend the Tariff Order applicable to that company for a further two years in order to provide some price certainty for its prospective purchasers. However, the Government was advised that some of the assumptions upon which the Tariff Order was based were no longer correct. The prescribed MAR was higher than that necessary to yield a reasonable return on capital. Amending the "X" factor would avoid a windfall to PNV or its acquirer by lowering permitted transmission charges. The problem with that approach was that reduction of the transmission charges would provide a windfall for distributors[123]. To overcome that problem, the State Government was advised that the excess revenue which would accrue to PNV or its purchaser before the Tariff Order lapsed in December 2000 should be

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122 The return on capital was assessed using the Optimised Depreciated Replacement Cost value of assets multiplied by a weighted average cost of capital.

123 The tariffs charged by distributors were fixed for the period to 31 December 2000.

recovered by the imposition of a "special licence fee". The fee could be separately invoiced and levied by imposition of a charge under s 163AA of the Electricity Act.

64 The Treasurer of Victoria agreed that the Tariff Order applicable to PNV or its purchaser after December 2000 should be varied by increasing the "X" factor for 2001 and 2002. The additional charges under s 163AA were imposed for the preceding years. An information memorandum to prospective bidders for PNV's assets foreshadowed charges that would be imposed by an Order in Council made under s 163AA of $50,000,000 per annum for each of the years ending 30 June 1998 to 30 June 2000 and a further $40,000,000 for the six months ending 31 December 2000. In its successful bid made on 10 October 1997 for the acquisition of the PNV assets, AusNet requested that the proposed charges be changed to reflect the fact that the sale would take place after the first quarter of the financial year ending 30 June 1998.

65 As appears below, the purpose for which the charges were imposed does not determine the character of the payments made by AusNet as holder of the Transmission Licence.

The characterisation of the AusNet payments

66 AusNet advanced six propositions, some of which overlapped, against characterisation of AusNet's payments of the s 163AA charges as being of a capital nature. First, it said that the purpose for which the charges were imposed informed the inquiry into the character of the advantage sought from AusNet's perspective in making the payments. Undue emphasis on the purpose of the charges, however, is apt to direct the inquiry away from the critical question — from AusNet's perspective what was the character of the advantage sought? — or, as Fullagar J put it in *Colonial Mutual Life*, what was the money really paid for? The answer to that question has already been reached. AusNet did not pay the charges in order to reimburse the State for excess revenue it might generate as licence holder. From a practical and business point of view, the assumption of the liability to make the expenditure was calculated to effect the acquisition of the Transmission Licence and the other assets the subject of the Asset Sale Agreement. The Transmission Licence was an intangible asset, but was properly viewed as part of the structure of the business. Without it, acquisition of the rest of the assets was pointless. If it were revoked after acquisition, the whole business structure would collapse.

67 The second proposition was that the charges were a tax imposed not upon AusNet specifically but upon whoever was the licence holder. AusNet argued that its liability did not arise until after it had acquired the Transmission Licence and that it acquired nothing by making the payments. This was analogous to the

approach of Barwick CJ in *Cliffs International* to the royalties paid on iron ore mined by the taxpayer. Whether or not the charges were a tax, that submission should be rejected. AusNet's assumption of the fixed and ascertained statutory liabilities and its contractual promise to pay the charges, whether or not they were validly imposed, was consideration moving from it, prior to and for the acquisition of the licence and the other assets.

68 The third submission, related to the second, was that the liability to pay the charges did not arise upon the execution of the Asset Sale Agreement in October 1997. That proposition did not advance the case any further than the second proposition.

69 Fourthly, AusNet submitted that the charges were not part of the Total Purchase Price and therefore not part of the payment it made "for" the acquisition of the transmission business. For the reasons already given, that submission, which relied in part upon the decision of this Court in *Commissioner of Taxation v Morgan*, is also rejected.

70 The fifth proposition was that the Asset Sale Agreement did not impose any contractual liability upon AusNet to pay the s 163AA charges. That submission has already been rejected in the discussion of the terms of the Asset Sale Agreement.

71 The final submission was that liability to pay the charges was contingent upon AusNet continuing as the holder of the Transmission Licence at the particular times the charges were due for payment pursuant to the Order in Council. AusNet could, at any time, have transferred the Transmission Licence and avoided future liability to pay the charges. However, as the Commissioner submitted, upon Completion of the Asset Sale Agreement, AusNet was under a present legal obligation to make the payments at the times specified in the Order in Council. No further or other matter was necessary for the liability to crystallise. The case was distinguishable from *Cliffs International*, where the relevant royalty payments were contingent upon the removal of iron ore from the relevant reserves[124].

Conclusion

72 For the preceding reasons, the charges paid by AusNet were of a capital nature. The primary judge and the majority in the Full Court were correct so to conclude. The appeal should be dismissed with costs.

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124 (1979) 142 CLR 140 at 149 per Barwick CJ, 175 per Jacobs J, 176 per Murphy J.

73 GAGELER J. The distinction between expenditure that is an outgoing of a capital nature and expenditure that is an outgoing of a revenue nature is sufficiently stated for present purposes as "the distinction between the acquisition of the means of production and the use of them"[125]. The distinction "depends on what the expenditure is calculated to effect from a practical and business point of view"[126].

74 To characterise expenditure from a practical and business perspective is not to disregard the legal nature of any liability that is discharged by the making of that expenditure[127]. It is not to inquire into whether the expenditure is similar or economically equivalent to expenditure that might have been incurred in some other transaction[128]. It is to have regard to the "whole picture" of the commercial context within which the particular expenditure is made[129], including most importantly the commercial purpose of the taxpayer in having become subjected to any liability that is discharged by the making of that expenditure[130]. It is, where necessary, to "make both a wide survey and an exact scrutiny of the taxpayer's activities"[131].

75 Adopting the abbreviations used in the joint reasons for judgment, the precise question here is as to the characterisation of the expenditure made by AusNet in three subsequent income years in discharge of its legal liability which then existed by virtue of the Order in Council having been made in 1997 under

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125 *Hallstroms Pty Ltd v Federal Commissioner of Taxation* (1946) 72 CLR 634 at 647; [1946] HCA 34.

126 *Hallstroms Pty Ltd v Federal Commissioner of Taxation* (1946) 72 CLR 634 at 648; *BP Australia Ltd v Federal Commissioner of Taxation* (1965) 112 CLR 386 at 397; [1966] AC 224 at 264.

127 *GP International Pipecoaters Pty Ltd v Federal Commissioner of Taxation* (1990) 170 CLR 124 at 137; [1990] HCA 25.

128 *City Link Melbourne Ltd v Commissioner of Taxation* (2004) 141 FCR 69 at 83 [42], affirmed in *Federal Commissioner of Taxation v Citylink Melbourne Ltd* (2006) 228 CLR 1; [2006] HCA 35.

129 *BP Australia Ltd v Federal Commissioner of Taxation* (1965) 112 CLR 386 at 399; [1966] AC 224 at 267.

130 *GP International Pipecoaters Pty Ltd v Federal Commissioner of Taxation* (1990) 170 CLR 124 at 137.

131 *Western Gold Mines NL v Commissioner of Taxation (WA)* (1938) 59 CLR 729 at 740; [1938] HCA 5.

s 163AA of the Electricity Act. Was that expenditure merely a cost to AusNet of holding or using the Transmission Licence during those income years so as to be an outgoing of a revenue nature, or was it part of the cost to AusNet of securing acquisition of the Transmission Licence and other assets from PNV in 1997 so as to be an outgoing of a capital nature?

76 The question cannot be answered, as AusNet seeks to have it answered, either by attempting to liken the expenditure to a simple case of a payment of land tax[132] or an adjustment for rates made on the settlement of a contract for the sale of land[133], or by attempting to liken the expenditure to the contractual payments which gave rise to the division of opinion in the peculiar circumstances considered in *Cliffs International Inc v Federal Commissioner of Taxation*[134] or in *Federal Commissioner of Taxation v Citylink Melbourne Ltd*[135].

77 Those cases can be taken to illustrate the negative proposition that the fact that a promise to make the expenditure formed part of the consideration for the acquisition of an asset does not foreclose the question of whether the expenditure when made is calculated to effect the acquisition of the asset. Other considerations – including the frequency of the expenditure, the circumstances in which it is to be paid and the method by which it is to be calculated – might yet lead to the conclusion that the expenditure when made is more appropriately to be characterised from a practical and business perspective as referable to the subsequent use of the asset or to some other circumstance.

78 Beyond that, I do not think that there is any general proposition to be taken from them. "The proper conclusion in each case in this particular area of the law", Barwick CJ observed as a member of the majority in *Cliffs*, "is peculiarly dependent upon the particular facts and circumstances of that case."[136] Writing for the majority in *Citylink*, Crennan J made the same point when she endorsed the observation that there was "danger in arguing by analogy"[137].

79 Utilising for the moment the language in recital F of the Asset Sale Agreement, I accept the central argument of AusNet that it is insufficient to

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132 Cf *Moffatt v Webb* (1913) 16 CLR 120; [1913] HCA 13.

133 Cf *Commissioner of Taxation v Morgan* (1961) 106 CLR 517; [1961] HCA 64.

134 (1979) 142 CLR 140; [1979] HCA 8.

135 (2006) 228 CLR 1.

136 (1979) 142 CLR 140 at 148.

137 (2006) 228 CLR 1 at 43 [151].

characterise the expenditure as an outgoing of a capital nature that the expenditure was part of the total payments made by AusNet to the State of Victoria "in connection with" AusNet's acquisition of the Transmission Licence and other assets from PNV. But to accept that argument is not to answer the question of characterisation; much less is it to characterise the expenditure as other than an outgoing of a capital nature.

80 In my view, from a practical and business perspective, the expenditure was expenditure which AusNet was required to make in order to acquire the Transmission Licence and other assets. It was a component of AusNet's cost of the acquisition; it was part of the price AusNet had to pay. Of course, AusNet would not have ended up paying it unless AusNet remained the holder of the Transmission Licence during the subsequent income years. But it was not a cost which AusNet bore in order simply to use the Transmission Licence during those income years.

81 That answer to the question of the characterisation of the expenditure does not depend on construing the Asset Sale Agreement to impose a contractual obligation on AusNet to make the expenditure, although it is none the worse for such a construction of the Asset Sale Agreement. In relation to the Asset Sale Agreement, it is enough for me to state that I agree with the joint reasons for judgment that cl 13.3(d) on its proper construction imposed a contractual obligation on AusNet to make the expenditure which was independent of the statutory liability imposed on AusNet under s 163AA of the Electricity Act. I do not think it necessary to consider the submission of the Commissioner of Taxation that AusNet had an additional and concurrent contractual obligation to make the expenditure under cl 7 of the Asset Sale Agreement.

82 What I consider to be more important to answering the question of characterisation is an analysis of the structure and commercial context within which AusNet's statutory liability to make the expenditure came to be imposed. That statutory liability was imposed during the subsequent income years by s 163AA(2) of the Electricity Act, by virtue of the continuing existence during those years of the Order in Council made under s 163AA(1) in 1997.

83 The statutory liability so imposed under the Electricity Act was not structured as a periodic payment referable simply to the holding of the Transmission Licence; it did not resemble a "fee" or "charge" payable to the Office of the Regulator-General under s 163(2) of the Electricity Act[138]. Nor was it structured in the usual way of a "tax"; it was not payable to the State and recoverable by the Commissioner of State Revenue under the *Taxation Administration Act* 1997 (Vic). It was structured instead as an "impost",

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138 Section 163(3)(a) of the Electricity Act.

relevantly payable by the holder of the Transmission Licence to the Treasurer in amounts and at times specified in the Order in Council. Whether, as so structured, it might also answer the description of a "tax" for constitutional purposes might be a nice question were it ever to arise[139]. It does not arise here.

84 Part 12 of the Electricity Act was amended in 1997 to make s 163AA applicable to a "transmission company"[140], for the express statutory purpose of providing for the "corporatisation and privatisation" of PNV[141]. By the time the Order in Council was made later in 1997 under s 163AA(1), it was apparent that the privatisation of PNV would take the form of a sale of the assets of PNV rather than a sale of the shares in PNV. In contemplation of that sale of assets, the Order in Council was expressed to apply to PNV, as the holder of the Transmission Licence, to a transferee of the Transmission Licence, and in the alternative to the holder of another licence who might "acquire all or substantially all the business" of PNV. The gazettal of the Order in Council in those terms was, by operation of cl 4.3(d), a condition precedent to the completion of the Asset Sale Agreement.

85 The prospective statutory liability of AusNet to pay the imposts to the Treasurer in the three subsequent income years was in that way established in 1997, in advance of, and with a view to, AusNet's acquisition of the assets of PNV. It was a prospective liability to which AusNet had to subject itself in 1997 if AusNet was to secure that acquisition.

86 The expenditure AusNet then made by way of payment of the imposts to the Treasurer was expenditure which AusNet was required to make to the State as a result of having made that acquisition. That the Transmission Licence might ultimately have been revoked if AusNet failed to pay the imposts[142] does not convert the expenditure into a cost to AusNet merely of holding or using the Transmission Licence.

87 The method by which the amounts and timing of the imposts specified in the Order in Council was determined does not point to a different conclusion. It

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139 Cf *Air Caledonie International v The Commonwealth* (1988) 165 CLR 462 at 467; [1988] HCA 61; *Harper v Minister for Sea Fisheries* (1989) 168 CLR 314 at 336; [1989] HCA 47.

140 Section 24 of the *Electricity Industry (Miscellaneous Amendment) Act* 1997 (Vic).

141 Section 1(b) of the *Electricity Industry (Miscellaneous Amendment) Act* 1997 (Vic).

142 Section 35 of the *Office of the Regulator-General Act* 1994 (Vic) and s 164(3) of the Electricity Act.

is correct, as AusNet submits, that the "purpose and effect" of the imposts was to enable the State to recover from AusNet the "excess amount of gross revenue" which AusNet was projected by the State to be likely to earn from the use of the assets which AusNet was to acquire from PNV in light of the belated realisation that the "X" factor in the "CPI minus X" calculation of the revenue cap had been set too low. But it is not really correct for present purposes to characterise that effect, as AusNet seeks to do, as being to "reset" the revenue cap. The revenue cap was to remain unaltered. The revenue cap remaining unaltered, but the "X" factor having been set too low, AusNet was projected to earn significantly higher returns from the use of the assets it was acquiring from PNV in the three subsequent income years. The effect of the imposts was to require AusNet to disgorge to the State the estimated amount of those projected additional returns.

88 In order to acquire the assets of PNV in 1997, AusNet was required to submit in advance to an obligation to remit to the State the estimated amount of above-normal returns it would earn from the use of those assets in the three subsequent years. From a practical and business perspective, that is to my mind the long and the short of it.

89 If an analogy were to be sought in the decided cases in this Court (and I do not suggest that it is necessary that one should be found), perhaps the closest analogy is *Colonial Mutual Life Assurance Society Ltd v Federal Commissioner of Taxation*[143], to which Edmonds and McKerracher JJ both referred in the decision under appeal[144]. There, land was sold to an insurance company on terms which required the company to erect a building on the land, to use its best endeavours to lease parts of the building, and to pay to the vendors for a period of 50 years 90% of all rents collected. The subsequent periodical payments of that proportion of rents by the insurance company to the vendors were held to constitute outgoings of a capital nature. Fullagar J, with whom Kitto and Taylor JJ agreed[145], said it was "incontestable" that those payments were made "in order to acquire a capital asset", and continued[146]:

> "The documents make it quite clear that these payments constitute *the price* payable on a purchase of land, and that appears to me to be the end of the matter. 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

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143 (1953) 89 CLR 428; [1953] HCA 68.

144 *SPI PowerNet Pty Ltd v Federal Commissioner of Taxation* (2014) 220 FCR 355 at 359 [12], 368 [56].

145 (1953) 89 CLR 428 at 460.

146 (1953) 89 CLR 428 at 454 (emphasis in original).

> 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. It does not indeed seem to me to be possible to say that they are incurred in the relevant sense in gaining or producing assessable income or in carrying on a business – any more than payment of a ... lump sum payable on transfer. The questions which commonly arise in this type of case are (1) What is the money really paid *for?* – and (2) Is what it is really paid for, in truth and in substance, a capital asset?"

Fullagar J concluded[147]:

> "Here we have a transaction of a purely business nature, in which it may be safely assumed that two parties, bargaining on equal terms, had full regard to the value of the land and the probable value of the consideration. According to the documents the periodical payments are the *price* for which the land is being bought, and no reason can be suggested for not giving to the documents their full literal effect. The transaction might perhaps have taken a form under which parts of the total payments to be made were, or could be, treated as interest on deferred payments of a price. But it did not take any such form. As matters stand, the total of the payments is simply the total price of the land."

90 Here, as there, we have a transaction of a purely business nature in which AusNet (on the one hand) and PNV and the State (on the other hand) can safely be assumed to have had full regard to the value of the assets which AusNet was acquiring from PNV. The imposts to be imposed through the making of the Order in Council were not held out by the State to be negotiable in the events which led up to the Asset Sale Agreement. The non-negotiable imposts were nevertheless plainly taken into account by AusNet in setting the additional amount it was prepared to bid as the "Total Purchase Price", which, when added with stamp duty and the imposts, came to be referred to in recital F of the Asset Sale Agreement as "the total payments to the State in connection with the privatisation of [PNV]". The amount AusNet was prepared to bid might well have been different had the revenue cap truly been "reset" and had the imposts not been imposed. But we are not concerned with hypotheticals. In the form in which the parties were content to enter into the transaction, the non-negotiable imposts and the additional amount which AusNet was prepared to bid and which the State was prepared to accept as the "Total Purchase Price" were together in a real commercial sense the price which AusNet committed to pay to the State in order to acquire the assets of PNV.

91 For these reasons, I would dismiss the appeal with costs.

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147 (1953) 89 CLR 428 at 459 (emphasis in original).

92 NETTLE J. This is an appeal from a judgment of the Full Court of the Federal Court of Australia[148]. By majority (Edmonds and McKerracher JJ, Davies J dissenting), the Full Court dismissed an appeal from the Federal Court of Australia (Gordon J)[149]. Gordon J had rejected an appeal against the respondent Commissioner's disallowance of the appellant's claim to be entitled to deductions under s 8-1 of the *Income Tax Assessment Act* 1997 (Cth) ("the ITAA") for imposts paid to the State of Victoria pursuant to an Order made under s 163AA of the *Electricity Industry Act* 1993 (Vic) ("the EIA"). This appeal concerns whether the imposts are deductible from the appellant's taxable income.

93 In brief summary, in 1997 the appellant purchased the assets of an electricity transmission business owned by the State of Victoria. Among the assets so purchased was an electricity transmission licence issued under s 163 of the EIA. Section 163 provided *inter alia* for an electricity transmission licence to be subject to such conditions as were determined by the Office of the Regulator-General, including conditions requiring the licensee to pay specified fees and charges in respect of the licence ("specified fees").

94 Over and above the specified fees, s 163AA of the EIA provided that the Governor in Council could, by Order, declare that further specified charges, or charges calculated in a specified manner, be payable by the licensee as an impost at the times and in the manner so determined ("specified charges").

95 Neither the specified fees imposed under s 163 nor the specified charges levied under s 163AA were expressed to be payable in exchange for holding the electricity transmission licence; but, perforce of cll 3.4 and 18 of the licence and s 35 of the *Office of the Regulator-General Act* 1994 (Vic), failure to pay the specified fees or the specified charges could have resulted in revocation of the licence[150].

96 Under the contract of sale, the appellant became the holder of the electricity transmission licence and as such liable to pay the specified fees and specified charges. In addition, the contract of sale expressly required the appellant to pay the specified charges to the State and to refrain from contesting their validity. The amount of the specified charges was also expressed to be a component of the "total payments to the State in connection with the privatisation of the Seller" but not part of the "Total Purchase Price" for the assets.

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148 *SPI PowerNet Pty Ltd v Federal Commissioner of Taxation* (2014) 220 FCR 355.

149 *SPI PowerNet Pty Ltd v Federal Commissioner of Taxation* 2013 ATC ¶20-416.

150 Clauses 3.4 and 18 of the licence (and relevant definitions) and s 35 of the *Office of the Regulator-General Act* 1994 are set out in the appendix to these reasons.

97 The appellant claimed that both the specified fees and the specified charges were deductible from its assessable income. The Commissioner did not dispute that the specified fees were deductible but rejected the claim for the specified charges. The basis of rejection was that the Commissioner conceived the specified charges to be payments out of taxable profits or alternatively paid on capital account.

98 At first instance, Gordon J affirmed the Commissioner's position. Her Honour held that the specified charges were not incurred in gaining or producing assessable income and therefore were not deductible because they were paid out of taxable profits; and further or alternatively were not deductible because they were paid on capital account.

99 On appeal to the Full Court, the majority held that the specified charges were incurred in gaining or producing assessable income but were not deductible because they were paid on capital account. Davies J, in dissent, agreed that the specified charges were incurred in gaining or producing assessable income but held that they were incurred on revenue account and thus deductible.

100 The two questions which fall to be determined in this appeal are, therefore, whether the specified charges were incurred in gaining or producing assessable income and whether they were incurred on capital account.

101 For the following reasons, it should be concluded that the specified charges were incurred in gaining or producing assessable income and they were not incurred on capital account. It follows that the specified charges were deductible from the appellant's assessable income and that the appeal should be allowed.

The facts

102 Until 1993, the State Electricity Commission of Victoria ("SECV") was responsible for most generation, all transmission and the majority of distribution and supply of electricity in Victoria.

103 Early in October 1993, SECV was disaggregated into three new businesses: Generation Victoria, to undertake the generation of electricity; National Electricity (later called Power Net Victoria or PNV) to undertake the State-wide transmission of electricity; and Electricity Services Victoria, to undertake the distribution of electricity to consumers.

104 The EIA came into full force on 3 January 1994. PNV was issued a transmission licence under Pt 12 of the EIA. Section 158A(1) of the EIA relevantly provided that the Governor in Council could, by Order published in the Government Gazette, regulate in such manner as the Governor in Council thought fit prices in respect of goods and services prescribed in respect of the electricity industry, including charges for connection to and use of the

transmission system. Section 158A(2) provided that the charges could be set by reference to certain factors, including a general price index or caps on revenue.

The Tariff Order

105 On 20 June 1995, an Order ("the Tariff Order") was made under s 158A imposing, amongst other things, a cap on the revenue which PNV could derive from the provision of "Prescribed Services"[151]. The object of the Tariff Order generally, and the revenue cap in particular, was to limit PNV's ability to exploit its natural monopoly over network and transmission services by increasing prices.

106 The Tariff Order provided that PNV's maximum allowed revenue ("MAR") in respect of the supply of the Prescribed Services for each financial year ("*t*") was to be calculated according to the following formula[152]:

$$MAR_t = MAC_t \times SMD_t$$

where:

> "MAC_t" (in $/kW) represented the maximum average charge ("MAC") in financial year *t* that PNV could charge for the capacity to transmit one kW of electricity at the forecast summer maximum demand ("SMD"); and
>
> "SMD_t" (in kW) represented the forecast SMD for the financial year *t*. The SMD for each financial year up to 30 June 2005 was specified in the Tariff Order.

107 The revenue cap was calculated to reflect efficient levels of operating and maintenance costs (which were estimated to be a percentage of the replacement cost value of assets); a return on capital equal to the optimised depreciated replacement cost value of assets multiplied by a weighted average cost of capital; and straight line depreciation at rates reflecting estimated useful lives on current cost accounting asset base.

108 The Tariff Order provided a mechanism by which the MAC was to be adjusted each financial year by multiplying the previous year's MAC by

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151 "Prescribed Services" were network services relating to the system existing at 3 October 1994, which PNV supplied to VPX; connection services relating to the connection facilities existing at 3 October 1994, which PNV supplied to distributors, generators and traders; and certain specified augmentations to the transmission system in the period up to 30 June 2000.

152 Subject to limited exceptions for transitional purposes.

(CPI − X). CPI referred to the Consumer Price Index, a proxy for inflation. The "X factor" was a fixed integer calculated to reflect expected annual efficiency gains. Consequently, in order to increase its profits in real terms, PNV had to make annual efficiency improvements in excess of the X factor.

Privatisation of PNV

109 In April 1997, the Victorian Government announced its intention to privatise PNV and, around the same time, the Government undertook a review of the Tariff Order. As a result of the review, it was determined that the X factor applicable to PNV would not be appropriate to a private transmission company. Rather than reset the X factor, however, which would have required amending the Tariff Order for the period up to 31 December 2000, the Government determined to impose additional charges to recover the difference between the gross revenue that would accrue to PNV under the Tariff Order as it stood and the MAR which Government modelling suggested would be derived if the X factor were modified appropriately. Section 163AA of the EIA was thus enacted to facilitate the imposition of the additional charges as specified charges[153].

110 The Government explained the intended effect of the specified charges in an "Information Memorandum for the Proposed Sale of PowerNet Victoria", dated August 1997 ("the Information Memorandum"), as follows:

> "***1.4.1 PowerNet's Operations and Market Position***
>
> ...
>
> *Incentive Based Regulatory Regime*
>
> PowerNet operates under an incentive based regulatory regime whereby its maximum allowed revenue ('MAR') in respect of the existing network and certain prescribed augmentations is subject to annual escalation based on the application of a CPI-X factor to the previous period's maximum average charge ('MAC') per kW of forecast summer maximum demand ('SMD') and any increase in forecast SMD ...
>
> As the CPI-X regulatory regime applies to PowerNet's revenue and not its profits, PowerNet will retain the benefit of any productivity gains during the regulatory period in excess of those assumed in setting the X factor (except in limited circumstances, where specific rules apply). Furthermore, any efficiency gains earned by PowerNet above the levels assumed are to be adjusted progressively over the subsequent regulatory

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153 *Electricity Industry (Further Amendment) Act* 1995 (Vic), s 13.

period and in a manner which ensures that such efficiency gains are fairly shared between PowerNet and its customers.

It is expected that there will be a number of opportunities for PowerNet to achieve productivity gains in excess of those assumed in setting the X factor."

111 The Information Memorandum explained how the X factor would be "effectively reset" for the period ending 30 June 2001 by the imposition of the specified charges under s 163AA as follows:

"***2.4.2 Specified Charges on Holder of Transmission Licence***

It is intended that an Order will be made pursuant to section 163AA of the Electricity Industry Act imposing the following specified charges on the holder of the PowerNet transmission licence ... of:

(a) $50 million per annum for each of the years ending 30 June 1998 through 2000; and

(b) $40 million for the year ending 30 June 2001.

The specified charges will be fixed amounts and payable quarterly in arrears for each financial year to 30 June 2000 and equal instalments payable on 30 September and 31 December 2000, in respect of the year ending 30 June 2000 [*scil* 2001].

It is intended that charges under section 163AA will not be imposed from 31 December 2000.

...

2.4.4 Background to Revised Revenue Controls and the [Specified Charges]

The Tariff Order currently specifies that an X-factor of 1.79% will apply to 31 December 2000. PowerNet's revenue caps have effectively been reset through the [specified charges] and the new X-factor for 2001 and 2002. This approach to re-setting the revenue caps was adopted:

(a) due to constraints imposed by the Maximum Uniform Tariffs which the [distributors] can charge franchise customers and which currently apply to consumers without revision to 31 December 2000; and

(b) to avoid any windfall gains accruing to PowerNet and its customers which may result from the re-set."

Sale of the assets of PNV to the appellant

112 On 12 October 1997, the appellant[154] entered into the contract of sale with PNV, the Treasurer on behalf of the Crown in right of the State of Victoria and GPU Inc (a guarantor) to purchase the assets and undertaking of PNV including PNV's transmission licence ("the Asset Sale Agreement"). The recitals to the Asset Sale Agreement provided as follows:

> "A. The Seller [PNV] is the owner of the Assets.
>
> B. The Seller agrees to sell and the Buyer [the appellant] agrees to buy the Assets ... on the terms and conditions set out in this agreement.
>
> ...
>
> E. The total value attributed by the parties to the sale of Assets (net of Creditors and Contract Liabilities) the subject of this agreement is $2,555,000,000 made up of:
>
> | | |
> |---|---|
> | Total Purchase Price | $2,502,600,000 |
> | Estimated Duty | $ 52,400,000 |
> | | $2,555,000,000 |
>
> F. The parties agree that the total payments to the State in connection with the privatisation of the Seller are $2,732,500,000 (including future [specified charges] of $177,500,000 payable by the Buyer, which the State values in net present value terms at approximately $161,000,000)."

113 The "Total Purchase Price" was relevantly defined as "$2,502,600,000 being the sum of the price of the Assets ... net of Contract Liabilities and Creditors ... assumed under this agreement".

114 Clause 4.3 of the Asset Sale Agreement provided that completion was subject to a number of conditions precedent, including that:

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154 At the time it entered the contract, the appellant's corporate name was Australian Transmission Corporation Pty Ltd. It was renamed GPU PowerNet Pty Ltd on 30 October 1997 and SPI PowerNet Pty Ltd on 2 July 2000, and acquired its present name in 2014.

"(a) the State, the Seller and the Buyer shall procure that the Office of the Regulator-General approves the transfer of the Transmission Licence from the Seller to the Buyer with effect from Completion;

(b) the State shall procure the publication in the Government Gazette of an Order in Council declaring that the Buyer is a transmission company for the purposes of the [EIA], to take effect when the Buyer holds a licence to transmit electricity issued under Part 12 of the [EIA];

...

(d) the State shall procure the publication in the Government Gazette of the [specified charges] Order ..."

115 Clause 4.4 provided for the appellant, upon completion, to pay the Total Purchase Price (plus interest, less deposit) to PNV and any duty owed to the State.

116 Clause 13.3 set forth a number of warranties and acknowledgments by the appellant including, in cl 13.3(d), the following relating to the specified charges:

"(1) the amounts to be payable by the Buyer pursuant to the [specified charges] Order are an integral part of the regulatory framework of the industry and the Buyer accepts that it must pay the amounts set out in the [specified charges] Order in order to carry on the Business transferred from the Seller;

(2) the Buyer must not challenge the validity of the [specified charges] Order or the amounts, or the basis of calculating the amounts, specified in the [specified charges] Order;

(3) the Buyer agrees to pay to the Treasurer the amounts specified in the [specified charges] Order in accordance with the terms of, and at the times specified in, the [specified charges] Order, whether or not the [specified charges] Order is valid or enforceable; and

(4) the Buyer may not transfer the Transmission Licence or allow any person to become a licensee under the Transmission Licence unless the proposed licensee has first delivered to the State a covenant (in form and substance satisfactory to the State) agreeing to be bound by this clause 13.3(d) as if it were the Buyer."

The specified charges

117 On 28 October 1997, the Governor in Council made the following Order under s 163AA of the EIA declaring the specified charges payable by PNV to the

Treasurer for payment into the Consolidated Fund in respect of PNV's licence ("the Order"):

> "The Governor in Council acting on the recommendation of the Treasurer under Section 163AA(1) of the Electricity Industry Act 1993 declares that the amounts payable as an impost by Power Net Victoria, as the holder of a licence (the 'Transmission Licence') to transmit electricity issued under Part 12 of the Electricity Industry Act 1993, to the Treasurer for payment into the Consolidated Fund under Section 163AA(2) of the Electricity Industry Act 1993, are as follows:
>
> (a) $37,500,000 in respect of the financial year ending 30 June 1998, payable in arrears in two instalments, being $25,000,000 on 31 March 1998 and $12,500,000 payable on 30 June 1998;
>
> (b) $50,000,000 in respect of each of the financial years ending 30 June 1999 and 30 June 2000, payable in arrears in four equal instalments on 30 September, 31 December, 31 March and 30 June in each relevant financial year; and
>
> (c) $40,000,000 in respect of the 6 months ending on 31 December 2000, payable in arrears in two equal instalments on 30 September 2000 and 31 December 2000.
>
> This Order applies to any person or persons (jointly and severally) to whom the Transmission Licence is transferred or any subsequent holder of the Transmission Licence or any person or persons (jointly and severally) who acquire all or substantially all the business of Power Net Victoria and who is or are issued with a licence to transmit electricity under Part 12 of the Electricity Industry Act 1993."

118 On completion on 6 November 1997, the appellant paid the amounts provided for in cl 4.4 and subsequently paid specified charges totalling $177,500,000 levied under the Order, as follows:

Year of income ended 31 December 1998	Year of income ended 31 December 1999	Year of income ended 31 December 2000
$62,500,000	$50,000,000	$65,000,000

119 The specified charge payable in respect of the financial year ended 30 June 1998 was $37,500,000, rather than the $50,000,000 provided for in the Information Memorandum, because, in the events which occurred, the Order did not take effect until after the first quarter of that financial year.

The claim for deductions

120 In brief summary, the transaction by which the appellant acquired the assets of PNV and the liability to pay the specified charges had the following features:

(1) The appellant contracted to buy the assets of PNV, which included the transmission licence necessary to carry out the business.

(2) An incident of carrying out the business was the Tariff Order, which included the revenue cap that regulated the price at which Prescribed Services could be provided.

(3) The specified charges were imposed to reflect a reconsideration of the assumptions that underpinned the calculation of the revenue cap for certain years.

(4) The obligation to pay the specified charges was imposed on the holder of the transmission licence.

(5) The specified charges were payable to the State over and above the purchase price for the assets, including the transmission licence.

(6) The specified charges were payable from time to time, according to the schedule set out in the Order.

(7) Under the Asset Sale Agreement, the appellant acknowledged that it must pay the specified charges as an "integral part of the regulatory framework of the industry", and it warranted that it would pay the specified charges to the State without challenging their validity.

121 In its amended tax returns for the 1998, 1999 and 2000 years of income, the appellant claimed the amounts so paid in each year of income as a deduction pursuant to s 8-1 of the ITAA. Section 8-1 relevantly provides:

"**8-1 General deductions**

(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".

Decisions below

122 At first instance, Gordon J held that the specified charges were not incurred in gaining or producing assessable income because they were in substance and effect payments out of taxable profits[155]. Her Honour reasoned in similar fashion to Lockhart J's process of reasoning in *United Energy Ltd v Commissioner of Taxation*[156]. In *United Energy*, the taxpayer, an electricity distributor, claimed a deduction for franchise fees paid to the State of Victoria pursuant to an Order made under s 163A of the EIA. Lockhart J held that[157]:

> "Properly analysed the franchise fees are in reality akin to the State of Victoria taking a share of the profits from the [distributors] (in this case the applicant), leaving the applicant an amount determined by the Treasurer to be a reasonable return on the capital of the company used in deriving the income ... The residue is taken by the State as its share of profits; it has similar characteristics to a payment by way of dividend."

123 In the present case, Gordon J applied similar reasoning as follows[158]:

> "As the Tariff Order provided (and the Information Memorandum recorded), the purpose of the Tariff Order was to regulate pricing of services – it imposed a cap on the revenue which could be derived from the provision of 'Prescribed Services' ...
>
> But the revenue cap in the Tariff Order was not limited to derivation of PNV's assessable income. The revenue cap in the Tariff Order was calculated to reflect three matters – efficient levels of operating and maintenance costs, a return on capital and straight line depreciation at rates reflecting estimated useful lives on Current Cost Accounting asset base ... The charges were set to enable PNV to recover the cost of its

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155 *SPI PowerNet Pty Ltd v Federal Commissioner of Taxation* 2013 ATC ¶20-416 at 15,500 [79].

156 (1997) 78 FCR 169.

157 (1997) 78 FCR 169 at 180.

158 *SPI PowerNet Pty Ltd v Federal Commissioner of Taxation* 2013 ATC ¶20-416 at 15,499-15,500 [72]-[73], [77]-[78].

> assets over time (reflecting depreciation), to provide it with a return on capital (using the Optimised Depreciated Replacement Cost value of assets multiplied by a weighted average cost of capital) and to recover its estimated operating and maintenance costs ... Those elements necessarily included calculation of PNV's taxable income – revenue less estimated operating and maintenance costs and depreciation.
>
> ...
>
> Here the payments ... represented amounts to be derived by the licence holder from the provision of the 'Prescribed Services' that were over and above all capital and operating costs (including borrowing costs) and after allowing for an appropriate return to shareholders.
>
> As is apparent, although the integers in the calculation of the MAR and the [specified charges] were not disclosed in the express terms of s 163AA, the structure of the imposition of the franchise fee in s 163A and the [specified charges] under s 163AA was the same – in substance and effect, a share of the profits leaving the holder of the licence with an amount determined to be a reasonable return on the capital of the company deriving that income. The residue, or surplus, was taken by the State as its share of profits."

124 On appeal to the Full Court, Edmonds J rejected that approach. He stated that he did not consider that it was enough to characterise an outgoing as a share of profits that one may be able to say that it was "'in reality akin' to a share of profits"[159]. In his Honour's view, the reasoning of Sundberg and Merkel JJ in *United Energy* was to be preferred[160]. He concluded that the specified charges were, however, outgoings of capital or capital in nature because the transmission licence was "unarguably a capital asset"[161] and because the specified charges were "part of the cost of acquisition" of the transmission licence[162]:

> "Critically, the transfer of the Transmission Licence to [the appellant] carried with it the s 163AA liability of PNV; equally critically, the s 163AA impost was not made on [the appellant] post the transfer of

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159 *SPI PowerNet* (2014) 220 FCR 355 at 359 [10].

160 *SPI PowerNet* (2014) 220 FCR 355 at 359 [10]. Edmonds J also quoted with approval *City Link Melbourne Ltd v Commissioner of Taxation* (2004) 141 FCR 69 at 84-85 [48]. See also at 85-86 [49]-[52].

161 *SPI PowerNet* (2014) 220 FCR 355 at 359 [12].

162 *SPI PowerNet* (2014) 220 FCR 355 at 361 [18].

> the Transmission Licence on Completion. The liability was assumed by [the appellant] on the transfer of the Transmission Licence, not by Order under s 163AA, and as such, forms as much part of the cost of acquisition of the Assets as the Total Purchase Price."

125 Edmonds J noted that the decision of this Court in *Cliffs International Inc v Federal Commissioner of Taxation*[163] was opposed to his conclusion. In *Cliffs*, the taxpayer agreed that, in consideration of the purchase of shares in a company which held a mining licence, the taxpayer would pay the vendors an initial lump sum and, in each year thereafter, 15 cents (US) per ton of ore mined from the licence area during that year. A majority of the Court (Barwick CJ, Jacobs and Murphy JJ, Gibbs and Stephen JJ dissenting) held that the payments of 15 cents per ton were paid on revenue account. Barwick CJ reasoned thus[164]:

> "[T]he 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.
>
> ...
>
> [The taxpayer's] promise to make the payments in the events which occurred formed part of the consideration given for the acquisition of the shares. But they were acquired without making the payments in question. The recurrent payments were not made for the shares though it might properly be said that they were payable as a consequence of the purchase of the shares.
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> ...
>
> The vendors for the transfer of their shares took a cash price and stipulated for a share of the proceeds of mining iron ore, if that eventuated. For its part, the appellant by agreeing to make the recurrent payments was prepared to admit the vendors of the shares to participation in the result of the mining of the iron ore. They were made, and necessarily made, by the appellant as disbursements in its business. ...
>
> If an analogue is felt to be of assistance, an analogy may be found in the grant of a licence to use a patent upon payment of a cash price and a continuing royalty on what might be produced by employment of the patent. The promise to pay the royalties is, in my opinion, in such a case

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163 (1979) 142 CLR 140; [1979] HCA 8.

164 *Cliffs* (1979) 142 CLR 140 at 148-151 (footnote omitted).

part of the consideration for the grant of the licence but neither the receipt nor the payment of the royalty is for that reason a capital receipt or payment. The reasoning in *Egerton-Warburton v Deputy Federal Commissioner of Taxation* strongly suggests the conclusions at which I have arrived. The payments were, in my opinion, disbursements by the appellant in the course of its business and were not of a capital nature."

126 To similar effect, Jacobs J reasoned as follows[165]:

"[I]t is submitted [for the Commissioner that], in the case of a leasehold, where there is a sub-lease for a consideration in the form of recurrent payments, those payments are on revenue account but it is submitted that when there is an assignment for a consideration in the form of identical recurrent payments, those payments are on capital account. And the same is said of mining leases and other interests.

In my opinion this distinction cannot be maintained so absolutely. It would mean that recurrent payments under a grant for the term less a day would be on revenue account but like payments under a grant of the term ... would be on capital account. ...

Where the acquisition is of a depreciating right or advantage of limited duration the manner of remuneration of the transferor is inevitably a factor which largely determines whether that remuneration is deductible as a revenue outgoing. The best known example is the lease for a term of years where the consideration is a premium and a rental."

127 Murphy J's reasoning, although much briefer, proceeded along similar lines[166]:

"The question is to be decided from a practical and business point of view (see Dixon J in *Hallstroms Pty Ltd v Federal Commissioner of Taxation*).

I am satisfied from a consideration of all the circumstances that the payments are not of capital or of a capital nature and that they are allowable deductions within s 51(1). The description given to the payments by the parties in their agreement is not decisive. The fact that payment of the outgoings was agreed as part of the consideration for the acquisition of a capital asset is not decisive. There is a strong analogy

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165 *Cliffs* (1979) 142 CLR 140 at 172-174.

166 *Cliffs* (1979) 142 CLR 140 at 176 (footnote omitted).

> with an agreement to pay rent as part of the consideration for acquisition of a lease.
>
> The acquisition of the asset did not depend upon the payment of any 'deferred payment'. The 'deferred payments' if any were made, would be for currently exercising the right to mine the ore in pursuance of the agreement. The amount of deferred payments was indeterminate; the rate of 15 cents per ton was certain but the amount to be paid in any year or during the life of the agreement was uncertain and depended on the exercise of the rights to mine."

128 Edmonds J said that he rejected the reasoning in *Cliffs* because he considered that the "[j]urisprudence both before and after *Cliffs International* does not support [Barwick CJ's] approach"[167]; Jacobs J was in error because, "[a]rguably, his Honour's focus was on the wrong asset" (being the mining tenements, rather than the shares in the company that held them)[168]; and Murphy J's approach was wrong because he treated the matter as analogous to an agreement to pay rent as part of the consideration for the acquisition of a lease and "the analogy with an agreement to pay rent as part of the consideration for acquisition of a lease, like many analogies, is apt to mislead"[169].

129 McKerracher J's judgment was to the same effect. Although his Honour stated that it would be too narrow an approach to confine the question to whether the payment of the specified charges was part of the purchase price[170], ultimately his Honour rested his conclusion on the *a priori* proposition that[171]:

> "The provisions of the Asset Sale Agreement imposed a separate contractual liability to pay the [specified charges] in order to acquire the Assets, including the Transmission Licence. The payment was therefore a capital amount."

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167 *SPI PowerNet* (2014) 220 FCR 355 at 361 [20].

168 *SPI PowerNet* (2014) 220 FCR 355 at 362 [22].

169 *SPI PowerNet* (2014) 220 FCR 355 at 362 [24].

170 *SPI PowerNet* (2014) 220 FCR 355 at 370 [65].

171 *SPI PowerNet* (2014) 220 FCR 355 at 371 [71].

McKerracher J referred[172] without criticism to the majority judgments in *Cliffs* but, like Edmonds J, his Honour was evidently of opinion that the reasoning of the minority was preferable and that he was free to prefer it.

130 Davies J did not refer to *Cliffs* or to whether expenditure promised as part of the consideration for the acquisition of a capital asset is necessarily an outgoing incurred on capital account. But, consistently with the majority's reasoning in *Cliffs*, her Honour approached the matter as follows[173]:

> "The obligation to pay the [specified charges] flowed as a necessary consequence of holding the licence, so that the thing that produced the assessable income was the thing that exposed [the appellant] to the liability discharged by the expenditure. The [specified charges] are therefore to be seen as an expense in the business operations of [the appellant] and on revenue account rather than as a cost in securing the right to conduct the transmission business."

131 Davies J rejected the Commissioner's argument that cl 13.3(d) of the Asset Sale Agreement made a difference. Her Honour reasoned that, although the appellant bound itself "as part of the terms of the Asset Sale Agreement" to pay the specified charges[174]:

> "the occasion for the incurrence of the liability to make the payments pursuant to the Order was not clause 13.3(d) but the fact that [the appellant] was the holder of the licence when the amounts became payable."

Outgoing incurred in gaining or producing assessable income

132 By notice of contention the Commissioner sought to uphold the judgment of the Full Court on the basis that, although the majority rejected Lockhart J's method of reasoning in *United Energy*, his Honour's method of reasoning was sound and, applied to this case, led to the conclusion that the specified charges were not incurred in gaining or producing the appellant's assessable income because they were calculated by reference to the appellant's expected profits.

133 That contention should be rejected. The majority of the Full Court were right not to follow Lockhart J's method of reasoning in *United Energy*. Principle and authority dictate that it does not follow from the fact that an obligation is

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172 *SPI PowerNet* (2014) 220 FCR 355 at 368-369 [59].

173 *SPI PowerNet* (2014) 220 FCR 355 at 378 [107] (citation omitted).

174 *SPI PowerNet* (2014) 220 FCR 355 at 378 [107].

paid or satisfied out of profits that the obligation may not have been incurred in gaining or producing assessable income[175]. The chief factor in the determination of the nature of expenditure is the character of the advantage which is sought to be obtained by it[176]. It is also necessary to have regard to the manner in which the acquisition is used or relied upon and the means which are adopted to obtain it[177].

134 In this case, the appellant derived the bulk of its assessable income from the amounts which it received from the transmission of electricity in the form of Prescribed Services. It was able to transmit electricity by way of Prescribed Services in those years of income and so derive that assessable income only so long as it held the transmission licence. So long as it remained the licence holder, it was bound to pay the specified charges. The occasion for payment of the specified charges thus inhered in the use, on a regular and recurrent basis, of the means of production of the appellant's assessable income. Accordingly, the specified charges were incurred in gaining or producing assessable income. Equally, the specified charges were incurred in carrying on business for the gaining or producing of assessable income because they were appropriate and adapted to that end[178].

135 It follows that, unless the payments were properly to be characterised as incurred on capital account, they were deductible under s 8-1 of the ITAA.

Outgoing incurred on capital account

The appellant's submissions

136 The appellant contended that the specified charges were not incurred on capital account because payment of the specified charges neither secured nor was

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175 *Emu Bay Railway Co Ltd v Federal Commissioner of Taxation* (1944) 71 CLR 596 at 606 per Latham CJ; [1944] HCA 28; *Federal Commissioner of Taxation v The Midland Railway Co of Western Australia Ltd* (1952) 85 CLR 306; [1952] HCA 5; *Nilsen Development Laboratories Pty Ltd v Federal Commissioner of Taxation* (1981) 144 CLR 616 at 628 per Gibbs J; [1981] HCA 6.

176 *GP International Pipecoaters Pty Ltd v Federal Commissioner of Taxation* (1990) 170 CLR 124 at 137 per Brennan, Dawson, Toohey, Gaudron and McHugh JJ; [1990] HCA 25.

177 *Sun Newspapers Ltd v Federal Commissioner of Taxation* (1938) 61 CLR 337 at 363 per Dixon J; [1938] HCA 73.

178 *Colonial Mutual Life Assurance Society Ltd v Federal Commissioner of Taxation* (1953) 89 CLR 428 at 443 per Williams ACJ; [1953] HCA 68.

capable of securing any lasting advantage. To suggest otherwise, it was said, would be to ignore the *raison d'être* of the specified charges, which was to deny the appellant a portion of the monopoly profits that would otherwise have flowed to it from its exploitation of the licence. The specified charges were not part of the consideration for the purchase of the licence because the Total Purchase Price of the assets, including the licence, was fixed; the specified charges were a separate matter. The specified charges were not incurred for the acquisition of the licence because, by the time the appellant came to pay the specified charges, it had already acquired the licence. The revenue character of the specified charges was revealed by the fact that the appellant's liability for each specified charge was contingent, both legally and commercially, upon the appellant remaining the holder of the licence at the time that the specified charges fell due. The appellant could have transferred the licence and thus avoided liability for future specified charges. So long as the appellant remained the licence holder, it was bound to pay each specified charge as it fell due, just as it was bound to pay each specified fee as it fell due. Otherwise, it would have been at risk of losing the licence. Each of the specified charges was therefore a regular and recurrent outgoing which inhered in the licence and was necessarily incurred in maintaining and exploiting the licence. Those submissions should be accepted.

The Commissioner's submissions

137 The Commissioner contended to the contrary that it necessarily followed from the proper construction of the Asset Sale Agreement that the specified charges were paid as part of the purchase price for the acquisition of capital assets, including the transmission licence. In the alternative, it was said that the circumstances of and surrounding the payments – the connection to the asset sale transaction and the means adopted to make the payments – led to the same result.

138 The Commissioner also advanced a further, independent proposition that the payments secured an advantage of a capital nature in that the specified charges formed an "integral part of the regulatory framework" in which the business was to operate. The specified charges were a mechanism adopted to adjust the regulated revenue of the transmission company to ensure that the newly privatised business would enjoy an appropriate return in its initial years. Thus, it was said, the specified charges formed part of the profit-generating subject, akin to the franchise fees considered in *United Energy*. Those submissions should be rejected.

The criteria of distinction

139 In *Hallstroms Pty Ltd v Federal Commissioner of Taxation*, Dixon J said that he was not prepared to concede that the distinction between outgoings on revenue account and those of a capital nature is "so indefinite and uncertain as to

remove the matter from the operation of reason and place it exclusively within that of chance"[179]. His Honour also stated that he did not accept that "the *discrimen* is so unascertainable that it must be placed in the category of an unformulated question of fact"[180]. But despite those observations and despite more than half a century of case law development since his Honour uttered them, the distinction remains elusive[181]. To a large extent it remains a truism that "each case in this particular area of the law is peculiarly dependent upon the particular facts and circumstances of that case"[182].

140 In *Sun Newspapers Ltd v Federal Commissioner of Taxation*, Dixon J identified the *discrimen* of the capital–income dichotomy as being the difference between expenditure on the acquisition of the profit-yielding subject and outlays on the process of operating the profit-yielding subject[183]. His Honour also described the tests by which expenditure may be assigned to one or other of those categories as turning upon the character of the advantage sought to be obtained, the manner in which it is to be used and the means adopted to obtain it[184]. In *Hallstroms* he added that the issue is to be decided from a practical and business point of view[185]. In *Colonial Mutual Life Assurance Society Ltd v Federal Commissioner of Taxation*[186], Fullagar J posed the question thus: what is the money really paid *for* – is what it is really paid for, in truth and in substance, a capital asset?

141 According to those criteria, the fact that the result or purpose of expenditure is the acquisition of some right or advantage of a lasting character for the benefit of the profit-yielding subject is a necessary but not sufficient indication that the expenditure is incurred on capital account. The final classification of an outgoing as being on capital or revenue account depends on the manner in which the right or advantage is to be used and the means which are adopted to obtain it.

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179 (1946) 72 CLR 634 at 646; [1946] HCA 34.

180 *Hallstroms* (1946) 72 CLR 634 at 646.

181 *Cliffs* (1979) 142 CLR 140 at 157 per Stephen J.

182 *Cliffs* (1979) 142 CLR 140 at 148 per Barwick CJ.

183 (1938) 61 CLR 337 at 359-360.

184 *Sun Newspapers* (1938) 61 CLR 337 at 363.

185 (1946) 72 CLR 634 at 648.

186 (1953) 89 CLR 428 at 454.

142 Other things being equal, where the means of obtaining a right or advantage of a lasting character is the payment of a lump sum purchase price or the payment of a lump sum purchase price by instalments, the expenditure is properly treated as incurred on capital account. If, however, the means of securing the right or advantage is by making recurrent payments accruing *de die in diem* or at other intervals, like rent, the payments may in some cases be treated as incurred on revenue account[187].

143 Difficulties sometimes arise in deciding whether the means of acquisition of an asset or advantage are to be viewed as payments of a lump sum purchase price by instalments or as recurrent payments accruing *de die in diem* or at other intervals. As Dixon J remarked in *Hallstroms*, the courts have tended to proceed not so much with conspicuous analysis as with what his Honour described as the "traditional way of stating what positive factor or factors" in a given case lead to assigning the expenditure to one category or another[188]. Where there is a decided case in point, the problem can be resolved in accordance with precedent. But where there is no decided case in point, the problem must be resolved in accordance with principle, by induction and, therefore, ultimately by analogy.

144 By way of illustration, if a property developer enters into an agreement to purchase land for a lump sum purchase price for redevelopment and subsequent retention as a long-term investment, there is no doubt that the payment of the purchase price is incurred on capital account. But what if the developer agrees that, instead of paying the purchase price, it will pay the vendor a share of the rents to be derived by the developer from the land once redeveloped? Apart from the decided cases, it might be open to classify the obligation to pay the share of rents either as an obligation to pay the purchase price by instalments or as an obligation to make recurrent payments accruing *de die in diem* or at other intervals. In view of the decided cases, precedent dictates that it should be classified as the former[189].

145 Similarly, suppose a taxpayer purchases land to be used as its place of business and agrees in consideration of the purchase that it will take over and meet a regular and recurrent obligation owed by the vendor to a third party. Apart from the decided cases, it might be open to classify the obligation either as an obligation to pay the purchase price by instalments or as an obligation to make

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187 *Sun Newspapers* (1938) 61 CLR 337 at 363 per Dixon J.

188 (1946) 72 CLR 634 at 646.

189 *Colonial Mutual* (1953) 89 CLR 428 at 444 per Williams ACJ.

recurrent payments accruing *de die in diem* or at other intervals. In view of the decided cases, precedent dictates that it should be classified as the former[190].

146 In contrast, since the lease of a shop at which a shopkeeper proposes to carry on business is an enduring asset and thus, once acquired, an accretion to the shopkeeper's profit-earning subject, absent precedent it would not be illogical to classify the shopkeeper's obligation to pay rent under the lease either as payment of the purchase price by instalments or as an obligation to make recurrent payments accruing *de die in diem* or at other intervals. In view of the decided cases, however, it is difficult to conceive of circumstances in which the rent should not properly be treated as an obligation incurred on revenue account[191].

147 In this case there is no decided case directly in point. Accordingly, it is necessary to proceed by induction from the decided cases. The task is to identify what it is in the decided cases which marks the distinction between a succession of payments that should properly be characterised as payments of purchase price by instalments and a succession of payments that should properly be characterised as satisfaction of a regular and recurrent obligation, like rent.

148 Some of the cases imply that the criterion of distinction is whether an obligation to make payments is incurred as consideration for the acquisition of a capital asset[192] as opposed to arising under or out of the operation of the capital asset once acquired[193]. Other cases show, however, that that is not a sufficient criterion of distinction where the obligation to make payments is incurred both as consideration for the acquisition of the asset and also under or arising out of the operation of the asset once acquired.

149 An assignment of a lease of business premises illustrates the point. A shopkeeper seeking an assignment of the lease of shop premises might be required to covenant with the assignor and the landlord that, in consideration of the assignment, the shopkeeper will pay all rent and other outgoings as they accrue due under the lease. Despite the covenant, there could be little doubt that

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190 *Tata Hydro-Electric Agencies, Bombay v Income-tax Commissioner, Bombay Presidency and Aden* [1937] AC 685 at 695.

191 *Federal Commissioner of Taxation v South Australian Battery Makers Pty Ltd* (1978) 140 CLR 645 at 653-655 per Gibbs ACJ; [1978] HCA 32.

192 See, eg, *Colonial Mutual* (1953) 89 CLR 428; *Tata* [1937] AC 685.

193 *Egerton-Warburton v Deputy Federal Commissioner of Taxation* (1934) 51 CLR 568; [1934] HCA 40; *Commissioner of Taxation v Morgan* (1961) 106 CLR 517; [1961] HCA 64; *Cliffs* (1979) 142 CLR 140.

each payment of rent and outgoings under the lease would be incurred on revenue account[194].

150 Pertinently for present purposes, the same would also be true of a promise to pay rent at an increased rate under the lease. If, as consideration for agreeing to the assignment of the lease, the landlord required the shopkeeper to agree to an increase in rent and to pay the increased rent for the term of the lease, or even for just some years of the term, the payment of rent at the new rate would doubtless be incurred on revenue account.

151 *Prima facie*, this case is sufficiently analogous to an assignment of a lease to suggest that similar considerations should apply. By cl 13.3(d) of the Asset Sale Agreement, the appellant covenanted with the State in part consideration for the assignment of the licence to pay the specified charges when due. Despite the covenant, however, the specified charges were recurrent obligations which arose under or out of the possession and operation of the licence, just as much as rent due under a lease arises under or out of the possession and operation of the leased premises.

152 Admittedly, there can be dangers in analogies[195]. What holds for a property developer or a shopkeeper does not necessarily apply to a distributor of electricity. Despite Dixon J's sanguinity as to the *discrimen* of the capital–revenue dichotomy rising above the category of an unformulated question of fact, there is obvious truth in Barwick CJ's apophthegm that in this area of the law each case turns on its facts. But analogies are useful in illuminating the manner in which established principle operates in fact and thereby revealing aspects of principle which may suggest that the result in a given case should be one thing rather than another.

153 The question, then, is what is there in principle which, in the circumstances postulated of a covenant to pay rent under a lease, mandates that, despite the covenant, the rent when due or paid is incurred on revenue account?

154 Ultimately, it appears from the majority judgments in *Cliffs*, and particularly from the judgment of Jacobs J[196], to be that primacy should be accorded to the character of the advantage or interest sought to be obtained by the payment of rent under the lease in preference to the character of the advantage

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194 *Federal Commissioner of Taxation v South Australian Battery Makers Pty Ltd* (1978) 140 CLR 645 at 653-655 per Gibbs ACJ.

195 *Federal Commissioner of Taxation v Citylink Melbourne Ltd* (2006) 228 CLR 1 at 43 [151] per Crennan J; [2006] HCA 35.

196 (1979) 142 CLR 140 at 174-175.

sought to be obtained by the covenant. The advantage or interest sought to be obtained by payment of rent under the assigned lease is the satisfaction of a regular and recurrent obligation which inheres in the lease[197]. It is not the acquisition of the lease, because by the time that rent is paid or becomes due the lease has been acquired. Admittedly, the advantage or interest sought to be obtained is also the satisfaction of the covenant given in consideration of the assignment of the lease. But, as appears from the majority's reasoning in *Cliffs*, that is conceived of as being of secondary importance. The predominant and, therefore, determinative character of the rent is of an outgoing of which the occasion is the use and exploitation of the means of production of assessable income.

155 It should be noted, too, that there was no disagreement between the majority and the minority in *Cliffs* as to the relevance of that criterion. Gibbs J disagreed with the majority only because, in effect, his Honour concluded that the payments in issue were not in fact made for the use and exploitation of the mineral leases. That was so because the mining operations could have been continued whether or not the payments were made. The situation was in that respect similar to *Colonial Mutual* and *Tata Hydro-Electric Agencies, Bombay v Income-tax Commissioner, Bombay Presidency and Aden*[198], to which reference will later be made. As Gibbs J put it[199]:

> "Although there was evidence, which was accepted, that the parties regarded the payments as in the nature of royalties, the payments did not in truth have that character. The payees had no interest in the mineral leases, and could not either give or withhold permission to mine them. The payments could not properly be said to have been made for the right to mine the ore, since the mining operations could be continued whether or not the payments were made. The case falls within the principle on which *Colonial Mutual Life Assurance Society Ltd v Federal Commissioner of Taxation* and *Ralli Estates Ltd v Commissioner of Income Tax* were decided. ... In my opinion the present case is indistinguishable from *Colonial Mutual Life Assurance Society Ltd v Federal Commissioner of Taxation*. The facts also appear to me to be indistinguishable from those in *Tata Hydro-Electric Agencies Bombay v Income Tax Commissioner, Bombay Presidency and Aden*, although of course that case was decided on a statute containing words different from those of s 51(1)."

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197 See *Cliffs* (1979) 142 CLR 140 at 149 per Barwick CJ.

198 [1937] AC 685.

199 *Cliffs* (1979) 142 CLR 140 at 156-157 (footnotes omitted).

156 Similarly, Stephen J based his conclusion on his perception that the payments were in truth and substance delayed instalments of the purchase price rather than payments for use or exploitation of the mineral leases. So much was demonstrated by the fact that the only connection between the amounts of the payments and the tonnage of ore extracted from the mine was that a percentage of the value of tonnage was the method of computation of the purchase price chosen by the parties[200]:

> "By promised payment the taxpayer secured to itself rights, in part existing, in large partly [sic] only prospective and in a sense speculative but from the exercise of which, directly or at one remove, it might look forward to the deriving of income in the future. Their promised payment formed a part of the consideration in return for which those rights were secured and they were aptly enough described in the agreement as a part of the 'purchase price'. Moreover that 'purchase price' was paid or promised once and for all in return for one bundle of rights. Once those rights were acquired by the taxpayer there remained nothing more for the vendors to give it: the transaction between them was complete save that the taxpayer's promise to make the 'deferred payments' remained to be performed. Those future payments were not to be paid in return for advantages to be granted in the future but, rather, in consideration of a single event occurring in the past, namely the transfer of the vendors' shareholding in Basic. The linking of the quantum of the future payments with matters contemporaneous with the making of those payments was but the outcome of the particular method adopted for the determination of their quantum."

157 Stephen J acknowledged that the situation is different where payments are for the right to use and exploit the asset, as with the payment of rent under a lease or royalties under a licence[201]:

> "The important distinction between such a case and instances of leases of land or the licensing of patents is that in those cases rent or royalties are paid for the right to occupy or use the property or rights of another. But here the vendors, upon exercise of the option, retained nothing and the taxpayer thereafter made no use of anything to which the vendors retained any claim."

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200 *Cliffs* (1979) 142 CLR 140 at 160.

201 *Cliffs* (1979) 142 CLR 140 at 160.

158 His Honour concluded, however, that where the only reason for the adoption of a stream of payments computed by reference to production was because it was the negotiated means of computation of the purchase price, the situation was in all relevant respects similar to *Colonial Mutual* and *Tata*[202]:

> "It may be that money paid by a purchaser as part of the purchase price of a capital asset which he buys will not, for that reason alone, necessarily always bear the character of an outgoing of capital. But at least where, as here, whatever indicia of a revenue nature which the agreed purchase price may possess can be seen to be due only to factors such as the impossibility of placing a value, at the date of grant of the option, upon what is bought, the capital nature of what is bought will be most cogent evidence of the capital nature of the outgoing. To such a case I would apply what was said by Fullagar J in *Colonial Mutual Life Assurance Society Ltd v Federal Commissioner of Taxation* where speaking of payments made as the price of acquiring an asset, his Honour said:
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> > '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.'"

Were the specified charges paid for the acquisition of the assets?

159 Allowing that the relevant criterion for determining whether a stream of payments is on capital or income account is whether, like rent paid under a lease, it is paid predominantly for the use and exploitation of an asset as opposed to its acquisition, is there anything in principle which dictates that the result should be different in this case?

160 Subject to what follows, it could not be said that the advantage or interest which the appellant sought to obtain by the payment of the specified charges was the acquisition of the licence. For just as in the case of the payment of rent under an assigned lease, by the time of payment of each specified charge the licence had been acquired. Each specified charge was paid in satisfaction of an annual obligation which inhered in the licence so acquired and, therefore, of which it can properly be said that the occasion was the maintenance or deployment of the

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202 *Cliffs* (1979) 142 CLR 140 at 161 (footnote omitted), quoting *Colonial Mutual* (1953) 89 CLR 428 at 454.

means of production of assessable income[203]. The appellant's retention of the licence was dependent upon payment of the specified charges. As has been noticed, the State retained the right to revoke the licence for breach if the specified charges were not paid. In those circumstances, why should the predominant character of the specified charges not be seen as relevantly similar to rent and therefore deductible outgoings?

161 The Commissioner contended that it was enough to render the payments capital that the appellant covenanted to pay the specified charges under the Asset Sale Agreement. The covenant was the predominant consideration and, as such, it characterised the payments of specified charges as, in effect, payments by instalments of the cost of acquisition of the licence.

162 Counsel for the appellant faintly suggested that, properly construed, the Asset Sale Agreement did not create a contractual obligation to pay the specified charges. But it is clear that it did. As previously noted, cl 13.3(d)(1) of the Asset Sale Agreement expressly provided that the appellant was bound to pay "the amounts set out in the [Order] in order to carry on the Business transferred from the Seller".

163 The Commissioner's submission must nonetheless be rejected. In effect, it does no more than restate the misconception that, where a covenant to perform a regular and recurrent obligation inherent in an asset is given as part of the consideration for acquisition of the asset, the obligation must be characterised as a capital outgoing. As has been seen, at least in the case of rent and royalties, that is not the case.

164 The Commissioner next contended that payment of the specified charges was in truth and substance payment of part of the purchase price under the Asset Sale Agreement because the amount styled "Total Purchase Price" was relevantly defined as the "price of the Assets" net of "Creditors ... assumed under this agreement". Under cl 2.1 of the Asset Sale Agreement, the appellant assumed PNV's "Creditors" as at completion. By the time of completion, the Order had been made and PNV's liability to the State for the specified charges had crystallised. Hence, by the time of completion, the State was a creditor of PNV and the appellant assumed that liability.

165 That contention must also be rejected. As at the date of completion, PNV's liability to the State to pay the specified charges was contingent on PNV still being the licence holder when the specified charges fell due. Consequently,

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203 See *Commissioner of Taxation v Morgan* (1961) 106 CLR 517 at 520-522; *Federal Commissioner of Taxation v Citylink Melbourne Ltd* (2006) 228 CLR 1 at 44 [153]-[154] per Crennan J.

the appellant took over PNV's obligation to pay the specified charges as it did PNV's obligation to pay the specified fees. The position in this respect is no different from that of an assignee of a lease, who covenants as a term of the assignment to pay rent under the lease, taking over the assignor's obligation to pay the rent.

166 When pressed to say why in principle the appellant's covenant to pay the specified charges should be regarded differently from an assignee's covenant to pay rent under an assigned lease, counsel for the Commissioner could offer no more than that payment of rent under a lease is an established category of revenue outgoing and that the Commissioner relied on the decision of the Privy Council in *Tata*[204].

167 Neither of those responses is persuasive. Granted, the payment of rent under a lease is an established category of revenue outgoing, and specified charges paid in connection with an electricity transmission licence are not. But to say so discloses nothing in point of principle as to why the two should not be treated alike.

168 *Tata* was concerned with whether an obligation of a purchaser of a business to the vendor to pay a share of profits from the business to a third party was incurred "solely for the purpose of earning ... profits or gains" of the business within the meaning of s 10(2)(ix) of the *Indian Income-tax Act* 1922[205]. As such, much of the reasoning in *Tata* is of little relevance to this case. Apart from differences between the facts, the question of whether an obligation is incurred solely for the purpose of earning profits or gains is different from whether an outgoing is incurred in gaining or producing assessable income or in carrying on business for the production of such income.

169 As was explained in *Egerton-Warburton v Deputy Federal Commissioner of Taxation*[206], the different construction of the Australian legislation means that revenue charges incurred on account of the acquisition of land or its continued occupation involve an outlay for the production of income derived from the land and are for that reason deductible. Under the ITAA, what counts is the nature of the obligation assumed. If it is an obligation of a recurrent nature incurred for the continued use of the asset acquired, it is hardly to the point that the obligation may have been assumed in consideration of the acquisition of the asset.

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204 [1937] AC 685.

205 [1937] AC 685 at 692.

206 (1934) 51 CLR 568 at 579-581 per Rich, Dixon and McTiernan JJ.

170 The Commissioner relied on the fact that, in *Tata*, it was held that the purchaser's promise to pay a share of profits to the third party was in the nature of a promise to pay the purchase price by instalments. But, as was earlier remarked, that was so because the only connection between the business acquired by the purchaser and the purchaser's obligation to pay the share of profits to the third party was that the purchaser covenanted with the vendor, in consideration of the acquisition of the business, to pay the third party a share of the profits to be derived from the business.

171 In contradistinction to an obligation to pay rent under an assigned lease or an obligation to pay specified charges which inheres in a licence, in *Tata* there was no connection between the purchaser's obligation to pay the share of profits to the third party and the purchaser's maintenance or deployment of the means of production of assessable income[207]. The purchaser's retention of the business was not in any sense dependent on the obligation to pay the third party. Breach of the obligation to pay the third party might have exposed the purchaser to an action for damages for breach of contract but not to forfeiture of the business assets. In form and substance, the purchaser's obligation to make payments to the third party was no different from an obligation to make payments to or at the direction of the vendor.

172 It is true that, in *Colonial Mutual*, Williams ACJ and Fullagar J referred to *Tata* as supporting their conclusion that an obligation on the part of the taxpayer to pay the vendors of land a share of rents to be derived by the taxpayer from properties it proposed to construct on the land once acquired was a capital outgoing[208]. But that was because in *Colonial Mutual* the share of rents was part of the purchase price. Although regular and recurrent, the payments were payments for the acquisition of the land as opposed to payments for the continued use and occupation of the land. As in *Tata*, the taxpayer's use and occupation of the land was not dependent upon payment of the share of the rents. Breach of its obligation might have resulted in an action for damages for breach of covenant but it held the land in fee simple.

Means adopted to make the payments

173 The Commissioner further contended that the specified charges were incurred on capital account because, unlike the specified fees, which were payable throughout the term of the licence, the specified charges were limited in number, fixed in amount and evidently connected with the Asset Sale Agreement, and so were far from being regular and recurrent. More specifically, it was submitted that the payments were in effect a one-off liability connected

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207 [1937] AC 685 at 695.

208 (1953) 89 CLR 428 at 444-445 per Williams ACJ, 455 per Fullagar J.

with the privatisation of the power network and were voluntarily assumed by the appellant as part of the acquisition of the assets as an alternative to payment of a higher price for the privatised business. That was borne out, it was said, by the fact that the specified charges were calculated by reference to the licensee's assumed profitability; that the appellant took the obligation to pay the specified charges into account in the determination of its bid price for the assets; that the appellant covenanted that it would not challenge the lawfulness of the specified charges; and that, at least initially, the appellant recorded the payments in its audited books of account as a capital outgoing. These considerations, it was submitted, reinforced the Commissioner's primary submission that the specified charges were paid for the acquisition of the transmission assets.

174 Those submissions face difficulties at several levels. First, although it is true that the number of payments was limited and that the payments were fixed in amount, their limited number is not of great significance. As Dixon J said in *Sun Newspapers*[209], recurrence is not a question of recurring every year or every accounting period. Nor is it a criterion of distinction. The real test is whether the expenditure is in the "wide class of things which in the aggregate form the constant demand which must be answered out of the returns of a trade or its circulating capital". "[A]ctual recurrence of the specific thing need not take place or be expected as likely."[210]

175 Secondly, assuming that "fixed amounts" means that the payments were pre-determined and set out in the Asset Sale Agreement rather than being imposed *ad valorem* on profits or income actually generated, the fact that they were so fixed is logically beside the point. In form and as a matter of substantive legal obligation, the payments were of a compulsory tax levied annually during the transition period. As the appellant submitted, a payment in the nature of a periodical tax is customarily conceived of as incurred on revenue account. As *Moffatt v Webb* shows[211], that is because the payment of a periodical tax does not secure to the taxpayer any capital advantage.

176 Here, as in *Moffatt v Webb*, the payment of the specified charges did not secure to the appellant any capital advantage. It secured the appellant against being disturbed in its operation of the licence and against the potential that the licence would be forfeit if the specified charges were not paid. According to ordinary conceptions, those attributes colour the specified charges as outgoings incurred on revenue account.

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209 (1938) 61 CLR 337 at 362.

210 *Sun Newspapers* (1938) 61 CLR 337 at 362.

211 (1913) 16 CLR 120 at 130 per Griffith CJ; [1913] HCA 13.

177 Thirdly, it is not clear why the fact that the specified charges were calculated by reference to the licensee's estimated revenue and profitability should be regarded as significant. Plainly deductible regular and recurrent obligations like rent[212], royalties[213], rates, land tax, resources rent tax and franchise fees[214] are not infrequently calculated by reference to a fixed percentage of actual or projected revenue, profits or value. There is nothing in principle or in the facts of the decided cases which suggests that, because they are so computed, the obligation to pay them should be regarded as incurred on capital account.

178 Admittedly, the specified charges were a "one-off" liability in the sense that they were imposed only during the transition period between 1998 and 2000, after which the X factor was increased to 11 per cent. It is also correct that the specified charges were associated with privatisation of the power network and that they were the means by which, figuratively speaking, the State took a share of the economic monopoly profits which it was projected would flow to the licensee during the transition period. But neither of those considerations detracts from the legal and fiscal reality that the specified charges were a regular and recurrent tax to which the appellant was subjected *qua* licence holder throughout the transition period.

179 Fourthly, the fact that the appellant covenanted not to challenge the lawfulness of the specified charges and to pay them in any event is also beside the point. It has not been suggested that they were unlawfully imposed and, in any event, unless and until their imposition was declared to be unlawful the appellant was under a legal obligation to pay them. It is true that, if their imposition under s 163AA had been declared unlawful, the appellant's only obligation to continue to pay them in those circumstances would have been its contractual liability under cl 13.3(d). No doubt, it might also be said that that was incurred in consideration of the transfer of the licence to the appellant. But, even then, the nature of the contractual liability, no less than a contractual liability to pay rent under a covenant given in consideration of an assignment of lease, would still have been a regular and recurrent liability which inhered in the asset – in this case, the licence – in respect of which it was charged.

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212 *Federal Commissioner of Taxation v South Australian Battery Makers Pty Ltd* (1978) 140 CLR 645.

213 See, eg, *H R Sinclair & Son Pty Ltd v Federal Commissioner of Taxation* (1966) 114 CLR 537; [1966] HCA 39.

214 *Federal Commissioner of Taxation v Citylink Melbourne Ltd* (2006) 228 CLR 1.

Payments of tax on capital account

180 The Commissioner contended that a tax can be and often is an affair of capital. Counsel for the Commissioner instanced conveyance duty payable on the acquisition of land and also referred to the decision of the Full Court of the Federal Court in *United Energy* as authority that compulsory imposts may be incurred on capital account.

181 Those comparisons are inapposite. Conveyance duty is an outgoing on capital account because it is a charge on the capital value of the property conveyed. As such, it is in the nature of an additional capital cost of acquisition of the property conveyed. A tax of that kind bears no relationship to the specified charges in this case, which, as opposed to being charged on the purchase price of the licence, were computed and levied in respect of each of the three transition period years of operation of the licence according to the profits which it was considered were capable of being generated from operation of the licence in that period.

182 Finally, the Commissioner contended that the specified charges were paid as part of the regulatory framework in which the transmission business was to operate. The regulatory framework, which included the Tariff Order, gave licence holders benefits that included predictable revenues and the ability to outperform the assumptions which underpinned those revenues. Those benefits formed part of the profit-yielding structure of the business. Thus, by analogy with *United Energy*, the payments should be treated as incurred on capital account.

183 That contention should also be rejected. The decision in *United Energy* rested on the conclusion of the plurality that the distribution franchise fee which United Energy was required to pay to the Government under s 163A of the EIA was consideration for the advantage of being free from competition of other distribution companies within an exclusive distribution area. Their Honours reasoned as follows[215]:

> "In the Explanatory Memorandum set out under the heading *The Franchise Fees*, the fee is said to be 'appropriately viewed … as a fee payable by the [distributors] for the benefit … of their franchise customer bases'. That is in our view an accurate description of the fee. The 'benefit' referred to is that a franchise customer, being one who has 'not yet become contestable' under the reforms, *must* buy electricity from the distribution company for its area for so long as that customer is not 'contestable'. The franchise fee is not payable for the right to sell electricity to customers in

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215 (1997) 78 FCR 169 at 192-193 per Sundberg and Merkel JJ (original emphasis).

> the distributor's licence area. That right is conferred by a licence to sell electricity granted under ss 162 and 163 for which a different fee is payable. Rather the franchise fee is payable for the advantage enjoyed by the distribution company of being free from the competition of the other four distribution companies for the custom of franchise customers in the distributor's licence area. The fee was aptly described by the Minister as a 'monopoly rent' for the exclusive right to sell to franchise customers in the distributor's licence area during the transitional period.
>
> The licence is consistent with the Act. The exclusivity granted to a licensee in respect of franchise customers does not arise by reason of any term of a Retail licence. Rather, it arises because each Retail licence authorises sales of electricity only to franchise customers within the licence area. That limited authorisation and the prohibition against unauthorised sales under s 159(1) ensure the exclusivity required by s 162(2B).
>
> Accordingly, the franchise fee is payable by the taxpayer for and by reason of the exclusivity provided for under ss 162(2B) and 163A(4) and conferred by a combination of s 159(1) and the terms of the Retail licences granted to the five distribution companies. This conclusion is significant as it is not strictly correct to contend, as did counsel for the taxpayer, that the franchise fee is payable in 'consequence' of the licence or the monopoly the licence entitled the taxpayer to exercise in relation to part of its market."

184 The decision is, therefore, distinguishable on the basis that the franchise fee was considered to have been paid in consideration of a legal monopoly whereas, in this case, the licence did not confer a legal monopoly. The only monopoly was economic.

185 More importantly, however, several aspects of the plurality's reasoning in *United Energy* are distinctly problematic. The fact that the Government chose to describe the franchise fee as "a fee payable by the [distributors] for the benefit … of their franchise customer bases", or even that the franchise fee was based on the Government's asseverated conviction that the State should receive some benefit from the monopoly profits which it was anticipated would flow to a licence holder, could not alter the formal and substantive legal reality that the franchise fee was a compulsory exaction levied on a licence holder because it was a licence holder. Whatever the underlying economic rationale of its imposition, it was a regular and recurrent obligation of which the occasion inhered in the means of production of assessable income.

186 It is true that United Energy's licence effectively conferred the benefits of exclusivity in the licence area. But *non constat* that the franchise fees were not expenditure of a kind among the wide class of things which in the aggregate form

the constant demand which must be answered out of the returns of trade or circulating capital. Allowing that exclusivity is to some extent a lasting advantage and, therefore, that sums outlaid in securing exclusivity may be characterised as outgoings of capital[216], whether they should be so characterised in a given case must depend upon the means of acquisition. As has been explained, if the means of obtaining exclusivity are by the making of recurrent payments analogous to rent accruing *de die in diem* or at other intervals, such payments may properly be characterised as incurred on revenue account. Thus, no one would doubt that rent paid under the lease of an hotel with the benefit of an exclusive liquor licence is deductible.

187 Most importantly, the reasoning of the plurality in *United Energy* is at odds with the later reasoning of this Court in *Federal Commissioner of Taxation v Citylink Melbourne Ltd*[217]. *Citylink* was concerned with the deductibility of concession fees payable under a Tollway Concession Deed that conferred an exclusive right to conduct a tollway for the period of the concession. The Court rejected the Commissioner's contention that the concession fees were in substance payments by instalments for the purchase of a capital asset comprised of the exclusive right to operate the tollway. As Crennan J (with whom Gleeson CJ, Gummow, Callinan and Heydon JJ agreed) said[218]:

> "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. 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."

188 The Commissioner submitted that *Citylink* was different because the concession fees in that case were paid for the right to operate a capital asset as opposed to consideration for the purchase of a capital asset, and that the concession fees were payable throughout the life of the licence in contrast to the specified charges, which were payable for just the first three years of the licence period.

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216 See, eg, *Sun Newspapers* (1938) 61 CLR 337.

217 (2006) 228 CLR 1.

218 (2006) 228 CLR 1 at 44 [154] (footnote omitted).

189 There is no substance in either of those distinctions. As was earlier noticed, although the appellant covenanted as part of the consideration for its acquisition of the licence that it would pay the specified charges when due, it paid the specified charges after it had acquired the licence in discharge of a regular and recurrent obligation in the nature of a tax imposed on it as the holder of the licence. And, although its payment of the specified charges could perhaps be viewed as being as much in discharge of its contractual liability to pay the imposts as in discharge of its statutory obligation to do so, principle and the analogy of rent payable by an assignee of a lease who has covenanted as a term of the assignment to pay the rent when due imply that the predominant and therefore determinative character of the specified charges was one of an outgoing of which the occasion was the maintenance or deployment of the licence as means of production of assessable income. As has been stated, recurrence is not a question of recurring every year or every accounting period. The test is whether the expenditure is in the wide class of things which in aggregate form the constant demand which must be answered out of the returns of trade or circulating capital. Actual recurrence of the thing need not take place or even be expected.

Economic equivalence?

190 It remains to mention the reliance which the Commissioner placed on the facts that the appellant computed the amount of its bid for the licence by reference to the anticipated specified charges burden, and at least initially recorded the specified charges in its books of account as a capital outgoing. As in several other aspects of the Commissioner's submissions, the significance which the Commissioner attributed to those facts appeared to proceed from an unstated sub-text – that, because the State could have structured the obligation to pay the specified charges as an obligation to pay an additional amount of purchase price, the specified charges should be treated as if they were additional amounts of purchase price. Thus, despite counsel taking care to avoid specific reference to conceptions of that nature, not a little of the argument presented as if it were based on notions of economic equivalence of the kind which this Court rejected in *Citylink*[219].

191 There is no room for notions of economic equivalence in the determination of what is deductible. Obviously, any capital outlay can be expressed in terms of an economically equivalent projected stream of income payments just as any projected stream of revenue outgoings can be expressed in terms of a present discounted capital value. Thus, the less the specified fees, specified charges and other revenue obligations, the more the assets were likely to be worth, and so the more that a rational self-interested purchaser would be

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219 (2006) 228 CLR 1 at 31 [95] per Crennan J.

prepared to pay; and vice versa. It is, therefore, not at all surprising that the appellant took the specified charges into account in determining its bid price for the assets and undertaking of PNV. But, absent notions of economic equivalence, that says nothing about the appropriate characterisation of the payments.

192 No doubt, the State could have structured the transaction as one of payments in consideration of the State's agreement to the assignment of the licence instead of specified charges payable *qua* licensee. Had it done so, the payments would have been a capital expense. But the State chose to proceed by way of specified charges exigible in respect of holding the licence instead of payments in consideration of assignment of the licence, just as it might have chosen to proceed by way of a variation in the X factor. The need to approach the characterisation of outgoings from a common sense business point of view does not mean that, because an outgoing on revenue account could have been structured as a transaction on capital account, by some process of economic equivalence it may be treated as if it were the latter. It was not suggested that Pt IVA of the *Income Tax Assessment Act* 1936 (Cth) applied.

193 The fact that the appellant recorded the outgoings as capital in its books of account is equally inconsequential[220]. It might have been to the point had there been a dispute about the reality of the transaction or if Pt IVA had been invoked. If it had been contended that the structuring of the specified charges as imposts was a pretence designed to mask what were in truth payments of instalments of purchase price, or that the dominant purpose in choosing imposts over an increased purchase price was a tax advantage, the fact that the appellant recorded the payments as capital outgoings might have been viewed as an admission of fact against interest and thus been admissible in proof of the truth about the transaction[221]. But, in the absence of a contention of either kind, the way in which the outgoings were treated in the books of account is irrelevant[222].

Conclusion and orders

194 In the result, the appeal should be allowed. The orders of the Full Court should be set aside. In their place, it should be ordered that the appeal to the Full Court is allowed with costs, the judgment of the Federal Court is set aside, and in

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220 *Broken Hill Theatres Pty Ltd v Federal Commissioner of Taxation* (1952) 85 CLR 423 at 434-435 per Dixon CJ, McTiernan, Fullagar and Kitto JJ; [1952] HCA 75.

221 See, eg, *Grey v Australian Motorists & General Insurance Co Pty Ltd* [1976] 1 NSWLR 669 at 675-676 per Glass JA; cf at 684-685 per Mahoney JA.

222 *Dovuro Pty Ltd v Wilkins* (2003) 215 CLR 317 at 327 [25] per Gleeson CJ, 340-342 [68]-[71] per Gummow J; [2003] HCA 51.

its place the appeal against the disallowance of objection is allowed and the matter is remitted to the Commissioner for reassessment according to law. The respondent should pay the appellant's costs of the appeal to this Court.

Appendix

Transmission Licence

3.4 The ***Office*** may at any time give at least 20 ***business days*** notice of revocation to the ***Licensee*** if the ***Licensee*** does not comply with an ***enforcement order*** or an ***undertaking***, and the ***Office*** decides that it is necessary or desirable to revoke this licence in order to achieve the ***policy objectives***, in which case the term of this licence ends, subject to clause 3.5, on the expiration of the period of the notice.

...

18. COMPLIANCE WITH LAWS

The ***Licensee*** must comply with all applicable laws including but not limited to the ***Tariff Order***.

...

"enforcement order" means a provisional or final order made and served by the ***Office*** under section 35 of the Office of the Regulator-General Act 1994;

...

"undertaking" means an undertaking given by the ***Licensee*** under section 35(5)(a) of the Office of the Regulator-General Act 1994;

...

Office of the Regulator-General Act 1994

35. *Enforcement orders*

(1) This section applies if a person is contravening, or in the opinion of the Office is likely to contravene—

(a) a determination; or

(b) if the Office is under the relevant legislation or by virtue of an Order in Council under section 3(2) responsible for licensing, the conditions of a licence—

and the Office considers that the contravention or likely contravention is not of a trivial nature.

(2) The Office may serve a provisional order or a final order on the person requiring the person to comply with the determination or licence condition.

(3) Unless sooner withdrawn by the Office, a provisional order has effect for a period of 7 days commencing on the day that it is served.

(4) The Office may serve another provisional order upon the expiry of a preceding provisional order.

(5) If the Office has made a provisional order, the Office must not make a final order if—

(a) the person has undertaken to comply with the determination or licence condition; or

(b) the Office is satisfied that the order would be inconsistent with the objectives of this Act.

(6) The Office must not make a final order unless the Office has—

(a) given the person at least 28 days notice of the intention to do so; and

(b) given the person the opportunity to make a submission in respect of the order; and

(c) considered any submission or other objection to the order received by the Office.

(7) The Office must as soon as possible after serving a provisional order or a final order on a person publish a copy of the order in the Government Gazette.

(8) A person must comply with a provisional order or a final order or an undertaking under sub-section (5)(a).

Penalty: 1000 penalty units and 100 penalty units for each day after service of the order that contravention continues.