IN THE HIGH COURT OF AUSTRALIA
MELBOURNE REGISTRY

No. M139 of 2014

BETWEEN:

AUSNET TRANSMISSION GROUP PTY LTD
(ACN 079 798 173)
Appellant

and

THE COMMISSIONER OF TAXATION OF THE COMMONWEALTH OF AUSTRALIA
Respondent

RESPONDENT'S SUBMISSIONS

Part I: *Publication*

1. The respondent certifies that these submissions are in a form suitable for publication on the internet.

Part II: *Issue on Appeal*

2. Under an agreement for the purchase of the government-owned Victorian electricity transmission business, the appellant undertook to the vendor, and to the State of Victoria, to make a limited number of fixed payments to the State totalling $177.5 million. As contemplated by the agreement, the liability was imposed on the vendor by way of an Order of the Governor in Council and assumed by the appellant. The payments represented amounts forecast to be derived by the appellant from the provision of "Prescribed Services"[1] that were over and above all capital and operating costs (including borrowing costs) and after allowing for an appropriate return to shareholders.[2] Were the payments deductible under s 8-1 of the *Income Tax Assessment Act 1997* (Cth) (the "1997 Act")?

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1 As defined in a Tariff Order (Exhibit AMC-1), being the instrument that enshrined in law the pricing arrangements for the monopoly elements of electricity supply: Victorian Government publication, Exhibit GRM-1, p 326; and see pp 321, 324.

2 TJ[77].

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Part III: ***Section 78B of the Judiciary Act***

3. The respondent has considered whether any notice should be given in compliance with s 78B of the *Judiciary Act 1903* (Cth) and submits that no such notice should be given.

Part IV: ***Contested facts***

4. The respondent does not dispute the statements of fact set out at paragraphs [8]-[27] and the second sentence of paragraph [28] of the appellant's submissions.

5. The respondent disputes the statement in the first sentence of paragraph [28] that the payments were not made to obtain the Transmission Licence.

10 **Part V:** ***Appellant's statement of applicable statutes***

6. The respondent accepts the appellant's statement of applicable legislation insofar as it refers to s 8-1 of the 1997 Act.

7. Although the differences are not material to this appeal, the respondent submits that the applicable version of the *Electricity Industry Act 1993* (Vic) ("EIA") is the one that existed at 12 October 1997, being the date of entry into the Asset Sale Agreement. The respondent also relies on ss 163, 163A and 167 of that Act. Sections 158A, 163, 163A, 163AA and 167, as they existed at 12 October 1997, are reproduced at Appendix A to these submissions.

Part VI: ***Argument in answer to the argument of the appellant***

20 8. As contended by the respondent's notice of contention (addressed below), the payments were not deductible under s 8-1(1) of the 1997 Act. They were not outgoings incurred by the appellant for the purposes of earning assessable income or incurred in the course of its business. Accordingly, the question, addressed by the notice of appeal, of whether the payments were outgoings of capital for the purposes of s 8-1(2)(a) does not, strictly, arise.

9. If it does, then the respondent says that the trial judge and the majority of the Full Federal Court were correct in finding that the payments were an affair of capital and not deductible by reason of s 8-1(2)(a).

Relevant principles

10. The respondent agrees that the usual starting point in determining whether a payment is an outgoing of capital or of a capital nature is the statement of Dixon J in *Sun Newspapers Ltd and Associated Newspapers Ltd v FCT* (1938) 61 CLR 337 at 363 cited at paragraph 32 of the appellant's submissions. As in *FCT v South Australian Battery Makers Pty Ltd*[3], the critical issue in this case is not to determine the character of the advantage sought, once it has been identified, but to identify the advantage sought by the taxpayer in making the payments. Thus, the focus is on the first of the two questions posed by Fullagar J in *The Colonial Mutual Life Assurance Society v FCT*[4] at 454.8, viz: (1) What is the money really paid for? (2) Is what it is really paid for, in truth and in substance, a capital asset? That question is to be judged from a "practical and business point of view".[5]

The payments were "for" the acquisition of the transmission system

11. Here, the payments were, as the trial judge and the majority of the Full Federal Court found, part of the cost of acquiring the transmission system assets, including the Transmission Licence.

12. *First*, on a proper construction of the Asset Sale Agreement,[6] the payments formed part of the price for the assets. The amount styled "Total Purchase Price" reflected both a money amount payable to PNV (the vendor) and the assumption by the purchaser of obligations to PNV's creditors that is, amounts payable to third parties:

    (a) The "Total Purchase Price" was relevantly defined as the "price of the Assets" net of, among other things, "Creditors ... assumed under this agreement";[7]

    (b) Recital E relevantly recorded that the total value attributed by the parties to the sale of the Assets was an amount "net of Creditors";

    (c) Under clause 2.1, the appellant assumed PNV's "Creditors" on the Completion Date (see also clause 7);[8]

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3 (1978) 140 CLR 645. See at 655.2 per Gibbs ACJ.
4 (1953) 89 CLR 428.
5 *Hallstroms Pty Ltd v FCT* (1946) 72 CLR 634 at 648 per Dixon J. And see *FCT v Citylink Melbourne Limited* (2006) 228 CLR 1 at [147]-[148] per Crennan J.
6 And contrary to the appellant's construction (appellant's submissions, [53(d)]).
7 Clause 1.1, Exhibit DGB-2, p 203.

(d) "Creditors" was relevantly defined as "all persons to whom are owed amounts, debts, obligations and liabilities, whether currently owed or prospectively or contingently owing by [PNV]...";

(e) The agreement required that the Order in Council be made prior to the Completion Date. By its terms, the Order applied to PNV when made.[9] This was consistent with the statutory scheme pursuant to which the imposts were imposed. Section 163AA(3) of the EIA envisaged that any Order in Council be made prior to privatisation such that the liability would be assumed by the private purchaser;[10]

10 (f) PNV's liability to the State was clearly in prospect. Indeed, by the making of the Order in Council, it crystallised prior to completion.[11] The State was, consequently, a "Creditor" of PNV in respect of the imposts for the purposes of the definition of "Total Purchase Price" and Recital E.

13. Forming part of the purchase price for the assets, the payments, when made, were clothed with the character of capital; cf. *Colonial Mutual Life Assurance Society v FCT.*[12]

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8 In addition, the appellant agreed to the transfer of the Transmission Licence which would carry with it the liability imposed on PNV by the Order in Council: clauses 4.2(c)(1), 4.3(a) and (d), 9.1.

9 Clause 4.3(d). Contrary to the appellants submissions, [53(d)]: "Nor, following the entry into and completion of that Agreement, would PNV become liable to pay the imposts..."; "[U]pon the making of the Order in Council the liability to pay the imposts was not an 'obligation of the seller existing before or after Completion'".

10 Section 163AA(3) provided:

> An Order made under this section does not apply to a distribution company, a transmission company or a generation company that ceased to be a public distribution company, public transmission company or public generation company before the Order was made.

11 The imposts were due, although not payable until a later time. See *Clyne v Deputy Commissioner of Taxation* (1981) 150 CLR 1 at 15.2. Further, section 163AA(4) contemplated that the liability might be discharged before or after Completion. It provided:

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

12 (1953) 89 CLR 428 at 454.3-454.8 per Fullagar J. And see 451.6, 452.7, 455.3, 459.8-459.9.

14. *Second*, even if not, strictly, part of the "price" of the assets, the payments were a cost of acquiring the transmission system assets, including the Transmission Licence. That is because:

(a) The payments were fixed in amount and limited in number. That connects them with the acquisition of the assets themselves and not the subsequent use of the assets, particularly the Transmission Licence; cf. *Cliffs International Inc v FCT*[13];

(b) The payments were a one-off liability connected with the one-off privatisation of the transmission business, as reflected by Recital F of the Asset Sale Agreement. Recital F also referred to the total amount of the imposts ("future licence fees of $177,500,000") and, importantly, to their approximate net present value. Evidently, the obligation was treated as a capital sum payable in instalments over time;

(c) As contemplated by the legislation itself,[14] the liability to make the payments was not imposed on the appellant by the Order in Council made under s 163AA. Rather, it was assumed by the appellant as part of the acquisition of the transmission assets. The appellant assumed PNV's liability to make the payments by the terms of the Asset Sale Agreement. Even if not, strictly, part of the purchase price, it formed part of the total value contributed for the sale of the assets, as Recital F acknowledged.[15] Further, the appellant agreed to[16] and accepted the transfer of the Transmission Licence[17] which would and did then carry with it the liability imposed on PNV by the Order;[18]

(d) The appellant assumed the liability to make the payments in order to acquire the right and opportunity to conduct the business, as it specifically acknowledged in clause 13.3(d) of the Asset Sale Agreement;

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13 (1979) 142 CLR 140 at 173.6-173.8 per Jacobs J.
14 Section 163AA(3) (set out in footnote 10 above).
15 Cf. Edmonds J, FC[13].
16 See clauses 4.2(c)(1), 4.3(a), 4.3(b), 4.3(d), 9.1 of the Asset Sale Agreement.
17 An asset for the purposes of the Asset Sale Agreement. See clause 1.1, definitions of "Assets", "Licences" and "Transmission Licence".
18 Cf. Edmonds J, FC[18].

(e) It does not matter that the payments were not made to PNV as vendor of the assets.[19] The appellant agreed to relieve PNV of liability to make the payments. In any event, the State (to whom the payments were made) was a party to the Asset Sale Agreement and the transfer of the assets to the appellant depended on fulfilment by the State of the conditions precedent in clause 4.3 of the agreement. These included procuring the transfer of the Transmission Licence to the appellant;[20]

(f) The occasion of the assumption of the liability was the acquisition of the electricity transmission system. It was not assumed in the process of deriving assessable income, nor could the liability be described as a working expense;

(g) The imposts were imposed as an alternative to extracting a higher price for the privatised transmission business;[21]

(h) The appellant took the liability to pay the imposts into account when determining its bid price for the business and a negotiated reduction in the imposts was capitalised into the purchase price;[22]

(i) The appellant treated the payments as a cost of acquisition in its accounts. The appellant's auditors, PricewaterhouseCoopers and KPMG,[23] signed those accounts on an unqualified basis, accepting them as prepared in accordance with applicable Australian Accounting Standards and the Corporations Law.[24] For accounting purposes, as well as from a practical business point of view, the payments were a cost of acquiring the transmission system assets.

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19 Appellant's submissions, [48].

20 Clause 4.3(a). See also clause 4.2(c)(1). The State was also required to procure that the "New Allocation Statement" became effective which had the effect of transferring the "Land" to the appellant: clause 2.1(c).

21 Cohen, [23].

22 TJ[89]; Exhibit GRM-8, p 715; Keller [20(a)], [22]. Exhibit RHK-2 at pp 189 (paragraphs 3.1 and 3.3), 190 (paragraph 6.1, item 5 of the table).

23 PricewaterhouseCoopers for the accounting periods 1 October 1997 to 31 December 1998 and 1 January 1999 to 31 December 1999; KPMG for the accounting period 1 January 2000 to 31 March 2001: Exhibit RHK-4, pp 275, 333 and 367.

24 Exhibit RHK-4, pp 280, 312, 343. Both parties' experts agreed that the payments were capitalised in the appellant's statutory accounts: Exhibit CP-4, pp 34-6 [B.7]-[B.9]; Exhibit DGB-5, p 6 [3].

15. Payments considered in *Tata Hydro-Electric Agencies Ltd, Bombay v Commissioner of Income Tax, Bombay Presidency and Aden*[25] exhibited many of the same features. There the Privy Council concluded:

> *"[The payments] were certainly not made in the process of earning their profits; they were not payments to creditors for goods supplied or services rendered to the appellants in their business; they did not arise out of any transactions in the conduct of their business. That they had to make those payments no doubt affected the ultimate yield in money to them from their business, but that is not the statutory criterion. They must have taken this liability into account when they agreed to take over the business. In short, the obligation to make these payments was undertaken by the appellants in consideration of their acquisition of the right and opportunity to earn profits, that is, of the right to conduct the business, and not for the purpose of producing profits in the conduct of the business. If the purchaser of a business undertakes to the vendor as one of the terms of the purchase that he will pay a sum annually to a third party, irrespective of whether the business yields any profits or not, it would be difficult to say that the annual payments were made solely for the purpose of earning the profits of the business."*[26]

16. *Tata Hydro-Electric* was followed by Williams ACJ and Fullagar J (with whom Kitto and Taylor JJ agreed) in *Colonial Mutual*[27] and by Gibbs J in *Cliffs International*.[28]

17. *Third*, leaving aside the Asset Sale Agreement, the payments were made for and in connection with the profit-yielding structure of the business. They were a special and non-recurrent charge payable as part of, and in order for the appellant to enjoy the benefits of operating the transmission system within, the regulatory framework established by the State. Those benefits included:

    (a) freedom from competition in respect of the provision of the "Prescribed Services" (as defined by the Tariff Order).[29] And cf. *United Energy Ltd v Commissioner of Taxation.*[30]

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25 [1937] AC 685.

26 At 695.3-8.

27 At 444.7-445.6 (Williams ACJ) and 455.3 (Fullagar J). By contrast with appellant's submissions (footnote 60), Fullagar J specifically stated that nothing turned on the presence of the word "solely" in the section considered in *Tata*.

28 At 155.1-5 and 157.1 (in dissent).

29 "Prescribed Services" were defined by the Tariff Order by reference to the transmission system as at 3 October 1994. The appellant, as sole purchaser of Victoria's only electricity transmission system, acquired the right to provide the "Prescribed Services". Only the appellant, and not any other entrant to the market, could provide those services. At the time of acquisition, "Prescribed Services"

(b) as emphasized by the Information Memorandum, ongoing and predictable revenue streams from the "Prescribed Services", representing 95% of the transmission business revenues at the time of acquisition;[31]

(c) certainty as to the principles to be applied by the regulator in setting prices for the future regulatory periods through to December 2007;[32]

(d) the potential to earn profits in excess of the regulated return by outperforming the cost assumptions on which the regulated return was calculated;[33]

(e) the ability, in the initial years, to recognize accounting profits that were over and above a reasonable rate of return on the assets purchased.[34]

10 18. As the trial judge and McKerracher J concluded,[35] the imposts were imposed as part of the regulatory framework in which the transmission business was conducted and the payments were made as part of the acquisition of the transmission business. This was recognised in Clause 13.3(d) which contained the specific acknowledgement that the payments were an "*integral part of the regulatory framework of the industry*" and paid "*in order to carry on the business*"[36] and Recital F of the Asset Sale Agreement which stated:

> *"the parties agree that the total payments to the State* ***in connection with the privatisation of the Seller*** *are $2,732,500,000 (including future licence fees of $177,500,000 payable by the Buyer, which the State values in net present*
20 *value terms at approximately $161,000,000)."* [Emphasis added.]

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accounted for 95% of the transmission business revenues. The Information Memorandum distinguished regulation of this monopoly element from competition for the provision of "extra capacity", "new transmission capacity" and "augmented transmission services" as well as other "contestable" services" that were unrelated to and independent of the transmission system existing as at 3 October 1994: Exhibit RHK-1, pp 21, 26, 73.

30 (1997) 78 FCR 169 at 193B-193D, per Sundberg and Merkel JJ.

31 Exhibit RHK-1, pp 22, 25, 73. See also Cohen at [14], [22].

32 Emphasized by the Information Memorandum: Exhibit RHK-1, p 42.

33 Cohen [17]; Information Memorandum, Exhibit RHK-1, p 45 (par (b)(v)).

34 The appellant capitalised the imposts in its accounts and did not throw them against the income earned during the years in which they were payable: Exhibit CP-4, pp 34-6 [B.7]-[B.9], DGB-5, p 6 [3]. (The "discount" representing the effect of the time value of money for the payment of the licence fee on deferred terms was recognised as an expense.)

35 TJ[85]; FC[66].

36 Exhibit DGB-2, p 215, clause 13.3(d)(1).

The payments were an affair of capital

19. As the appellant correctly states, in the usual case, an outgoing which forms part of the consideration of the acquisition of a capital asset will, when incurred, be also "for" the advantage of securing, on an enduring basis, that asset.[37] This is such a case. Neither *Cliffs International Inc v FCT* nor *FCT v Morgan*[38] dictates a contrary conclusion.

20. Edmonds J correctly distinguished *Cliffs International* on the basis that:

(a) the obligation to make the payments in question there continued throughout the life of the asset, right or advantage, or the entitlement of the taxpayer to the asset, right or advantage; and

(b) the amount of the payments was not fixed but was dependent on the use made of or the profits derived from the asset, right or advantage.[39]

21. Here, unlike in *Cliffs International*, the payments were for a limited duration – the first 3 years of a perpetual licence – and were fixed.

22. If it be relevant, there is no inconsistency between the judgments of Fullagar J in *Colonial Mutual* and Barwick CJ in *Cliffs International.*[40] Read in the full context of the paragraph in which it appears, Fullagar J's statement is readily seen to be directed only to the facts of the case before the Court.[41] Accordingly, the passage relied on does not create any inconsistency with the result in *Cliffs International.*[42]

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37 Appellant's submissions, [36]; see also the survey of authorities by Stephen J in his dissenting judgment in *Cliffs International Inc v FCT* (1979) 142 CLR 140 at 161.4-163.3 .

38 (1961) 106 CLR 517.

39 FC[22]. With respect, his Honour's discussion of the judgment of Barwick CJ (FC[20]) was not dispositive of the matter before him.

40 Appellant's submissions, [38].

41 We note, for example, that each occurrence of the word "they" is a reference back to "these payments", being the particular payments constituting the "price" under the documents. Note also the reference to "the company", being the taxpayer.

42 Further, any apparent inconsistency between the two cases may be explained by the particular meaning apparently afforded to the "price" for an asset (suggesting that it is "for" the asset: see *Colonial Mutual* at 454.5, 549.2, 549.6 and 549.8, per Fullagar J) as opposed to "consideration for the acquisition" of an asset (which may or may not be "for" the asset: see *Cliffs International* at 148.3 and 148.5, 149.9, per Barwick J).

23. Indeed, in the latter case, Barwick CJ pointed out, at some length, that "each case in this particular area is peculiarly dependent upon the particular facts and circumstances of that case".[43] Barwick CJ and Jacobs J each distinguished *Colonial Mutual*, without criticism, on the basis that the facts were not analogous.[44]

24. In the judgments of Jacobs and Murphy JJ those matters relied on by Edmonds J below to distinguish *Cliffs International* were decisive.[45]

25. Ultimately, the approach of the plurality in *Cliffs International* was consistent with that of the questions posed by Fullagar J in *Colonial Mutual* where his Honour asked: "(1) What is the money really paid *for*? – and (2) Is what it is really paid for, in truth and in substance, a capital asset?".[46] Whilst in *Colonial Mutual*, in answering those questions, there was no reason for not giving to the contractual documents their full literal effect,[47] in *Cliffs International*, it was necessary to go behind the contractual documents to determine what the payments were for.[48]

26. In any event, the facts of the present case are materially different from both *Cliffs International* and *Colonial Mutual*. There is nothing about the present matter that requires revisiting either of those cases.

27. *FCT v Morgan*[49] is also distinguishable from the present case. That case concerned payments made by a purchaser of a rent-yielding property by way of reimbursement of rates paid by the vendor. As the Court noted, rates are an outgoing which is recurrent and inherently an outgoing on revenue account.[50] The outgoing is treated as such under proper principles of accounting.[51] Moreover, it is measured by the passage of time and is treated as apportionable as between the vendor and purchaser

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43 See 147.9-148.5.
44 At 151.4-151.6 per Barwick CJ; 173.10-175.5 per Jacobs J.
45 At 175.8 per Jacobs J; 176.6-176.7 per Murphy J. And see 149.2-149.3 and 150.1 per Barwick CJ.
46 At 454.8.
47 At 455.3 and 459.8. See also 454.4: "For it is incontestable here that the moneys are paid in order to acquire a capital asset".
48 At 148.7-149.2 per Barwick CJ; 175.6-175.9 per Jacobs J and 176.4-176.6 per Murphy J. See also *QCT Resources v FCT* (1997) 34 ATR 504 at 509.10-510.3, 510.10-511.2.
49 (1961) 106 CLR 517
50 At 520.10-521.1.
51 At 521.4.

on the footing of days of enjoyment of the fruits of the property.[52] Here, the imposts bore no such character. They were not ongoing, but rather a special charge relating to privatisation. They were not inherently on revenue account. In fact, they were capitalised in the appellant's accounts. Moreover, the imposts were not for the benefit of holding the licence during the years they were payable. A separate and ongoing licence fee was paid for that advantage.[53]

28. As McKerracher J correctly pointed out below,[54] the fact that the imposts were notionally referrable to anticipated profits during the first 3 years following acquisition does not affect the above conclusion.[55] The payments were fixed and not dependent upon the profits earned by the appellant. Moreover, they were treated under the agreement as a capital sum.[56]

Incurrence of the liability

29. Many of the appellant's arguments are founded on the proposition that it did not incur the liability to pay the imposts until the dates for payment.[57] That proposition should be rejected.

30. *First*, it cannot be reconciled with clause 13.3(d)(3) of the Asset Sale Agreement pursuant to which the appellant promised to pay the Treasurer the amounts specified in the proposed Order in Council "***whether or not*** the [Order] is valid or enforceable" (our emphasis). The words in bold above foreclose any argument that the clause was

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52 At 521.3.

53 Pursuant to s 163(4) of the EIA and clause 16 of the licence (Exhibit #A).

54 FC[69].

55 Cf. appellant's submissions, [45]. See, for example, *Associated Portland Cement Manufacturers Ltd v Inland Revenue Commissioners; Associated Portland Cement Manufacturers v Kerr* (1946) 1 All ER 68 at 70, cited by Fullagar J in *Colonial Mutual* at 458.6. See also: *Tata Hydro-Electric Agencies Ltd, Bombay v Commissioner of Income Tax, Bombay Presidency and Aden* [1937] AC 685; *Delage v Nugget Polish Co Ltd* (1905) 92 LT 682; *Indian Radio and Cable Communications Co Ltd v Income Tax Commissioner* [1937] 3 All ER 709; *United Energy Limited v Federal Commissioner of Taxation* (1997) 78 FCR 169.

56 As mentioned above, Recital F referred to a total amount for the imposts expressed in net present value terms. The obligation was, evidently, in respect of a total amount payable over time.

57 Appellant's submissions, [47]. See also [34], [49(a)], [49(d)], [50], [52], [53(c)], [53(d)], [54].

only operative in the event that the Order was found to be invalid or unenforceable.[58] Further, unlike the statutory liability arising under the Order in Council, the liability arising under clause 13.3(d)(3) was guaranteed by the appellant's then parent.[59] The commercial benefit of that guarantee would be significantly reduced if it only secured payment of the imposts in circumstances where the Order in Council was invalid.

31. *Secondly,* the appellant incurred the liability to make the payments upon settlement of the Asset Sale Agreement (at the latest). It was, at that time, "definitively committed" to making the payments.[60] That was the effect of clause 13.3(d). It also followed from the combination of clauses 4.4(a), 4.4(b), 4.2(c)(1) and 9.1, performance of which was intended to result in the appellant replacing PNV as licensee under the Transmission Licence and thereby assuming PNV's liability to pay the imposts pursuant to the Order in Council.

32. This does not represent a departure from the position taken by the respondent below. As in the cases of *New Zealand Flax Investments Ltd v FCT*[61] and *Coles Myer Finance Ltd v FCT*[62], it is possible for a taxpayer to incur an outgoing in a particular year of income which is properly referable to, and therefore deductible in, a later year of income.[63] Whilst the respondent did not dispute below that the appellant incurred the liability to pay the imposts, he disputed their deductibility. Hence no question arose as to whether the amounts, if deductible, were properly referable to the years in which they were claimed – nor does the question arise on this appeal.[64]

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58 Cf. appellant's submissions, [40(b)].

59 Clauses 13.3(d) and 19.1. The guarantee can be seen as important insofar as it secured the ongoing liability to pay the imposts.

60 *FCT v James Flood Pty Ltd* (1953) 88 CLR 492 at 506.4.

61 (1938) 61 CLR 179.

62 (1993) 176 CLR 640.

63 See: *New Zealand Flax Investments Ltd v FCT*(1938) 61 CLR 179 at 207.5 in relation to the future liability to interest bondholders and at 207.8 in relation to the commissions payable on the sale of the bonds; *Coles Myer Finance Ltd v FCT* (1993) 176 CLR 640 at 665.4. See also: *Commissioner of Taxation (NSW) v Ash* (1938) 61 CLR 263 at 281.9-282.8.

64 Cf. appellant's submissions, [50], where the appellant asserts that the respondent did not dispute that the imposts were incurred by the appellant in the years of income in which they became due for payment. TJ[41] (referred to in support) does not go that far.

33. *Thirdly*, the liability was not contingent in either a legal or commercial sense. Upon completion of the Asset Sale Agreement, the appellant was under a present legal obligation to make the payments at the times specified in the Order in Council.[65] There was no further act or matter, yet to occur, the occurrence of which was necessary to crystallise that liability. It is to be contrasted, in this respect, with the "deferred payments" considered in *Cliffs International*. As Barwick CJ observed,[66] the contract for the sale of the shares created no present debt for the amounts to be paid. His Honour noted that none of the payments might ever be due and that:

> *"It was only in the eventuality that iron ore was drawn from the temporary reserves by or at the instance of the appellant that cl. 5 would be activated so as to result in an obligation to make the stipulated payments."*

34. It was this feature which justified the focus on the occasion of the making of the payments in determining their character.[67] Similarly, Jacobs and Murphy JJ placed particular emphasis on the fact that liability to make the payments was dependent on the use made of the asset.[68]

35. In considering whether the liability to pay the imposts was contingent, it is appropriate to draw a distinction between: a) a potential liability to make a payment at a future date if one or more conditions are satisfied; and b) a present liability to make a payment at a future date which may be "avoided" (to use the appellant's term[69]) by the taking of certain steps.

36. The potential to transfer the Transmission Licence prior to the date the imposts became payable did not render the liability contingent. The proper legal characterisation is that, as holder of the licence, the appellant was liable to make the payments.[70] It could only be relieved of that liability if another entity assumed it.

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65 The case can be distinguished from those dealing with accrued long service leave or holiday pay where, under the relevant award, the liability to make the payment does not arise until the employee is terminated or commences leave: *Nilsen Development Laboratories Pty Ltd v FCT* (1981) 144 CLR 616 at 621.8.

66 At 148.9.

67 See at 150.1.

68 At 175.8, per Jacobs J, and 176.3, per Murphy J.

69 Appellant's submissions, [50].

70 The correct analogy is with a liability which may be incurred even though it is defeasible: see *FCT v James Flood Pty Ltd* (1953) 88 CLR 492 at 506.9;

Moreover, the appellant was obliged to procure from any transferee of the Transmission Licence a covenant to be bound by clause 13.3(d) of the Asset Sale Agreement as if it were the appellant.[71]

37. To the extent the appellant contends the liability was contingent in a commercial sense, there is no evidence of any intention to transfer the Transmission Licence prior to the dates the payments were payable. Such a transfer would have required the approval of the Office of the Regulator General pursuant to s 167 of the EIA after having gone through the procedures set out therein. Moreover, under clause 11.2 of the Asset Sale Agreement, the appellant agreed that it would not, without the consent of the Treasurer, transfer, sell or otherwise dispose of any right, title or interest in the whole or any substantial part of the Business for a period of two years after the Completion Date. It also undertook to deliver to the State covenants from its shareholders in similar terms.[72]

38. *Finally*, even if it were correct to describe the liability to pay the imposts as being contingent upon the appellant continuing to hold the licence up to and including the dates when they were payable (which is denied), the question of characterisation should still be answered by reference to the appellant's assumption of PNV's liability to make the payment as part of the process of privatisation. The payments were made in discharge of the obligation so assumed and the factors that influenced the plurality in *Cliffs International* are not present.[73] The connection of the payments with the acquisition of the transmission assets (whether as part of the purchase price or otherwise) and/or the benefits of the regulatory framework in which the transmission business was operated, clothed the payments with the character of capital when made.

A payment of a tax may be on capital account

39. The appellant asserts that a payment in the nature of a true tax will almost never bear a capital nature because it will not secure to the taxpayer any capital advantage; nor, indeed, any advantage at all. That proposition should be rejected.

Commonwealth Aluminium Corporation Ltd v FCT (1977) 32 FLR 210 at 224.3 - 224.7; *FCT v Australian Guarantee Corporation Ltd* (1984) 2 FCR 483 at 487.2.

71 Clause 13.3(d)(3) and (4).

72 Clause 4.4(c).

73 Referred to in paragraph 20 above.

40. Payment of a tax can, and often is, an affair of capital. The case of *United Energy Ltd v Federal Commissioner of Taxation* (1997) 78 FCR 169 provides an example of such. There the Full Federal Court held, unanimously, that amounts paid as non-voluntary statutory imposts imposed by an Order in Council made pursuant to the EIA were on capital account.[74] The majority noted that, in determining the advantage sought by payment of the imposts, from a practical and business point of view, an examination of its role under and as part of the scheme of privatisation was required.[75] Their Honours concluded that payment of the imposts secured the taxpayer immunity from competition which was of enduring benefit to the business entity, structure or organisation of the taxpayer.[76] Lockhart J held that the relevant payments could be seen, in substance, as a purchase price for a business which gave it monopoly power in a defined area of Melbourne.[77] An application to this Court for special leave to appeal was refused.[78]

41. A more common example of a tax being on capital account is the payment of a duty levied by a State, the liability for which arises upon the acquisition of a capital asset. For example, in the present case, like legal and other expenses associated with the acquisition, payment of the stamp duty referred to in Recital E of the Asset Sale Agreement was an affair of capital and not deductible to the appellant by reason of s 8-1(2)(a) of the 1997 Act. It is by reason of their connection with the acquisition of a capital asset that such costs may be on capital account even though they do not form part of the consideration for the sale.

42. There is no reason to suppose that the imposts, being connected with the "privatisation" of PNV as they were (a term which denotes, principally, the one-off sale of the State-owned assets to the appellant), ought not also be an affair of capital. In this respect, the case of *Moffat v Webb*[79] does not advance matters. It was not concerned with taxes paid in connection with the *acquisition* of a capital asset as opposed to its ongoing use.

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74 At: 181G-182D, per Lockhart J; 195A, per Sundberg and Merkel JJ.
75 At 192C.
76 At 195A.
77 At 182C-D.
78 *United Energy Ltd v The Commissioner of Taxation of the Commonwealth of Australia* [1998] HCA Trans 41.
79 (1913) 16 CLR 120. Referred to in the appellant's submissions at [57].

Part VII: ***Argument on notice of contention***

43. Following the reasoning of Lockhart J in *United Energy Ltd v Federal Commissioner of Taxation*,[80] the imposts were not a loss or outgoing incurred in gaining or producing assessable income or in carrying on a business for that purpose. As to that reasoning, the Full Court observed in *City Link Melbourne Limited v Federal Commissioner of Taxation*[81]:

> *"It is not difficult to see on the facts of the case why Lockhart J saw the fee as "akin" to the State taking a share of profits but the conclusion reached by his Honour was not dependent upon there being some joint venture between the State and the distributor. Rather it depended upon the more orthodox analysis that the fee was not a cost of the distributor of deriving its income."*[82]

44. Here, having regard to the "orthodox analysis", the payments were not a cost of the appellant of deriving its income. The payments were not related to the "process" of derivation of income, or a "working expense" whereby the occasion of the outgoing is to be found in the income-earning activity itself.[83]

45. Moreover, like in *United Energy*,[84] the payments were akin to the State (as former owner) taking a share of the appellant's profits. In this regard:

(a) The payments related to the provision of the "Prescribed Services";

(b) The appellant's likely profits from the "Prescribed Services" could fairly be predicted having regard to the regulation of its income;

(c) The payments represented amounts to be derived by the appellant from the provision of the "Prescribed Services" that were over and above all capital and

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80 (1997) 78 FCR 169.

81 (2004) 141 FCR 69 at [52].

82 And see TJ[79].

83 Cf. *Morris & Ors v Federal Commissioner of Taxation* (2002) 50 ATR 104 at [79] per Goldberg J.

84 Contrary to the findings of Davies J (at [97]) the computation of the imposts did not relevantly differ from the s 163A(2) imposts considered in *United Energy*. Nor was the regulatory framework materially different (cf. [99]). As the trial judge found (at [78]), after examining the two regimes, "although the integers in the calculation of the MAR and the licence fee were not disclosed in the express terms of s 163AA, the structure of the imposition of the franchise fee in s 163A and the licence fees under s 163AA was the same".

operating costs (including borrowing costs) and after allowing for an appropriate return to shareholders (i.e. profit);[85] and

(d) Critically, the payments were not remuneration for services rendered, a reward for the use of money or some other payment laid out for the purpose of earning profits.[86]

46. As the trial judge found, the imposts were, in substance and effect, a share of the profits leaving the holder of the licence with an amount determined to be a reasonable return on the capital of the company deriving that income. The residue, or surplus, was taken by the State as its share of profits.[87] As Lockhart J said of the franchise fees in *United Energy*, which bore the same characteristics, it is "unreal" to regard the imposts as falling within either of the positive limbs in s 8-1.[88]

47. With respect, the Full Federal Court erred in focussing on the actual source of the payments as a matter of fact.[89] In doing so, it ignored the question which underpinned Lockhart J's conclusion and its endorsement in *City Link*. As Lockhart J was careful to say, the payments were *akin* to a payment out of profits and so not laid out for the purposes of earning profits. The question is not whether the payments were, strictly, out of a fund called "profits" but whether they were made in the course of deriving profits.

48. Those cases which give attention to the particular fund from which outgoings are sourced are ones where the outgoing is measured by reference to profits after they have been derived;[90] for example, a payment to a director of a percentage of profits in

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85 TJ[77]; and see TJ[72]-[76]; cf. *Pondicherry Railway Company, Limited v Commissioner of Income Tax, Madras* [1931] 58 IA 239 at 245, 251.7-252.7. See also the trial judge's description of the calculation of the franchise fee in *United Energy* at TJ[69].

86 TJ[77]. cf. *Commissioner of Taxation (WA) v Boulder Perseverance Ltd* (1937) 58 CLR 223 at 229.6-230.7.

87 TJ[78].

88 *United Energy Ltd v Federal Commissioner of Taxation* (1997) 78 FCR 169 at 180F.

89 Edmonds J appeared to focus on the actual source of funds for the payments, as a matter of fact, rather than looking at the manner in which the imposts were calculated and their role in the appellant's income producing activities in order to discern their character (FC[7]). Cf. Davies J at FC[96]-[97].

90 See, for example, *FCT v Boulder Perseverance Ltd* (1937) 58 CLR 223. See also *British Sugar Manufacturers Ltd v Harris (Inspector of Taxes)* (1938) 21 TC 528 and

a year of income. In those cases, a notional fund needs to be struck in order to determine the amount of the outgoing. A question arises whether that is the same fund that is available for distribution to the taxpayer's proprietors which, as Dixon J noted in *Federal Commissioner of Taxation v Midland Railway Co of Western Australia Ltd*[91] is *"pretty nearly* what is the taxable fund under the Income Tax Acts of the United Kingdom and *roughly so* for the purposes of the Federal Income Tax Assessment Acts".[92] That is, whether it represents the "real net profit".[93]

49. The critical factor in answering that question is the nature of the payment under consideration[94] and whether it should properly be seen as being antecedently deductible as a trade expense.[95] Thus a payment for remuneration for services rendered, a reward for the use of money or some other payment laid out for the purpose of earning the profits will be deductible even if calculated as a percentage of "profits".[96]

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50. Here, the payments were not ascertained as a percentage of profits. Nevertheless, they represented profits, being amounts to be derived by the appellant from the provision of the "Prescribed Services" that were over and above all capital and operating costs (including borrowing costs) and allowing for an appropriate return to shareholders.[97] If it be relevant, it can be seen by their method of ascertainment, that the payments represented a portion of what was, pretty nearly, the taxable income of

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Federal Commissioner of Taxation v Midland Railway Co of Western Australia Ltd (1952) 85 CLR 306.

91 (1952) 85 CLR 306.

92 At 316.5 (emphasis added).

93 *British Sugar Manufacturers Ltd v Harris (Inspector of Taxes)* (1938) 21 TC 528 at 548.5.

94 *Federal Commissioner of Taxation v Midland Railway Co of Western Australia Ltd* (1952) 85 CLR 306 at 317.2.

95 *Federal Commissioner of Taxation v Midland Railway Co of Western Australia Ltd* (1952) 85 CLR 306 at 316.7. In *FCT v Boulder Perseverance Ltd* (1937) 58 CLR 223 at 229.4, the High Court characterised the problem as the distinction between "a distribution of profits or income forming the subject or part of the subject of an income tax or profits tax and a payment which [is] made to earn those profits and therefore a necessary deduction in ascertaining them".

96 *Commissioner of Taxation (WA) v Boulder Perseverance Ltd* (1937) 58 CLR 223 at 229-230.

97 McCormick [16]; Cohen [15].

the appellant from the provision of the "Prescribed Services".[98] However, what is critical is that they were not a cost of deriving that income. In substance and effect, the payments were, as the trial judge found, a mechanism to distribute a share of profits derived by the appellant to the State.[99]

51. The appellant's reliance on the character of the imposts as a tax does not assist it.[100] It raises a question as to the nature of the tax. A tax on income, being an impost on profits after they have been earned, is also not deductible.[101] Here, having regard to the way they were calculated and their purpose and function, the imposts can also be seen as being akin to a tax on income.

10 **Part VIII: *Estimate***

52. The respondent estimates that it requires 3 hours to present its oral argument.

Dated: 11 February 2015

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98 To the extent the appellant was able to outperform the assumed cost efficiencies, that would have enlarged its profits. However, the payments would still have represented a portion of those profits.

99 TJ[78].

100 Appellant's submissions, [46].

101 *Smith's Potato Crisps (1929) Ltd v IRC* [1948] AC 508 at 529.10-530.3; *IRC v Dowdall, O'Mahoney & Co Ltd* [1952] AC 401 at 409.6-9.

IN THE HIGH COURT OF AUSTRALIA
MELBOURNE REGISTRY

No. M139 of 2014

BETWEEN:

AUSNET TRANSMISSION GROUP PTY LTD
(ACN 079 798 173)
Appellant

and

THE COMMISSIONER OF TAXATION OF THE COMMONWEALTH OF AUSTRALIA
Respondent

APPENDIX A: LEGISLATION

(A) RELEVANT PROVISIONS IN FORCE AT RELEVANT TIME

Relevant provisions of the ***Electricity Industry Act 1993*** **(Vic)** in force as at 12 October 1997 are as follows:

PART 12 REGULATION OF ELECTRICITY INDUSTRY

...

Section 158A. ***Tariff Order***

(1) The Governor in Council may, by Order published in the Government Gazette, regulate, in such manner as the Governor in Council thinks fit—

(a) tariffs for the sale of electricity to franchise customers;

(b) charges for connection to, and the use of, any distribution system;

(c) charges for connection to, and the use of, the transmission system;

(d) any other prices in respect of goods and services, being prices and goods and services declared in accordance with sub-section (1A) to be prescribed prices and prescribed goods and services in respect of the electricity industry.

(1A) The Order may declare prices and goods and services to be prescribed prices and prescribed goods and services in respect of the electricity industry for the purposes of the **Office of the Regulator-General Act 1994**.

Filed on behalf of the Respondent by:

Australian Government Solicitor
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19 Martin Place
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Date of this document: 11 February 2015

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(1B) The Order may direct the Office to make a determination under the **Office of the Regulator- General Act 1994** in respect of such factors and matters or in accordance with such procedures, matters or bases as are specified in the Order, or both.

(1C) The first Order made under this section has effect from 3 October 1994.

(2) Without limiting the generality of sub-section (1), the manner may include—

(a) fixing the price or the rate of increase or decrease in the price;

(b) fixing a maximum price or maximum rate of increase or minimum rate of decrease in the maximum price;

(c) fixing an average price for specified goods or services or an average rate of increase or decrease in the average price;

(d) specifying pricing policies or principles;

(e) specifying an amount determined by reference to a general price index, the cost of production, a rate of return on assets employed or any other specified factor;

(f) specifying an amount determined by reference to quantity, location, period or other specified factor relevant to the rate or supply of the goods or services;

(g) fixing a maximum revenue or maximum rate of increase or minimum rate of decrease in the maximum revenue in relation to specified goods or services.

(3) An Order under sub-section (1)—

(a) has effect as from the date specified in the Order as if the tariffs, charges and other matters to which the Order applies had been determined by the Office.

* * * * *

...

Section 163. ***Provisions relating to licences***

(1) A licence is to be issued for such term (if any) as is determined by the Office and is specified in the licence.

(2) A licence is subject to such conditions as are determined by the Office.

(2A) If a licence is issued to 2 or more persons for the purpose of the carrying on by those persons of the activities authorised by the licence in partnership or as an unincorporated joint venture, the licence may include conditions relating to the carrying on of those activities in that manner.

(3) Without limiting the generality of sub-section (2) or (2A), the conditions may include provisions—

(a) requiring the licensee to pay specified fees and charges in respect of the licence to the Office;

(b) requiring the licensee to enter into agreements on specified terms or on terms of a specified type;

(c) requiring the licensee to observe specified industry codes and specified pool rules with such modifications or exemptions as may be determined by the Office;

(d) requiring the licensee to maintain specified accounting records and to prepare accounts according to specified principles;

(da) specifying requirements about the ownership of real or personal property used in or in connection with the carrying on of the activities authorised by the licence;

(e) preventing the licensee from engaging in or undertaking specified business activities;

(f) specifying methods or principles to be applied by the licensee in determining prices or charges;

(g) specifying methods or principles to be applied in the conduct of activities authorised by the licence

(h) specifying procedures for variation or revocation of the licence;

(ha) specifying procedures for variation of the conditions by the Treasurer;

(i) specifying the procedures to apply if an administrator is appointed under section 166;

(j) requiring the licensee to provide, in the manner and form determined by the Office, such information as the Office may from time to time require;

(k) requiring the licensee to develop, issue and comply with customer-related standards, procedures, policies and practices (including with respect to the payment of compensation to customers).

(4) For the purposes of sub-section (3)(a) the fees and charges to be specified in respect of a licence are to be determined by the Minister having regard to the proportion of the total costs of the Office that are incurred in the administration of this Part.

(5) If the Office—

(a) issues a single licence authorising each of the activities referred to in section 161(1)(a) and (c); or

(b) issues to the same person separate licences which together authorise each of those activities; or

(c) approves the transfer of a licence as a result of which the same person holds separate licences which together authorise each of those activities—

the licence, or each such licence, must contain a condition prohibiting the person from having an entitlement—

(d) to generating capacity within the meaning of Part 13 of more than 30 megawatts derived from facilities which are not co-generation facilities; and

(e) to generating capacity within the meaning of Part 13 of more than 200 megawatts derived from facilities of any kind.

(6) If a licence is subject to conditions of a kind referred to in sub-section (3)(c), the Office—

(a) may, in accordance with procedures specified by the Office, amend the specified industry codes or specified pool rules, or a document referred to in such a code or rule, for the purposes of their application under the licence;

(b) may resolve, or seek to resolve, disputes between the licensee and any other person relating to the specified industry codes or specified pool rules, or a document referred to in such a code or rule, as they apply under the licence.

(7) If the Office amends an industry code or the pool rules or a document referred to in a code or the rules under sub-section (6), the Office may at the same time, in accordance with procedures specified by the Office, amend that code or those rules or that document for the purposes of their application otherwise than under the licence.

...

Section 163AA. ***Charges payable to Treasurer***

(1) The Governor in Council, on the recommendation of the Treasurer, may, by Order published in the Government Gazette, declare that specified charges, or charges calculated in a specified manner, are payable as an impost by the holder of a licence at such times and in such manner as are so specified.

(2) The holder of a licence must pay to the Treasurer for payment into the Consolidated Fund the charges determined under sub-section (1) and applicable to the licence at the times and in the manner so determined.

(3) An Order made under this section does not apply to a distribution company, a transmission company or a generation company that ceased to be a public distribution company, public transmission company or public generation company before the Order was made.

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

Section 163A. ***Franchise fee***

(1) A distribution company that holds, or has held, an exclusive licence under this Part authorising it to sell electricity to franchise customers must pay to the Treasurer, in respect of each financial year during which it holds, or held, such a licence the impost determined in respect of that year by Order of the Governor in Council, on the recommendation of the Treasurer, applying to that company and published in the Government Gazette—

(a) if the licence is issued before 30 June 1996—

(i) before 30 June 1995, in the case of the impost in respect of the financial year ending on that date; and

(ii) before 30 June 1996, in the case of the impost in respect of each year ending on 30 June in the period beginning on 30 June 1996 and ending on 30 June 2001; and

(b) if the licence is issued on or after 30 June 1996, before the end of the first year of the term of the licence.

(2) The Treasurer, in recommending the amount of an impost for each financial year payable by a distribution company, must be satisfied that the amount reasonably represents the amount by which the income of the company derived from the sale of electricity to franchise customers in that year is likely to exceed the sum of—

(a) the costs of deriving the income; and

(b) taxes payable in deriving that income; and

(c) an amount determined by the Treasurer to be a reasonable return on the capital of the company used in deriving that income—

having regard to—

(d) any relevant Order in force under section 158A; and

(e) the value of property and rights vested in the company under Parts 10 and 11; and

(f) the amount of liabilities that became liabilities of the company under Parts 10 and 11; and

(g) the likely number of franchise customers of the company in that financial year; and

(h) such other matters as the Treasurer determines after consultation with the company.

(3) The impost in respect of a financial year is payable at such times and in such manner as are determined in the Order.

(4) For the purposes of this section, a distribution company has an exclusive licence authorising the sale of electricity to franchise customers if that licence is the only licence in force under this Part authorising the sale of electricity to those customers.

...

S 167. ***Transfer of licence***

(1) The holder of a licence may apply to the Office for approval to transfer the licence.

(2) An application must be in a form approved by the Office and accompanied by such documents as may be determined by the Office.

(3) An application must be accompanied by the application fee (if any) fixed by the Office.

(4) The Office must publish in a daily newspaper generally circulating in Victoria a notice—

(a) specifying that an application for the transfer of the licence has been lodged with the Office for the transfer by the holder to a proposed transferee specified in the notice; and

(b) inviting interested persons to make submissions to the Office in respect of the application within the period and in the manner specified in the notice.

(5) Subject to this section, the Office may approve, or refuse to approve, the application for any reason it considers appropriate, having regard to the objectives specified in section 157.

(6) The Office must not approve the application unless the Office is satisfied that—

(a) the proposed transferee has the technical capacity to comply with the conditions of the licence or the conditions as varied by the Office under this section; and

(b) subject to sub-section (7), in the case of an application for the transfer of a licence to sell electricity, the proposed transferee is financially viable; and

(c) in the case of an application for the transfer of a licence—

(i) to generate electricity for supply or sale; or

(ii) to distribute or supply electricity—

the proposed transferee is a company incorporated under the Corporations Law of Victoria or a statutory authority or a corporation all the shares in which are held by, or on behalf of, the State or by a statutory authority.

(7) The Office does not have to be satisfied as to the matter specified in sub-section (6)(b) if the licence includes a condition requiring compliance with the pool rules and the pool rules include prudential requirements.

(7A) The Office does not have to be satisfied as to the matter specified in sub-section (6)(c) if, having regard to the conditions to which the licence will be subject upon the transfer of the licence, the Minister so approves at the request of the Office.

(8) The Office may determine that, upon the transfer of the licence under this section, the conditions to which the licence is subject are varied as determined by the Office.

(9) Subject to this section and any requirements specified in regulations made for the purposes of this section under section 92, the Office may determine the procedures that are to apply in respect of the transfer of the licences.

(10) The Office must notify an applicant in writing of its decision to approve or refuse to approve the application and, in the case of a decision to refuse to approve the application, of the reasons for its decision.

(B) WHETHER PROVISIONS STILL IN FORCE

1. Sections 158A, 163, 163AA and 167 of the *Electricity Industry Act 1993 (Vic)* were repealed with effect from 1 January 2001: see Part (B) of Appendix A to the appellant's submissions.

2. Section 163A was repealed with effect from 1 January 2001 by virtue of section 39 of the *Electricity Amendment Act 1995* (Act No 56 of 1995) which provided:

PART 4—FURTHER AMENDMENT OF PRINCIPAL ACT

...

39. *Amendment of Part 12*

In the Principal Act—

(a) ...

(b) ...

(c) ...

(d) ...

(e) section 163A is repealed;

(f) ...

Section 2 of the amending Act provided:

2. Commencement

(1) Part 1 comes into operation on the day on which this Act receives the Royal Assent.

(2) Section 67 (2) is deemed to have come into operation on 20 December 1994.

(3) Part 4 comes into operation on 1 January 2001.

(4) Subject to sub-section (5), the remaining provisions of this Act come into operation on a day or days to be proclaimed.

(5) If a provision referred to in sub-section (4) does not come into operation within the period of 12 months beginning on, and including, the day on which this Act receives the Royal Assent, it comes into operation on the first day after the end of that period.