

HIGH COURT OF AUSTRALIA

BRENNAN CJ,
GAUDRON, McHUGH, GUMMOW, KIRBY, HAYNE AND CALLINAN JJ

THE COMMISSIONER OF TAXATION OF
THE COMMONWEALTH OF AUSTRALIA

APPELLANT

AND

ORICA LIMITED

RESPONDENT

Commissioner of Taxation v Orica (M97-1996 and M98-1996)
[1998] HCA 33
12 May 1998

ORDERS

Matter No M97 of 1996

1. *Appeal allowed.*
2. *Set aside paragraphs 1, 3, 4 and 5 of the orders of the Full Court of the Federal Court of Australia made on 24 July 1996 (in so far as those orders relate to Matter No VG95 of 1995) and in lieu thereof order:*
 - (a) *appeal allowed;*
 - (b) *set aside the decision of the Commissioner of Taxation disallowing the taxpayer's objection to the assessment in respect of the 1987 year of income;*
 - (c) *direct that the Commissioner of Taxation amend the assessment in accordance with law;*
 - (d) *taxpayer to pay one half of the Commissioner's costs of the appeal to the Full Court of the Federal Court of Australia;*
 - (e) *each party to bear its own costs of the proceedings before Ryan J.*

2.

3. *Respondent to pay one half of the appellant's costs of the appeal in this Court.*

Matter No M98 of 1996

Appeal dismissed with costs.

On appeal from the Federal Court of Australia

Representation:

B J Shaw QC and D H Bloom QC with G J Davies for the appellant
(instructed by Australian Government Solicitor)

D F Jackson QC with R F Edmonds SC for the respondent (instructed by
Mallesons Stephen Jaques)

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subject to formal revision prior to publication in the
Commonwealth Law Reports.

CATCHWORDS

Commissioner of Taxation v Orica Limited

Income tax – Agreement for third party to discharge taxpayer's future liability to repay debentures – Taxpayer pays third party net present value of liabilities – Whether difference between net present value and face value of liabilities is assessable income – Whether income according to ordinary concepts – Historical cost approach – Economic equivalence – Single transaction – Whether profit-making scheme.

Income tax – Capital gains – Whether difference between net present value and face value of liabilities is a capital gain – Whether taxpayer's rights against third party under agreement are an asset – Whether performance of contractual obligations amounts to disposal of asset.

Income Tax Assessment Act 1936 (Cth), ss 19, 25, 25A, 160A, 160M.

Words and phrases – "income", "asset", "discharge", "satisfaction".

- 1 BRENNAN CJ. These are appeals from a judgment of the Full Court of the Federal Court¹ allowing appeals against orders made by Ryan J² relating to the assessable income in the income years ended 30 September 1986 and 30 September 1987 of the respondent taxpayer, then known as ICI Australia Ltd ("ICI"). The appellant Commissioner of Taxation ("the Commissioner") assessed ICI to tax in respect of those income years by including in ICI's assessable income amounts representing what was contended to be a gain or a portion of a gain made by ICI from a transaction which included the making of an agreement known as the Principal Assumption Agreement. To explain the nature and effect of that transaction, it is necessary to state the circumstances in which the Principal Assumption Agreement came into existence.

The relevant facts

- 2 ICI, a Trustee (The Trustees Executors & Agency Company Limited, for which ANZ Executors & Trustee Company Limited was later substituted³) and Nobel (Australasia) Pty Ltd ("Nobel"), an ICI subsidiary, entered into two trust deeds dated respectively 17 October 1966 and 10 August 1970 governing the issue of debentures by ICI. Each contained a guarantee by Nobel of payment by ICI of the principal moneys to become payable by ICI under the deed. The debentures to be issued under the 1966 Deed were to be repayable by ICI on 30 November of 1973, 1981 or 1986, at the debenture holder's option, the interest on the debenture varying with the selected date of repayment. Pursuant to the 1966 Deed, \$1,719,900 worth of debentures were issued with a redemption date of 30 November 1986. The 1970 Deed made similar provisions in respect of debentures that were to be repayable on 30 November 1975, 30 November 1980 and 31 May 1985 but, in addition, ICI was authorised to issue other debentures repayable at different dates or on demand carrying interest at such rates as ICI might offer. Under the 1970 Deed, debentures were issued for varying sums having redemption dates between 30 November 1986 and 31 January 2000.
- 3 Each of the deeds imposed on ICI an obligation relating to the ratio of liabilities to assets. ICI and such subsidiary companies as were guaranteeing the payment by ICI of the principal moneys payable under the debentures ("the group") were not to have total liabilities exceeding 60% of the amount of the group's tangible assets⁴, or secured liabilities exceeding 40% of the group's tangible assets, or secured liabilities ranking prior to the debentures issued under

1 *ICI Australia Ltd v Commissioner of Taxation* (1996) 68 FCR 122; 138 ALR 705.

2 (1994) 125 ALR 63.

3 *ANZ Executors & Trustee Company Act* 1983 (Vic).

4 Amending Deeds of 28 April 1978 added a definition of "Tangible Assets of the Subsidiary Company" to the definition clauses of each of the 1966 and 1970 Deeds.

the particular deed exceeding 20% of the group's tangible assets. This obligation placed a restriction on ICI's commercial operations which led to the making of the Principal Assumption Agreement.

4 Although the trust deeds provided that the moneys subscribed for debentures were to be repaid by ICI, the 1966 deed acknowledged ICI's indebtedness to the Trustee in respect of the principal moneys. That deed contained a covenant to pay the principal moneys to the Trustee on the due date but payment to the debenture holder was to "operate as a payment in satisfaction of the debt due ... to the Trustee in respect thereof". ICI also covenanted with the Trustee to pay the interest on the principal moneys outstanding under the respective categories of debentures at the appropriate rate. ICI created a floating charge over its undertaking "in favour of the Trustee" to secure ICI's "payment of all moneys for the time being owing on the security of this Deed". The 1970 Deed contained similar, but not identical, provisions.

5 It is an unresolved, but not critical, question whether the debts owing by ICI on the due dates for redemption of debentures issued under these deeds were debts owing to the Trustee or debts owing to the debenture holders⁵. For present purposes, the material fact is that ICI was bound to pay the principal sum payable to redeem a debenture on the stipulated dates either to the Trustee or to the debenture holder and was bound to pay the interest thereon to the same payee in the meantime⁶. I shall refer to ICI's liability to pay the principal sum payable either

5 See the discussion by Beaumont J in *Commissioner of Taxation v Unilever* (1995) 56 FCR 152 at 165-169; 127 ALR 437 at 449-453; see also at 157, 179; 127 ALR 437 at 441, 462-463.

6 The form of the debentures which were to be issued under the 1966 Deed contained a condition reading as follows:

"5. The principal and interest secured by the said Trust Deed will be paid without regard to any equities between the Company and the original or any intermediate holder hereof or any right of set-off or cross claim."

But cll 59 and 66 of the 1966 Deed subjected the conditions expressed in the form of a debenture to the substantive provisions of the Trust Deed under which the debenture was to be issued.

The 1970 Deed was more specific. It provided for payments to be made by ICI to the debenture stockholders (proviso to cl 3(1)) and the form of the debentures to be issued included the condition:

"2. The Company will pay to the Debenture Stockholder named on the face of this Certificate the amount of the Debenture Stock shown on the face of this Certificate on the date therein mentioned or on demand (as the case may be) and in the meantime will pay interest thereon at the rate and at the times also shown on the face of this Certificate."

(Footnote continues on next page)

3.

to the Trustee or to the debenture holder as ICI's liability for principal and its liability to pay interest on the face value of the debenture as ICI's liability for interest.

6 The liabilities to tangible asset ratios prescribed by the 1966 and 1970 Deeds posed considerable problems for ICI and its group of companies. They precluded further borrowings for expansion and the acquisition of new businesses. Moreover, the restriction was tightened when the ratio was raised by reclassification of balance sheet items to accord with the then new Accounting Standard AAS17. ICI entered into the Principal Assumption Agreement as a means of obtaining a release from the restriction.

7 ICI entered into the Principal Assumption Agreement on 6 June 1986. At the same time, it entered into an Interest Assumption Agreement. The parties to the Principal Assumption Agreement were ICI, the Trustee and the Melbourne and Metropolitan Board of Works ("MMBW"), which was described in that agreement as the Assumption Party⁷. The Principal Assumption Agreement dealt with ICI's liability for principal under the Debenture Trust Deeds. The Interest Assumption Agreement, to which ICI, the Trustee and the State Bank of New South Wales were parties, dealt with ICI's liability for interest under the Debenture Trust Deeds in similar but not identical terms. Under that agreement, the State Bank was to pay the interest payable on the debentures as it fell due and ICI was to pay the State Bank the amount of interest payable plus a fee equal to 0.125% of that interest⁸. These proceedings relate to the effect of the Principal Assumption Agreement.

8 The key provisions of the Principal Assumption Agreement are contained in cl 2 and 3 which read as follows:

"2. Payment by Company

- (a) On the Assumption Date, the Company [that is, ICI] shall pay to the Trustee (for the account of the Assumption Party) in Melbourne in same day funds, in consideration for the agreement by the Assumption Party under Clause 3, an amount equal to the aggregate of the respective Present Values of the respective principal amounts of all Stock.

Clauses 59 and 66 of the 1970 Deed followed the terms of the corresponding clauses in the 1966 Deed.

7 Certain subsidiaries of ICI's obligations under the trust deeds were added as parties to the Principal Assumption Agreement and the Interest Assumption Agreement but neither of those agreements contains a covenant or promise by any subsidiary.

8 The fee was subject to revision after 5 years: cl 2(c) and (d).

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- (b) The Trustee shall invest until the Payment Date the amount paid by the Company under Clause 2(a). Such investment shall be with an Australian trading bank or an authorized dealer in the short-term money market. On the Payment Date the Trustee shall -
 - (i) pay to the Assumption Party in same day funds the amount paid by the Company under Clause 2(a); and
 - (ii) pay to the Company any interest earned on the amount invested as aforesaid.
- (c) If at any time after the date hereof any change in law, regulation or regulatory requirement, or in the interpretation thereof by any competent governmental authority, increases the cost to the Assumption Party of making the payments required of it under this Agreement, then the Company shall indemnify the Assumption Party on demand in respect of such increase in cost PROVIDED THAT in that event the Assumption Party shall negotiate in good faith with the Company so as to avoid or minimize such increase in cost (at all times to the satisfaction of the Trustee)."

The Assumption Date was 6 June 1986; the Payment Date was 1 July 1986. Under cl 2, MMBW received on 1 July 1986 a payment from the Trustee of the amount of \$62,309,546 paid by ICI to the Trustee on 6 June 1986. The interest derived by the investment of this amount between the two dates was paid to ICI. Clause 3 reads as follows:

"3. Assumption of Principal Payments

- (a) In consideration for the payment to be made by the Company under Clause 2(a), the Assumption Party shall, on and after the Assumption Date, assume in the manner provided in this Agreement the obligations of the Company to make due and punctual payment of the principal amount of all Stock in accordance with Clause 3 of each of the Trust Deeds and notwithstanding that after the date hereof an order is made for the winding up or dissolution of the Company or that the Company enters into any composition or arrangement binding on its creditors generally; and the Assumption Party shall indemnify the Company and the Guarantors, and keep them indemnified, in respect of such obligations.
- (b) Unless otherwise agreed between the Assumption Party and the Trustee, the Assumption Party shall pay or cause to be paid to a bank account held in the name of the Trustee and nominated by the Trustee the amounts payable by the Assumption Party under Clause 3(a) and such payment shall be in pro tanto satisfaction of the obligations of the

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Assumption Party under Clause 3(a) and likewise in pro tanto satisfaction of the obligations of the Company as to repayment of principal under Clause 3 of each of the Trust Deeds.

- (c) Unless otherwise required by the Trustee, the Company shall procure that the Registry dispatches cheques drawn on the bank account referred to in Clause 3(b) to the relevant Stockholders and, subject to Clause 3(a) and (b), the Company shall bear the cost of such dispatch by the Registry. For this purpose, unless the Trustee otherwise requires, the Trustee shall authorize appropriate officers of the Registry to operate on the said bank account.
- (d) The Company shall, at its own expense, procure that the Auditors check the completion and dispatch of the cheques to be dispatched under Clause 3(c) and that the Auditors confirm in writing to the Company, the Trustee and the Assumption Party, within three (3) days after such dispatch, that payment has been made to the Stockholders entitled thereto and the date on which it was made."

The stock to which the Principal Assumption Agreement referred was the debenture stock issued pursuant to the deeds of 1966 and 1970. The respective maturity dates and principal amounts payable in respect of the various categories of debentures were set out in a schedule to the agreement. The maturity dates fell between 30 November 1986 and 31 January 2000. The aggregate of the principal amounts payable was \$98,662,800.

9 The "Present Values" of the several principal amounts payable on their respective maturity dates were calculated by discounting those amounts at a rate equal to the Commonwealth Bond rate for Bonds maturing on or reasonably close to the respective maturity dates less 0.03% per annum⁹. The Bond Rate was the rate agreed by the parties or, in default, an average of rates quoted as at 6 June 1986¹⁰. The aggregate of the "Present Values" was \$62,309,546. This was the amount paid by ICI in accordance with cl 2 of the Principal Assumption Agreement¹¹.

10 The financial strength of MMBW was undoubted. Its agreement to discharge ICI's liability for principal was intended to satisfy the Trustee and the debenture holders that the interests of the debenture holders were fully protected and the floating charge over ICI's undertaking and the liabilities to tangible assets ratios in

9 cl 2(a).

10 cl 1(a).

11 (1994) 125 ALR 63 at 73.

the Trust Deeds could be released without detriment to their interests. Ryan J accepted¹² -

"that the prime motivation for ICI's entering into the liability assumption agreement was to procure the release of ICI from the restrictions imposed by the asset to liability ratios specified in the debenture deeds. That, it was apparent, could be achieved by laying out a present sum of money less than the liability being assumed in return for the promise to discharge that liability as it fell due on dates in the future."

On 6 June 1986, by deeds amending the 1966 and 1970 trust deeds, the Trustee and the other parties to those deeds deleted from those deeds a number of clauses including the clauses imposing the liabilities to group tangible assets ratios, the floating charges given by ICI to secure payment to the Trustee of moneys owing under the respective Trust Deeds were released and Nobel's guarantee of ICI's obligations were discharged.

- 11 During the 1986 income year, no redemption payments were made by MMBW. During the 1987 income year, four series of debentures were redeemed. Pursuant to cl 3 of the Principal Assumption Agreement, MMBW paid the \$16,811,000 required to redeem those debentures. The amount which ICI had paid under cl 2 referable to the "Present Values" of those amounts was \$14,702,619.

The issues for determination

- 12 The issues for determination have been refined and confined in the course of the litigation. Before Ryan J the Commissioner contended that the difference between the aggregate of the amounts which MMBW had agreed to pay on the redemption dates of the debentures, namely \$98,662,800, and the amount which ICI paid under the Principal Assumption Agreement, namely \$62,309,546, was assessable income of ICI in the income year ended 30 September 1986, the income year in which the Principal Assumption Agreement was made. Ryan J accepted that the difference between these amounts, \$36,353,254, was assessable income under s 25(1) and s 25A(1) of the *Income Tax Assessment Act* 1936 (Cth) ("the Act"). However, his Honour attributed portions of that difference to the income years 1986 and 1987 in purported compliance with Div 16E of Pt III of the Act. The Commissioner no longer contends that the difference is income in the 1986 income year. Nor does the Commissioner submit that Div 16E of Pt III of the Act applies.
- 13 In the Full Court, the majority held that the difference was not assessable income under either s 25 or s 25A. The Court allowed ICI's objection to the inclusion in its assessable income of any amount arising from the Principal

¹² (1994) 125 ALR 63 at 79.

Assumption Agreement in the 1986 income year. The consequence of the Commissioner's abandonment of the arguments which persuaded Ryan J to hold that a portion of the \$36,353,254 was assessable income of ICI in the 1986 income year is that the appeal to this Court in respect of the 1986 income year must be dismissed.

14 The Commissioner raised an assessment in respect of the 1987 income year which included an amount said to be a "profit made from debt defeasance transactions included as income"¹³. Ryan J, applying Div 16E of Pt III, ordered that the assessments be amended by reducing the amount of assessable income to an amount calculated in accordance with that Division¹⁴. His Honour rejected the Commissioner's alternative argument that, by application of Pt IIIA of the Act, it should be held that ICI made a net capital gain of \$661,968 in the income year and should be assessed to tax accordingly¹⁵.

15 In the Full Court, the majority found that any profit or gain derived from ICI's entry into the Principal Assumption Agreement and from the performance of that agreement was on capital account¹⁶. Further, their Honours held that there was no profit-making undertaking or scheme from which ICI derived a profit or gain that was assessable income for the purposes of s 25A¹⁷. The Commissioner raised an alternative argument based on Pt IIIA seeking to bring to tax as a capital gain the difference between the value of the rights acquired under the Principal Assumption Agreement and the amount paid out by MMBW under that agreement. That argument was rejected for two reasons: the rights ICI acquired under the Principal Assumption Agreement were said not to constitute an "asset" within the meaning of that term in s 160A, and the payments made by MMBW in accordance with the agreement did not constitute a disposal of an asset within the meaning of that term in s 160M(3)(b) of the Act¹⁸. In dissent, Sundberg J held that the difference between the amount that MMBW was required to pay, and paid, to discharge ICI's obligation to redeem the debentures and the amount ICI paid as the present values of those amounts under cl 2 of the Principal Assumption Agreement was a profit analogous to interest and that that difference was income according to ordinary

13 (1994) 125 ALR 63 at 72.

14 (1994) 125 ALR 63 at 86-87, 93.

15 (1994) 125 ALR 63 at 91-93.

16 (1996) 68 FCR 122 at 134-135, 139; 138 ALR 705 at 715-716, 720.

17 (1996) 68 FCR 122 at 135, 139; 138 ALR 705 at 716, 720.

18 (1996) 68 FCR 122 at 137-139; 138 ALR 705 at 718-720.

concepts falling within s 25(1)¹⁹. Moreover, his Honour held that the profit arose from a profit-making scheme within the meaning of that term in s 25A²⁰. The time when ICI derived this assessable income was when the payments were made to redeem the debentures²¹.

- 16 The issues for determination on this appeal are threefold: first, whether the difference between the amounts which MMBW paid to redeem the debentures and the present values of those amounts which ICI paid under cl 2 of the Principal Assumption Agreement was income of ICI according to ordinary concepts of income derived in the 1987 income year; second, whether that difference was a profit arising from a profit-making undertaking or scheme which came home to ICI in the 1987 income year; third, whether that difference was a capital gain received by ICI in the 1987 income year and assessable to tax under Pt IIIA of the Act (as it then stood).

Income according to ordinary concepts

- 17 Where a taxpayer enters into a contract which entitles the taxpayer to the payment of money or the provision of a pecuniary benefit, the character of the payment or pecuniary benefit in the taxpayer's hands is to be ascertained by reference to the operation of the contract in the whole of the particular circumstances²². It is the quality of the payment or benefit in the taxpayer's hands viewed from the standpoint of the taxpayer that must be ascertained²³. But the test is objective²⁴. The taxpayer's motives for entering into the transaction are not determinative²⁵.

19 (1996) 68 FCR 122 at 143-145; 138 ALR 705 at 724-725.

20 (1996) 68 FCR 122 at 146; 138 ALR 705 at 727.

21 (1996) 68 FCR 122 at 145; 138 ALR 705 at 725.

22 *The Squatting Investment Co Ltd v Federal Commissioner of Taxation* (1953) 86 CLR 570 at 627.

23 *Hayes v Federal Commissioner of Taxation* (1956) 96 CLR 47 at 55; *Scott v Federal Commissioner of Taxation* (1966) 117 CLR 514 at 526; *Federal Commissioner of Taxation v Myer Emporium Ltd* (1987) 163 CLR 199 at 216.

24 *Hayes v Federal Commissioner of Taxation* (1956) 96 CLR 47 at 55-56; *Federal Coke Co Pty Ltd v Federal Commissioner of Taxation* (1977) 34 FLR 375 at 390; 15 ALR 449 at 462.

25 *Commissioner of Taxation v Cooling* (1990) 22 FCR 42 at 50; 94 ALR 121 at 129-130.

18 In the present case, although the primary motive for ICI's entry into the Principal Assumption Agreement was, as Ryan J found, the procuring of the release of ICI from the restriction imposed by the ratios of liability to group tangible assets, that motive is not an indicium of the character of the pecuniary benefit obtained by ICI when MMBW paid the amounts required to redeem the debentures falling due in the 1987 income year. The question is not whether ICI obtained a benefit of a capital nature when it was released from the restriction imposed by the liability to tangible assets ratio; the question is whether the payments made by MMBW in redemption of debentures was a pecuniary benefit of a capital or income nature. To ascertain the character of the benefit, the transaction in which the benefit was obtained must be identified.

19 The transaction which gave rise to the benefit appears in the terms of the Principal Assumption Agreement. That agreement does not alter the liabilities imposed on ICI by the Trust Deeds. It would be erroneous to regard the agreement as a debt defeasance agreement or as an agreement in which MMBW "assumes" the liabilities of ICI. MMBW assumed liabilities under the Principal Assumption Agreement but they were its own liabilities, not the liabilities of ICI. No debtor or obligor can relieve himself of the debt or obligation owed to another by making an agreement with a third party. Debts and obligations are not assignable²⁶. Nor was there any novation whereby the Trustee or the debenture holders agreed with ICI and MMBW to discharge ICI from liability to redeem the debentures and to accept MMBW as the party liable.

20 The transaction consisted of a number of steps. First, ICI paid MMBW \$62,309,546 on 1 July 1986 as the price of MMBW's promise contained in the Principal Assumption Agreement. That sum was outlaid by ICI not as a pre-payment to be held by MMBW until needed by ICI to redeem the debentures but in consideration for the payments promised to be made by MMBW. Secondly, the Principal Assumption Agreement had no effect on the relationship between ICI on the one hand and the Trustee and debenture holders on the other. As dates for the redemption of the respective classes of debentures arrived, the debt owed by ICI to the Trustee or to the debenture holders fell due for payment. In the meantime, interest on the debentures was payable by ICI. Thirdly, MMBW paid the Trustee or the debenture holders the debts of ICI as they fell due for payment on the dates for redemption of the respective classes of debentures. The State Bank of New South Wales paid ICI's debts for interest. When MMBW paid out money in redemption of the debentures under cl 3 of the Principal Assumption Agreement, ICI obtained the pecuniary benefit of the payment of its debts. The question is whether the difference between the amounts paid out by MMBW under cl 3 during the 1987 income year and an amount paid by ICI under cl 2 as the

26 *Tolhurst v Associated Portland Cement Manufacturers (1900)* [1902] 2 KB 660 at 668; *Linden Gardens Ltd v Lenesta Ltd* [1994] 1 AC 85 at 111.

"Present Values" of the amounts paid out was income derived by ICI in that income year.

21 Although the transaction for which the Principal Assumption Agreement provided was entered into chiefly in order to obtain a release from the restriction imposed by the liabilities to tangible assets ratios in the 1966 and 1970 trust deeds, it does not follow that those trust deeds or the issuing of debentures under them were part of the transaction relevant to the payments made in redemption of the debentures. The trust deeds and the debentures outstanding when the Principal Assumption Agreement was entered into provide the factual matrix in which the Principal Assumption Agreement transaction took place, but the trust deeds and the issuing of debentures were not in any sense a part of the transaction out of which the payments made to or by MMBW arose. In this respect, the facts are dissimilar from those considered in *Federal Commissioner of Taxation v Myer Emporium Ltd*²⁷ where two transactions were "essential and integral elements in an overall [profit-making] scheme".

22 The parties to the relevant transaction were ICI and MMBW: ICI paid money to MMBW under cl 2 of the Principal Assumption Agreement; MMBW paid ICI's debts under cl 3. When a third party pays a debtor's debt, the debtor is discharged provided the debtor has assented to the payment or ratifies the payment by subsequent assent²⁸. A payment made by a third party to the creditor with the prior authority of the debtor discharges the debtor from liability as it is a payment made to the creditor not by a stranger but "as agent, for and on account of the debtor and with his prior authority or subsequent ratification"²⁹. MMBW acted as ICI's agent for the payment of ICI's debts.

23 Although s 25(1) does not define the term "gross income derived ... from all sources", it brings into the assessable income of a taxpayer pecuniary benefits of an income nature. "It is not open to question that income can be in the form of money's worth", as Sir Wilfrid Greene MR said in *Cross v London and Provincial Trust, Ltd*³⁰. ICI received no money into its own hands, but it obtained the benefit of payments in discharge of its debts. It is immaterial that the money which

27 (1987) 163 CLR 199 at 216; cf *Ditchfield v Sharp* [1983] 3 All ER 681 at 685-686 where the income-producing transaction was isolated.

28 *Simpson v Eggington* (1855) 10 Ex 845 at 847 [156 ER 683 at 684]; *Walter v James* (1871) LR 6 Ex 124.

29 *Simpson v Eggington* (1855) 10 Ex 845 at 847 [156 ER 683 at 684] per Parke B.

30 [1938] 1 KB 792 at 796; see, to the same effect, MacKinnon LJ at 803, followed in *Federal Commissioner of Taxation v Cooke* (1980) 42 FLR 403 at 413; 29 ALR 202 at 211; *Midland Railway Co of Western Australia Ltd v Federal Commissioner of Taxation* (1950) 81 CLR 384.

redeemed the debentures was not paid first to ICI but was paid directly by MMBW to the Trustee or to the debenture holders. The money was applied to discharge ICI's pecuniary liability and the benefit which ICI received was "that which can be turned to pecuniary account", to adopt Lord Watson's phrase in *Tennant v Smith*³¹. Here MMBW's obligation was "turned to pecuniary account" by payment of ICI's debts.

- 24 Income may consist of a payment made by A to B when the taxpayer receives credit in a monetary amount for the payment to B. I adopt as applicable to this case the opinion of the Supreme Court of the United States in *Old Colony Trust Company v Commissioner of Internal Revenue*³²:

"[W]e think the question presented is whether a taxpayer, having induced a third person to pay his income tax or having acquiesced in such payment as made in discharge of an obligation to him, may avoid the making of a return thereof and the payment of a corresponding tax. We think he may not do so. The payment of the tax by the employers was in consideration of the services rendered by the employee and was a gain derived by the employee from his labor. ... The discharge by a third person of an obligation to him is equivalent to receipt by the person taxed."

In *Commissioner of Internal Revenue v Jacobson*³³ the Supreme Court accepted that "gross income" would include discharges of a taxpayer's debts by payments made for his benefit. Burton J, delivering the opinion of the Court, footnoted *Douglas v Willcuts*³⁴ where the Court said:

"We have held that income was received by a taxpayer, when, pursuant to a contract, a debt or other obligation was discharged by another for his benefit. The transaction was regarded as being the same in substance as if the money had been paid to the taxpayer and he had transmitted it to his creditor. *Old*

31 [1892] AC 150 at 159; see also *Australian Machinery & Investment Co Ltd v Deputy Commissioner of Taxation* (1946) 180 CLR 9 at 53-54; *Federal Commissioner of Taxation v Cooke* (1980) 42 FLR 403; 29 ALR 202.

32 279 US 716 at 729 (1929).

33 336 US 28 at 39 (1949).

34 296 US 1 at 9 (1935).

*Colony Trust Co v Commissioner*³⁵; *United States v Boston & Maine Railroad*³⁶."

That proposition is equally applicable to cases arising under s 25 of the Act. It is not necessary that the money used to discharge the taxpayer's debts is received by the taxpayer if the taxpayer is discharged from debts corresponding in amount with the payments made. Although receipt of income by a taxpayer is the ordinary mode of derivation of that income, income may be derived without receipt³⁷.

- 25 However, I would not hold that s 19 of the Act has application to payments made by MMBW in the 1987 income year. That section³⁸ reads:

" Income or money shall be deemed to have been derived by a person although it is not actually paid over to him but is reinvested, accumulated, capitalized, carried to any reserve, sinking fund or insurance fund however designated, or otherwise dealt with on his behalf or as he directs."

To attract the operation of that section, the "income or money" must, I think, be income or money that the taxpayer would have been entitled to receive but for the fact that it was dealt with³⁹. In the present case, ICI was not entitled to receive any payment of money from MMBW. And it did not "deal with" the benefit which it obtained by having the debentures redeemed. It was entitled only to have MMBW pay money to the Trustee or the debenture holders. However, it is not necessary to define the operation of s 19 to determine this case.

- 26 Once it is appreciated that ICI received money's worth - the equivalent of money - by payments made in discharge of its debts, it is the quality and quantum of the money's worth received by ICI from MMBW that is determinative. The relevant transaction was bilateral. In my respectful opinion, it is erroneous to regard the benefit obtained by ICI as a saving in capital expenditure. ICI's debt to the Trustee or the debenture holders was a capital debt, but the discharge of that debt by MMBW's payments was not the transaction out of which the pecuniary benefit obtained by ICI arose. If the discharge by ICI of its debt to the Trustee or

35 279 US 716 (1929).

36 279 US 732 (1929).

37 *Federal Commissioner of Taxation v Thorogood* (1927) 40 CLR 454 at 458; *Commissioner of Taxes (SA) v Executor Trustee and Agency Co of South Australia Ltd ("Carden's Case")* (1938) 63 CLR 108 at 155; *Hartland v Diggins* [1926] AC 289 at 292.

38 Now s 19(1).

39 *Brent v Federal Commissioner of Taxation* (1971) 125 CLR 418 at 430-431.

the debenture holders were thought to be the relevant transaction or a critical element in the relevant transaction, no saving in capital expenditure could be found in that transaction. ICI was liable at all material times to pay its capital debts in full; that liability was discharged by payments made by MMBW as the agent of ICI.

27 In my respectful opinion, much of the difficulty in this case has arisen from the erroneous identification of the relevant transaction. The relevant transaction is the transaction out of which the benefit obtained by ICI arose, not the antecedent transaction of the trust deeds or the issuing of debentures. The parties to the relevant transaction were ICI and MMBW: ICI received neither capital nor income from any other party. The redemption of the debentures and the discharge of ICI's debts to the Trustee or the debenture holders were part of the relevant transaction only in so far as ICI thereby obtained money's worth from MMBW.

28 ICI obtained the benefit of MMBW's payments totalling \$16,811,000 in the 1987 income year. The "present values" of those payments calculated as the Principal Assumption Agreement directs amounted to \$14,702,619. That sum was part of the sum outlaid by ICI under cl 2 in the 1986 income year. The question is whether the difference between the two figures was income. That question is not necessarily answered by holding, as I do, that it was not interest. MMBW made no promise to pay interest either to or at the direction of ICI. Interest is earned or accrues periodically but no increment on the sum outlaid was earned or accrued periodically prior to the dates on which debentures were due to be redeemed⁴⁰. No intermediate benefit in money or money's worth accrued to ICI between 1 July 1986 and the respective dates on which MMBW paid out the debentures.

29 Although the difference is not interest, it does not follow that it is not "income". In principle - not merely by way of analogy - there is no difference between the transaction provided for by the Principal Assumption Agreement and the issuing of a debenture or a bill or promissory note at a discount. In each case a sum is outlaid in exchange for the promise of payment of a larger sum in the future. When the maturity date is reached, the question whether the difference between the amount paid to the holder and the amount originally outlaid is income or capital depends on whether the difference is to be accounted for as "the value of the usufruct foregone" or a payment for "the risk that the money will never be repaid at all"⁴¹. If the former, the difference is income; if the latter, it may be capital. In the present case, the financial strength of MMBW denied the existence of a risk that it would not meet its commitments as they fell due. The calculation of the "present values" by reference to the bond rate demonstrates that there was

40 See *Willingale v International Commercial Bank Ltd* [1978] AC 834 at 841.

41 These being the economic elements of a discount: per Lord Sumner in *Brown v National Provident Institution* [1921] 2 AC 222 at 255.

an increment of the amounts to be paid by MMBW over the amount outlaid by ICI and that increment is attributable to "the value of the usufruct foregone".

- 30 True it is that the amount outlaid by ICI under cl 2 of the Principal Assumption Agreement was the present value of the amounts to be paid out by MMBW under cl 3 (leaving aside the adjustment to the bond rate) but that does not deny that the difference between the two amounts may be income for the purposes of the Act⁴². In *Federal Commissioner of Taxation v Myer Emporium Ltd*⁴³ this Court's judgment affirmed the historical cost basis adopted by the Act:

" The accounting basis which has been employed in calculating profits and losses for the purposes of the Act is historical cost (*McRae v Federal Commissioner of Taxation*⁴⁴; and see *Lowe v Inland Revenue Commissioner (NZ)*⁴⁵) not economic equivalence: *Inland Revenue Commissioner v Europa Oil (NZ) Ltd*⁴⁶. And so a taxpayer who lends money for a stipulated period at interest is treated as exchanging the money lent for a debt of the same amount, unless the loan is made at a discount or premium, in which case there may be a gain or loss on capital account: *Lomax (HM Inspector of Taxes) v Peter Dixon & Co Ltd*⁴⁷. In the ordinary case, the debt is brought to account in the same amount as the money lent. The amount of the debt is not reduced because the lender is kept out of the use and enjoyment of the money lent for the period of the loan.

If economic equivalence were the appropriate accounting basis, the debt would be brought to account at the beginning of the period in an amount less than the amount of the money lent and would increase day by day until it equalled the amount of the money lent when the period expired."

- 31 The difference between the amount outlaid by ICI in respect of the debentures to be redeemed in the 1987 income year and the pecuniary benefit ICI obtained in that year is analogous to the difference between the discounted purchase price and

42 *Lowe v Commissioner of Inland Revenue* [1983] NZLR 416 at 417; (1983) 15 ATR 102 at 103-104.

43 (1987) 163 CLR 199 at 216-217.

44 (1969) 121 CLR 266.

45 [1983] NZLR 416; (1983) 15 ATR 102.

46 [1971] AC 760 at 772.

47 [1943] KB 671.

the face value of a loan made at a discount⁴⁸. The character of the difference depends on the commercial reason for the discount, as Lord Greene MR pointed out in *Lomax v Peter Dixon & Son*⁴⁹ in reference to an outlay made and a larger sum received under the terms of a contract:

" In many cases, however, mere interpretation of the contract leads nowhere. If A lends B 100/ on the terms that B will pay him 110/ at the expiration of two years, interpretation of the contract tells us that B's obligation is to make this payment. It tells us nothing more. The contract does not explain the nature of the 10/, yet who could doubt that the 10/ represented interest for the two years? The justification for reaching this conclusion may well be that, as the transaction is obviously a commercial one, the lender must be presumed to have acted on ordinary commercial lines and to have stipulated for interest on his money. In the case supposed, the 10/, if regarded as interest, is obviously interest at a reasonable commercial rate, a circumstance which helps to stamp it as interest."

His Lordship was not using the term "interest" in the strict sense in which it was used in *Willingale*⁵⁰. He was clearly referring to what is paid for the use of the sum outlaid over the time before that sum is repaid to the party which laid it out.

32 These cases were considered by Gummow J in *Commr of Taxn v Hurley Holdings (NSW)*⁵¹ where the taxpayer purchased a bill of exchange with a face value of \$500,000 for \$442,199 and was paid the face value on maturity. His Honour held the increment to be income. He said⁵²:

" The submission of counsel for the Commissioner was that the amount representing the discount had the character of recompense to the taxpayer for loss of the use of the moneys invested by the taxpayer during the currency of the term of the accommodation bill and thus was income according to the ordinary concepts and usages of mankind: cf *Federal Wharf Co Ltd v Deputy Federal Commissioner of Taxation*⁵³. The taxpayer purchased the bill,

48 *Coles Myer Finance Limited v Federal Commissioner of Taxation* (1993) 176 CLR 640 at 665.

49 [1943] KB 671 at 675; see also *Davies v Premier Investment Co, Ltd* [1945] 2 All ER 681.

50 [1978] AC 834 at 841.

51 (1989) 23 FCR 435; 89 ALR 125.

52 (1989) 23 FCR 435 at 440; 89 ALR 125 at 129-130.

53 (1930) 44 CLR 24 at 28.

seeking to invest its funds with no risk and a reasonable return. The circumstance that the purchase of the bill was an isolated transaction would not, of itself, deprive the amount in question of the character of income: *Federal Commissioner of Taxation v Myer Emporium Ltd*⁵⁴. I accept these submissions."

33 When capital moneys are paid out under a contract in exchange for a promise of payment of a larger sum of money at a later date, the transaction is different from a transaction in which capital money is outlaid in purchase of an asset that increases in value and which is sold at a later date to return a larger sum of money. The difference exists because the historical cost basis adopted by taxation law denies to domestic currency the capacity to change in value over time. The "tree" is always of the same size; unlike other assets, it cannot grow in value. If there be no other factor to indicate that a receipt is other than an increment upon the capital money paid out - evidence dehors the contract being admissible to explain the quality of the receipt⁵⁵ - the increment wears the aspect of the "fruit" of the tree and has the character of income⁵⁶.

34 The income character of an increment on money outlaid under a contract to obtain the repayment of a larger sum at a later date does not depend upon the transaction being one in the ordinary course of the taxpayer's business. Unless there be evidence, either within or without the contract, which stamps part of the amount received with the character of capital, the increment can be regarded only as a return to the taxpayer for the use of the money outlaid during the stipulated period⁵⁷. Such an increment is income when it is derived.

35 When is the income derived? ICI submits that, if there be an increment on the money outlaid by ICI, none of that increment was received by payments made to redeem debentures during the 1987 income year. The submission points out that under cl 2 of the Principal Assumption Agreement, ICI outlaid a lump sum of \$62,309,546 and that ICI would receive no pecuniary benefit in excess of that amount until MMBW had paid out the moneys needed to redeem debentures having an equivalent face value. That would not have occurred until July 1990. The submission treats what was received by ICI on the redemption of each series of debentures as undifferentiated sums that ought not to be attributed to the

54 (1987) 163 CLR 199 at 211.

55 *Lomax v Peter Dixon & Son* [1943] KB 671 at 677.

56 See *IR Commrs v Thomas Nelson & Sons Ltd* (1939) 22 TC 175; *Lomax v Peter Dixon & Son* [1943] KB 671; *Ditchfield v Sharp* [1983] 3 All ER 681 at 685, 688; and cf *Davies v Premier Investment Co, Ltd* [1945] 2 All ER 681 at 683; 27 TC 27 at 35.

57 See *Bennett v Ogston (HM Inspector of Taxes)* (1930) 15 TC 374 at 379.

particular "Present Values" which were included in the aggregate of the \$62,309,546 outlaid by ICI. But cl 2 of the Principal Assumption Agreement provided that that amount should be "the aggregate of the respective Present Values of the respective principal amounts" of the debenture stock. The Present Values of the four "respective principal amounts" that were paid by MMBW in the 1987 income year were calculated by the formula prescribed by the Principal Assumption Agreement and, in aggregate, amounted to \$14,702,619. As the "respective principal amounts" paid by MMBW in the 1987 income year amounted to \$16,811,000 there was an increment of \$2,108,381. The "respective principal amounts" (being the money's worth received by ICI) can and should be dissected and the increment of those amounts over the respective Present Values thereof brought to tax as income⁵⁸. Dissecting the payments made by MMBW in this way, income is derived when the redemption of each series of debentures is made. The derivation of income does not await the exhaustion of \$62,309,546 by payments in redemption of debentures.

36 Although the payments made by MMBW to redeem the debentures were made to extinguish a capital debt owing by ICI to the Trustee or the debenture holders, that is immaterial to the character of the increment obtained by ICI in the transaction provided for by the Principal Assumption Agreement. A payment made to discharge a taxpayer's capital liability to a third party does not acquire the character of a capital payment if the money used to make the payment came into the taxpayer's hands as income⁵⁹. It is not the purpose to which money (or money's worth) is applied by or on behalf of a taxpayer but the transaction in which the taxpayer receives the money or obtains money's worth which determines its character: *GP International Pipecoaters Pty Ltd v Federal Commissioner of Taxation*⁶⁰.

37 For these reasons, I would hold that the increments contained in the payments made by MMBW during the 1987 income year are income derived by ICI in that income year. They are assessable to tax as income according to ordinary concepts. It is unnecessary to consider whether the increments were brought to tax by s 25A. The conclusion that the 1987 increments are income derived by ICI in that income

58 See *McLaurin v Federal Commissioner of Taxation* (1961) 104 CLR 381 at 391; *Secretary of State in Council of India v Scoble* [1903] AC 299; *IRC v Church Comrs* [1977] AC 329; *Whitaker v Cmr of Taxation* (1996) 63 FCR 1 at 11; 140 ALR 257 at 265-266; *Goole Corp'n v Aire & Calder Navigation Trustees* [1942] 2 All ER 276 at 278.

59 See *Mersey Docks and Harbour Board v Lucas* (1883) 8 App Cas 891.

60 (1990) 170 CLR 124 at 136-137.

year is a minority view. Therefore I must consider whether Pt IIIA brings any part of the amounts paid by MMBW during that income year to tax as a capital gain.

Part IIIA: Capital Gain

38 A "capital gain" exists when the consideration in respect of the disposal of an asset⁶¹ exceeds the indexed cost base to the taxpayer in respect of the asset: s 160Z(1)(a). An "asset" is defined to mean "any form of property and includes ... a chose in action ... and any other form of incorporeal property": s 160A(a). The definition, if it stood alone, would require the choses in action acquired by ICI under the Principal Assumption Agreement to be classified as either proprietary (and falling within the definition) or personal⁶² (falling outside the definition). ICI contends that the chose in action consisting of ICI's contractual right to compel MMBW to make the payments stipulated in cl 3 of the Principal Assumption Agreement is personal, not proprietary. The definition of "asset" in s 160A(a) does not stand alone. Section 160D(1)(b) and (2) provide -

" (1) For the purposes of this Part -

...

(b) a taxpayer shall be deemed to be entitled to receive money or other property if the taxpayer is entitled to have the money or other property applied for the benefit, or in accordance with the directions, of the taxpayer.

(2) For the purposes of this Part, a reference in sub-section (1) to the application of money or other property for the benefit of a taxpayer includes, without limiting the generality of the expression, a reference to the application of money or other property in the discharge, in whole or in part, of a debt due by the taxpayer."

Thus the entitlement of ICI to have MMBW apply money in discharge of ICI's debts is deemed to be an entitlement in ICI to receive that money. It is a present entitlement whether the money is payable immediately or in the future⁶³. In other words, for the purposes of Pt IIIA, a taxpayer's contractual entitlement to have money paid on the taxpayer's behalf at a future time is deemed to be, or is taken to be the equivalent of, a present debt albeit payable in the future. And a debt is

61 Other than a "personal use" asset.

62 *Commissioner of Stamp Duties (NSW) v Yeend* (1929) 43 CLR 235 at 244-245.

63 s 160K(3).

property⁶⁴. For the purposes of Pt IIIA, ICI became MMBW's creditor in respect of the payments MMBW was bound to make under cl 3 of the Principal Assumption Agreement.

- 39 When MMBW paid the Trustee or the debenture holders in accordance with its obligation under cl 3, the deemed debt was discharged. ICI's chose in action was satisfied. Thus a "change ... in the ownership" of the deemed debt was taken to have occurred pursuant to s 160M(3)(b) which reads:

" Without limiting the generality of sub-section (2), a change shall be taken to have occurred in the ownership of an asset by -

...

- (b) in the case of an asset being a debt, a chose in action or any other right, or an interest or right in or over property - the cancellation, release, discharge, satisfaction, surrender, forfeiture, expiry or abandonment, at law or in equity, of the asset".

The change in ownership is then deemed by s 160M(1) "to have effected a disposal of the asset". As s 160ZI requires apportionment of the cost base attributable to any part of an asset disposed of, there is no problem in dissecting the aggregate of the Present Values paid by ICI under cl 2 of the Principal Assumption Agreement in order to ascertain the cost base attributable to the payments made by MMBW during the 1987 income year. The indexing of the cost base and the calculation of the net capital gain to be included in ICI's assessable income for the 1987 income year should be made by the Commissioner.

- 40 I would dismiss the appeal in respect of the 1986 income year.

- 41 I would allow the appeal in respect of the 1987 income year and make orders upholding the Commissioner's assessment of ICI to tax in that year but, as that is a minority view, I would join in the making of orders that will remit the assessment to the Commissioner for amendment in accordance with the opinion of the majority of this Court as to the application of Pt IIIA.

64 *Mutual Pools & Staff Pty Ltd v The Commonwealth* (1994) 179 CLR 155 at 176.

GAUDRON, McHUGH, KIRBY AND HAYNE JJ.

The issue

- 42 The taxpayer, having liabilities that will fall due for payment in the future, agrees with a third party that in return for the taxpayer's payment of the present value of those liabilities, the third party will (when the liabilities fall due) pay amounts sufficient to discharge the taxpayer's liabilities. Is the difference between the amount paid by the taxpayer and the face value of the liabilities to be brought to taxation whether as income, profit or capital gain?

The facts

- 43 Before 1986, the respondent ("the taxpayer") issued debentures to the public pursuant to two debenture trust deeds, the first dated 17 October 1966 and the second dated 10 August 1970. Each of those deeds was made between the taxpayer, one or more of its subsidiaries as guarantor, and a trustee company as trustee for debenture holders. The 1966 deed provided for the issue of debentures not exceeding a total nominal amount of \$10 million. The 1970 deed provided for the issue of debenture stock to a nominal value of \$10 million but provided also that, in addition to the initial issue of debenture stock, the amount of debenture stock which the taxpayer might create and issue was unlimited. Each deed provided, however, some limitations on the amounts that the company might borrow. Among the limitations was a requirement that the taxpayer not permit or suffer the total liabilities of the taxpayer (and subsidiaries of the taxpayer guaranteeing repayment of the principal moneys secured by the trust deed) to exceed a specified percentage of the amount of the tangible assets of the taxpayer and those guarantor companies. It is not necessary to notice otherwise the detail of the borrowing limitations.

- 44 On 31 May 1986, the total amount outstanding under the two trust deeds was about \$98.7 million. Various debenture issues had been made with different maturity dates and coupon rates. By 1986 the borrowing restrictions imposed by the trust deeds were seen by the taxpayer as a burden. The taxpayer was considering making significant acquisitions which would be financed largely by debt and some of the assets which it intended to acquire were intangible assets which would be excluded from the assets taken into account in making the calculation of asset to liabilities ratios required by the trust deeds. The taxpayer's principal shareholder was unwilling to support the raising of equity by a fresh issue of shares and accordingly the taxpayer's board began to consider what steps it might take which would permit it to give effect to its plans.

45 In March 1986 the taxpayer's board approved a proposal that the taxpayer enter two separate liability assumption agreements. The paper submitted to the board described the proposal in the following terms:

"Under the principal assumption agreement [the taxpayer] would pay to a Principal Assumption Party an amount calculated as the net present value of the debenture principal repayments only, discounted at a rate approximating the Commonwealth Bond yield for each of the principal repayment dates. The amount of principal assumed would be \$99 million and the payment required would be approximately \$59 million which could be provided from available cash sources of the company.

In the interest assumption agreement [the taxpayer] would undertake to make a series of payments to a Interest Assumption Party to coincide precisely with existing debenture interest obligations. A fee would be payable to the Interest Assumption Party as consideration for assuming the primary legal responsibility for these payments.

It is expected that an extraordinary profit of approximately \$17 million (after tax) would arise from the two transactions in the 1986 year comprising a capital profit of \$40 million on the principal assumption less \$23 million (after tax) for the interest assumption payments."

The paper submitted to the board also proposed that debenture holders be given an option to redeem their holdings before maturity. This last aspect of the proposal did not proceed because it was thought that too many debenture holders would accept the option.

46 On 6 June 1986, the taxpayer made four agreements:

- a "Principal Assumption Agreement" between the taxpayer, ANZ Executors & Trustee Company Limited ("ANZET"), Melbourne and Metropolitan Board of Works ("MMBW") and four companies associated with the taxpayer and referred to in the agreement as guarantors;
- an "Interest Assumption Agreement" between the taxpayer, ANZET, State Bank of New South Wales and the guarantors;
- a "Second Amending Deed to 1966 Debenture Trust Deed" between the taxpayer, ANZET and the subsidiary of the taxpayer named in the 1966 trust deed;

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- a "Second Amending Deed to 1970 Debenture Stock Trust Deed" between the taxpayer, ANZET and the subsidiary of the taxpayer named in the 1970 trust deed.

ANZET was then trustee under both the 1966 deed and the 1970 deed having become trustee in the place of The Trustees Executors & Agency Company Limited (the original trustee) pursuant to the *ANZ Executors & Trustee Company Act 1983* (Vic).

The Principal Assumption Agreement

47 The Principal Assumption Agreement provided that on 6 June 1986 the taxpayer should pay to ANZET ("the trustee") (for the account of MMBW) "in consideration for the agreement by [MMBW] under Clause 3, an amount equal to the aggregate of the respective Present Values of the respective principal amounts of all Stock". "Stock" was defined by the agreement as meaning all debentures and debenture stock issued and from time to time outstanding pursuant to either of the trust deeds. "Present Value" of stock was defined as meaning:

"in respect of the principal amount of any Stock, the amount obtained by discounting that amount, from the maturity date of that Stock to the Payment Date [1 July 1986], at the Discount Rate in respect of that amount, calculated semi-annually in arrears."

The "Discount Rate" was defined, in effect, as a rate equal to the yield rate for Commonwealth Government Bonds maturing on or reasonably close to the maturity date of the stock in question, less 0.03 per cent per annum. The Principal Assumption Agreement obliged the trustee to invest the amount to be paid by the taxpayer on 6 June 1986 until 1 July 1986 and on that day to pay to MMBW the amount which had been paid by the taxpayer. (Interest which accrued in the meantime on the amount paid by the taxpayer was to be paid by the trustee to the taxpayer.)

48 Clause 3 of the Principal Assumption Agreement provided:

"(a) In consideration for the payment to be made by the Company [the taxpayer] under Clause 2(a), the Assumption Party [MMBW] shall, on and after the Assumption Date [6 June 1986], assume in the manner provided in this Agreement the obligations of the Company to make due and punctual payment of the principal amount of all Stock in accordance with Clause 3 of each of the Trust Deeds and notwithstanding that after the date hereof an order is made for the winding up or dissolution of the Company or that the Company enters

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into any composition or arrangement binding on its creditors generally; and the Assumption Party shall indemnify the Company and the Guarantors, and keep them indemnified, in respect of such obligations.

- (b) Unless otherwise agreed between the Assumption Party and the Trustee, the Assumption Party shall pay or cause to be paid to a bank account held in the name of the Trustee and nominated by the Trustee the amounts payable by the Assumption Party under Clause 3(a) and such payment shall be in pro tanto satisfaction of the obligations of the Assumption Party under Clause 3(a) and likewise in pro tanto satisfaction of the obligations of the Company as to repayment of principal under Clause 3 of each of the Trust Deeds.
- (c) Unless otherwise required by the Trustee, the Company shall procure that the Registry dispatches cheques drawn on the bank account referred to in Clause 3(b) to the relevant Stockholders and, subject to Clause 3(a) and (b), the Company shall bear the cost of such dispatch by the Registry. For this purpose, unless the Trustee otherwise requires, the Trustee shall authorise appropriate officers of the Registry to operate on the said bank account.
- (d) The Company shall, at its own expense, procure that the Auditors check the completion and dispatch of the cheques to be dispatched under Clause 3(c) and that the Auditors confirm in writing to the Company, the Trustee and the Assumption Party, within three (3) days after such dispatch, that payment has been made to the Stockholders entitled thereto and the date on which it was made."

In order to understand the operation of that provision, it is necessary to refer to cl 3 of each of the trust deeds because it is the obligation of the taxpayer to make due and punctual payment of the principal amount of all stock in accordance with that clause which MMBW assumed under the Principal Assumption Agreement. Clause 3(1) of the 1970 trust deed provided:

"The Company hereby acknowledges its indebtedness to the Trustee in respect of the moneys hereby secured and covenants with the Trustee that as and when any of the Debenture Stock in issue shall become payable in accordance with the terms of issue thereof or on such earlier date as the security hereby constituted becomes enforceable the Company shall pay to the Trustee in Melbourne aforesaid the principal interest and premium (if any) payable in respect of such Debenture Stock in issue and such payment shall operate in satisfaction of the Company's obligations to the holders thereof in respect of such Debenture Stock PROVIDED always and

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notwithstanding the foregoing and unless otherwise required by the Trustee the Company will pay to the Debenture Stockholders all principal interest and premium (if any) payable in respect of the Debenture Stock PROVIDED further and subject to the provisions of the proviso of clause 3(1) and notwithstanding the other provisions of clause 3(1) payment to the Debenture Stockholders of principal interest and premium (if any) in accordance with the terms and conditions appearing on their Stock Certificates shall operate pro tanto in satisfaction of the principal interest and premium (if any) payable in respect of the Debenture Stock the indebtedness for which is acknowledged by this Clause."

Clause 3 of the 1966 deed is worded slightly differently but those differences are not important.

- 49 A schedule to the Principal Assumption Agreement identified the maturity dates and principal amount of stock then on issue. The aggregate of those principal amounts was \$98,662,800. The maturity dates ranged from 30 November 1986 to 31 January 2000.

The Interest Assumption Agreement

- 50 By the Interest Assumption Agreement the taxpayer agreed that on each day for the payment of interest in respect of stock on issue it would pay to State Bank of New South Wales the amount of interest payable in respect of the stock on that date, together with an amount equal to 0.125 per cent of the amount of interest then payable. In consideration for the taxpayer's agreement to make those payments, State Bank of New South Wales agreed "on and after the Assumption Date [6 June 1986], [to] assume the obligations of [the taxpayer] to make due and punctual payment of all amounts of interest in respect of the Stock in accordance with Clause 3 of each of the Trust Deeds".

- 51 No issue arises in these appeals about the Interest Assumption Agreement or the steps taken under it.

The amendments to the debenture trust deeds

- 52 Each of the amending deeds provided that no further debenture stock could be issued under the deed which was being amended. Each provided that the trustee released the charge created by the trust deed. Each provided for acceleration of the taxpayer's obligations to pay principal and interest if it defaulted in making due and punctual payment of amounts due under the deed. Most other clauses of the two trust deeds were deleted by the amending deeds.

53 On 6 June 1986, pursuant to the Principal Assumption Agreement, the taxpayer paid to the trustee \$62,309,546 and on 1 July 1986 the trustee paid that amount to MMBW. During the year ended 30 September 1986 the taxpayer paid the State Bank of New South Wales \$3,410,626 pursuant to the Interest Assumption Agreement.

54 In its profit and loss account for the year ended 30 September 1986 (appended to its tax return for that year) the taxpayer, under the heading "Extraordinary Profit", disclosed what it described as a "[c]apital profit arising from refinancing Company's debenture borrowings under separate principal and interest liability assumption agreements". The amount of that capital profit was said to be \$36,353,254 being the difference between "[p]rincipal liability transferred to assumption party" of \$98,662,800 and the "payment to assumption party" of \$62,309,546. The profit and loss account offset against that amount what were described as "[f]ees payable from 1/7/86 until maturity of debentures in respect of interest liability assumption" (an amount of \$50,629,595). It also disclosed a future income tax benefit of \$23,289,615 being the future tax benefit of future obligations at the then applicable company tax rate.

55 In a note to its statutory accounts for the year ended 30 September 1986 the taxpayer referred to the transactions as having resulted in "extraordinary net gains" to the taxpayer and its associated group of companies which had "arisen from capital profits ... on the liability assumption offset by liabilities and related tax benefits brought to account for facility fees". The amount of this "capital profit" was recorded as \$36.4 million, that is, the difference between the total amount of the principal liability in respect of the debentures and the amount of the taxpayer's payment under the Principal Assumption Agreement.

The Commissioner's assessments

56 The Commissioner issued a notice of assessment in respect of the 1986 year on 14 May 1987 and subsequently issued amended assessments in respect of that year on 20 April 1988, 23 April 1990 and 11 February 1991. The detail of the assessment and subsequent amendments is not important. In effect, the Commissioner added \$36,353,254 to the taxpayer's taxable income for the year ended 30 September 1986 on the basis that the difference between the total principal amount that the taxpayer would have been obliged to pay as principal in respect of the debentures, and the amount that it paid to MMBW, was assessable income. The Commissioner disallowed the taxpayer's claimed deduction in respect of the payments which it made to State Bank of New South Wales but the taxpayer's objection to this disallowance was later allowed.

57 For the year ended 30 September 1987 the Commissioner issued an assessment on 18 March 1988 and amended assessments on 6 June 1988 and 29 April 1991. Again, their detail is not important. In effect, the Commissioner added to the taxpayer's income an amount of \$8,033,418 in respect of "profit made from debt defeasance transactions included as income".

58 The taxpayer objected to the assessments made with respect to the 1986 and 1987 years of income and, when the objections were disallowed, asked that the decision on each objection be referred to the Federal Court of Australia.

The Federal Court decisions

59 At first instance, Ryan J held that "the difference between the amount payable under the principal assumption agreement and the face value of the [taxpayer's] debentures is assessable as income of [the taxpayer] under either s 25 or s 25A"⁶⁵ of the *Income Tax Assessment Act* 1936 (Cth) ("the Act"), but that "it should be assessed as accruing in the manner stipulated in Div 16E of Pt III"⁶⁶ of the Act. The Commissioner had assessed the taxpayer on the basis that the Principal Assumption Agreement was a "qualifying security" within the meaning of that Division, that it was the "holder" of that security as therein defined, and that the taxpayer as "holder" was required by s 159GQ(1) to include a portion of the gain from the Principal Assumption Agreement in its assessable income for the year of income ended 30 September 1986.

60 The taxpayer appealed to the Full Court of the Federal Court which, by majority, allowed the appeal⁶⁷. The majority of the Court (Lockhart J with whose reasons Sheppard J agreed) held that the difference between the amount paid by the taxpayer under the Principal Assumption Agreement and the amount that it would have been required, but for the agreement, to pay to redeem the debentures was not income according to ordinary concepts⁶⁸ and was not income arising from a profit-making scheme⁶⁹.

65 *ICI Australia Ltd v Federal Commissioner of Taxation* (1994) 125 ALR 63 at 93.

66 (1994) 125 ALR 63 at 93.

67 *ICI Australia Ltd v Commissioner of Taxation* (1996) 68 FCR 122.

68 (1996) 68 FCR 122 at 133.

69 (1996) 68 FCR 122 at 135.

61 On appeal to the Full Court of the Federal Court the Commissioner had contended, as an alternative basis for upholding the assessments, that Pt IIIA of the Act applied and that the taxpayer had made a capital gain⁷⁰. The majority of the Full Court held that the taxpayer's rights under the Principal Assumption Agreement were not an "asset" within the meaning of Pt IIIA of the Act⁷¹ but that, even if those rights did amount to an asset, there was no disposal of it by MMBW's performing its obligations under the Principal Assumption Agreement⁷².

62 All of the judges in the Full Court held that Div 16E of Pt III of the Act did not apply⁷³.

63 Sundberg J concluded that the taxpayer made a profit or gain when each of the relevant debentures matured and, in performance of its obligations under the Principal Assumption Agreement, MMBW paid the taxpayer's debt to the debenture holder⁷⁴. The profit was "analogous to interest" and was income according to ordinary concepts because "it was recompense for the loss of use of the [taxpayer's] money"⁷⁵. He also held that the taxpayer made a profit from the carrying out of a profit-making scheme within s 25A(1)⁷⁶.

64 By special leave, the Commissioner appealed to this Court. Three principal contentions were advanced in support of the appeal:

1. that the difference between the amount paid by the taxpayer to MMBW and the face value of the debentures was income according to ordinary concepts or was a profit arising from the carrying out of a profit-making scheme;

70 This contention was first made by the Commissioner in response to requests made by the taxpayer for further and better particulars of the basis of the assessments. The primary judge did not find it necessary to decide the question.

71 (1996) 68 FCR 122 at 138.

72 (1996) 68 FCR 122 at 138.

73 (1996) 68 FCR 122 at 135-137 per Lockhart J, 147 per Sundberg J.

74 (1996) 68 FCR 122 at 145.

75 (1996) 68 FCR 122 at 146.

76 (1996) 68 FCR 122 at 146.

Gaudron J
McHugh J
Kirby J
Hayne J

28.

2. that the income or profit was derived as each of the taxpayer's debentures was redeemed following payment made by MMBW; and
3. that if the taxpayer had not derived income or profit, it had nevertheless made a capital gain as each of its debentures fell due for payment and was paid because it then disposed of an asset (in whole or in part) when MMBW performed its obligation to make the payment which it did.

The Commissioner expressly disclaimed any reliance upon Div 16E. Because none of the taxpayer's debentures fell due for payment in the year ended 30 September 1986, but some did in the 1987 year, the Commissioner acknowledged in argument that if his contentions were accepted, his appeal to this Court in relation to the 1986 year would fail.

65 It is convenient to deal first with whether the taxpayer derived income (as income is ordinarily to be understood) or made a profit from a profit-making scheme.

Income or profit?

66 Consideration of these matters must begin from an understanding of the effect of the Principal Assumption Agreement. In particular, it must begin from the recognition that following the making of the Principal Assumption Agreement, the taxpayer remained liable on its debentures. MMBW agreed that it would "assume ... the obligations of the [taxpayer] to make due and punctual payment of the principal amount of all Stock in accordance with Clause 3 of each of the Trust Deeds"⁷⁷ and agreed that it would indemnify the taxpayer and its guarantors, and keep them indemnified, in respect of those obligations. But this stops well short of discharging the taxpayer from the obligations which it owed under each of the trust deeds. Those obligations included the obligation to pay to the trustee the principal due on each debenture subject to the proviso that in the absence of contrary direction by the trustee, the taxpayer would pay the principal (and interest) due on the debentures to the debenture stock holders directly (such payment being pro tanto in discharge of the taxpayer's obligations to the trustee)⁷⁸.

67 No debenture stock certificates were tendered in evidence. Assuming, as the parties invited us to do, that the certificates issued to debenture holders took the

77 Principal Assumption Agreement, cl 3(a).

78 1966 Trust Deed, cl 3(a); 1970 Trust Deed, cl 3(1).

form appearing in the schedule to each of the relevant trust deeds, it seems likely that the taxpayer bound itself to the individual stockholders to repay the principal of the debenture on the due date. It is, however, not necessary to pursue this aspect of the matter further. For present purposes it is enough to note that the taxpayer's obligations under the trust deed were not swept away by the Principal Assumption Agreement.

68 It follows that when MMBW made its first payment to the trustee under the Principal Assumption Agreement, it made a payment that was applied in satisfaction of an obligation of the taxpayer. Thus, each time MMBW made a payment under the Principal Assumption Agreement the taxpayer received a benefit, being the discharge of the obligation which the taxpayer owed its debenture holders. The amount, and the character of the benefit as income or capital, require separate consideration. It will be necessary to return to those subjects but before doing so, some other aspects of the Principal Assumption Agreement should be noted.

69 The taxpayer made a single payment under the Principal Assumption Agreement - \$62,309,546. That agreement required payment of "an amount equal to the aggregate"⁷⁹ of the respective present values of the debenture stock then on issue. MMBW's obligation under that agreement was to make a series of payments - a payment as each debenture issue fell due for repayment. On no view, then, did the taxpayer receive, at the time of the making of the Principal Assumption Agreement, a benefit which was to be calculated as the difference between the amount which it outlaid under that agreement and the total amount which MMBW bound itself to pay in the future. At the time of the making of the agreement, the taxpayer received nothing except MMBW's promise to perform in the future. That promise is not income.

70 Next, little or no guidance is offered by considering what other transactions the taxpayer might have made to achieve a commercial result substantially the same as the commercial result said to flow from the making of the Principal Assumption Agreement. No doubt the taxpayer *might* have taken the amount of \$62,309,546 which it paid to MMBW and instead of paying it to MMBW under the Principal Assumption Agreement have invested it in Commonwealth Bonds maturing at or about the same time as its debentures were to mature. If it had done that it would have derived income which it might then have applied in satisfaction of most, if not all, of its liabilities to debenture holders. Similarly, it might have invested the same amount as it paid to MMBW on more speculative investments and it might then have obtained returns greater than the amount necessary to pay

79 Principal Assumption Agreement, cl 2(a).

the debenture holders. Examination of those other transactions does not reveal whether or when the taxpayer derived income as a result of the making of the Principal Assumption Agreement. In particular, the characterisation of the gains or receipts obtained in accordance with hypothetical transactions of the kind described is of little, if any, assistance in characterising the nature of the benefits identified as flowing from the making of the Principal Assumption Agreement.

Income according to ordinary concepts?

71 The Commissioner did not contend that the whole of each payment made by MMBW was income of the taxpayer. Central to the Commissioner's contentions was the proposition that the "benefit" or the "gain" which the taxpayer obtained was the difference between the amount which it outlaid and the amounts which MMBW paid under the agreement. This difference would be measured, so the argument proceeded, without regard to what is often called the "true value" of money and was properly to be considered as income emerging as each payment was made by MMBW.

72 For present purposes, two aspects of this argument may be accepted: that the taxpayer received a benefit each time MMBW made a payment and that⁸⁰:

"The accounting basis which has been employed in calculating profits and losses for the purposes of the Act is historical cost (*McRae v Federal Commissioner of Taxation*⁸¹; and see *Lowe v Inland Revenue Commissioner (NZ)*⁸²) not economic equivalence: *Inland Revenue Commissioner v Europa Oil (NZ) Ltd*⁸³."

It follows that the fact that the amount outlaid by the taxpayer at the time of making the Principal Assumption Agreement may be seen as the then present value of the rights which it acquired is nothing to the point. It follows also that nothing turns on the parties' choice of the Commonwealth Bond rate as the basis of the calculation of the net present value of the obligations undertaken rather than some

80 *Federal Commissioner of Taxation v Myer Emporium Ltd* (1987) 163 CLR 199 at 216-217 per Mason ACJ, Wilson, Brennan, Deane and Dawson JJ.

81 (1969) 121 CLR 266.

82 (1983) 15 ATR 102.

83 [1971] AC 760 at 772.

other discount rate such as the rate of return that the taxpayer might have generated from the use of the funds within its own business.

The nature of the "benefit" or "gain"

73 Plainly, then, the difference between the taxpayer's payment and MMBW's payments can be found reflected in the taxpayer's accounts. Is that difference a benefit or gain to the taxpayer and, if it is, what is its nature? (For the moment we leave to one side any complication presented by the fact that the taxpayer made a single payment and MMBW made a series of payments.)

74 There are several features of the difference between the amounts of the payments which are important. First and foremost, the difference is a difference between an amount that was expended and an amount that would have had to be expended.

75 Secondly, the obligation of the taxpayer that was satisfied by the payment made by MMBW was an obligation of the taxpayer that was on capital account. Thirdly, the transaction was a singular transaction concerning liabilities separately created by the taxpayer in raising capital for its business.

76 We deal with each of these in turn.

A reduction in expenditure

77 When MMBW made each payment and that payment was applied in satisfaction of the principal due on debentures, the taxpayer received the benefit of its liability being discharged to the extent of the payment made. But what is said to be the benefit to the taxpayer is not that receipt but the difference between outlays - one it actually made and one that it would have otherwise had to make. Thus the question of characterisation is very different from the question which arose in cases such as *Hartland v Diggines*⁸⁴ upon which the Commissioner relied in this respect. There, voluntary payments made by an employer in discharge of an employee's obligations to income tax were held to be "profits and emoluments" of the taxpayer within the meaning of Sched E of the *Income Tax Act* 1842 (UK) (5 & 6 Vict c 35).

78 Leaving aside the radical differences in statutory regime under consideration, the question in that case was to characterise the benefit constituted by the payments, not to characterise the difference between actual and hypothetical

84 [1926] AC 289.

outlays. That difference is a reduction in expenditure not any inflow or gain to the taxpayer.

79 If, however, the relevant enquiry is an enquiry about the character of the difference between an outlay (the sum paid by the taxpayer under the Principal Assumption Agreement) and a receipt (the value of the benefit received in money's worth when MMBW paid an amount applied in satisfaction of the taxpayer's liability to debenture holders) other considerations arise.

80 Again we note, but do not stay to consider, that there may well be difficulties presented by the facts that the taxpayer's outlay was made in one year of income (1986) and that MMBW's payments (and thus the benefits to the taxpayer) would occur over several later years (between 1987 and 2000). What is significant in this context is that the benefit received was satisfaction of an obligation on capital account.

Capital account?

81 That the taxpayer's liability to its debenture holders was a liability on capital account was not (and could not be) disputed. No doubt, as is established by *GP International Pipecoaters Pty Ltd v Federal Commissioner of Taxation*⁸⁵:

"... it cannot be accepted that an intention on the part of a payer and a payee or either of them that a receipt be applied to recoup capital expenditure by the payee determines the character of a receipt when the circumstances show that the payment is received in consideration of the performance of a contract, the performance of which is the business of the recipient or which is performed in the ordinary course of the business of the recipient."

But that is not this case. The benefit obtained by the taxpayer was not the receipt of money into its hands which at its choice was then applied in satisfaction of a capital obligation. It was a benefit constituted by the discharging of that capital obligation.

⁸⁵ (1990) 170 CLR 124 at 142 per Brennan, Dawson, Toohey, Gaudron and McHugh JJ.

A singular transaction

82 Nor is this a case of the kind considered in *Avco Financial Services Ltd v Federal Commissioner of Taxation*⁸⁶ or *Coles Myer Finance Ltd v Federal Commissioner of Taxation*⁸⁷ in which a finance company engages in various transactions on capital account yielding a difference properly regarded as a gain or loss on revenue account from the use of the company's working or circulating capital⁸⁸. The present transaction was a singular transaction, not part of the regular means whereby the taxpayer obtained returns⁸⁹. It must be acknowledged, of course, that the fact that it was a singular transaction is important but, standing alone, is not determinative of the characterisation of a "profit" or "gain" under consideration.

83 In *Federal Commissioner of Taxation v Myer Emporium Ltd* the Court said⁹⁰:

"Although it is well settled that a profit or gain made in the ordinary course of carrying on a business constitutes income, it does not follow that a profit or gain made in a transaction entered into otherwise than in the ordinary course of carrying on the taxpayer's business is not income. Because a business is carried on with a view to profit, a gain made in the ordinary course of carrying on the business is invested with the profit-making purpose, thereby stamping the profit with the character of income. But a gain made otherwise than in the ordinary course of carrying on the business which nevertheless arises from a transaction entered into by the taxpayer with the intention or purpose of making a profit or gain may well constitute income. Whether it does depends very much on the circumstances of the case. Generally speaking, however, it may be said that if the circumstances are such as to give rise to the inference that the taxpayer's intention or purpose

86 (1982) 150 CLR 510.

87 (1993) 176 CLR 640.

88 See *Coles Myer Finance Ltd v Federal Commissioner of Taxation* (1993) 176 CLR 640 at 663-664 per Mason CJ, Brennan, Dawson, Toohey and Gaudron JJ, 668-669 per Deane J, 681-682 per McHugh J.

89 *Sun Newspapers Ltd and Associated Newspapers Ltd v Federal Commissioner of Taxation* (1938) 61 CLR 337 at 359 per Dixon J; *Commercial and General Acceptance Ltd v Federal Commissioner of Taxation* (1977) 137 CLR 373 at 384; cf *Commissioner of Taxation v Unilever Australia Securities Ltd* (1995) 56 FCR 152.

90 (1987) 163 CLR 199 at 209-210.

in entering into the transaction was to make a profit or gain, the profit or gain will be income, notwithstanding that the transaction was extraordinary judged by reference to the ordinary course of the taxpayer's business. Nor does the fact that a profit or gain is made as the result of an isolated venture or a 'one-off' transaction preclude it from being properly characterised as income: *Federal Commissioner of Taxation v Whitfords Beach Pty Ltd*⁹¹. The authorities establish that a profit or gain so made will constitute income if the property generating the profit or gain was acquired in a business operation or commercial transaction for the purpose of profit-making by the means giving rise to the profit."

But here the taxpayer acquired no asset which it put to use in a way that realised a profit⁹². Rather, it acquired rights in relation to the satisfaction of liabilities it had incurred to provide it with capital in its business. While the difference between outlay and liability must find its reflection in the taxpayer's accounts, the accounting difference between the amount outlaid in a singular transaction to acquire the rights to have another pay sufficient to meet existing capital liabilities of the taxpayer in the future is not a profit or gain to the taxpayer and is not income according to ordinary concepts.

Profit-making scheme

- 84 The Commissioner contended that the transaction by which the taxpayer outlaid money to procure future payment of moneys to be applied in payment of the debentures was a profit-making scheme for the purposes of s 25A of the Act. Section 25A(1) states:

"The assessable income of a taxpayer shall include profit arising from the sale by the taxpayer of any property acquired by him for the purpose of profit-making by sale, or from the carrying on or carrying out of any profit-making undertaking or scheme."

The Principal Assumption Agreement created obligations closely related to the debentures that the taxpayer had issued and it cannot be understood without reference to the arrangements governing those debentures. But that is not to say that there was a scheme whereby the taxpayer incurred certain future obligations and acquired the right (for a smaller price) to have someone make payments which would discharge those obligations. If that had been the course of events, the two

91 (1982) 150 CLR 355 at 366-367, 376.

92 cf *Californian Copper Syndicate v Harris* (1904) 5 TC 159.

35.

transactions might be seen as "integral elements in one profit-making scheme"⁹³. If the two transactions are to be considered as separate and independent transactions, the taxpayer's argument that no relevant profit arose would have "compelling force"⁹⁴.

- 85 The Commissioner did not seek to mount a case that the two transactions were to be seen as integral elements in the one profit-making scheme. The issue of the debentures being unrelated to the later arrangements made with MMBW, the two transactions (or sets of transactions) are properly seen as separate and independent and the Commissioner contended that the "scheme" was constituted by or reflected in the Principal Assumption Agreement.

Not income or profit from profit-making scheme

- 86 Standing alone, the Principal Assumption Agreement reveals no profit for the taxpayer, only an accounting difference between the face value of the debentures and the amount paid by the taxpayer to have MMBW pay amounts satisfying the principal sums due. For the same reasons that this difference does not constitute income according to ordinary concepts, it is not profit arising from a profit-making scheme. The taxpayer outlaid a smaller sum than the total it would have had to outlay over the next 14 years but it thereby reduced the expenditure it would otherwise have made on capital account and did so by the singular transaction embodied in the Principal Assumption Agreement (and associated agreements).

- 87 For these reasons we reject the Commissioner's contentions that the taxpayer derived income according to ordinary concepts or made a profit arising from a profit-making undertaking or scheme. We turn then to the alternative contentions based on the capital gains provisions of Pt IIIA of the Act.

Capital Gains Tax

- 88 Two issues were debated: whether, by making the Principal Assumption Agreement, the taxpayer acquired an asset and whether, when MMBW performed its obligations under the Principal Assumption Agreement, a change occurred in the ownership of an asset.

93 cf *Federal Commissioner of Taxation v Myer Emporium Ltd* (1987) 163 CLR 199 at 216.

94 cf *Federal Commissioner of Taxation v Myer Emporium Ltd* (1987) 163 CLR 199 at 216.

An asset?

89 Section 160A provides that in Pt IIIA, unless the contrary intention appears, "asset":

"means any form of property and includes -

(a) an option, a debt, a chose in action, any other right, goodwill and any other form of incorporeal property;

..."⁹⁵

90 We have no doubt that the rights acquired by the taxpayer against MMBW under the Principal Assumption Agreement are an asset for the purposes of Pt IIIA. The contention, accepted by the majority of the Full Court, that the right acquired by the taxpayer "was merely a personal right ... which was incapable of being assumed by a third party"⁹⁶ must be rejected. The conclusion that the taxpayer's right against MMBW was only a right to compel MMBW to specifically perform its obligations appears to have been founded in the proposition, adopted by the primary judge, that "no conceivable assignee would have any interest in enforcing MMBW's obligation which was to discharge [the taxpayer's] obligation to the debenture holders"⁹⁷. It may be doubted that enquiring whether there is any person who would have a commercial interest in taking an assignment will determine whether something is an item of property capable of assignment⁹⁸. The question is whether the rights are capable of assignment, not whether anyone is interested in taking an assignment.

91 Furthermore, in construing the term "any form of property" in s 160A, it is important to bear in mind the following statement by Kitto J in *National Trustees*

⁹⁵ Nothing turns on the amendments later made to s 160A by the *Taxation Laws Amendment Act (No 4)* 1992.

⁹⁶ *ICI Australia Ltd v Commissioner of Taxation* (1996) 68 FCR 122 at 138 per Lockhart J.

⁹⁷ *ICI Australia Ltd v Federal Commissioner of Taxation* (1994) 125 ALR 63 at 92.

⁹⁸ *R v Toohey; Ex parte Meneling Station Pty Ltd* (1982) 158 CLR 327 at 342-343 per Mason J.

*Executors and Agency Co of Australasia Ltd v Federal Commissioner of Taxation*⁹⁹:

"It may be said categorically that alienability is not an indispensable attribute of a right of property according to the general sense which the word 'property' bears in the law. Rights may be incapable of assignment, either because assignment is considered incompatible with their nature, as was the case originally with debts (subject to an exception in favour of the King) or because a statute so provides or considerations of public policy so require, as is the case with some salaries and pensions; yet they are all within the conception of 'property' as the word is normally understood ..."

In any event, we do not accept that there is "no conceivable assignee" who would have an interest in taking an assignment from the taxpayer of its rights against MMBW. The debenture holders are an obvious class of persons who would have a real and lively commercial interest in having MMBW perform its obligations. It follows that the rights which the taxpayer had against MMBW under the Principal Assumption Agreement are an asset for the purposes of Pt IIIA.

Disposal?

92 Section 160M provided in 1986 and 1987:

"(1) Subject to this Part, where a change has occurred in the ownership of an asset, the change shall be deemed, for the purposes of this Part, to have effected a disposal of the asset by the person who owned it immediately before the change and an acquisition of the asset by the person who owned it immediately after the change.

(2) A reference in sub-section (1) to a change in the ownership of an asset is a reference to a change that has occurred in any way, including any of the following ways:

- (a) by the execution of an instrument;
- (b) by the entering into of a transaction;
- (c) by the transmission of the asset by operation of law;

⁹⁹ (1954) 91 CLR 540 at 583.

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- (d) by the delivery of the asset;
 - (e) by the doing of any other act or thing;
 - (f) by the occurrence of any event.
- (3) Without limiting the generality of sub-section (2), a change shall be taken to have occurred in the ownership of an asset by -
- (a) a declaration of trust in relation to the asset under which the beneficiary is absolutely entitled to the asset as against the trustee;
 - (b) in the case of an asset being a debt, a chose in action or any other right, or an interest or right in or over property - the cancellation, release, discharge, satisfaction, surrender, forfeiture, expiry or abandonment, at law or in equity, of the asset;

39.

- (c) in the case of an asset being a share in or debenture of a company - the redemption in whole or in part, or the cancellation, of the share or debenture;

...

(6) A disposal of an asset that did not exist (either by itself or as part of another asset) before the disposal, but is created by the disposal, constitutes a disposal of the asset for the purposes of this Part, but the person who so disposes of the asset shall be deemed not to have paid or given any consideration, or incurred any costs or expenditure, referred to in paragraph 160ZH(1)(a), (b), (c) or (d), (2)(a), (b), (c) or (d) or (3)(a), (b), (c) or (d) in respect of the asset.

(7) Without limiting the generality of sub-section (2) but subject to the other provisions of this Part, where -

- (a) an act or transaction has taken place in relation to an asset or an event affecting an asset has occurred; and
- (b) a person has received, or is entitled to receive, an amount of money or other consideration by reason of the act, transaction or event (whether or not any asset was or will be acquired by the person paying the money or giving the other consideration) including, but not limited to, an amount of money or other consideration -
 - (i) in the case of an asset being a right - in return for forfeiture or surrender of the right or for refraining from exercising the right; or
 - (ii) for use or exploitation of the asset,

the act, transaction or event constitutes a disposal by the person who received, or is entitled to receive, the money or other consideration of an asset created by the disposal and, for the purposes of the application of this Part in relation to that disposal -

- (c) the money or other consideration constitutes the consideration in respect of the disposal;

...¹⁰⁰

The Commissioner submitted that s 160M(3)(b) applied to deem performance by MMBW of its obligations under the Principal Assumption Agreement to be a change in the ownership of the taxpayer's asset (its rights under that agreement). It was submitted that MMBW's performance of its obligations was the "discharge" or "satisfaction" of the asset being the "chose in action or any other right" constituted by the taxpayer's rights under the Principal Assumption Agreement.

93 The Full Court held that "discharge" and "satisfaction", when used in s 160M(3), were not to "be construed as extending to the performance of obligations under an agreement giving rise to the rights in accordance with the terms of the agreement"¹⁰¹ and were words which "must be confined to cases where the rights are satisfied or discharged otherwise than by performance of the obligations which give rise to the rights by the other party to the contract"¹⁰².

94 There is no basis for confining "discharge" or "satisfaction" in this way. First, as a matter of ordinary language, "discharge" can be used in the sense of "[t]he act of clearing off a pecuniary liability; payment"¹⁰³ or "[f]ulfilment, performance, execution (of an obligation, duty, function, etc)"¹⁰⁴.

95 Secondly, it is common for lawyers to speak of a contractual obligation being discharged by performance. No doubt there are other ways in which the obligation can be discharged but performance is one. There is nothing in the ordinary usages in the law of the terms the "discharge" or the "satisfaction" of an obligation which

100 Section 160M(1A) was inserted by *Taxation Laws Amendment Act 1990* (Cth), s 14(a). The terms of that sub-section do not affect the disposition of the present matter.

101 *ICI Australia Ltd v Commissioner of Taxation* (1996) 68 FCR 122 at 139 per Lockhart J.

102 (1996) 68 FCR 122 at 139 per Lockhart J.

103 *The Oxford English Dictionary*, 2nd ed (1989), "discharge" sense 5.

104 *The Oxford English Dictionary*, 2nd ed (1989), "discharge" sense 6.

would suggest that the use of the terms in s 160M(3) is to be confined in the manner suggested.

96 Thirdly, when the sub-section speaks, as it does, of the "discharge" of a debt it is plainly using the word "discharge" in a way that at least includes payment of the debt according to the terms of the obligation incurred by the debtor.

97 Fourthly, far from the other provisions of Pt IIIA (or s 160M in particular) providing a sound basis for reading down the apparent generality of s 160M(3)(b), the context in which the provision sits discloses an intention to give it a very wide operation. Sub-sections (1) and (2) of s 160M centre upon a change in ownership of an asset. Sub-section (1) deems a change in ownership to effect a disposal of an asset by one person to another and sub-s (2) amplifies what is meant by a "change in the ownership". Sub-section (3) provides that a change "shall be taken to have occurred in the ownership of an asset" upon the happening of any of several events or transactions. It is clear from the reference to redemption or cancellation of shares or debentures in par (c) that the events that are to be taken to amount to a change in ownership include events where the asset ceases to exist as an item of property. Similarly, sub-s (6) demonstrates that there can be a disposal of an asset for the purposes of Pt IIIA where an asset is created by the disposal.

98 It was submitted that unless the provision was read down by confining "discharge" and "satisfaction" to discharge or satisfaction otherwise than by performance of the obligation undertaken, performance of every executory contract would be brought within the reach of the capital gains provisions. No doubt that is so but it does *not* mean that a party to an executory contract will always be liable to tax. It is necessary to recall that tax will be payable only if there is a capital gain, that is, only "if the consideration in respect of the disposal exceeds the indexed cost base to the taxpayer in respect of the asset"¹⁰⁵. If what the taxpayer receives on performance of the obligation undertaken by the other party to an executory contract does exceed the indexed cost base to the taxpayer in respect of the acquisition of the right to have the obligation performed, we see no incongruity in concluding that the taxpayer has made a capital gain.

99 Accordingly, there is no basis for confining the word "discharge" (or, for that matter, the word "satisfaction") to discharge or satisfaction otherwise than according to the tenor of the obligation incurred.

100 In all these circumstances it follows that for the purposes of Pt IIIA performance by MMBW of its obligations under the Principal Assumption

105 s 160Z(1)(a).

Agreement, and discharge pro tanto of those obligations by performance, is a disposal of part of the taxpayer's asset (being its rights against MMBW under the Principal Assumption Agreement)¹⁰⁶.

101 The taxpayer contended that if the difference between the amount paid by the taxpayer under the Principal Assumption Agreement and the face value of the debentures was income or profit from a profit-making scheme the Commissioner's appeal in respect of the 1987 year should nevertheless be dismissed because the taxpayer made no gain until MMBW had paid out more than the \$62,309,546 that the taxpayer paid under the Principal Assumption Agreement. Debentures maturing between 30 November 1986 and 31 May 1990 were for principal amounts totalling \$61,869,800. Accordingly, not until payment in relation to debentures maturing on 31 July 1990 (which had a face value of \$4,275,000) would MMBW pay out more than the taxpayer had paid under the Principal Assumption Agreement. Because we consider that the difference between the two amounts is not income or profit, we need not decide whether this argument is good. It is, however, an argument that does not arise under Pt IIIA because where, as here, part of an asset is disposed of, s 160ZI requires apportionment of the cost base attributable to the asset.

102 MMBW having made no payment under the Principal Assumption Agreement during the 1986 year, the Commissioner's appeal in respect of that year should be dismissed with costs. MMBW having made payments in the 1987 year, the appeal to this Court in respect of that year of income should be allowed, the orders made by the Full Court set aside, and in lieu it should be ordered that the appeal to that Court should be allowed, the decision of the Commissioner disallowing the taxpayer's objection set aside and the Commissioner directed to amend the assessment concerned.

103 The parties are agreed that each should bear its own costs of the proceedings before the primary judge. So far as the costs of the appeals to the Full Court and to this Court are concerned, the Commissioner having been entitled to succeed on the capital gains tax point in the Full Court, and having succeeded on that point in this Court, but failed on the other points argued, he should have part of his costs of both appeals. The taxpayer should pay half the Commissioner's costs of the appeals to the Full Court and to this Court.

106 By s 160R "a reference to a disposal of an asset" in Pt IIIA "includes, unless the contrary intention appears, a reference to a disposal of part of an asset". No contrary intention is to be found in s 160M(3).

104 GUMMOW J. I agree, for the reasons given by Gaudron, McHugh, Kirby and Hayne JJ, that the Court should not accept the appellant's submissions with respect to the application of the principles concerning the derivation of income according to ordinary concepts and with respect to the application of s 25A of the *Income Tax Assessment Act 1936* (Cth) ("the Act").

105 The primary question is whether the increments contained in the payments made by Melbourne and Metropolitan Board of Works ("MMBW") under the Principal Assumption Agreement in the 1987 tax year yielded in the hands of the taxpayer a benefit or gain "in the form of money's worth"¹⁰⁷ which was of an income character. This depends for its answer, to use the words of Kitto J, "upon a consideration of the whole of the circumstances"¹⁰⁸.

106 The payments by MMBW worked a discharge of the indebtedness of the taxpayer in respect of the stock issued under the trust deeds¹⁰⁹. The taxpayer thereafter had a good defence to any action against it in respect of its indebtedness for the stock. That indebtedness had been a capital obligation. The benefit in the hands of the taxpayer from the payments made by MMBW takes its character accordingly as filling the place of liabilities for outgoings incurred on capital account¹¹⁰.

107 There remains the two capital gains tax issues which arise under Pt IIIA of the Act.

108 As to the first, I agree that the rights acquired by the taxpayer under the Principal Assumption Agreement constituted an asset within the meaning of s 160A. The obligations of MMBW to the taxpayer, particularly under cl 3 of the Principal Assumption Agreement, were not debts due and owing by MMBW to the taxpayer. However, the benefit of the covenants by MMBW in cl 3 were choses in action within the meaning of "asset" in s 160A. The covenants obliged MMBW to pay third parties not the taxpayer. However, the payments would discharge liabilities of the taxpayer and, if they had not been made by MMBW, the

107 *Federal Commissioner of Taxation v Cooke* (1980) 42 FLR 403 at 413-414; 29 ALR 202 at 211-212.

108 *The Squatting Investment Co Ltd v Federal Commissioner of Taxation* (1953) 86 CLR 570 at 627; *Federal Commissioner of Taxation v Rowe* (1997) 71 ALJR 624 at 636; 143 ALR 406 at 422.

109 *Sheahan v Carrier Air Conditioning Pty Ltd* (1997) 71 ALJR 1223 at 1233-1234; 147 ALR 1 at 14-15.

110 *Carapark Holdings Ltd v Federal Commissioner of Taxation* (1967) 115 CLR 653 at 663; *Federal Commissioner of Taxation v Rowe* (1997) 71 ALJR 624 at 626-627, 634-635; 143 ALR 406 at 409-410, 420-421.

taxpayer would have had an action against MMBW for substantial not nominal damages¹¹¹.

- 109 In the submissions, perhaps too much significance was attached to the approval by Mason J in *R v Toohey; Ex parte Meneling Station Pty Ltd*¹¹² of the statement by Lord Wilberforce in *National Provincial Bank Ltd v Ainsworth*¹¹³:

"Before a right or an interest can be admitted into the category of property, or of a right affecting property, it must be definable, identifiable by third parties, capable in its nature of assumption by third parties, and have some degree of permanence or stability."

- 110 Mason J was concerned to analyse particular statutory rights, and Lord Wilberforce was dealing with the novel development of the "deserted wife's equity". Neither was dealing with rights created under the general law of contract. However, that is the case with the Principal Assumption Agreement. Mason J did observe that assignability is not in all circumstances an essential characteristic of a right of property¹¹⁴. The passage in the earlier judgment of Kitto J in *National Trustees Executors and Agency Co of Australasia Ltd v Federal Commissioner of Taxation*¹¹⁵, which Gaudron, McHugh, Kirby and Hayne JJ set out, further emphasises and develops that point.

- 111 The second capital gains tax issue is one on which I have reached a conclusion adverse to the appellant. I do not treat s 160M(3)(b) as requiring the conclusion that, by reason of the performance by the promisor of its obligations to the taxpayer under the Principal Assumption Agreement, there is to be taken to have occurred a change in the ownership of the rights of the taxpayer under that Agreement, which change then is deemed by s 160M(1) to have effected the disposal of the asset represented by those rights.

- 112 Part IIIA applies in respect of certain disposals of assets (s 160L). Section 160M(1) treats certain changes in ownership as dispositions by the person

111 *Coulls v Bagot's Executor and Trustee Co Ltd* (1967) 119 CLR 460 at 501-502; *Beswick v Beswick* [1968] AC 58 at 88; *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) 165 CLR 107 at 118-119, 158; cf *Woodar Investment Development Ltd v Wimpey Construction UK Ltd* [1980] 1 WLR 277 at 284, 297, 300-301; [1980] 1 All ER 571 at 577, 588, 591.

112 (1982) 158 CLR 327 at 342-343.

113 [1965] AC 1175 at 1247-1248.

114 (1982) 158 CLR 327 at 342.

115 (1954) 91 CLR 540 at 583.

who was the owner before the change and as acquisitions by the new owner. This is consistent with the normal concept of the continued existence of the subject-matter of a disposition. The primary meaning of "disposition" is alienation by the disponor¹¹⁶. However, as Hill J pointed out in *Commissioner of Taxation v Cooling*¹¹⁷, pars (b) and (c) of s 160M(3) clearly extend the operation of Pt IIIA beyond the normal concept of disposal.

113 Paragraphs (b) and (c) of s 160M(3) state:

"Without limiting the generality of sub-section (2), a change shall be taken to have occurred in the ownership of an asset by:

...

- (b) in the case of an asset being a debt, a chose in action or any other right, or an interest or right in or over property - the cancellation, release, discharge, satisfaction, surrender, forfeiture, expiry or abandonment, at law or in equity, of the asset;
- (c) in the case of an asset being a share in or debenture of a company - the redemption in whole or in part, or the cancellation, of the share or debenture".

Each of the steps listed in pars (b) and (c) is apt to identify supervening activity by the disponor (for example, by surrendering a lease or permitting it to expire without the exercise of a right of renewal or continuation)¹¹⁸ or by a third party exercising some superior authority (for example, by forfeiting a lease, redeeming a debenture or cancelling a share) which extinguishes the asset in question.

114 The legal nature of some of the steps identified in par (b) is such that their operation may overlap. At common law, the release of an obligation created other than by deed may be brought about by agreement for valuable consideration or under seal. In either case, the release discharges and extinguishes the obligation¹¹⁹. A right of action arising solely under a deed could be released only by deed, so

116 *Henty House Pty Ltd (In Voluntary Liquidation) v Federal Commissioner of Taxation* (1953) 88 CLR 141 at 151-152.

117 (1990) 22 FCR 42 at 60. Nothing of present significance turns upon the circumstance that, as to the result, this was a dissenting judgment.

118 A lease may "expire" on the date when the relationship of landlord and tenant under the lease is determined otherwise than by the term granted coming to an end: *A'Beckett v Federal Commissioner of Taxation* (1959) 104 CLR 508 at 515.

119 See *Commissioner of Stamp Duties (NSW) v Bone* (1976) 135 CLR 223 at 229.

that at law an accord and satisfaction was not pleaded in bar of an action upon a speciality¹²⁰. However, equity would enforce an agreement for value to release or vary a contract under seal¹²¹. Hence, the statements that such agreements operated as releases¹²² and thus as discharges¹²³. A discharge in equity may also be brought about by the exercise of an election to accept the provision of a substantial equivalent of performance. The satisfaction of a debt by a legacy is an example. A release may also be achieved by operation of law. Thus, the appointment by a creditor of the debtor as executor at law (though not in equity) extinguished the debt, the executor not being able to sue himself at law¹²⁴.

115 In all these instances, the discharge is the product of some supervening activity beyond the receipt of the benefit by the promisee of performance of an executory obligation. However, performance in this latter sense will answer the description of a discharge¹²⁵. The question that arises on this appeal is whether the inclusion of the term "discharge" in the collection of expressions found in par (b) of s 160M(3) brings with it this particular operation of the term.

116 The appellant suggested that the term "satisfaction" was amphibolous in the same way as "discharge". However, in my view, that is not so. The matter was explained by Dixon J in *McDermott v Black*¹²⁶ in terms which indicate that the essence of accord and satisfaction "is the acceptance by the plaintiff of something in place of his cause of action", that the accord is the agreement or consent to accept the satisfaction and that, upon provision of the satisfaction, there is a discharge which extinguishes the cause of action.

117 It is to be emphasised that par (b), like the other provisions of s 160M(3), is concerned with the identification of circumstances where changes are to be taken to have occurred in the ownership of an asset. This is by way of expansion of what would otherwise, in accordance with ordinary concepts, be the operation of s 160M(1) with respect to changes in ownership of debts, choses in action or other

120 *McDermott v Black* (1940) 63 CLR 161 at 187.

121 *McDermott v Black* (1940) 63 CLR 161 at 176-177, 187; *Creamoata Ltd v The Rice Equalization Association Ltd* (1953) 89 CLR 286 at 306, 321, 326.

122 *McDermott v Black* (1940) 63 CLR 161 at 177.

123 *Creamoata Ltd v The Rice Equalization Association Ltd* (1953) 89 CLR 286 at 321.

124 *Commissioner of Stamp Duties (NSW) v Bone* (1976) 135 CLR 223 at 227-228.

125 *Government Insurance Office of NSW v Atkinson-Leighton Joint Venture* (1981) 146 CLR 206 at 217-218.

126 (1940) 63 CLR 161 at 183-185.

rights or interests or rights in or over property. The nature of the various elements in par (b) of s 160M(3) is such that they have a common characteristic, namely some supervening activity of the nature described, beyond performance in the ordinary course, whilst one element, discharge, has a further characteristic.

118 Care is required in the adoption of any interpretation which would exclude that further characteristic¹²⁷. However, this is a case where to take that course would not be to bring about a result which the legislature is unlikely to have intended¹²⁸. The contrary is the case. In construing the British capital gains legislation, Lord Wilberforce observed¹²⁹ that, whilst no doubt anomalies might occur, in straight-forward situations the courts should hesitate before accepting results which were "paradoxical and contrary to business sense". His Lordship went on in the same passage to refer to the general precept that capital gains tax is concerned with taxing gains, not mere arithmetical differences. This suggests that, where there are several constructions of the legislation which are open, "the courts should where at all possible avoid slavishly following the provisions of the legislation if that produces a charge to tax on something other than a true gain"¹³⁰.

119 A construction of s 160M(3)(b) which gave effect to the term "discharge" in all its operations would lead to curious results. In particular, it may be thought unlikely that the legislature set out to achieve the result that merely upon the performance of an executory contract in accordance with its terms there was, on the part of the promisee, a disposal of an asset for the purposes of Pt IIIA.

120 This is not a case of legislation directed to tax avoidance and thus to ensuring that the substance of the relevant transactions is not concealed by artificialities of form¹³¹. The provision under present consideration attracts the observation by Deane J¹³² upon other provisions of s 160M that the taxpayer is entitled to demand

127 cf *Benning v Sydney City Council* (1958) 100 CLR 177 at 196; *Rathborne v Abel* (1964) 38 ALJR 293 at 301; *Houssein v Under Secretary of Industrial Relations and Technology (NSW)* (1982) 148 CLR 88 at 94; *O'Sullivan v Farrer* (1989) 168 CLR 210 at 215; *Ainsworth v Criminal Justice Commission* (1992) 175 CLR 564 at 575; *PMT Partners Pty Ltd (In Liq) v Australian National Parks and Wildlife Service* (1995) 184 CLR 301 at 311, 320.

128 See *Ainsworth v Criminal Justice Commission* (1992) 175 CLR 564 at 575.

129 *Aberdeen Construction Group v IRC* [1978] AC 885 at 893.

130 Whiteman, Gammie, Herbert, *Whiteman on Capital Gains Tax*, 4th ed (1988), §1-12.

131 cf *Federal Commissioner of Taxation v Spotless Services Ltd* (1996) 186 CLR 404 at 414.

132 *Hepples v Federal Commissioner of Taxation* (1992) 173 CLR 492 at 511, 517.

of government expression in clear words of a legislative intent to impose a tax in respect of commonplace transactions. These include the discharge by performance of contractual obligations owed the taxpayer. Inconvenience or improbability of result here assists the preference to a literal construction of an alternative construction which is reasonably open¹³³.

121 I would dismiss both appeals with costs.

133 *Cooper Brookes (Wollongong) Pty Ltd v Federal Commissioner of Taxation* (1981) 147 CLR 297 at 320; *Hepples v Federal Commissioner of Taxation* (1992) 173 CLR 492 at 536-537.

CALLINAN J.

The factual background

- 122 The respondent¹³⁴, a listed public company, raised money by issues of debenture stock pursuant to trust deeds dated 17 October 1966 and 10 August 1970. To protect the stockholders, the deeds restricted the borrowing capacity of the respondent.
- 123 In 1979, the respondent reorganised some of its financial arrangements. It lent the money raised by the issues of debenture stock to a subsidiary, ICI Operations Pty Ltd. Interest to meet the cost of the respondent's obligations to the stockholders was charged by the respondent to its subsidiary.
- 124 After 1979, the respondent desired to expand its activities and to put itself into a position to acquire new businesses. Among other things, the respondent wished to build a plant to produce ethylene at Botany in New South Wales.
- 125 In March 1984, a new Australian Accounting Standard, AAS 17 became binding on listed public companies. It obliged them to treat as liabilities in their balance sheets, money remaining to be paid on equipment leases. This obligation adversely affected the respondent's assets-to-liabilities ratio.
- 126 In consequence of the inhibition on fund raising imposed by the debenture deeds and the new accounting standard, the respondent cast around for ways to refinance its operations. Possible means of doing this were canvassed in a board paper prepared by the Corporate Treasurer of the respondent, for a Board meeting in December 1985. That paper relevantly provides:

"(i) Seek modifications to the Trust Deed

Provisions are available to have the Deed modified to possibly expand borrowing ratios (e.g. by increasing percentage of qualifying assets from 60% to 66%) but the process is legally cumbersome requiring an extraordinary resolution to be passed by debenture holders and the possibility of having to increase existing coupon rates.

(ii) Seek early redemption of all outstanding debentures

This would involve a similar approach to that adopted in the early redemption of \$10M of debentures during 1984/85. However as the Trust Deed does not provide an option for the company to compulsorily redeem its debentures and

134 Then ICI Australia Ltd.

some debenture holders may not accept the offer no matter how attractive, the problem with the Trust Deed would remain.

(iii) Undertake a defeasance

A defeasance involves the purchase of a portfolio of risk free securities such as government or semi-government stock with the cash flows from the portfolio matching as closely as possible those of the company's own debentures. This defeasance portfolio of investments is held by the Trustee and as the interest and principal commitments of the company's debentures are matched by the defeasance portfolio, negotiation with the Trustee results in the release by the Trustee of the debenture Trust Deed floating charge and restrictive borrowing ratios.

(iv) Arrange a liability assumption

As an alternative to a defeasance, a liability assumption can be arranged. Under this alternative, in consideration for a payment by the company, the obligations to pay interest and principal on the debentures are assigned to a risk-free party such as the Commonwealth Bank, State Bank or a semi-government guaranteed body, the Trustee can be satisfied that obligations to debenture holders will be honoured and agree to release the floating charge over assets and the restrictive borrowing ratios. The success of a liability assumption is dependent upon identifying a suitable counter-party to assume the liability for debentures."

127 The directors requested that a recommendation be brought to the Board by March or April 1986. Executives of the respondent explored various internal and external proposals. A firm recommendation was then made by a memorandum presented to, and adopted by, the Directors at a meeting of the Board in March 1986:

"It is recommended that the company enter into two separate assumption agreements, one for the outstanding debenture principal and the other for the ongoing interest payment obligations until the respective debenture maturities. These obligations would be assumed by two separate parties whose obligations are guaranteed either by the Commonwealth or a State Government.

Under the principal assumption agreement ICI Australia would pay to a Principal Assumption Party an amount calculated as the net present value

51.

of the debenture principal repayments only, discounted at a rate approximating the Commonwealth Bond yield for each of the principal repayment dates. The amount of principal assumed would be \$99 million and the payment required would be approximately \$59 million which could be provided from available cash sources to the company.

In the interest assumption agreement ICI Australia would undertake to make a series of payments to an Interest Assumption Party to coincide precisely with existing debenture interest obligations. A fee would be payable to the Interest Assumption Party as consideration for assuming the primary legal responsibility for these payments.

It is expected that an extraordinary profit of approximately \$17 million (after tax) would arise from the two transactions in the 1986 year comprising a capital profit of \$40 million on the principal assumption less \$23 million (after tax) for the interest assumption payments.

While the \$40 million capital profit would not be subject to income tax the regular fee payments would be claimed as tax deductions.

It is proposed that debenture holders be given the option to early redeem their holding based on current market yield to redemption rates prior to the liability and interest assumption agreements being entered into. This step is recommended to avoid any adverse reaction from debenture holders. The number of debenture holders accepting the early redemption offer will affect the final extraordinary profit on the transaction.

Imperial Chemical Industries PLC have been advised of the need to restructure the Trust Deed and the options considered.

Accounting and Audit Implications

The accounting and auditing implications of separate liability and interest assumption agreements have been discussed with Price Waterhouse.

It is expected that in the year the principal liability assumption transaction takes place the accounts would disclose a general description of the transaction and the amount of debt that has been extinguished. The gain arising from the liability assumption less the aggregate amount payable to the Interest Assumption Party (net of tax) would be treated as an extraordinary profit."

128 The respondent's executives and Board were well aware that the implementation of the recommendation would yield a substantial, extraordinary, capital profit. That such a profit might be significantly reduced if there were a

high acceptance of an early redemption offer by debenture holders caused the respondent to refrain from offering early redemption of stock to the holders of it.

129 By a deed titled "Principal Assumption Agreement" dated 6 June 1986, Melbourne & Metropolitan Board of Works ("MMBW") agreed, in exchange for an immediate payment of \$62,309,546 by the respondent, to repay, as and when they fell due, the principal amounts due on the debentures. The trustee for the stockholders, ANZ Executors and Trustees Pty Ltd and some other corporations as guarantors were also parties to the deed. As between the trustee, the respondent and the debenture stockholders, the respondent remained liable to the last to redeem the stock. That liability would be highly unlikely ever to have to be met by the respondent after 6 June 1986 because of the undoubted financial capacity of MMBW as a public utility. That was of course the reason why that body was selected by the respondent, and acceptable to the other parties, as a suitable "assumption party".

130 The total amount payable at the date of the Principal Assumption Agreement to redeem the debentures, the last of which fell due for repayment on 31 January 2000, was \$98,662,800.

131 There was another assumption agreement ("the Interest Assumption Agreement") of the same date relating to interest. By it, the respondent agreed to pay to the State Bank of New South Wales ("the Bank"), on each date for the payment of interest to stockholders, the amount of that interest plus a margin of 0.125%. As on the Principal Assumption Agreement, the respondent remained liable to the stockholders, but the obligation to them would, in practice, be discharged by the Bank. It is unnecessary to refer to the other consequential deeds because they are not material to the issues that have to be resolved.

132 Before 30 September 1986, the respondent paid MMBW the sum of \$62,309,546. During the financial year of the respondent which ended on that date, the respondent paid to the Bank \$3,410,626, pursuant to the interest agreement.

133 As a result of these arrangements and payments, the respondent was relevantly able to present its accounts in this form:

53.

<u>"Extraordinary Profit</u>	\$
Capital profit arising from refinancing Company's debenture borrowings under separate principal and interest liability assumption agreementsPrincipal liability transferred to assumption party	98,662,800
Less payment to assumption party	<u>(62,309,546)</u>
Capital Profit	36,353,254
Fees payable from 1/7/86 until maturity of debentures in respect of interest liability assumption	(50,629,595)
Income Tax – Future Income Tax Benefit	23,289,615"

134 The difference therefore, of \$36,353,254, between the total amount of the face value of the debentures, \$98,662,800, and the immediate payment of \$62,309,546 to MMBW, was treated in the annual accounts of the respondent appended to its tax return, for the year ending 30 September 1986, as a capital profit.

135 In the same accounts, the respondent recognised its total liability for interest payable to the Bank until 31 January 2000 of \$50,629,595. The respondent claimed as a deduction in its tax returns for the years ending 30 September 1986 and 1987, the sums of \$3,410,626 and \$11,801,357 respectively, being the amounts actually paid to the Bank for interest pursuant to the Interest Assumption Agreement.

136 Another detailed calculation was made in a memorandum of 11 February 1992 by the Corporate Treasurer which set out his assessment of the nett position after allowing for the incidence of income tax:

	\$	\$
"Debenture liability assumed		98,662,800
<u>Less</u> Liability Assumption Payment	62,309,546	
Accrued future obligations	50,629,595	(112,939,141)
Loss before income tax		(14,276,341)
<u>Plus</u> Future tax benefit of future obligations (at 46% rate)		<u>23,289,614</u>
Extraordinary Gain after income tax		<u>\$ 9,013,273"</u>

137 The appellant issued an amended assessment of income tax, which included as assessable income for the year ended 30 September 1986, the sum of \$36,353,254. The claim for a deduction of the interest payments to the Bank of \$3,410,626 during the same year was disallowed. The respondent objected to the assessment. The objection was disallowed except for the sum of \$3,410,626 paid by the respondent to the Bank. The appellant's decision was referred to the Federal Court¹³⁵.

138 In response to a request for particulars requiring him to state under which sections of the *Income Tax Assessment Act* 1936 (Cth) ("the Act") the gain of \$36,353,254 was asserted to be assessable, the appellant replied:

"(1) The gain was income of the applicant for the income year ended 30 September 1986 pursuant to the provisions of subsection 25A(1) of the *Income Tax Assessment Act* (ITAA) as a profit derived from the carrying on or carrying out of a profit-making undertaking or scheme.

(2) Alternatively, the gain constitutes assessable income of the Applicant for the income year ended 30 September 1986, pursuant to subsection 25(1), ITAA, being gross income derived directly or indirectly from a source in Australia, which is not exempt income, an amount to which section 26AC or 26AD applies or an eligible termination payment within the meaning of subdivision AA of the [ITTA].

(3) Alternatively, the PAA (principal assumption agreement) is a security which is a qualifying security within the meaning of those terms contained in Division 16E, ITAA. The Applicant, as holder of the qualifying security, is to include pursuant to subsection 159GQ(1) of the ITAA, an amount representing a portion of the gain from the principal assumption transactions in its assessable income for the 1986 year of income."

139 On 29 April 1991, the appellant amended its earlier assessment for the year ending 30 September 1987 by including as assessable, an amount of \$8,033,418 (later reduced to \$7,898,095) in respect of "profit made from debt defeasance transactions included as income". Objection to this amended assessment was made by the respondent, disallowed, referred to the Federal Court¹³⁶ and was the subject of a request for particulars, the appellant's response to which was as follows:

"(1) The gain is assessable pursuant to the provisions of section 19 and subsection 25(1) or alternatively subsection 25A(1).

135 VG 208 of 1991.

136 VG 209 of 1991.

(2) Alternatively, the Principal Assumption Agreement ('the PAA') entered by the Applicant on 6 June 1986 is a security which is a qualifying security within the meaning of those terms contained in Division 16E of the Income Tax Assessment Act ('ITAA'). The Applicant, as holder of the qualifying security is to include pursuant to subsection 159GQ(1) ITAA an amount representing a portion of the gain from the PAA in assessable income for the 1986 year of income.

(3) Alternatively, pursuant to the PAA, the Applicant has acquired an asset, being a right, according to the provisions of section 160A ITAA. Pursuant to the provisions of paragraph 160M(3)(b) ITAA, that asset was disposed of in part on each occasion during the year of income ended 30 September 1987 on which the MMBW made a payment pursuant to the PAA for the benefit of the Applicant.

(4) The consideration received on each partial disposal of that asset as determined under the provisions of ss 160ZD and 160D ITAA was in excess of the indexed cost base on the asset, determined under ss. 160ZH and 160ZI(2) and 160ZS ITAA. Thus a capital gain was realised by the Applicant on each partial disposal.

(5) The Applicant reported no capital losses determined in accordance with the provisions of Part IIIA ITAA for the income year ended 30 September 1987. By the operation of the provisions of s.160ZC ITAA the total capital gains constituted the net capital gains of the Applicant for that year and pursuant to the provisions of s.160ZP ITAA were included in the Applicant's assessable income."

The proceedings in the Federal Court

140 The matter was heard at first instance by Ryan J¹³⁷. After referring to the sections of the Act relied upon by the appellant, his Honour held that the difference between the amount paid by the respondent under the Principal Assumption Agreement and the total amount required to redeem all outstanding debentures, was income according to the ordinary connotation of that word. It represented, his Honour said, the price paid by the MMBW for the use of the respondent's money: it was not to the point that fluctuating interest and inflation rates might or might not make the transaction economically advantageous to the respondent. His Honour then set out a passage from the judgment of this Court in *Federal*

137 *ICI Australia Ltd v Federal Commissioner of Taxation* (1994) 125 ALR 63.

*Commissioner of Taxation v Myer Emporium Ltd*¹³⁸ which the appellant relies upon here and is quoted below.

141 His Honour inferred from that passage the proposition that the value of the assumption of a liability is not reduced because the assumption party has the use and enjoyment of the principal's fund for the period before the liability falls to be discharged.

142 In concluding that the sum of \$36,353,254 was income, Ryan J had regard to what he saw as the relatively short and ascertainable period before the debentures had to be redeemed, the selection of MMBW as a low risk, statutory authority and the fact that the "premium" was calculated by reference to Commonwealth bond rates. It followed, he thought, that the "premium" notionally receivable by the respondent was interest.

143 His Honour¹³⁹ was of the view that s 19 of the Act¹⁴⁰ (as it then was) operated to give the "premium", as he described it, the character of income even though the premium was not actually to be received by the respondent.

144 His Honour next went on to consider whether the respondent had a purpose of profit-making by sale, or from the carrying out of a profit-making scheme within the meaning of s 25A(1) of the Act. As to this, his Honour held, the arrangements did involve a scheme. He found that the respondent intended as an integral part of it, to receive a return on the money it was required to outlay to procure MMBW to assume its liabilities and that accordingly the transaction should be characterised as a profit-making scheme.

145 His Honour next posed the question whether there had been a profit made on capital account by the discharge of a capital liability. He answered the question in the negative, adhering to the view which he had already expressed, that notwithstanding that the difference, the sum of \$36,353,254, was to be applied in eliminating a capital liability, it still had the character of income.

146 With respect to the alternative contention of the appellant that the difference was assessable as a capital gain, his Honour was of the opinion that what the respondent acquired under the Principal Assumption Agreement was, not before breach by

138 (1987) 163 CLR 199 at 216-217.

139 (1994) 125 CLR 63 at 75.

140 "Income or money shall be deemed to have been derived by a person although it is not actually paid over to him but is reinvested, accumulated, capitalized, carried to any reserve, sinking fund or insurance fund however designated, or otherwise dealt with on his behalf or as he directs."

MMBW, an assignable debt or chose in action, that is to say, an "asset" within the meaning of s 160A of the Act, and therefore did not attract capital gains tax. His Honour did not think that any conceivable assignee would have any interest in enforcing MMBW's obligation to meet the respondent's primary obligation to the debenture holder. Had it been necessary to decide the point, his Honour would however have held that payment of a debt or performance of an obligee's obligation under some other form of contract would amount to a discharge or satisfaction of a right constituting an asset within the meaning of those words as used in s 160M(3)(b) of the Act.

147 The Full Court of the Federal Court by a majority (Lockhart J with whom Sheppard J agreed, Sundberg J dissenting) upheld an appeal from the decision of Ryan J¹⁴¹.

148 The respondent argued in the Full Court of the Federal Court that the amount which it paid, \$62,309,546, was equal to the value of the promise made by MMBW and, applying ordinary business concepts, there was no profit. The promise made by MMBW was not income and did not become income because it brought about a saving of expenditure.

149 It was put in the alternative that if there were a reduction in the respondent's liability, that reduction could only be characterised as a gain in income for the purpose of the Act if the underlying liability was on revenue account and came forward from a previous period, or in the case of a finance company, the company in the ordinary course of its business lent to another at a profit, money that it had borrowed.

150 Lockhart J was of the view that once the respondent paid the sum of \$62,309,546 to MMBW, it lost the right to use that money: subsequently, it derived no interest or other form of income from it. His Honour accepted the respondent's argument that the amount paid by the respondent to MMBW was equal to the promise it received from MMBW. Lockhart J was impressed by the fact that the respondent did not carry on a money lending business in the ordinary sense and that the transaction under consideration was an isolated one. His Honour was prepared to accept the proposition that a reduction of a liability on revenue account could give rise to a profit or gain for the purposes of the Act but he was of the view that here the liability to the stockholders was plainly on capital account.

151 Lockhart J also reached a firm conclusion that if there were any profit derived, it was not derived in the course of the respondent's ordinary business activities and was not income arising from a profit-making scheme.

141 (1996) 68 FCR 122.

152 Sundberg J (dissenting) reasoned that the respondent had an asset, namely \$62,309,546 which it employed to yield a larger amount in the future, to produce a yield to discharge its liabilities to the debenture holders. The respondent could, his Honour said, have lent that lesser amount to MMBW on terms that the capital and interest could be paid to it at some time in the future. There was, his Honour concluded, no significant difference between the actual transaction and a loan of that kind. Effectively therefore, his Honour thought, money came in, and was not simply "saved from going out". He regarded the respondent's argument that there was no profit because the money paid to MMBW as the present value of the appellant's long term liability to shareholders, as confusing assets and liabilities because a liability could have no present value.

153 His Honour was of the view that a profit was derived when the relevant debentures matured and the repayments made to the debenture holders: notwithstanding that the respondent did not receive any interest on the sum of \$62,309,546 paid to MMBW, because the respondent's profit was analogous to interest, it was income according to ordinary concepts. His Honour substantially agreed with the reasoning and conclusions of Ryan J that the difference of \$36,353,254 could also be regarded as a profit arising from the carrying out of a profit-making scheme within s 25A(1) of the Act.

154 His Honour accepted that to be an asset to which the capital gains tax provisions might apply, the right must be of a proprietary nature, an important characteristic of which is assignability. He thought that the Principal Assumption Agreement possessed that characteristic, and that it was irrelevant whether in a particular case anyone might or might not be interested in taking an assignment.

155 Both at first instance and on appeal, there was argument as to the application of Div 16E of Pt III of the Act. It is unnecessary to review the reasons of the Full Court of the Federal Court with respect to that part of the Act as the appellant presents no argument concerning that division in this Court.

The first question for this Court is, did the respondent derive income?

156 Section 25(1) of the Act at the relevant time provided:

"(1) The assessable income of a taxpayer shall include –

(a) where the taxpayer is a resident –

the gross income derived directly or indirectly from all sources whether in or out of Australia; and

(b) where the taxpayer is a non-resident –

the gross income derived directly or indirectly from all sources in Australia,

which is not exempt income, an amount to which section 26AC or 26AD applies or an eligible termination payment within the meaning of Subdivision AA."

157 The case raises difficulties which will often arise when the Act has to be applied to the operations of businesses which increasingly need flexibility and resourcefulness to reconcile long-term business plans, fluctuating interest rates, international transactions, changing currency values, and alterations to accountancy standards and listing requirements as they occur. The difficulties are compounded by the need to bring to account, for accounting and income tax purposes, profits or losses on an annual basis. Otherwise many companies would no doubt take a longer term view of their gains or losses.

158 Counsel for the appellant stressed in argument the following proposition stated in *Myer Emporium*¹⁴²:

" The accounting basis which has been employed in calculating profits and losses for the purposes of the Act is historical cost (*McRae v Federal Commissioner of Taxation*¹⁴³; and see *Lowe v Inland Revenue Commissioner (NZ)*¹⁴⁴) not economic equivalence: *Inland Revenue Commissioner v Europa Oil (NZ) Ltd*¹⁴⁵".

142 (1987) 163 CLR 199 at 216-217 per Mason ACJ, Wilson, Brennan, Deane and Dawson JJ.

143 (1969) 121 CLR 266.

144 (1983) 15 ATR 102.

145 [1971] AC 760 at 772.

159 The balance of the passage was also relied on by the appellant¹⁴⁶:

"And so a taxpayer who lends money for a stipulated period at interest is treated as exchanging the money lent for a debt of the same amount, unless the loan is made at a discount or premium, in which case there may be a gain or loss on capital account: *Lomax (HM Inspector of Taxes) v Peter Dixon & Co Ltd*¹⁴⁷. In the ordinary case, the debt is brought to account in the same amount as the money lent. The amount of the debt is not reduced because the lender is kept out of the use and enjoyment of the money lent for the period of the loan.

If economic equivalence were the appropriate accounting basis, the debt would be brought to account at the beginning of the period in an amount less than the amount of the money lent and would increase day by day until it equalled the amount of the money lent when the period expired. On that basis the right to interest on the money lent would be brought to account at the beginning of the period at a maximum figure reducing to nil when the period expired. The aggregate of the two amounts – the debt and the right to interest – would equal, throughout the period, the amount of the money lent, assuming that the rate at which the principal debt was discounted and the rate of interest payable on the principal debt were the same. On that basis, both the debt and the right to interest might be treated as capital assets.

But when a debt is brought to account in the same amount as the amount of the money lent, the right to interest on the money lent is not treated as an asset at all. It does not appear in either the balance sheet or the profit and loss account of the lender. The right to interest is not distinguished for accounting purposes from the interest to which it relates. So long as the amount of the principal debt is treated as equivalent to the amount of the money lent, the right to interest cannot be treated as an additional capital asset. The making of a loan does not immediately produce a capital gain equal to the present value of the interest to be paid. The right to interest is not a capital asset which is progressively transformed into income as and when the interest is received."

160 *Myer Emporium* is distinguishable factually because what the taxpayer assigned there was the right to receive the present value of interest payable over the term of the loan on the sum lent, in circumstances in which the initial loan and the assignment were interdependent transactions, and the consideration for the

¹⁴⁶ (1987) 163 CLR 199 at 217.

¹⁴⁷ [1943] 2 All ER 255.

assignment was calculated by direct reference to the interest payable, that is to say, money payable periodically, regularly and recurrently¹⁴⁸ to the assignor.

161 It is convenient to deal at this point with another issue. Counsel for the appellant drew attention to the second schedule to the Principal Assumption Agreement which forms the basis for a calculation of the present value of each block of debenture stock having regard to its redemption date. \$62,309,546 is the sum of those present values calculated at the discount rate as defined in the Principal Assumption Agreement. On any view, the appellant urged, a profit by way of income must at least accrue in respect of each of those blocks on its redemption date.

162 The respondent argues, in the alternative, that even though the parties obviously did recognise the separate present values of the blocks of stock in calculating the sum of \$62,309,546, at worst for the respondent, if the difference between that sum and \$98,662,800 is to be regarded as income, none of it was derived before 31 May 1990, that is, during the first financial year when the total of the repayments made exceeded \$62,309,546. There was a debate whether the respondent should be permitted to advance this argument in this Court. As it raises no new factual issues there is no reason why it should not be allowed to do so.

163 If it became necessary to decide the point I would hold for the respondent. Whilst it is true that the parties made their calculations by reference to the respective present values of the different blocks of debenture stock, the transaction was one which related to the whole of the stock, and an assessment of the present value of that whole. Quite different considerations might well have applied if the transaction related to a portion, or portions only of the stock.

164 The preceding discussion highlights the appellant's difficulty in characterising the difference between the sums as income. The fact is that the respondent has not received, and will not ever receive that difference. What the respondent receives is relief, so long as the assumption party, MMBW, repays the debenture holders from its remaining primary obligation to do so.

165 The appellant submits that the respondent is in the same position as it would have been had it outlaid the sum of \$62,309,546 in order to obtain payment of sums totaling \$98,662,800 over a period of years: that according to ordinary concepts the difference between those amounts would be income. It does not matter, the appellant argues, that the respondent does not actually receive the \$98,662,800.

148 (1987) 163 CLR 199 at 215.

166 Reliance was again placed on s 19 of the Act, which I have already reproduced.

167 That section does not assist the appellant here. Neither the sum of \$62,309,546 nor the difference, \$36,353,254 which is said to be income, was reinvested, accumulated, capitalised, carried to any reserve sinking fund or insurance fund, or otherwise dealt with on the respondent's behalf or as the respondent desired. This is not a case in which, but for the application of s 19, the taxpayer's resources would have been increased by the accrual of income and its transformation into some form of capital wealth¹⁴⁹.

168 The fact that the entry into the Principal Assumption Agreement occurred once only and was not an activity regularly undertaken by the respondent, is a relevant factor, but is not one which would of itself mean that any property or financial advantage accruing to the respondent could not be treated as income¹⁵⁰.

169 The appellant's arguments, and indeed the reasoning of Ryan J at first instance and Sundberg J (dissenting) on appeal, relied on analogies drawn between the payment of interest to an investor or lender, and the releasing of the respondent from the obligation of paying the difference between the amount paid by it to MMBW and the amount payable by the latter over time. Although the drawing of analogies may be helpful in some cases, that will not often be so when a comprehensive piece of legislation such as the Act here is under consideration. The fact that had a particular transaction been carried out differently so as to render a party to it liable to tax, cannot of itself mean, because a similar practical result is achieved by the mode of transaction actually chosen, that that party should accordingly be liable to the same tax. Nor is it the point therefore, as the appellant argues, that had the agreement required the MMBW to make the payments to the appellant and not the debenture holders, the difference involved would have been income in the hands of the respondent.

170 For this reason, I do not think that references by the appellant to *Coles Myer Finance Ltd v Federal Commissioner of Taxation*¹⁵¹, *Hannan's Principles of Income Taxation*¹⁵², *Federal Wharf Co Ltd v Deputy Federal Commissioner of*

149 *Permanent Trustee Co v Federal Commissioner of Taxation* (1940) 6 ATD 5 at 12 per Rich J.

150 *Federal Commissioner of Taxation v Myer Emporium Ltd* (1987) 163 CLR 199 at 211.

151 (1993) 176 CLR 640 at 665.

152 (1946) at 104.

*Taxation*¹⁵³, *Commissioner of Taxation v Hurley Holdings (NSW)*¹⁵⁴ and *Lomax (Inspector of Taxes) v Peter Dixon & Son*¹⁵⁵ assist him. Each of these cases and the text, deal with transactions quite different from those under consideration here.

171 So too the United States cases referred to by the appellant are distinguishable. In *United States v Kirby Lumber Co*¹⁵⁶ the transaction fell within the provisions of valid regulations defining as taxable precisely the type of gains made there on the purchase and redemption by a company of its own bonds. *Helvering v American Chicle*¹⁵⁷ was a case of similar facts and applied *Kirby Lumber*.

172 It is a logical exercise to compare for the purposes of characterisation, the nature of the original interest, asset or right with the interest, asset or right which replaces it. The money originally borrowed from the debenture holders, and such other funds as became available to the respondent after the Principal Assumption Agreement was made, and the consequentially enhanced fund raising capacity of the respondent, were all to be utilised to strengthen "the business entity, structure, or organization set up or established for the earning of profit,"¹⁵⁸ that is to be used on capital account.

173 That this was so was effectively recognised by Ryan J at first instance when his Honour found that the funds which the respondent had raised by issuing the debentures were a permanent or long term addition to its funds¹⁵⁹.

174 The difference therefore, of \$36,353,254, does not, in my opinion, have the character of income according to ordinary notions of income or otherwise within the meaning of s 25 of the Act.

153 (1930) 44 CLR 24 at 28.

154 (1989) 23 FCR 435 at 440.

155 [1943] KB 671.

156 284 US 1 (1931).

157 291 US 426 (1934).

158 *Sun Newspapers Ltd and Associated Newspapers Ltd v Federal Commissioner of Taxation* (1938) 61 CLR 337 at 359 per Dixon J; see also *Commissioner of Taxation v Energy Resources* (1996) 70 ALJR 629 at 631; 137 ALR 18 at 20 per Dawson, Toohey, Gummow, McHugh and Kirby JJ.

159 See *Avco Financial Services Ltd v Federal Commissioner of Taxation* (1982) 150 CLR 510 at 517-518, 527; *The Commonwealth v Northern Land Council* (1993) 176 CLR 604 at 663-664.

Did the respondent make a profit from the carrying out of a profit-making undertaking or scheme within the meaning of s 25A(1) of the Act?

175 Ryan J at first instance found that the respondent's entry into the Principal Assumption Agreement was, for it, a novel initiative, undertaken to overcome the defective trust deeds and to avail itself of more flexible methods of financing capital expansion which had emerged by 1986.

176 It is however, going too far, to hold, as his Honour did, that the purpose of making a profit was a purpose that, "underlay, and was an integral part of the whole transaction"¹⁶⁰. What the evidence of intention showed was that according to conventional business concepts, the respondent certainly did not intend to be worse off financially if it could help it, by paying a very substantial capital sum in 1986 which would be matched over time by the sum of future repayments of borrowings of greater face value, but in the money of the day of each such repayment. Neither that intention nor the fact that in internal documents the difference of \$36,353,254, or other amounts variously calculated and taking into account the incidence of income tax, may have been described as profit, leads inevitably to a conclusion that the difference is a profit arising from the carrying out of a profit-making undertaking or scheme.

177 Here the raising of funds by the issue of debentures long predated the entry into the Principal Assumption Agreement. There was, unlike what occurred in *Myer Emporium*, no interdependence between, or contemporaneity with, the raising of funds by the issuing of the debentures and the entry into the Principal Assumption Agreement.

178 In these circumstances, there was no scheme or undertaking within the meaning of s 25A(1) of the Act.

Were the respondent's rights under the Principal Assumption Agreement an asset to which Part III of the Act applied and whether, if they were an asset, MMBW's performance of its obligations constituted a disposal of that asset by the respondent?

179 Section 160A of the Act at the relevant time provided:

"In this Part, unless the contrary intention appears, 'asset' means any form of property and includes -

- (a) an option, a debt, a chose in action, any other right, goodwill and any other form of incorporeal property;

¹⁶⁰ (1994) 125 ALR 63 at 81.

65.

- (b) currency of a foreign country; and
- (c) any form of property created or constructed, or otherwise coming to be owned without being acquired,

but does not include a motor vehicle of a kind mentioned in paragraph 82AF(2)(a)."

180 The appellant contends that the rights of the respondent under the Principal Assumption Agreement are an asset or assets within the meaning of s 160A. The real test, the only test, the appellant puts, is whether the right is inherently capable in law of assignment. The appellant's case was that there was no legal impediment to the assignment of the respondent's rights to enforce MMBW's obligations to redeem the debentures: furthermore that there was a potential "market" for those rights, the debenture holders themselves. Sundberg J (dissenting) in the Full Court of the Federal Court accepted all of these propositions. Circumstances in which the debenture holders might wish to purchase the respondent's rights under the Principal Assumption Agreement are foreseeable: for example, a decline in the fortunes of the respondent against whom the debenture holders' rights ultimately lie; or the possible cessation of business by the respondent in Australia. I agree that the rights were assignable and constituted an asset within the meaning of s 160A.

181 Because of the conclusion which I have reached, that the relevant rights were assignable and therefore proprietary in character, it is unnecessary for me to decide whether in any circumstances a personal right can be an "asset" for the purposes of s 160A.

182 In argument, various cases in which the nature of proprietary rights was discussed were drawn to our attention.

183 In *R v Toohey; Ex parte Meneling Station Pty Ltd*, Mason J, in construing the words "estate or interest" in the *Aboriginal Land Rights (Northern Territory) Act 1976* (Cth), was in no doubt that they meant in their ordinary and natural usage, a proprietary interest¹⁶¹. His Honour held that meaning was reinforced by the context in which the words appeared. In the course of his reasons, his Honour referred to a passage in the speech of Lord Wilberforce in *National Provincial Bank Ltd v Ainsworth*¹⁶²:

"Before a right or an interest can be admitted into the category of property, or of a right affecting property, it must be definable, identifiable by third

161 (1982) 158 CLR 327 at 342-343.

162 [1965] AC 1175 at 1247-1248.

parties, capable in its nature of assumption by third parties, and have some degree of permanence or stability."¹⁶³

184 Mason J was also influenced by the fact that the licence, propounded as an estate or interest by the prosecutor, was liable to cancellation by the Minister on three months notice, a factor which gave it an impermanence incompatible with a readily assignable right. But for this liability to cancellation, Wilson J, who was one of the majority in *R v Toohey*, might perhaps have found the licence to be an interest in land¹⁶⁴. Murphy J¹⁶⁵ agreed with the reasons of Wilson J. Gibbs CJ¹⁶⁶ agreed with the reasons of Mason J and Wilson J. Brennan J¹⁶⁷ agreed with Mason J with respect to the meaning of an "estate or interest".

185 In *Hepples v Commissioner of Taxation*¹⁶⁸, Gummow J carefully reviewed the authorities and analysed s 160A in its context. His Honour concluded that the section was concerned with proprietary rights only. In discussing the decision of McPherson J in *Bailey v Uniting Church in Australia Property Trust (Qld)*¹⁶⁹ Gummow J said this¹⁷⁰:

"In my view, what was said by McPherson J is consistent with the proposition in this case that whilst the expression 'any other right' is susceptible of meaning personal or proprietary right in its particular setting in the definition in s 160A, it is concerned only with proprietary rights. Further, those rights must exist at the time at which one asks, in applying the provisions of Pt IIIA, whether there was an 'asset'. So called 'future property' not yet acquired or in existence would not then be 'assets', nor would purely contingent interests which had not yet vested (whether in interest or in possession): cf *Commissioner of Stamp Duties (NSW) v Bryan*¹⁷¹."

163 (1982) 158 CLR 327 at 342.

164 (1982) 158 CLR 327 at 352-354.

165 (1982) 158 CLR 327 at 345.

166 (1982) 158 CLR 327 at 332.

167 (1982) 158 CLR 327 at 364.

168 (1990) 22 FCR 1 at 24-27.

169 [1984] 1 QdR 42.

170 (1990) 22 FCR 1 at 24.

171 (1989) 20 ATR 868 at 871-872.

186 Hill J in *Commissioner of Taxation v Cooling*, reached the same conclusion¹⁷²:

"Three points may be noted from the definition of 'assets' in s 160A. First, it is clear that the definition is expressed in wide terms and that the concept of 'asset' was intended to be comprehensive. Second, it is clear that the concept of 'asset' takes some colour from the context of the present legislation. An asset must be capable of disposition to give rise to a taxable gain. Prima facie, this suggests that when the Act speaks of an 'asset', what is comprehended is an item of property or an interest in property rather than rights of a non-proprietary kind: cf as to the comparable United Kingdom definition (s19(1) of the *Capital Gains Tax Act* 1979 (UK) ... and its predecessor, s 22(1) of the *Finance Act* 1965 (UK)); see *Kirby (Inspector of Taxes) v Thorn EMI Plc*¹⁷³; *O'Brien (Inspector of Taxes) v Benson's Hosiery (Holdings) Ltd*¹⁷⁴. The meaning of the expression 'disposal' and cognate terms must be explored to confirm whether this prima facie view is to be accepted. Third, the words 'any other right' and the words 'any other form of incorporeal property' in par (a) of the definition suggest that, in that paragraph at least it is only proprietary rights and interests that are included within the definition of 'asset': cf *Commissioner of Stamp Duties (NSW) v Yeend*¹⁷⁵."

187 As persuasive as this reasoning is, and leaving aside all of the problems that might be associated with realising and valuing a personal right, I would not for myself wish to be taken as holding that s 160A should be construed for all times and in all cases as necessarily confining an asset to a proprietary right or interest. It is unnecessary for me to make such a determination in this case because I have formed the view that the rights of the respondent under the Principal Assumption Agreement are proprietary ones. They clearly meet the criteria for such stated by Lord Wilberforce in *National Provincial Bank Ltd v Ainsworth* and accepted by this Court in *R v Toohey*.

Has there been a change of ownership of the "asset" so that Capital Gains Tax is payable?

188 The final question is whether a change has occurred in the ownership of the "asset" within the meaning of s 160M of the Act.

172 (1990) 22 FCR 42 at 59.

173 [1988] 1 WLR 445; [1988] 2 All ER 947.

174 [1980] AC 562.

175 (1929) 43 CLR 235 at 241, 244-245.

189 That section at the relevant time provided:

- "(1) Subject to this Part, where a change has occurred in the ownership of an asset, the change shall be deemed, for the purposes of this Part, to have effected a disposal of the asset by the person who owned it immediately before the change and an acquisition of the asset by the person who owned it immediately after the change.
- (2) A reference in sub-section (1) to a change in the ownership of an asset is a reference to a change that has occurred in any way, including any of the following ways:
 - (a) by the execution of an instrument;
 - (b) by the entering into of a transaction;
 - (c) by the transmission of the asset by operation of law;
 - (d) by the delivery of the asset;
 - (e) by the doing of any other act or thing;
 - (f) by the occurrence of any event.
- (3) Without limiting the generality of sub-section (2), a change shall be taken to have occurred in the ownership of an asset by:
 - (a) a declaration of trust in relation to the asset under which the beneficiary is absolutely entitled to the asset as against the trustee;
 - (b) in the case of an asset being a debt, a chose in action or any other right, or an interest or right in or over property – the cancellation, release, discharge, satisfaction, surrender, forfeiture, expiry or abandonment, at law or in equity, of the asset;
 - (c) in the case of an asset being a share in or debenture of a company – the redemption in whole or in part, or the cancellation, of the share or debenture; or
 - (d) subject to sub-section (4), a transaction in relation to the asset under which the use and enjoyment of the asset was or is obtained by a person for a period at the end of which the title to the asset will or may pass to that person.
- (4) A change shall not be taken to have occurred in the ownership of an asset by a transaction referred to in paragraph (3)(d) if the period for

which the person referred to in that paragraph has the use and enjoyment of the asset terminates without the title to the asset passing to that person and nothing in section 170 prevents the amendment of an assessment for the purpose of giving effect to this sub-section.

...

- (6) A disposal of an asset that did not exist (either by itself or as part of another asset) before the disposal, but is created by the disposal, constitutes a disposal of the asset for the purposes of this Part, but the person who so disposes of the asset shall be deemed not to have paid or given any consideration, or incurred any costs or expenditure, referred to in paragraph 160ZH(1)(a), (b), (c) or (d), (2)(a), (b), (c) or (d) or (3)(a), (b), (c) or (d) in respect of the asset.
- (7) Without limiting the generality of sub-section (2) but subject to the other provisions of this Part, where –
 - (a) an act or transaction has taken place in relation to an asset or an event affecting an asset has occurred; and
 - (b) a person has received, or is entitled to receive, an amount of money or other consideration by reason of the act, transaction or event (whether or not any asset was or will be acquired by the person paying the money or giving the other consideration) including, but not limited to, an amount of money or other consideration –
 - (i) in the case of an asset being a right – in return for forfeiture or surrender of the right or for refraining from exercising the right; or
 - (ii) for use or exploitation of the asset,

the act, transaction or event constitutes a disposal by the person who received, or is entitled to receive, the money or other consideration of an asset created by the disposal and, for the purposes of the application of this Part in relation to that disposal –

- (c) the money or other consideration constitutes the consideration in respect of the disposal; and
- (d) the person shall be deemed not to have paid or given any consideration, or incurred any costs or expenditure, referred to in paragraph 160ZH(1)(a), (b), (c) or (d), (2)(a), (b), (c) or (d) or (3)(a), (b), (c) or (d) in respect of the asset.

..."

190 The section defines a change in ownership of an asset, as the cancellation, release, discharge, satisfaction, surrender, forfeiture, expiry or abandonment, at law or in equity, of the asset¹⁷⁶.

191 Ryan J at first instance was of the view that this language extended to the performance of a contractual obligation: that the performance of an obligee's obligation or the payment of a debtor's debt could constitute an extinguishment within the meaning of the section.

192 Whilst it must be accepted that s 160M may apply to situations in which an asset or right may cease to exist after its release, discharge, or satisfaction, the language of the section is not, in my opinion, apt for the performance by a party of that party's obligations under an agreement of the kind entered into here. I say this notwithstanding the wide meaning dictionaries give to the word "discharge", and indeed, "satisfaction", and the use of the expression "discharge" by performance in the law of contract. However, as expansive as the language of the section is¹⁷⁷, it omits the words which I think would be needed if it were to be applicable here, "[discharge] by performance".

193 It is also relevant to this issue that the respondent remained personally liable to the debenture holders. Up until MMBW's performance of each of its obligations under the Principal Assumption Agreement there was, and is, a possibility, albeit a remote one, that the respondent might be called upon to repay each group of bond holders then entitled to repayment. Moreover, a construction that treated performance here as a discharge, satisfaction or disposition for the purposes of the Act could give rise to the prospect that the completion of ordinary executory contracts might render a party thereto liable to capital gains tax. For those reasons I would hold that no change of ownership within the meaning of s 160M has occurred and therefore no capital gains tax is payable.

194 I would dismiss the appeals with costs.

176 s 160M(3)(b).

177 s 160M(3)(b).