HIGH COURT OF AUSTRALIA

GLEESON CJ,
GAUDRON, GUMMOW, KIRBY AND CALLINAN JJ

KATHLEEN FAYE STEELE APPELLANT

AND

DEPUTY COMMISSIONER OF TAXATION RESPONDENT

Steele v Deputy Commissioner of Taxation (P30-1998) [1999] HCA 7
4 March 1999

ORDER

1. *Appeal allowed.*

2. *Set aside the order of the Full Court of the Federal Court made on 18 March 1997. In lieu thereof, order that the appeal to that Court be allowed.*

3. *Set aside the orders of R D Nicholson J made on 29 January 1996, except in so far as they relate to the question of penalty.*

4. *Set aside the decision of the Administrative Appeals Tribunal made on 4 March 1994.*

5. *Remit the matter to the Administrative Appeals Tribunal for a rehearing of the appellant's appeal against the disallowance of her objection with or without the hearing of further evidence as the Tribunal may determine.*

6. *The respondent pay the appellant's costs of the appeal to this Court, of the appeal to the Full Court of the Federal Court, and of the proceedings before R D Nicholson J.*

On appeal from the Federal Court of Australia

Representation:

J McCusker QC with R K O'Connor QC and C T Gollow for the appellant (instructed by Ilbery Barblett)

R L Le Miere QC with J D Allanson and L B Price for the respondent (instructed by Australian Government Solicitor)

CATCHWORDS

Steele v Deputy Commissioner of Taxation

Taxation and revenue – Income tax – Interest paid on loan for purpose of purchasing land intended for commercial development – Deductions – Interest on borrowed moneys – Losses or outgoings of a capital nature or incurred in gaining assessable income – Temporal relationship between incurred outgoing and receipt of income – *Income Tax Assessment Act* 1936 (Cth) s 51 (1).

Words and phrases – "The assessable income" – "Outgoings of a capital nature".

1 GLEESON CJ, GAUDRON AND GUMMOW JJ. The principal issue in this appeal concerns the deductibility, for income tax purposes, of interest where the borrowed money has been used to purchase and hold a capital asset intended to be developed for income-producing purposes.

2 In respect of the year of income ending 30 June 1987, the appellant claimed but was denied a deduction for interest, and certain other relatively minor outgoings, under s 51(1) of the *Income Tax Assessment Act* 1936 (Cth) ("the Act"). An objection by the appellant to the respondent's assessment was disallowed. The other outgoings were rates and rents. It is common ground that the decision in relation to the interest will apply equally to those other amounts. The disallowance by the respondent of the appellant's objection to the assessment was referred to the Administrative Appeals Tribunal ("the Tribunal") pursuant to s 187 of the Act. The respondent's decision was substantially upheld, although it was varied in certain respects. An appeal to the Federal Court was dismissed by R D Nicholson J[1]. The appellant appealed to the Full Court of the Federal Court which, by majority (Burchett and Ryan JJ; Carr J dissenting) dismissed her appeal[2].

3 The facts may be summarised as follows.

4 For a number of years before 1980 the appellant had been engaged, both as an owner of businesses and in a managerial capacity, in the catering and hospitality industry. In 1980, having recently sold a business, she was looking for a new opportunity. She observed that a property near Perth Airport, named "Tibradden", was for sale. The area of the property was 7.4 hectares. The land was being used for purposes associated with horse racing. The improvements on the land included twelve brick stables, horse exercise paddocks, feed preparation rooms, a training ring, a breaking-in ring, and two houses. They were in good condition. The appellant investigated the possibility of using Tibradden for agistment and as a site for motel development. She was informed that zoning would not be a problem. She also made enquiries about some adjoining land, owned by a public authority, which was leased by the company which owned Tibradden.

5 In December 1980 the appellant contracted to purchase the property for $1 million. A deposit of $5,000 was paid. A further payment of $95,000 was to be made on 8 January 1981. The balance of $900,000 was to be paid on 8 January 1982. The contract of sale obliged the appellant to pay interest on the unpaid

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1 *Steele v Federal Commissioner of Taxation* (1996) 31 ATR 510; 96 ATC 4131.

2 *Steele v Commissioner of Taxation* (1997) 73 FCR 330.

purchase money from 16 December 1980. The appellant took possession on 18 December 1980.

6 The interest in dispute in these proceedings was interest paid to the vendor on the unpaid balance of purchase money, and on moneys owing to a finance company and, later, a bank, on the security of Tibradden. The issue between the appellant and the taxation authorities formally arose in relation to her assessment to income tax in respect of the year ended 30 June 1987. She claimed deductions amounting to $909,649 in respect of losses said to have been incurred in that year and in each of the six previous years. The losses were said to have arisen mainly from the interest payments and, to a minor extent, the rates and rents, referred to above.

7 From December 1980 until the time she sold her remaining interest in the property, the only business conducted on the property was that of agisting horses. At the same time, the appellant pursued, actively and in a variety of ways, the possibility of using the land for motel and residential development.

8 In July 1981 the appellant engaged a firm of architects to prepare schematic designs for 80 townhouses. The proposal was described as "Residential Development with Community Facilities, Restaurant, Office Accommodation, Recreation Sports and Riding". She also entered into negotiations with Mr Williams, a business associate who was the managing director of a construction company, for a possible joint development of the property. In December 1981 the appellant and Mr Williams, having received engineering advice, applied to the local council for planning approval in respect of the construction of 40 units of motel-style accommodation, including administration and restaurant facilities, together with 110 free-standing units which could be either self-contained or serviced from the motel administration centre. The application was refused on grounds related to zoning and sewerage requirements. In January 1982 the appellant sold half of her interest in Tibradden to Mr Williams for $650,000. There was a collateral agreement which required Mr Williams to pay a specified additional sum "if the project proceeds to profitable completion".

9 In January 1982 a further application was made to the local council, and the development was approved in principle. Later in that year a new architect was engaged, and a revised motel development plan, including livestock stables and a yearling sales complex, was prepared, and was approved by the council. The appellant and Mr Williams completed the purchase of Tibradden and took title in accordance with the contract. In 1982, and during 1983, they negotiated with Southern Pacific Hotel Corporation Ltd for the sale to that company of an interest in, and management rights over, the proposed motel. Those negotiations ultimately fell through. In 1984 the taxpayer and Mr Williams fell into dispute about the project. This resulted in litigation, and an order of the Supreme Court of

Western Australia for partition or sale of the property. The property went to auction in December 1986. The appellant was the successful bidder. In May 1987 she sold a half interest, and she sold her remaining half interest some eighteen months later.

10 While these things were going on, the land was being used for the commercial agistment of horses. The income derived from that activity was modest. The Tribunal accepted as approximate estimates of the appellant's one half share in such income figures which amounted in total, from 1981 to 1987, to $28,943.

11 The Tribunal made the following finding as to the appellant's purpose in acquiring Tibradden:

> "We accept that in 1979, [the appellant], having sold her business, was looking round for an investment which would provide her a good income. However, we reject [her] assertion that her equestrian interests played any role in her initial search. Indeed, we are satisfied that when she discovered that Tibradden was on the market, her interests were focused on its commercial possibilities as a motel site, and the fact that the property was presently used for agisting horses was merely fortuitous. We therefore accept as accurate – and accurately reflecting [her] intention – the answer she gave … as to how she intended to use Tibradden, viz: 'my intention was to build a motel and operate it by myself. It was my belief that another motel business in that area would be profitable, given the proximity to the airport and the city'. The fact that Tibradden was used for agistment purposes was thus a lucky coincidence – lucky in the sense that it coincided both with her own interests, as well as contributing, however modestly, to the holding costs whilst the motel plans were being developed. It also provided accommodation and an occupation for [her] sister."

12 The manner in which those findings are expressed appears to reflect an emphasis placed by the appellant's counsel on certain aspects of the facts which was rather different from the emphasis placed in this Court. It reflects, and responds to, an argumentative suggestion that what was important in securing the deductibility of the interest was the income-earning activity involved in the agistment business. That is not the way the case was put in this Court.

13 The Tribunal also pointed out that, when the appellant purchased Tibradden, she had not undertaken any feasibility studies, or costing, of the development of the site. Exactly what such development would involve, how much it might cost, who might join her in the enterprise, and what might be done if development proved to be commercially unattractive or impractical, remained to be considered. One estimate of development costs later received was of the order of $9.7 million.

These considerations were regarded as of relevance to the concept of "commitment", to which further reference will be made below.

14 The Tribunal summarised the appellant's purposes, in language which assumed particular significance in the Federal Court, as follows:

> "The [appellant] incurred interest on a loan to secure 'Tibradden' for a dual purpose, one to derive assessable income from the agistment activities – an affair of revenue – and the other to develop a profit-yielding structure of a future business enterprise – an affair of capital."

15 On that basis, the Tribunal concluded that there should be an apportionment of the interest and other outgoings, the appellant being allowed a deduction in an amount equal to her share of agistment income and being denied a deduction in respect of the rest, which was the greater part.

16 At first instance in the Federal Court, R D Nicholson J substantially upheld the Tribunal's decision, although he allowed the appeal in so far as it related to penalty tax, which is no longer in issue.

17 Section 51(1) of the Act at the relevant times provided:

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

18 The appellant argued that the interest was an outgoing wholly incurred in gaining or producing the assessable income referred to in the first part of the provision, and that it was not to any extent an outgoing of capital or of a capital nature. The majority in the Full Court of the Federal Court held that the interest was an outgoing of a capital nature, and on that ground rejected the appellant's claim. In this Court the respondent supported that conclusion but argued, alternatively, that the first limb of s 51(1) was not satisfied, and that it was unnecessary to rely upon the exception.

An outgoing of a capital nature?

19 It was common ground in this Court that the question whether the interest incurred by the appellant was an outgoing of a capital nature is a question of law. This is of significance, because the appeal to the Federal Court from the Tribunal was brought under s 44 of the *Administrative Appeals Tribunal Act* 1975 (Cth) and was "on a question of law". In the Full Court of the Federal Court, the majority decided that the dispute between the parties should be resolved, adversely to the appellant, upon this issue of law. It was also common ground that the facts as summarised above, including the Tribunal's findings as to the appellant's purpose in acquiring Tibradden, were to be accepted as the facts on which the question of law was to be decided.

20 It is not in dispute that the interest incurred by the appellant related to borrowings (or deferred payments) wholly used to purchase and hold a capital asset, Tibradden. Nor is it in dispute that the appellant's purpose in acquiring Tibradden was entirely commercial; she intended to develop it and use it for the purpose of gaining or producing assessable income. The majority in the Full Court of the Federal Court held that, since the advantage sought by the payment of interest was the acquisition of a capital asset, that determined the character of the payments, subject to one qualification which, in the events that occurred, never became relevant. The qualification was expressed as follows[3]:

> "Had the project proceeded and a motel been opened, of course, that advantage would then have been achieved; and if the loan had not been paid off, but had been continued, the advantage thereafter sought by further payments of interest would have been the continued availability of the sum borrowed to support from period to period the use of the capital asset in income-gaining activities."

21 This reasoning was regarded as being supported by the decision of the Privy Council, on an appeal from the Court of Appeal of Hong Kong, in *Wharf Properties Ltd v Commissioner of Inland Revenue*[4]. It will be necessary to examine that decision, but reference should first be made to Australian authorities bearing upon the question.

22 Three preliminary matters should be noted. The first is an established principle as to the meaning and effect of s 51(1), which is of direct relevance to the second main issue on the appeal, but which is also of indirect relevance to this

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3 (1997) 73 FCR 330 at 342.

4 [1997] AC 505.

first issue. It concerns the meaning of the expression "the assessable income" in the first limb of s 51(1). The principle is not in dispute. It was summarised in *Fletcher v Federal Commissioner of Taxation*[5] as follows:

> "[A] point to be made about s 51(1) is that the reference in it to '*the* assessable income' is not to be read as confined to assessable income actually derived in the particular tax year. It is to be construed as an abstract phrase which refers not only to assessable income derived in that or in some other tax year but also to assessable income which the relevant outgoing 'would be expected to produce'…
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> …
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> It has also been said that the test of deductibility under the first limb of s 51(1) is that 'it is both sufficient and necessary that the occasion of the loss or outgoing should be found in whatever is productive of the assessable income or, if none be produced, would be expected to produce assessable income'."

23 The legislative history together with the background of judicial interpretation, was examined in *Ronpibon Tin NL v Federal Commissioner of Taxation*[6]. The principle stated above has been recognised and applied in many decisions of this Court[7].

24 The second matter to be noted is that it only becomes necessary to consider the exceptions to s 51(1) if it has already been concluded, or accepted by hypothesis, that one or other of the positive limbs applies. Leaving aside the agistment income, which was not relied upon in this Court to support the deductibility of other than a small part of the interest, the present case was not said to fall within the second limb of s 51(1). However, it is not difficult to imagine examples of property development, and pre-construction liability for interest, which would fall within that limb, and which could give rise to an issue as to the

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5 (1991) 173 CLR 1 at 16-17.

6 (1949) 78 CLR 47 at 55-57.

7 eg *Moffatt v Webb* (1913) 16 CLR 120; *Amalgamated Zinc (De Bavay's) Ltd v Federal Commissioner of Taxation* (1935) 54 CLR 295 at 309-311; *Ash v Federal Commissioner of Taxation* (1938) 61 CLR 263 at 271; *Federal Commissioner of Taxation v Snowden & Willson Pty Ltd* (1958) 99 CLR 431 at 436; *John Fairfax & Sons Pty Ltd v Federal Commissioner of Taxation* (1959) 101 CLR 30 at 35, 46; *Commissioner of Taxation v Finn* (1961) 106 CLR 60 at 68; *AGC Advances Ltd v Federal Commissioner of Taxation* (1975) 132 CLR 175 at 185.

application of the same exception as is presently under consideration. The present appeal was argued on the basis that it was the first limb that was relevant. Thus, the question is whether interest outgoings which, by hypothesis, were incurred in gaining or producing assessable income, in the sense outlined above, were outgoings of a capital nature. The majority in the Full Court of the Federal Court did not find it necessary to make a decision as to the validity of the hypothesis. That would have involved an issue of fact and the subject-matter of the "appeal" to the Federal Court was limited to "a question of law". However, they indicated that they were favourably inclined towards the arguments advanced by the appellant on the point. It was submitted in this Court that, in their reasoning as to the application of the exception, the majority failed to recognise the full significance of the hypothesis. As will appear, that turned upon the existence of a connection implicit in the phrase "*in* gaining or producing the assessable income". That requirement is not to be disregarded in considering whether the interest was an outgoing of a capital nature.

25 The third matter concerns the qualification, quoted above, by which the Full Court expressed the opinion that the interest paid by the appellant would have ceased to be capital in nature, and would have been on revenue account, if and when a motel had been built on the land and had commenced to produce income. There are some problems involved in this reasoning. The interest in question was on funds borrowed (including deferred instalments of purchase price) to fund the acquisition and holding of real estate. Tibradden was, and would have remained, a capital asset, even if, as a consequence of a motel development, (presumably funded by further borrowings), it had become income-producing. There would have been no change in the purpose of the original borrowing. A capital asset was acquired for the purpose of gaining or producing assessable income. If it were otherwise, the first limb of s 51(1) would not have been satisfied, and the exception would not have arisen for consideration. The immediate purpose of the borrowing, and the application of the borrowed funds, was, and would have remained, the acquisition of a capital asset. In so far as the ultimate objective was to use the capital asset in the gaining or production of assessable income, that objective was there from the beginning. This is not a case in which real estate was acquired by a purchaser who had a number of alternative possible uses in mind, some of an income-producing nature and others of a different nature. The finding of fact was that the appellant's intention was to build a motel and conduct a profitable motel business. That is why she bought the land. It is not clear how it can be said that the purpose of the borrowing would change when, at some unspecified time, her original intention in acquiring the land came closer to fulfilment. To use the words of the Tribunal, Tibradden was acquired by the appellant as "an investment which would provide her a good income". The Full Court's view was that the character of the interest paid on moneys borrowed to purchase that investment would change either once it commenced to produce income or perhaps at some unidentified

earlier stage. However, the nature of the investment, which was in commercial real estate, remained, and would remain, constant.

26 In *Texas Co (Australasia) Ltd v Federal Commissioner of Taxation*[8] Dixon J said:

> "Some kinds of recurrent expenditure made to secure capital or working capital are clearly deductible. Under the Australian system interest on money borrowed for the purpose forms a deduction. So does the rent of premises and the hire of plant."

27 The reference to "the Australian system" may have been intended to contrast the position in the United Kingdom, where what fell to tax were the profits of a business activity, rather than taxable income calculated as assessable income less allowable deductions as defined in s 51(1) and its precursor[9]. An example of the difference between the British and Australian systems is provided by *The European Investment Trust Co Ltd v Jackson*[10], a case decided eight years before Dixon J's observation, where Finlay J said[11] that in the British system it was "thoroughly well established by a long line of cases that [interest] is not deductible if it is in truth the interest on capital". In that case a distinction was drawn between a sum expended in order to earn profits, which formed a valid deduction in arriving at the profits, and a sum expended to obtain capital. That has never been the critical distinction in Australia. In *Federal Commissioner of Taxation v Ilbery*[12] Toohey J, with whom Northrop and Sheppard JJ agreed, noted[13], without disapproval, the generalisation that "[i]nterest on moneys which are borrowed for the purpose of acquiring an income-producing asset is deductible under s 51(1)" and recorded[14] the Commissioner's concession that "so long as the … property was held for an income-producing purpose, interest paid on a loan to acquire that property was deductible under s 51." Such generalisations may require qualification in particular cases, but they fairly reflect the ordinary position referred to by Dixon

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8 (1940) 63 CLR 382 at 468.

9 cf *Anglo-Continental Guano Works v Bell* (1894) 3 TC 239.

10 (1932) 18 TC 1.

11 (1932) 18 TC 1 at 9.

12 (1981) 38 ALR 172.

13 (1981) 38 ALR 172 at 177.

14 (1981) 38 ALR 172 at 181.

J. Because of the issue that has arisen in the present case, it is necessary to examine why that is so, having regard to the language of s 51(1).

28 The present case does not raise problems, of the kind that have been considered elsewhere, relating to pre-payment of interest, or payment of interest, between the parties not at arm's length, at a non-commercial rate. Here interest was paid on ordinary commercial terms for the use of money expended to acquire and hold Tibradden. The case was decided in the Tribunal, and in the Federal Court, and argued on both sides in this Court, on the footing that there was no material difference between the interest paid to the vendor on the unpaid balance of purchase moneys and the interest paid to the finance company and later to the bank. It was all treated as interest on money borrowed for the purpose of purchasing and holding Tibradden.

29 As was explained in *Australian National Hotels Ltd v Commissioner of Taxation*[15], interest is ordinarily a recurrent or periodic payment which secures, not an enduring advantage, but, rather, the use of borrowed money during the term of the loan. According to the criteria noted by Dixon J in *Sun Newspapers Ltd v Federal Commissioner of Taxation*[16] it is therefore ordinarily a revenue item. This is not to deny the possibility that there may be particular circumstances where it is proper to regard the purpose of interest payments as something other than the raising or maintenance of the borrowing and thus, potentially, of a capital nature[17]. However, in the usual case, of which the present is an example, where interest is a recurrent payment to secure the use for a limited term of loan funds, then it is proper to regard the interest as a revenue item, and its character is not altered by reason of the fact that the borrowed funds are used to purchase a capital asset. The fact that the asset has not yet become, and may never become, income-producing may be relevant to a decision as to whether the case falls within the first limb of s 51(1). However, once it is determined, or accepted by hypothesis, that the interest is, during the relevant year, an outgoing incurred in gaining or producing the taxpayer's assessable income, (even though no assessable income is derived during that year, and no such income may ever be derived), the circumstance that the capital asset has produced no income is not a reason to conclude that the interest is an outgoing of a capital nature.

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15 (1988) 19 FCR 234 at 239-241 per Bowen CJ and Burchett J.

16 (1938) 61 CLR 337 at 359-363.

17 See, for example, Parsons, *Income Taxation in Australia*, (1985) at par 6.111.

30 The decision in *Travelodge Papua New Guinea Ltd v Chief Collector of Taxes*[18], which held that interest paid on borrowed funds during the construction of a new hotel, even though it had been capitalised in the taxpayer's accounts, was nevertheless deductible under the equivalent of s 51(1)[19], was in accordance with Australian authority.

31 The decision of the Judicial Committee of the Privy Council in *Wharf Properties Ltd v Commissioner of Inland Revenue*[20] turned upon legislation which may well have been regarded as materially different from the Australian legislation. It does not represent the law in Australia. That case concerned a taxpayer which acquired real estate intending eventually to redevelop it to produce rental income. The taxpayer incurred interest on funds borrowed for the purpose of the acquisition. The Inland Revenue Ordinance of Hong Kong followed the British scheme of bringing to tax the profits of a particular period. In ascertaining the taxable profits, outgoings and expenses were deductible to the extent to which they were incurred during the basis period in the production of profits in respect of which the taxpayer was chargeable to tax for any period. Their Lordships declined to hear argument upon whether that condition was satisfied. They decided the case against the taxpayer on the basis that it fell within an exception covering expenditure of a capital nature.

32 Lord Hoffmann, delivering the judgment, said[21]:

> "Thus, while the question of whether money is intended to be used for a capital or revenue purpose is inconclusive as to whether its receipt is a revenue receipt or an addition to the company's capital, the purpose of the loan during the period for which the interest payment was made is critical to whether it counts as a capital or revenue expense. In the present case, during the whole of the two years in question, the loan was clearly being applied for the purpose of acquiring and creating a capital asset rather than holding it as an income-producing investment. It follows that the interest was being expended for a capital purpose."

33 The three preliminary matters referred to earlier are all relevant to this reasoning, or, more accurately, to its application to the Australian legislation. In particular, the distinction between acquiring a capital asset and holding it as an

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18 (1985) 16 ATR 867; 85 ATC 4432.

19 *Income Tax Assessment Act* 1981 (PNG), s 68.

20 [1997] AC 505.

21 [1997] AC 505 at 512.

income-producing investment, which may be related to the concept of calculating the profits of a business activity, is not one upon which the Australian legislation turns.

34 The majority in the Full Court of the Federal Court erred in deciding the case against the appellant upon the ground that the interest was an outgoing of a capital nature.

35 However, the respondent seeks to support the decision against the appellant on the basis that the first limb of s 51(1) was not satisfied. That gives rise to the second main issue in the appeal.

The first limb of s 51(1)

36 Leaving to one side the matter of the agistment income, the Tribunal decided against the appellant, in respect of the bulk of the interest payments, substantially upon the ground that the first limb of s 51(1) was not satisfied. However, as Carr J pointed out in the Full Court of the Federal Court[22], the Tribunal's reasoning in that respect was substantially influenced by the notion that, whereas deriving assessable income from agistment activities was "an affair of revenue", developing a profit-yielding structure of a future business enterprise was "an affair of capital".

37 R D Nicholson J, at first instance in the Federal Court, decided that it was open to the Tribunal to conclude that the first limb of s 51(1) was not satisfied. He said[23]:

> "An outgoing may be precluded from deductibility if it is incurred at a point too soon before the commencement of the business or income producing activity.
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> The evidence showed that existing zoning did not permit the motel complex development. The applicant had made informal and preliminary inquiries about zoning, road closure and sewerage connection. The identity of the project varied. Initially townhouse units were included as strata units for investor purchase. A half interest was acquired in the property on 8 January 1982. In October 1982 the applicant approached Southern Pacific Hotels to take an equity interest in the project but the agreement was not

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22 (1997) 73 FCR 330 at 362.

23 (1996) 31 ATR 510 at 518-519; 96 ATC 4131 at 4138-4139.

> carried through. [Further facts as summarised above were mentioned]. Finance for the motel complex, as distinguished from the purchase of the land, was never obtained. In my opinion the evidence relied upon for the respondent in this respect fully entitled the tribunal to conclude that there was an insufficiency of connection [to satisfy the first limb of s 51(1)], so that it did not err in law in reaching that conclusion."

38 In the Full Court of the Federal Court, Burchett and Ryan JJ were critical of the reasoning of the Tribunal on the first limb of s 51(1). They took issue with statements to the effect that there were too many contingencies to say with any certainty that income would ever be derived from the project and that the appellant's aim was never more than an idea or hope. Their Honours observed that there does not have to be certainty that an endeavour will be crowned with success in order to justify a deduction under s 51(1)[24]. They also referred to the evidence as to the efforts which the appellant made to achieve her original objective. Referring to a suggestion of a relevant lack of "commitment" they said[25]:

> "These matters, of course, raise questions of fact; but it appears to us there is much to be said for the proposition that the Tribunal's own findings of fact … suggest it was not open to the Tribunal to find in this case a relevant lack of commitment."

39 However, they found it unnecessary to express a conclusion as to whether the Tribunal's reasoning involved an error of law, because they went on to decide the case against the appellant upon the basis that the interest was an outgoing of a capital nature.

40 Carr J decided the appeal in favour of the appellant. He was satisfied that the reasoning of the Tribunal on the application of the first limb of s 51(1) was affected by errors of law and he proposed that the case should be remitted to the Tribunal for reconsideration of the application of the first limb of s 51(1). In that respect, Carr J acknowledged that the ultimate issue was one of fact, and he accepted that, even if the Federal Court came to the conclusion that the decision of the Tribunal involved legal error, nevertheless, it was not in a position to substitute its own findings as to the application of the first limb for those of the Tribunal.

41 Carr J said that the Tribunal had moved too quickly from the premise that the purpose of the loan funds borrowed by the appellant was to acquire a capital asset

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24 *John Fairfax & Sons Pty Ltd v Federal Commissioner of Taxation* (1959) 101 CLR 30 at 49.

25 (1997) 73 FCR 330 at 336.

to the conclusion that there was not the necessary connection between the interest outgoing and the gaining or producing of assessable income. In that context, Carr J raised a consideration which did not appear to have been taken into account either by the Tribunal or by the other members of the Federal Court who had dealt with the case. He pointed out that it was extremely difficult to envisage any use of the property within the contemplation of the appellant which would not have produced assessable income. If the appellant had gone ahead with her plans to develop a motel complex then that would have produced assessable income. If, on the other hand, she had decided not to go ahead with the development, perhaps because it was too expensive, or because she could not find a suitable partner, then her only apparent alternative was to resell the land, or her interest in it. As things turned out, that is what happened. Having regard to the original purpose for which she acquired the land, Carr J said, any profit on a resale would have constituted assessable income. He considered that from the time the appellant acquired the land she had embarked on a profit-making undertaking or scheme. In those circumstances, the appellant's operations, were, in his view, sufficiently linked to the derivation of assessable income to be capable of falling within the first limb of s 51(1).

42 Carr J concluded[26]:

> "In my view, the matter should be remitted to the Tribunal for it to consider the appellant's business activities as a whole from the time of acquisition of 'Tibradden' to its disposal. In doing so, it should not focus on the horse agistment business for the purposes of contrasting it with the appellant's main objective. The appellant is entitled to have all of her activities taken into account as a whole. In my opinion, an important part of those activities was her purpose and plan to construct 80 town houses for resale to investors. Any profit so realised would have to have been assessable income. Furthermore, the indications are that income was also to be generated from the management of those town houses after such sale. The uncontested evidence points to a conclusion that the appellant's intention at all times in entering into the various transactions was to make a profit or gain."

43 In deciding whether, in the present case, the interest was an outgoing "incurred *in* gaining or producing the assessable income", it is unnecessary to become involved in seeking to distinguish between the purpose of the taxpayer in borrowing the money and the use to which the borrowed funds were put[27]. The

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26 (1997) 73 FCR 330 at 365.

27 cf *Commissioner of Taxation v Roberts* (1992) 37 FCR 246 at 255 per Hill J.

respondent accepts the principle, referred to above, that an outgoing may qualify for deduction even though no assessable income to which the outgoing is shown to be "incidental and relevant"[28] is gained or produced in the year in which the outgoing is incurred, or at all. Bearing in mind that the assessable income referred to is the assessable income of the taxpayer generally, it seems difficult to deny the relevance of the outgoing presently in question.

44 There are cases where the necessary connection between the incurring of an outgoing and the gaining or producing of assessable income has been denied upon the ground that the outgoing was "entirely preliminary" to the gaining or producing of assessable income[29] or was incurred "too soon" before the commencement of the business or income producing activity[30]. The temporal relationship between the incurring of an outgoing and the actual or projected receipt of income may be one of a number of facts relevant to a judgment as to whether the necessary connection might, in a given case, exist, but contemporaneity is not legally essential, and whether it is factually important may depend upon the circumstances of the particular case.

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28 *Ronpibon Tin NL v Federal Commissioner of Taxation* (1949) 78 CLR 47 at 56.

29 eg *Softwood Pulp and Paper Ltd v Federal Commissioner of Taxation* (1976) 7 ATR 101 at 113; 76 ATC 4439 at 4450.

30 *Federal Commissioner of Taxation v Maddalena* (1971) 45 ALJR 426; *Lodge v Federal Commissioner of Taxation* (1972) 128 CLR 171; cf *Commissioner of Taxation (Cth) v Riverside Road Lodge Pty Ltd (In Liq)* (1990) 23 FCR 305.

45 As Lockhart J said in *Federal Commissioner of Taxation v Total Holdings (Aust) Pty Ltd*[31]:

> "[I]f a taxpayer incurs a recurrent liability for interest for the purpose of furthering his present or prospective income-producing activities, whether those activities are properly characterized as the carrying on of a business or not, generally the payment by him of that interest will be an allowable deduction under s 51.
>
> …
>
> I say 'generally' as some qualification may be necessary in appropriate cases, for instance, where interest is paid by a taxpayer as a prelude to his being in a position whereby he may commence to derive income. In such cases the requirement that the expenditure be incidental and relevant to the derivation of income may not be satisfied."

46 This is consistent with cases which have decided that a taxpayer may be entitled to a deduction after a business has ceased, provided the occasion of a business outgoing is to be found in the business operations directed towards the gaining or production of assessable income generally[32]. However, cessation of business may be of factual importance[33].

47 The respondent placed reliance upon the concept of commitment as an aid to the formation of a factual judgment, in a case such as the present, as to the sufficiency of the relevant connection between outgoing and income. The utility of that concept may vary with the circumstances of individual cases. The views of the majority in the Full Court of the Federal Court on the question are set out above. The present is not a case in which the appellant had in contemplation a variety of alternative possible uses of Tibradden, some of an income-producing nature and others not. There was no suggestion, for example, that she ever contemplated using the property for private or domestic purposes. That was never an option. As Carr J pointed out, whilst she was not financially committed to a motel development, and had not decided upon any particular development, she does not

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31 (1979) 24 ALR 401 at 406.

32 *AGC (Advances) Ltd v Federal Commissioner of Taxation* (1975) 132 CLR 175; *Placer Pacific Management Pty Ltd v Federal Commissioner of Taxation* (1995) 31 ATR 253; 95 ATC 4459.

33 *Inglis v Federal Commissioner of Taxation* (1979) 28 ALR 425.

appear to have envisaged any use of or dealing with the property other than one which would produce assessable income.

48 The criticisms made by all the members of the Full Court of the Federal Court of the reasoning of the Tribunal upon the application of the first limb of s 51(1) are valid, and Carr J was correct to conclude that such reasoning involved errors of law.

49 However, the resolution of the issue ultimately involves a judgment of fact, even though questions of law are involved[34]. This means that the course proposed by Carr J, of remitting the matter to the Tribunal, is appropriate[35]. This is not a case where, on the evidence, only one conclusion would be open to the Tribunal.

Orders

50 The following orders should be made. The appeal should be allowed. The orders of the Full Court of the Federal Court should be set aside. In lieu thereof, the appeal to the Full Court of the Federal Court should be allowed and the orders of R D Nicholson J, except in so far as they related to the matter of penalty, should be set aside. The decision of the Tribunal should be set aside. The matter should be remitted to the Tribunal for further hearing. It will be a matter for the Tribunal whether, if any application is made to it in that regard, either party should be permitted to lead further evidence on that rehearing. The respondent should pay the appellant's costs of the appeal to this Court, of the appeal to the Full Court of the Federal Court, and of the proceedings before R D Nicholson J.

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34 cf *Federal Commissioner of Taxation v Roberts* (1992) 37 FCR 246 at 251.

35 As in *Fletcher v Federal Commissioner of Taxation* (1991) 173 CLR 1 at 24-25.

51 KIRBY J. The decision of the Full Court of the Federal Court of Australia[36], from which this appeal comes, caused a certain amount of consternation when it was published[37]. The opinion was expressed that the treatment of interest deductions required by the decision was in conflict with more than 50 years of case law[38]. And that it even challenged the understandings of that law held by the Commissioner of Taxation (the Commissioner) who was obliged, as a consequence, to withdraw a number of his rulings[39]. The Full Court decision was denounced as "heresy"[40].

52 When fresh eyes are focused on a statutory text, it sometimes happens that new insights are secured. Assumptions, long accepted, when placed under a judicial microscope, are found to be wanting[41]. Those regularly engaged in the application of legislation such as the *Income Tax Assessment Act* 1936 (Cth)

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36 *Steele v Commissioner of Taxation* (1997) 73 FCR 330 (Burchett and Ryan JJ, Carr J dissenting).

37 See eg Lehmann and Southon, "Can interest have a capital nature? - The heresy in *Steele's* case - Part 1", (1997) 40 *Weekly Tax Bulletin* [1095]; Part 2, (1997) 41 *Weekly Tax Bulletin* [1136]; Part 3, (1997) 42 *Weekly Tax Bulletin* [1174]; Part 4, (1997) 43 *Weekly Tax Bulletin* [1207]; Pane and Andreyev, "The deductibility of interest post *ERA* and *Steele*", (1997) 26 *Weekly Tax Bulletin* [658]; D'Ascenzo, "Deductibility of Interest - *Steele's Case*", (1998) *Asia-Pacific Tax Bulletin* 132. The Law Council of Australia, exceptionally, sought leave to appear as amicus curiae and referred to the "novelty of the principle" upheld by the Full Court and the "uncertainty now prevailing".

38 Lehmann and Southon, "Can interest have a capital nature? - The heresy in *Steele's* case - Part 1", (1997) 40 *Weekly Tax Bulletin* [1095].

39 Taxation Ruling IT 166 (Interest on money borrowed to acquire an income producing asset); Taxation Ruling IT 2374 (Loss from rental property before being leased); Taxation Ruling IT 2461 (Deductibility of outgoings incurred before income derived from undeveloped land).

40 Lehmann and Southon, "Can interest have a capital nature? - The heresy in *Steele's* case - Part 1", (1997) 40 *Weekly Tax Bulletin* [1095] at 919.

41 A dramatic example affecting the Constitution was *R v Kirby; Ex parte Boilermakers' Society of Australia* (1956) 94 CLR 254. In *Grace Brothers Pty Ltd v The Commonwealth* (1946) 72 CLR 269 at 289, Dixon J remarked: "Time does not run in favour of the validity of legislation. If it is *ultra vires*, it cannot gain legal strength from long failure on the part of lawyers to perceive and set up its invalidity." Outside the field of constitutional law, see eg *Scobie v K D Welding Co Pty Ltd* (1959) 103 CLR 314; *Zickar v MGH Plastic Industries Pty Ltd* (1996) 187 CLR 310; *Rathborne v Abel* (1964) 38 ALJR 293; [1965] ALR 545.

(the Act) enjoy the advantage of affectionate familiarity with its terms. But it is no more than a statute enacted by the Parliament. It is to be construed, as every statute must, in accordance with its purpose as disclosed in its language. Decisional authority provides necessary guidance, not least because of the complexity and size of the Act, the subtlety of some of its concepts and the high desirability that its application should be clear and predictable, without the need for undue litigation in the huge number of cases to which it is applied. But when an appeal comes, there is no substitute for a study of the legislative language and purpose.

53 At the risk of intruding a jarring note into the response to the appeal (and the critics) I am obliged by my opinion to offer a dissenting view from that reached by the majority of this Court. I can derive a measure of comfort from Bertrand Russell's assurance that every advance in civilisation has been denounced as unnatural while it was recent[42]. I am also reassured by the fact that my dissenting view is harmonious with the recent unanimous judgment of the Privy Council in *Wharf Properties Ltd v Commissioner of Inland Revenue*[43].

The facts

54 Most of the facts relevant to my opinion are set out in the reasons of Gleeson CJ, Gaudron and Gummow JJ. Mrs Kathleen Steele (the taxpayer) contests the decision of the Commissioner to disallow, as a deduction against her assessable income of later years, the interest payments on borrowings to acquire a property known as "Tibradden", together with rates and a small sum of other expenses – in all, $909,649. The taxpayer unsuccessfully challenged this decision, originally before the Administrative Appeals Tribunal (the Tribunal) and then before a single judge of the Federal Court[44]. Her appeal to the Full Court was dismissed by majority. However, on the issue which was determinative for the majority in that court (as it is for me), the dissentient specifically stated that there was "no point of legal principle expressed in [the majority's] reasons with which I would disagree"[45]. His disagreement rested on a conclusion that the Tribunal had not "correctly applied those principles to the facts of this matter"[46]. Similarly, he did

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42 "An Outline of Intellectual Rubbish" in *Unpopular Essays* (1950).

43 [1997] AC 505.

44 See *Steele v Federal Commissioner of Taxation* (1996) 31 ATR 510; 96 ATC 4131 (R D Nicholson J).

45 *Steele* (1997) 73 FCR 330 at 365 per Carr J.

46 *Steele* (1997) 73 FCR 330 at 365.

not disagree with the judgment of the Privy Council in *Wharf Properties*. He distinguished it "on the facts"[47].

55 Certain points about the facts need to be emphasised. When the taxpayer purchased "Tibradden", the zoning of the land forbade the kind of development necessary to permit the achievement of her general objective. The enquiries which she made about the possibility of rezoning before she purchased the property produced nothing more than the somewhat vague statement, from someone on the Council of the local government authority concerned, that "there probably would not be a problem in getting it rezoned". Any future development of the land for the motel and townhouse complex which the taxpayer envisaged would have required road closures and sewerage connections, none of which was ever commenced.

56 The Tribunal found that the taxpayer did not have any specific plan in mind as to how the investment might be made profitable. All that she had was "an idea, at best, to develop a motel to be managed by herself"[48]. Her plans were never finalised. Project finance was never obtained. During 1982, the taxpayer approached a hotel chain to purchase an equity in the project and to manage her proposed hotel. It agreed to do so but this agreement was not carried through. In the following year, the taxpayer and the managing director of a construction company, Mr Williams, made an agreement with Malaysian investors for the formation of a company which would purchase the property and build a motel. This agreement was also never performed. After March 1984, the taxpayer made no attempt whatever to proceed with any development. As the majority observed in the Full Court, the "idea" which she formulated may not have warranted the "more flamboyant language" by which one member of the Tribunal described it[49]. By the same token, as a matter of practicality, the motel development project never went very far at all beyond the "idea" which the Tribunal found, even if it did rise to more than just "a fond hope".

57 Certainly, the "idea" never came within range of the reality of producing income to offset the huge deductions for interest from the taxpayer's taxable income which she claimed. Her "idea" may well have continued percolating in her conscious and subconscious mind from the first moment she saw "Tibradden" until

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47 *Steele* (1997) 73 FCR 330 at 365.

48 *Kathleen Fay Steele v Commissioner of Taxation* unreported, Administrative Appeals Tribunal, 4 March 1994 at 29 (constituted by Dr P Gerber (Deputy President) and Messrs R D Fayle and S D Hotop (Senior Members)).

49 The Tribunal described the "motel development [as] no more than a fond hope", and commented: "It is … not enough to come within sub-sec 51(1) to buy some land and announce to the world 'I have a dream'". Cited *Steele* (1997) 73 FCR 330 at 336.

her last interest in that property was sold. But, as found by the Tribunal (and as the objective facts indicate) it was a somewhat desultory tale of apparently unenthusiastic and ultimately fruitless endeavours to convert the "idea" into an income producing asset.

58 The Act, properly construed, may require that the large deduction for interest incurred to keep the taxpayer's "idea" afloat be allowed, although there was no relevant income from it[50] and very little real or effective endeavour to secure such income. But it is not a result to which one feels otherwise compelled by the apparent merits of the taxpayer's claim. That fact does not deny the taxpayer success. But it does concentrate the mind on the legal basis of her claim.

The Act and the issues

59 The only safe approach to the taxpayer's claim, and thus to the appeal, is to be found in an analysis of the applicable statutory provisions. Relevantly, in relation to the year of income in question, the Act read[51]:

> "51(1) All losses and outgoings to the extent to which they are incurred in gaining or producing the assessable income … shall be allowable deductions except to the extent to which they are losses or outgoings of capital, or of a capital, private or domestic nature …".

60 The provision appears under the heading "Losses and Outgoings". It provides "allowable deductions", ie from the income which would otherwise be liable to tax under the Act.

61 Two grounds of disallowance of the taxpayer's claim were relied on by the Commissioner. The first was that the first limb of s 51(1) was not satisfied, in that the "losses and outgoings" for interest, claimed as deductions, were not (save for the trivial agistment income undoubtedly earned from the property) "incurred in gaining or producing the assessable income". The Tribunal upheld the Commissioner's contention in this regard. The primary judge in the Federal Court found that the Tribunal's conclusion was open to it[52]. In the Full Court, the majority, whilst offering various criticisms of the reasoning of the Tribunal, did not finally resolve the application of the first limb of s 51(1)[53]. Instead, their

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50 There was a very small income from the continuing agistment activities on the property which may be disregarded for this purpose.

51 See now s 51(1AA).

52 *Steele v Federal Commissioner of Taxation* (1996) 31 ATR 510 at 519; 96 ATC 4131 at 4139 per R D Nicholson J.

53 *Steele* (1997) 73 FCR 330 at 336 per Burchett and Ryan JJ.

Honours turned to the second head of the Commissioner's argument which, they held, was sufficient to sustain the primary judge's order rejecting the deduction claimed. The second argument rests on the proposition that, to the extent to which the "losses and outgoings" were incurred by the taxpayer, they were "losses or outgoings …of a capital … nature" and thus not allowable.

62 Although I incline to the view that no error of law was shown in the conclusion of the Tribunal, and of the primary judge, that the "losses and outgoings" claimed as deductions were not "incurred in gaining or producing the assessable income", it is unnecessary for me (as it was for the Full Court) to determine that issue if the taxpayer is bound to fail on the "capital … nature" question. Because in my view she is, I will confine myself to that question, particularly because my opinion is a minority one whose value, if any, lies only in its appeal to the future.

63 The issue for decision is effectively, whether the Full Court erred in concluding that the "losses and outgoings", in the form of the taxpayer's large interest bill, was "of a capital … nature". In my view, the Full Court did not err. The majority judges were right to hold as they did.

"[O]f a capital … nature": general propositions

64 A number of general propositions assist in resolving the problem presented by the exception to deductibility which the Commissioner successfully invoked in the Full Court:

65 First, as with any task of statutory construction, the starting point for anyone applying the Act to the facts of the case is to understand the meaning of the sub-section, read in its context and for the purpose for which the Parliament enacted it, and in particular the exception which is critical[54]. The Act is not to be approached in a way antagonistic, or favourable, to the Commissioner or the taxpayer. To understand the deductions that are allowed by s 51(1) it is important to appreciate the place of the sub-section in the overall scheme of the Act. Sometimes it is useful to go back to such basics.

66 Relevantly, the Act levies tax on a taxpayer's assessable income[55]. It permits "losses and outgoings" as "allowable deductions". But it only does so, relevantly,

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54 *Bropho v Western Australia* (1990) 171 CLR 1 at 20; *Kingston v Keprose Pty Ltd* (1987) 11 NSWLR 404 at 421-424; *Newcastle City Council v GIO General Ltd* (1997) 191 CLR 85 at 109-110; *James Hardie & Coy Pty Ltd v Seltsam Pty Ltd* (1998) 73 ALJR 238 at 252-253; 159 ALR 268 at 287-289.

55 The framework of Australian income tax legislation is such that assessable income is taken as a base and from it are deducted all allowable deductions: ss 6(1) and 48.

(Footnote continues on next page)

"to the extent to which they are incurred in gaining or producing the assessable income". Even then, it provides an exception, relevantly, to the extent to which the "losses and outgoings" are "of a capital … nature".

67 It is sometimes hazardous to specify the purpose of provisions of the Act, because of the complex terms in which this legislation is often expressed. But s 51(1) is a central provision of the Australian system of taxation. It is relatively simple and conceptual in its expression. Its overall purpose seems clear enough. It represents, in a sense, an accommodation between the taxpayer's legitimate claim to allowable deductions where and to the extent to which, the losses or outgoings in question were incurred in gaining or producing the assessable income upon which tax may be levied. Behind this part of the sub-section lies an acknowledgment by the Parliament that it is just that such "losses and outgoings" should be deducted from the income brought to tax. In part, this idea rests upon a notion that the income of the taxpayer may then, or in the foreseeable future, be diminished by the losses or outgoings concerned. In part, it represents a *quid pro quo* afforded by the Parliament to the taxpayer. It says, in effect: if you incur "losses and outgoings … in gaining or producing the assessable income" upon which we can levy tax, we (the community) will allow you (the taxpayer) deductions to that extent. We will do so out of recognition that, without the expenditures which constitute such "losses and outgoings", the taxpayer's assessable income might well be lessened and could even be non-existent.

68 A series of decisions of this Court demonstrate that a precise coincidence between the gaining of the assessable income and the incurring of "losses and outgoings" is not required[56]. Instant returns upon investments are not always the reward of the entrepreneur. Sometimes there is no reward at all. But that is not to say that a link between the fact of the one and the possibility of the other is totally

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Assessable income includes gross income according to ordinary concepts, gains which may not be "income", such as net capital gains (s 160ZO), specifically made assessable and some "deemed income" amounts, less amounts defined as "exempt income": s 23. The net result after deducting "allowable deductions" is "taxable income" which is subject to tax at rates declared by the Parliament: s 17. Section 51(1) is the generic provision allowing deductions providing a basis for the deduction from assessable income of most business related revenue expenditure.

56 See eg *Commissioner of Taxation (NSW) v Ash* (1938) 61 CLR 263 at 271; *Ronpibon Tin NL and Tongkah Compound NL v Federal Commissioner of Taxation* (1949) 78 CLR 47 at 56-57; *Federal Commissioner of Taxation v Snowden & Willson Pty Ltd* (1958) 99 CLR 431 at 436; *John Fairfax & Sons Pty Ltd v Federal Commissioner of Taxation* (1959) 101 CLR 30 at 35, 46; *Commissioner of Taxation v Finn* (1961) 106 CLR 60 at 68; *AGC (Advances) Ltd v Federal Commissioner of Taxation* (1975) 132 CLR 175 at 185; *Inglis v Federal Commissioner of Taxation* (1979) 28 ALR 425 at 427-428; *Fletcher v Federal Commissioner of Taxation* (1991) 173 CLR 1 at 16.

irrelevant. The words "to the extent to which" contradict a complete divorce between the two. The word "in" also suggests the necessity of a connection between the "losses and outgoings" in question and the real possibility of "assessable income". Further, the very notion of "allowable deductions", so described, suggests a relationship of some kind between the "losses and outgoings" in question and "the assessable income". The exception must be given meaning in that statutory context.

69 By the clear authority of this Court, the exception applies even where the taxpayer has been able to satisfy both of the positive limbs of s 51(1) which precede the exception. As Dixon CJ observed in *John Fairfax & Sons Pty Ltd v Federal Commissioner of Taxation*[57]:

> "Perhaps the most important thing to notice in sub-s (1) is the character of the phrase 'except to the extent to which they are losses or outgoings of capital, or of a capital nature'. Its character is that of an exception which necessarily presupposes the possibility of the subject matter excepted falling under the description that precedes it. In other words it is supposed by the sub-section that a loss or outgoing incurred in gaining or producing the assessable income or in carrying on a business for that purpose may nevertheless be a loss or outgoing of capital."

70 It must therefore be contemplated that cases will exist where the "losses and outgoings" in question have been specifically and exclusively incurred "in gaining or producing the assessable income" yet are not allowable. The reference in the exception to "outgoings of capital, or of a capital … nature" suggests that the purpose of denying the taxpayer the deduction in such circumstances rests on the footing that losses or outgoings of such a character are to be classified as insufficiently warranting the deduction. The enumeration of such losses or outgoings with those of a "private" or "domestic" nature suggests a legislative judgment that in such cases, despite the contribution which the losses and outgoings may have made to the actual gaining or producing of the assessable income, they are still to be classified, relevantly, as for the benefit of the taxpayer alone, and therefore denied deductibility.

71 Secondly, there is no point in complaining about the exception or the uncertainties which its application is said to cause for the decision of whether particular losses or outgoings are "of a capital … nature" or not. That is what the Act provides. The provision must be given effect. It necessitates a task familiar to every lawyer, and I venture to suggest to every accountant and tax agent. After all, characterisation of payments as being of an "income" or "capital" nature is not new. Judges and other commentators have been complaining about this distinction

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57 (1959) 101 CLR 30 at 34.

for more than a century. In *Inland Revenue Commissioners v British Salmson Aero Engines, Ltd*, Sir Wilfrid Greene MR, after a review of much authority, observed[58]:

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

72 To like effect were the comments of Starke J in this Court in *Hallstroms Pty Ltd v Federal Commissioner of Taxation*[59]. In *BP Australia Ltd v Federal Commissioner of Taxation*[60], Lord Pearce, delivering the judgment of the Privy Council in an Australian appeal involving a dispute over allowable deductions under s 51 of the Act, described the process of reasoning which is required:

> "The solution to the problem is not to be found by any rigid test or description. It has to be derived from many aspects of the whole set of circumstances some of which may point in one direction, some in the other. One consideration may point so clearly that it dominates other and vaguer indications in the contrary direction. It is a commonsense appreciation of all the guiding features which must provide the ultimate answer. Although the categories of capital and income expenditure are distinct and easily ascertainable in obvious cases that lie far from the boundary, the line of distinction is often hard to draw in border line cases; and conflicting considerations may produce a situation where the answer turns on questions of emphasis and degree. That answer 'depends on what the expenditure is calculated to effect from a practical and business point of view, rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process' (per *Dixon J* in *Hallstrom's* Case[61]). As each new case comes to be argued felicitous phrases from earlier judgments are used in argument by one side and the other. But those phrases are not the deciding factor, nor are they of unlimited application. They merely crystallize particular features which may incline the scale in a particular case after a balance of all the considerations has been taken."

The exception to s 51(1) has largely escaped a reasoned analysis. However, as I shall show, in *Federal Commissioner of Taxation v Energy Resources of Australia*

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58 [1938] 2 KB 482 at 498.

59 (1946) 72 CLR 634 at 644.

60 (1965) 112 CLR 386 at 397.

61 (1946) 72 CLR 634 at 648.

Ltd[62] this Court brought into focus the capital/revenue distinction found in this limb of s 51(1).

73 Thirdly, the suggestion that, of its very nature, the payment of interest is of an "income" character and not "of a capital … nature" is totally inconsistent, with the foregoing authority. It is also inconsistent with the recognition by this Court that, for some circumstances, interest may take on the characteristic of capital - not, of course, in the hands of the recipient (for whom it will be income) but in the hands of the payer[63]. Whatever criticisms exist of the analysis of *Munro* in the Full Court[64], by reference to the statutory regime applicable in 1926[65], the basic principle cannot be gainsaid. It is a simple matter of statutory law. Interest may certainly be a loss or outgoing within s 51(1). Whether it is of a capital or non-capital nature depends upon the facts of the particular case. No hard and fast, and certainly no absolute, rule can be adopted. This is because, as a matter of law, the Act denies such a possibility. Convenient and congenial as absolute rules are for those who live their lives in the company of the Act, they are fundamentally incompatible with the task of characterisation which the exception in the Act calls forth. Necessarily, that task requires evaluation and judgment of each particular loss and outgoing, including where it is in the form of interest and where it is propounded as an allowable deduction.

74 Where the Commissioner suggests that, in the particular circumstances, the interest payment, although undoubtedly a loss or outgoing to the taxpayer, is "of a capital … nature" it is therefore no valid answer to that proposition to assert, as the taxpayer did, that all interest payments, of their essence, are non-capital in nature. Such a proposition may have been accepted or assumed in earlier cases. It may have been assumed by the Commissioner in his earlier rulings. It may even have provided a false foundation for particular provisions of the Act[66], drafted and enacted upon an assumption about the universal character of interest. But that assumption simply will not stand with the legal characterisation which the exception to s 51(1) requires. The common likelihood that, in most circumstances, interest payments will not be characterised as capital in nature cannot deny the possibility that, in particular circumstances they can, and should be so classified.

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62 (1996) 185 CLR 66.

63 *Federal Commissioner of Taxation v Munro; British Imperial Oil Co Ltd v Federal Commissioner of Taxation* (1926) 38 CLR 153 at 197-198.

64 See eg Lehmann and Southon, "Can interest have a capital nature? - The heresy in *Steele's* case - Part 3", (1997) 42 *Weekly Tax Bulletin* [1174] at 981-982.

65 *Income Tax Assessment Act* 1922 (Cth).

66 See the Act, s 160ZH(6A).

75 Fourthly, to throw light on the interest payments claimed as an allowable deduction in this case, it is useful to have regard to what this Court said in its recent and unanimous decision in *Federal Commissioner of Taxation v Energy Resources of Australia Ltd*[67]. That case concerned not interest but promissory notes expressed in United States dollars, issued at a discount to the face value. The Court said[68]:

> "Where a taxpayer incurs loss or expense in raising funds by issuing promissory notes at a discount to their face value, its entitlement to a s 51 deduction for that loss or expense depends on the use to which the funds are to be put[69]. If the funds are to be used as working capital, the cost of the discounts will be deductible as a revenue expense[70]. If the funds are to be used to strengthen 'the business entity, structure, or organisation set up or established for the earning of profit'[71], the cost of the discounts will generally not be deductible because they will be a capital, and not a revenue, expense[72]. But sometimes the raising of capital may be such a recurrent event in the business life of a taxpayer that the cost of raising the capital will qualify as a revenue expense[73]. As Dixon J pointed out in *Texas Co (Australasia) Ltd v*

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67 (1996) 185 CLR 66.

68 (1996) 185 CLR 66 at 73-74.

69 *Federal Commissioner of Taxation v Munro; British Imperial Oil Co Ltd v Federal Commissioner of Taxation* (1926) 38 CLR 153 at 197; *Commercial & General Acceptance Ltd v Federal Commissioner of Taxation* (1977) 137 CLR 373 at 384; *Ure v Federal Commissioner of Taxation* (1981) 34 ALR 237; *Fletcher v Federal Commissioner of Taxation* (1991) 173 CLR 1 at 19.

70 *Crawford v Federal Commissioner of Taxation* (1993) 27 ATR 326; 93 ATC 5234; *Coles Myer Finance Ltd v Federal Commissioner of Taxation* (1993) 176 CLR 640 at 664-665, 668-669.

71 *Sun Newspapers Ltd and Associated Newspapers Ltd v Federal Commissioner of Taxation* (1938) 61 CLR 337 at 359.

72 cf *Federal Commissioner of Taxation v Hunter Douglas Ltd* (1983) 50 ALR 97; *Associated Minerals Consolidated Ltd v Federal Commissioner of Taxation* (1994) 53 FCR 115 at 117-118.

73 *Australian National Hotels Ltd v Federal Commissioner of Taxation* (1988) 19 FCR 234 at 239-241.

Federal Commissioner of Taxation[74]: 'Some kinds of recurrent expenditure made to secure capital or working capital are clearly deductible.'"

76 In *Energy Resources*, in the Federal Court, the primary judge[75] and a majority in the Full Court[76] concluded that the funds were raised for the purpose of strengthening the capital structure of the business and not to finance its day to day operations. This Court acknowledged that "[a]t first sight" that proposition was "strongly arguable". But the Court was not prepared to go behind the Commissioner's acceptance that the cost of the discounts was a revenue expense and therefore an allowable deduction. The issue now presented is different in two respects. Here, the Commissioner (perhaps encouraged by the analysis in the *Energy Resources* case) contests the application of the positive limbs of s 51(1). He also asserts the application of the exception. Whilst discount expense is not the same as an interest expense, there are obvious analogies. Each is a cost of raising finance. So far as commercial substance is concerned, interest on capital raised by way of loan (as in the present case) is not relevantly different from "losses and outgoings" incurred on a bill acceptance facility (as considered in *Energy Resources*)[77]. If, therefore, interest on borrowed funds is used to strengthen "the business entity, structure, or organisation set up or established for the earning of profit", the logic of *Energy Resources* suggests that it should receive the same taxation treatment as discount expenses incurred in the same circumstances. Periodicity of payment and the recurrence of expenditure do not provide a universal differentiating criterion to exclude interest payments from characterisation as "of a capital … nature". Wages may certainly be "of a capital … nature"[78] although liability to pay them is typically, if not invariably, recurrent[79].

77 Fifthly, the result of this analysis is that, if a capital asset is not being used to produce the assessable income, although it is accepted that the taxpayer has the intention to use it in that way at some uncertain time in the future, expenditure

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74 (1940) 63 CLR 382 at 468.

75 *Energy Resources of Australia Ltd v Federal Commissioner of Taxation* (1994) 28 ATR 67; 94 ATC 4225 per Davies J.

76 *Federal Commissioner of Taxation v Energy Resources of Australia Ltd* (1994) 54 FCR 25 per Beaumont and Gummow JJ.

77 *Crawford v Federal Commissioner of Taxation* (1993) 27 ATR 326 at 334.

78 *Sun Newspapers Ltd and Associated Newspapers Ltd v Federal Commissioner of Taxation* (1938) 61 CLR 337 at 362-363; *Mount Isa Mines Ltd v Federal Commissioner of Taxation* (1992) 176 CLR 141 at 148.

79 *Goodman Fielder Wattie Ltd v Commissioner of Taxation* (1991) 29 FCR 376 at 394.

which is incurred in connection with the capital asset itself may be liable to characterisation as being "of a capital … nature" and thus not an allowable deduction[80]. In some cases, interest payments have been held to be "of a capital … nature"[81]. Given the absence of absolutes and the requirement, in each case, to characterise the particular "losses and outgoings" against the disqualifying exception provided by the Act, there is no reason to doubt the correctness of these decisions. There is every reason to conclude that they were correct. Interest payments made in the context of current income gaining activities[82] can be readily distinguished from interest payments made in relation to the acquisition or creation of a capital asset which the taxpayer has the "idea", rising to a sufficient "intention", later to utilise in income gaining activity, if only a myriad of obstacles can be overcome.

78 Thus, interest on a loan taken out to finance the acquisition of assets purchased with a view to the eventual conduct of a business may be incurred too early to be on revenue account. At that stage, the hoped for income is too remote and the asset being created is then viewed as of a capital nature[83].

The reasoning in *Wharf Properties*

79 It is many years since the Privy Council has had the pleasure of labouring in the garden of s 51(1) of the Act, as Lord Pearce did in the *BP Australia* case[84]. However, in one of the last appeals from Hong Kong, their Lordships in *Wharf Properties*[85] had to consider a problem analogous to that arising in this appeal, which was presented by the Inland Revenue Ordinance (the Ordinance) of the Colony[86]. Critics of *Wharf Properties* and of the use which the majority in the Full

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80 *Inglis v Federal Commissioner of Taxation* (1979) 28 ALR 425 at 428-429. Note that the expenditures considered in that case included interest payments.

81 *Associated Minerals Consolidated Limited v Commissioner of Taxation* (1994) 53 FCR 115. See also *Temelli v Federal Commissioner of Taxation* (1997) 36 ATR 417; 97 ATC 4716; *Stamoulis v Federal Commissioner of Taxation* (1997) 37 ATR 326; 97 ATC 5051 per Ryan J.

82 As was the case in *Texas Co (Australasia) Ltd v Federal Commissioner of Taxation* (1940) 63 CLR 382 at 430.

83 *Stamoulis v Federal Commissioner of Taxation* (1997) 37 ATR 326 at 344; 97 ATC 5051 at 5068 per Ryan J.

84 (1965) 112 CLR 386.

85 [1997] AC 505.

86 Laws of Hong Kong, 1995 rev, c 112.

Court made of the reasoning of the Privy Council in that case, lay emphasis upon suggested distinctions between revenue law in England and the distinctive "Australian system"[87], so described by this Court. Whatever may be that distinction, valid for the applicability of other decisions on revenue law, the suggested point of differentiation has no validity in respect of the applicable provision of the Ordinance considered in *Wharf Properties.*

80 That was a case bearing certain factual similarities to this. In 1987 the taxpayer had agreed to buy a tram depot with the stated intention, eventually, to redevelop the site to produce rental income. Part of the purchase price was paid in 1987 and the balance in 1988. To fund the acquisition, the taxpayer took short term loans from banks and financial institutions to which the taxpayer incurred a liability to pay interest. For the financial years 1987-1988 and 1988-1989, the taxpayer claimed deductions from its income for the interest payments incurred and paid. In those years it derived trivial income from the site, prior to its development. The Commissioner of Inland Revenue disallowed the deductions. As in the present case, there were two asserted foundations for the disallowance. The first was that the interest payments fell outside s 16(1) of the Ordinance, the positive limb affording deductibility for expenses incurred for the purpose of producing taxable profits in future years. It is here that a suggested point of distinction between Hong Kong and Australian revenue law might arise. But this point was decided, both at first instance[88] and in the Hong Kong Court of Appeal[89] against the Commissioner. The Privy Council indicated their Lordships' unwillingness to interfere with these concurrent findings of fact[90]. That point was accordingly decided for the taxpayer. The Privy Council proceeded on the assumption that, prima facie, the interest was deductible under s 16(1)(a) of the Ordinance.

81 Their Lordships then turned to the exception provided by the Ordinance. This was relevantly indistinguishable from the exception provided in s 51(1) of the Act. It reads:

> "17(1) For the purpose of ascertaining profits in respect of which a person is chargeable to tax under this Part no deduction shall be allowed in respect of -

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87 See Dixon J in *Texas Co (Australasia) Ltd v Federal Commissioner of Taxation* (1940) 63 CLR 382 at 468.

88 *Wharf Properties* [1995] 1 HKLR 347 per Patrick Chan J.

89 *Wharf Properties (No 2)* [1995] 2 HKLR 552.

90 Noted [1997] AC 505 at 509.

…

(c) any expenditure of a capital nature or any loss or withdrawal of capital".

Except for the more imperative language of the Hong Kong Ordinance, the exclusion of deductibility is identical to that in the exception stated in s 51(1) of the Act. Nor is the scheme of the legislation relevantly different. A prima facie liability to bring taxable income ("profits") to tax is enacted[91]. A deduction for "outgoings and expenses" is then provided[92]. This later entitlement is then qualified by an exclusion from deductibility where the expenditure for which deduction is claimed is "of a capital nature"[93]. The argument that the Ordinance is distinguishable from s 51(1) of the Act in this respect is unconvincing. It should be rejected.

82 This Court is not bound, as it was in the days of the *BP Australia* case, to follow the authority of the Privy Council. However, where the logic of that court's reasons is compelling and the matter of statute or common law is relevant to our own situation, we are at liberty to adopt that reasoning. In my view, that is what this Court should do here. The majority in the Full Court was right to feel the force of the persuasiveness of the judgment in *Wharf Properties*[94]. So do I.

83 Lord Hoffmann, who gave the unanimous opinion of the Privy Council, rejected, as I have, the proposition that "interest [is] by definition a revenue payment and could not be anything else"[95]:

> "[T]his confuses the position of payer and recipient. It is true that in the hands of the recipient, interest will be either the earnings of capital advanced or, in some cases, additional income derived from trading in money. In either case, it will have the character of income. From the point of view of the payer, however, a payment of interest may be a capital or revenue expense, depending upon the purpose for which it was paid. The fact that it is income in the hands of the recipient and a recurring and periodic payment does not necessarily mean that it must be a revenue expense. Wages and rent are income in the hands of their recipients; periodic payments, in return for services or the use of land or chattels respectively. But whether such payments are of a capital or revenue nature depends on their purpose. The

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91 Ordinance, s 14.

92 Ordinance, s 16(1).

93 Ordinance, s 17(1)(c).

94 *Steele* (1997) 73 FCR 330 at 342.

95 *Wharf Properties* [1997] AC 505 at 511.

> wages of an electrician employed in the construction of a building by an owner who intends to retain the building as a capital investment are part of its capital cost. The wages of the same electrician employed by a construction company, or by the building owner in maintaining the building when it is completed and let, are a revenue expense."

84 The taxpayer complained that the examination of the purpose for which money was borrowed, in order to decide whether the interest was paid for a capital or non-capital (revenue) purpose, would involve inconvenience and uncertainty which the absolute rule propounded by it avoided. However, Lord Hoffmann indicated their Lordships' answer to that argument[96]:

> "Their Lordships agree with Litton V-P[97], that, on the contrary, there is no other way in which the nature of the interest payment can be discovered. The immediate consideration for each payment of interest is, of course, the use of money during the period in respect of which the interest has been paid, but since money is no more than a medium of exchange which may be expended for either capital or revenue purposes, the question can be answered only by ascertaining the purpose for which the loan was required during the relevant period."

85 The "derivative" nature of the characterisation of interest was explained in similar terms in *Ure v Federal Commissioner of Taxation*[98]:

> "In a case such as the present where the outgoing claimed as a deduction is interest paid on borrowed money, one cannot ordinarily look to the direct object or advantage which the outgoing was intended to achieve for the reason that that will ordinarily be the receipt of the borrowed money which is likely to be neutral in character. One must, of necessity, look more to the objects or advantages which the application and use of the borrowed money were intended to gain."

86 These observations make clear a point which the argument for the taxpayer before this Court overlooked. All capital, of its nature, has the potential to generate income. Yet it is not every expenditure on capital which contributes to the gaining or producing of the assessable income. Depending on the purpose, some such expenditures will be "of a capital ... nature". Where they are, they are no more allowable deductions under s 51(1) of the Act than they were held to be under the

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96 *Wharf Properties* [1997] AC 505 at 511.

97 [1995] 2 HKLR 552 at 562.

98 (1981) 34 ALR 237 at 249 per Deane and Sheppard JJ.

Hong Kong Ordinance. Their "nature" must be ascertained. When ascertained, it may forbid deductibility.

87 Lord Hoffmann addressed the problem, inherent in the ascertainment of the "nature" of the loss or outgoing concerned, that difficulties might be experienced in drawing the line between those "losses and outgoings" which are "of a capital ... nature" and those which are not. He offered a practical solution. Whilst admittedly lacking the certainty of an absolute rule it has the merit of legal integrity, compatibility with the hypothesis inherent in the nature of the characterisation required and sufficient predictability to make its application workable[99]:

> "Each payment of interest must be considered in relation to the purpose of the loan during the period for which the interest was paid. Once the asset has been acquired or created and is producing income, the interest is part of the cost of generating that income and therefore a revenue expense. In this respect their Lordships agree with the judgment of McMullin J in *Tai On Machinery Works Ltd v Commissioner of Inland Revenue*[100] and are unable to follow the reasoning by which the National Court of Papua New Guinea arrived at a contrary conclusion in *Travelodge Papua New Guinea Ltd v Chief Collector of Taxes*[101]."

88 In this Court, the taxpayer urged the merits of the decision in *Travelodge Papua New Guinea Ltd v Chief Collector of Taxes* and the rejection of the approach favoured in *Wharf Properties.* With all respect, I disagree. The Act posits that some "losses and outgoings", including some of which may be in the form of interest, will be "of a capital … nature". In such circumstances, no absolute rule is legally possible. Each loss and outgoing, including in the form of an interest payment, must be judged against the criterion of whether it is "of a capital … nature". To make that judgment no other course is available than to look to the purpose for which the particular payment is made at that stage of the taxpayer's investment. Whilst an exact correlation between the receipt of assessable income and the incurring of "losses and outgoings" (including interest) is not required by the Act, the more distant, nebulous, uncertain or unpromising the prospect of assessable income, the more likely it will be that the "losses and outgoings" (including interest payments) will be assigned to the classification "of a capital … nature".

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99 [1997] AC 505 at 513.

100 [1969] 1 HKTC 411.

101 (1985) 16 ATR 867; 85 ATC 4432.

89 That is how I see the scheme of s 51(1) of the Act operating. I believe that this view conforms more closely with the language and structure of the Act than does the appellant's proposition. In my respectful opinion, it also conforms more closely to common sense. It is more compatible with the treatment by this Court of the analogous problem which arose so recently in the *Energy Resources* case[102].

Conclusion and order

90 The majority in the Full Court were therefore correct. It was open to the Tribunal, on the facts which it found, to conclude that the "losses and outgoings" incurred by the taxpayer with respect to interest (even if "incurred in gaining or producing the assessable income") were "of a capital … nature" and thus excepted from the allowable deductions to which the taxpayer was entitled. It is unnecessary to go further. That conclusion sustains the decision of the Commissioner to disallow the deduction. It affirms the decision of the Tribunal upholding that opinion, the conclusion of the primary judge and the orders favoured by the majority in the Full Court.

91 I would dismiss the appeal with costs.

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102 cf D'Ascenzo, "Deductibility of Interest - *Steele's Case*", (1998) *Asia-Pacific Tax Bulletin* 132.

92 CALLINAN J. Inclusive of the application for special leave, there have been seven hearings before the Administrative Appeals Tribunal and courts in this matter. It is highly desirable that this case be brought to an end at this point, if that can, with propriety, be done. I am of the opinion that it can be.

93 I agree with the reasons for judgment of the majority (Gleeson CJ, Gaudron and Gummow JJ) except in one respect, and that is as to the disposition of the case at this point. Their Honours would allow the appeal and set aside the orders of the Full Court of the Federal Court. In lieu thereof they would order that the appeal to the Full Court of the Federal Court be allowed and the orders of R D Nicholson J (save those regarding penalty) should be set aside. The decision of the Tribunal also, should, according to the majority, be set aside and the matter remitted to the Tribunal for further hearing, leaving it to the Tribunal to decide whether either party should be permitted to lead further evidence on that rehearing. Consequential orders with respect to costs are also proposed by the majority.

94 In this Court the respondent sought to support the decisions against the appellant on the basis that the first limb of s 51(1) of the *Income Tax Assessment Act* 1936 (Cth) was not satisfied: that is to say, that the losses and outgoings in question were not, or had not been shown to have been, incurred in gaining or producing assessable income (actual or prospective). With respect to this argument the majority in this Court were of the opinion that the resolution of that issue ultimately involved a judgment of fact, even though questions of law might be involved and that accordingly the course proposed by Carr J (who dissented in the Full Court of the Federal Court) of remitting the matter to the Tribunal, was the appropriate course. Their Honours expressed the view that this is not a case where, on the evidence, only one conclusion would be open to the Tribunal. It is as to this last matter that I find myself in respectful disagreement with the majority.

95 There is no doubt that under the *Administrative Appeals Tribunal Act* 1975 (Cth) the Tribunal had jurisdiction to review the decision of the respondent in this case, and that that review could and would likely involve a review and a determination of factual matters. However, by s 44 of the Act, an appeal from a decision of the Tribunal lies on a question of law only. Sub-section 44(4) empowers the Federal Court to make such order as it thinks appropriate by reason of its decision. The Court may also make orders affirming or setting aside the decision of the Tribunal and an order remitting the case to be heard and decided again, either with, or without the hearing of further evidence by the Tribunal in accordance with the directions of the Court.

96 There has been controversy in Australia since the decision of the High Court in *Australian Broadcasting Tribunal v Bond*[103] as to the meaning of "error of law" when there is a question whether an appropriate factual substratum exists or not to

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103 (1990) 170 CLR 321.

support an ultimate legal conclusion[104]. What may be accepted is that if there is no evidence at all to support a finding of fact and therefore the ultimate conclusion upon which that finding depends, then error of law will have occurred. Not the same certainty can be expressed about a proposition that if evidence is entirely one way, a Tribunal must make a finding of fact in accordance with that evidence, and reach its decision solely upon the basis of it. It is open to a Tribunal (in what may well be exceptional cases only) to reject such evidence or simply not to be satisfied by it. This is not a case which falls within that latter category. In my opinion, this is a case in which the necessary factual substratum and all necessary findings of fact based upon it have been made.

97 As Burchett and Ryan JJ in the Full Court of the Federal Court said[105], perusal of the Tribunal's reasons shows the central conclusion to have been that the appellant intended to use the property, as she told a taxation officer, "to build a motel and operate it by myself".

98 Their Honours continued[106]:

> "The ability to recover a small part of the holding charges from agistment fees was merely an incidental advantage. The Tribunal accepted that these two matters constituted dual purposes of the acquisition, the 'main or dominant purpose' being 'to erect a motel upon the site' and 'any activity involving horses [being] subsidiary to her main purpose'."

99 Their Honours quoted in somewhat more detail some of the findings of the Tribunal[107]:

> "Her evidence makes it clear that she did not have any specific plan in mind as to how this investment might be made profitable; all that she had was an idea, at best, to develop a motel to be managed by herself. Her idea was that what she developed would produce income under her management.... The idea to develop the investment was not incompatible with the fact that there existed on the property an agistment business which, with virtually no effort on her part, could be continued at least until redevelopment commenced and would provide income. The purpose of the applicant in acquiring the property was therefore twofold – to obtain income from 'Tibradden' so long as that was convenient (the subsidiary purpose) and to develop the property

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104 See for example, Aronson and Dyer, *Judicial Review of Administrative Action*, (1996) at 273-289.

105 *Steele v Commissioner of Taxation* (1997) 73 FCR 330 at 334.

106 (1997) 73 FCR 330 at 334.

107 (1997) 73 FCR 330 at 334.

(the main purpose), an activity which would not of itself amount to a present purpose of gaining assessable income."

100 This last sentence can only be taken as an explicit finding that the appellant acquired the property in order to obtain income both before and after a redevelopment of it. The purpose was accordingly always a purpose of gaining assessable income. What the Tribunal thought however, was that, as a matter of law, unless the purpose could fairly readily and promptly be translated into effective action then the outgoings incurred would not be able to be treated as deductible outgoings within the meaning of s 51(1). This is apparent from the use of the word "present" in the reasons of the Tribunal. The word "present" is obviously misplaced in the sentence in which it is used. The sentence cannot be taken literally. In terms, it seeks to equate an activity with a purpose. It is clear that the relevant clause in it was intended to mean, and can only be read as meaning "an activity which would not presently produce assessable income". Such a construction is consistent with the approach of the Tribunal to the case generally.

101 In other words the Tribunal, whilst accepting that the appellant's intentions or purpose never changed throughout the period that she held the property seemed to think contemporaneity an essential requirement to deductibility under s 51(1).

102 Nothing that has been held at any level beyond the Tribunal with respect to factual matters is to any different an effect from the findings of the Tribunal that I have quoted and analyzed for their true meaning. R D Nicholson J[108] expressed the opinion that because the Tribunal sought to distinguish *Travelodge Papua New Guinea Ltd v Chief Collector of Taxes*[109], implicitly, they must have been of the view that the first limb of s 51(1) had not been satisfied. I do not read the Tribunal's findings in that way. Indeed, inexorably, a conclusion to a contrary effect does and must follow from the factual findings to which I refer in these reasons. They involved express findings with respect to the appellant's purposes. The appellant's intentions were always entirely commercial ones for the purpose of gaining or producing assessable income. As the majority here has also said, there was no suggestion that the appellant ever contemplated using the property for private or domestic purposes. That was never an option. Coupled with the continuing, indeed unaltered intentions of the appellant to develop the property over a period of three and one half years for an income producing complex, were numerous

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108 *Steele v Federal Commissioner of Taxation* (1996) 31 ATR 510 at 518-519; 96 ATC 4131 at 4138.

109 (1985) 16 ATR 867; 85 ATC 4432.

efforts to achieve that end, as the Tribunal has effectively found. Those efforts extended beyond efforts to determine whether to go into such a venture at all[110].

103 Carr J thought that the matter should be remitted to the Tribunal for reasons which his Honour developed in this passage[111]:

> "In my view, the matter should be remitted to the Tribunal for it to consider the appellant's business activities as a whole from the time of acquisition of 'Tibradden' to its disposal. In doing so, it should not focus on the horse agistment business for the purposes of contrasting it with the appellant's main objective. The appellant is entitled to have all of her activities taken into account as a whole. In my opinion, an important part of those activities was her purpose and plan to construct 80 town houses for resale to investors. Any profit so realised would have to have been assessable income. Furthermore, the indications are that income was also to be generated from the management of those town houses after such sale. The uncontested evidence points to a conclusion that the appellant's intention at all times in entering into the various transactions was to make a profit or gain. Focusing on one or other separate but related business activity can (as I think happened here) result in the total picture being overlooked. An overall view of the business activity is required"[112].

104 With respect, the fact that a party or parties may have put a particular focus upon a case which turns out to be the inappropriate one is not of itself a reason for the ordering of another hearing of the case. Both parties appear to me to have put forward all relevant factual matters upon which they wished to rely. Findings have been made on the basis of those matters. Now that the respondent might wish to change the focus of the case, is not a reason for a fresh hearing of it, when, as here, in my view, the essential facts have been found. It was always the case that the appellant relied on the first limb of s 51(1) and it was for the respondent to meet such a case if it could, at all stages. That the appellant contended that she had presented and made out a case for the application of the first limb of s 51(1) is apparent from Ground 5 of her Notice of Appeal to the Federal Court:

> "Further, or alternatively, the Tribunal should have held that the outgoings in question were wholly deductible under the first limb of s 51(1), as being

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110 Contrast *Softwood Pulp and Paper Ltd v Federal Commissioner of Taxation* (1976) 7 ATR 101; 76 ATC 4439.

111 (1997) 73 FCR 330 at 365.

112 See for example *GP International Pipecoaters Pty Ltd v Federal Commissioner of Taxation* (1990) 170 CLR 124 at 138.

incurred for a dual purpose, both purposes being the gaining or producing of assessable income."

105 In this Court, the majority, in discussing the relevance of any temporal connexion between an outgoing or an expenditure and the purpose for which it was made says this[113]:

> "There are cases where the necessary connection between the incurring of an outgoing and the gaining or producing of assessable income has been denied upon the ground that the outgoing was 'entirely preliminary' to the gaining or producing of assessable income[114] or was incurred 'too soon' before the commencement of the business or income producing activity[115]. The temporal relationship between the incurring of an outgoing and the actual or projected receipt of income may be one of a number of facts relevant to a judgment as to whether the necessary connection might, in a given case, exist, but contemporaneity is not legally essential, and whether it is factually important may depend upon the circumstances of the particular case."

106 *Softwood Pulp and Paper Ltd v Federal Commissioner of Taxation*[116] upon which the respondent relies, depends upon its own facts which show clearly that the expenses incurred and disallowed by the respondent were incurred at a time before the taxpayer had even taken a decision to enter into the relevant business in Australia. In any event, the Court in that case was able to conclude that the outgoings were of a capital nature. I do not regard that decision as being of any assistance in the resolution of this case. The same may be said of the other cases cited. In *Federal Commissioner of Taxation v Maddalena*[117] the taxpayer failed because the expenses incurred by him as a professional Rugby League footballer in negotiating with a metropolitan club with a view to its engagement of him, and legal expenses associated with that negotiation, were held to have been incurred in getting, and not in doing, work as an employee. *Lodge v Federal Commissioner*

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113 [1999] HCA 7 at [44].

114 eg *Softwood Pulp and Paper Ltd v Federal Commissioner of Taxation* (1976) 7 ATR 101 at 113; 76 ATC 4439 at 4450.

115 *Federal Commissioner of Taxation v Maddalena* (1971) 45 ALJR 426; *Lodge v Federal Commissioner of Taxation* (1972) 128 CLR 171; cf *Federal Commissioner of Taxation v Riverside Road Lodge Pty Ltd* (1990) 23 FCR 305.

116 (1976) 7 ATR 101; 76 ATC 4439.

117 (1971) 45 ALJR 426.

of Taxation[118] is distinguishable on the ground that the expenditure there was of a private or domestic nature.

107 In *Federal Commissioner of Taxation v Riverside Road Lodge Pty Ltd*[119] the Full Court of the Federal Court discussed *Texas Co (Australasia) Ltd v Federal Commissioner of Taxation*[120] and *Federal Commissioner of Taxation v Total Holdings (Australia) Pty Ltd*[121]. They then referred to *Maddalena* and *Lodge* and a text of Professor RW Parsons[122] which they said established that there should be an element of contemporaneity between the expenditure and the commencement of the business or income producing activity. I doubt whether they do establish such a proposition. If they do, they cannot now be taken as correct in view of the decision of the majority here.

108 The finding of the Tribunal to which I have referred, accepts that at all material times, the appellant's intention was to generate income from the property both before and after a redevelopment of it. That finding together with other findings in my opinion establish the factual foundation for the application of s 51(1). These other findings are:

(i) that even before she bought the property "Tibradden", the appellant consulted an architect about the possibility of its redevelopment for various purposes;

(ii) within seven months of the purchase, the appellant and Williams (the manager of a building company) began "to take initiatives in relation to possible developments of Tibradden";

(iii) in December 1981 (about a year after the purchase), Williams applied to the Local Authority for planning approval in principle for a "holiday/recreation style motel complete with swimming pool, tennis courts and other sporting facilities";

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118 (1972) 128 CLR 171.

119 (1990) 23 FCR 305 at 313-314.

120 (1940) 63 CLR 382.

121 (1979) 43 FLR 217.

122 *Income Taxation in Australia: Principles of Income, Deductibility and Tax Accounting*, (1985) at 5-37 to 5-48.

(iv) in January 1982, the appellant entered into an agreement with Williams pursuant to which he was to receive a fee on "satisfactory completion … of the motel hotel complex";

(v) in February 1982 the Local Authority had granted an approval in principle to an amended plan for a holiday complex;

(vi) various negotiations were undertaken by Williams with respect to the possible development of the site for a Casino, and with potential operators of the complex when it was completed although the appellant says that her ideas were more modest;

(vii) other attempts were made to interest joint venturers but by March 1984 it became apparent that no project could proceed and that the property would have to be sold, a process which was not completed despite continuing attempts to do so, for about eighteen months.

109 It was not contested by the respondent that the appellant intended to redevelop the property for a motel complex. Indeed, that that was so was part of the respondent's case. This appears from the exchange quoted by the Tribunal:

> "[Counsel for the respondent: (cross-examining the appellant):] Well, I put to you that your purpose in buying the property, the reason that you bought it, was to build some development or buildings upon it? --- Yes.
>
> …
>
> Subject to the qualification [that you were saying it may have been something more than a hotel; it was a complex involving a motel and other facilities] you accept that you told the taxation officers that you intended to use the property to build a motel and the other buildings set out in the plans that you sent to the Council *and to run the motel by yourself*? --- Yes." (Emphasis added)

110 The Tribunal went on to make an explicit finding upon the basis of that exchange:

> "We accept that in 1979, [the appellant], having sold her business, was looking round for an investment *which would provide her a good income*. However, we reject [the appellant's] assertion that her equestrian interests played any role in her initial search. Indeed, we are satisfied that when she discovered that Tibradden was on the market, her interests were focused on its commercial possibilities as a motel site, and the fact that the property was presently used for agisting horses was merely fortuitous. We therefore accept as accurate – and accurately reflecting [the appellant's] intention – the answer she gave to [the taxation department officer who had investigated her affairs]

> as to how she intended to use Tibradden, viz: '*my intention was to build a motel and operate it by myself*. It was my belief that another motel business in that area would be profitable, given the proximity to the airport and the city'. The fact that Tibradden was used for agistment purposes was thus a lucky coincidence – lucky in the sense that it coincided both with her own interests, as well as contributing, however modestly, to the holding costs whilst the motel plans were being developed. It also provided accommodation and an occupation for [the appellant's] sister." (Emphasis added)

111 The fact that the respondent was conducting his case with a view to establishing that the outgoings were of a capital nature, and that he now seeks to make out a case that the first limb of s 51(1) is not satisfied cannot alter the nature and effect of the ultimate findings of the Tribunal that I have quoted.

112 They lead to this factual and legal conclusion: that the expenditures in question, made over a period which may be viewed as a relatively short one in the relevant industry (of hotel and motel development), were made with one end in view, of gaining or producing assessable income, were made to achieve that end whilst continuing efforts in that regard were being undertaken, and were therefore within the first limb of s 51(1). I do not think that this case is one in which any other conclusion is open.

113 It follows that I would join in all of the orders proposed by the majority save as to the remitter of the matter, in lieu of which I would order that the assessment of the respondent dated 8 May 1989 with respect to the year ended 30 June 1987 be set aside to the extent that the respondent disallowed the appellant's claim to deduct losses of $909,649.00 against her assessable income for that year. The respondent should pay the appellant's costs of the appeal to this Court, of the appeal to the Full Court of the Federal Court and of the proceedings before R D Nicholson J.