A review of recent revenue law decisions of the High Court

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Two major questions which arise under section 51(1) of the *Income Tax Assessment Act 1936* (Cwlth)[1] (the ITAA) have recently been considered by the High Court. *Coles Myer Finance Ltd v. Federal Commissioner of Taxation*[2] addressed the question of when losses on bills of exchange and promissory notes issued at a discount were 'incurred' by the taxpayer. Was it when they were issued at a discount or on redemption or did the loss accrue over the period they were on issue? The timing and quantification of assessable income under section 25(1) and allowable deductions under section 51(1) of the ITAA cause much confusion in both practice and teaching.[3] The problems arise because the rules used to recognise income under section 25 are different to the rules for recognising deductions under section 51(1). Furthermore, there is no one rule for recognising when an expense has been 'incurred' under section 51(1). The *Coles Myer Finance* case concerns the tax accounting rules under section 51(1) which have had a consistent set of tests for recognising deductions except for provisions for holiday and long-service leave.[4]

The second problem under section 51(1) considered by the High Court is whether a particular expenditure was of a revenue nature and therefore deductible. Alternatively, was the expenditure of capital or of

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1 Section 51(1) provides:

> 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.

2 (1992-93) 176 CLR 640; 112 ALR 322; (1993) 25 ATR 95; 93 ATC 4214.

3 This area of revenue law is commonly referred to as 'tax accounting'.

4 See *Nilsen Development Laboratories Pty Ltd v. FCT* (1979-80) 144 CLR 616 and *FCT v. James Flood Pty Ltd* (1953-54) 88 CLR 492.

a capital nature and therefore non-deductible? The case of *Mount Isa Mines Ltd v. Federal Commissioner of Taxation*[5] indicates that the High Court is taking a far more realistic approach in applying Dixon J's tests in the *Sun Newspapers* case[6], an approach that has been missing in Federal Court decisions[7].

In a third case under the ITAA, *Registrar of the Accident Compensation Tribunal v. Federal Commissioner of Taxation*[8], the High Court considered whether a person holding office under the Crown in the right of the State of Victoria could be subject to sections 95—99 of the ITAA and therefore be liable to pay income tax on monies held under the *Workers Compensation Act 1958* (Vic.).

In the last of the recent cases, *Commonwealth of Australia v. Genex Corporation Pty Ltd; Kodak (Australasia) Pty Ltd v. Commonwealth of Australia,*[9] the High Court determined whether the Commissioner had correctly assessed the taxpayers for sales tax under the now repealed *Sales Tax Assessment Act (No 1) (1930)* (Cwlth) on the 'price' of processing film from which photographic prints had then been made. The decision highlights the difficulty involved in expressing legislative intent in an explicit and clear manner.

1 *Coles Myer Finance Ltd v. Federal Commissioner of Taxation*[10]

This case was an ideal opportunity for the High Court to overturn the decisions in *Nilsen Development Laboratories Pty Ltd v. FCT*[11] and *FCT v. James Flood Pty Ltd*[12] and to thereby provide a consistent and logical application of section 51(1). It is a matter of great regret that this was not the outcome. With due respect it is the author's view that the dissenting decision of McHugh J is preferable from the point of view of consistency and rigour of legal reasoning; a rigour which was missing in both *James Flood* and *Nilsen Developments.* Not only did the

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5 (1992-93) 176 CLR 141; (1992) 110 ALR 29; 24 ATR 261; 92 ATC 4755.

6 *Sun Newspapers Ltd v. FCT; Associated Newspapers Ltd v. FCT* (1938-39) 61 CLR 337; (1938) 1 AITR 403; 5 ATD 87.

7 See for example *Nizich v. FCT* (1991) 22 ATR; 91 ATC 4747.

8 (1993) 178 CLR 145; 117 ALR 27; 26 ATR 353; 93 ATC 4835.

9 (1992-93) 176 CLR 277; (1992) 110 ALR 154; 24 ATR 328; 92 ATC 4764.

10 (1992-93) 176 CLR 640; 112 ALR 322; (1993) 25 ATR 95; 93 ATC 4214.

11 (1979-80) 144 CLR 616.

12 (1953-54) 88 CLR 492.

majority judgment[13] fail to simplify this area, it introduced yet another exception to the general principles for recognising losses under section 51(1). The Court did however clarify some confusion which certain commentators have had with understanding the decision in *W. Nevill & Co. Ltd v. FCT*[14]. The decision in the *Coles Myer* case is of concern in that it makes the teaching and understanding of tax accounting more difficult, when it could have been simplified. It is not surprising therefore that the decision has resulted in considerable discussion in the literature.[15]

The case stated

This case came to the High Court, via the Federal Court, by way of a special case stated by the Administrative Appeals Tribunal. The special case raised the following questions for consideration:[16]

> **First question**
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> On the facts stated in this special case does the amount of $2,375,579 ... or some other and what amount constitute, within the meaning of s. 51(1) of the *Income Tax Assessment Act 1936*, a loss or outgoing incurred by the applicant:
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> (a) in the year of income ended 30 June 1984?
>
> (b) in the year of income ended 30 June 1985?

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13 Mason CJ, Brennan, Deane, Dawson, Toohey and Gaudron JJ.

14 (1936-37) 56 CLR 290.

15 See for example *Taxation in Australia* (Blue Edition) - 'Coles Myer - the Aftermath', Vol. 28 No. 1 July 1993 pp. 41-41, comments pp. 46-47; Vol. 28 No. 2 August 1993, comment p. 113; Vol. 28 No. 3 September 1993 pp. 171-172; Gzell, I.V., 'The *Coles Myer* and *Fletcher* Decisions' Vol. 28 No. 5 November 1993 pp. 275-280; Richardson, G.A. 'Section 51(1): Genesis, Evolution, Implications' Vol. 28 No. 9 March 1994 pp. 450-456; *Taxation in Australia* (Red Edition) 'Joint Submission to ATO by ASCPA, ICA Law Council of Australia and Taxation Institute', Vol. 2 No. 1 August 1993 pp. 53-55; Barkoczy, S and Bellamy, N., "Losses and Outgoings: The "Matching Principle" - a Heavier Burden' Vol. 2 No. 3 February 1994 pp. 151-160; Russell, D., 'Sub-section 51(1): Disquieting Trend in the Courts' Vol. 2 No. 3 February 1994 pp. 161-172 at pp. 163-164 and 171; *Australian Accountant* - Richards, R. 'Taxation' June 1993 pp. 51-52; July 1993 p. 59; November 1993 pp. 60-61; March 1994 pp. 56-57.

16 (1992-93) 112 ALR 322 at 324-325.

(c) partly and to what extent in the year of income ended 30 June 1984 and partly and to what extent in the year of income ended 30 June 1985?

Second question

On the facts stated in this special case does the amount of $2,359,893 ... or some other and what amount constitute, within the meaning of s. 51(1) of the *Income Tax Assessment Act 1936*, a loss or outgoing incurred by the applicant:

(a) in the year of income ended 30 June 1984?
(b) in the year of income ended 30 June 1985?
(c) partly and to what extent in the year of income ended 30 June 1984 and partly and to what extent in the year of income ended 30 June 1985?

The facts

Coles Myer Finance[17] had in the course of its finance business drawn and sold at less than their stated face value, bills of exchange and promissory notes. A significant proportion of them were outstanding as at the 30 June 1984.

Outstanding 30/6/84	face value	discounted by the taxpayer on sale	discount
Bills of exchange	$70,000,000	$67,624,421	$2,375,579
Promissory notes	$40,000,000	$37,640,106	$2,359,893

The taxpayer claimed a deduction for the difference between the face value and the sale price on the bills and notes in its return of income for the year ended 30 June 1984 under section 51(1) of the ITAA. The Commissioner disallowed the claim because no relevant loss had been incurred nor was the expenditure paid until the instruments were redeemed in the following taxation year. The taxpayer objected, contending that the relevant loss or expenditure was incurred when the taxpayer drew the bills and issued the notes. It was at that time that it incurred the liability to pay their full face value, despite the fact that the date for payment was a future date. This report is an appeal from the decision of

17 Hereafter referred to as 'the taxpayer'.

the Full Court of the Federal Court upholding the Commissioner's assessment.

The taxpayer's and Commissioner's arguments

Before the High Court the Commissioner and the taxpayer maintained their basic arguments. Both parties presented an identical alternate argument that the relevant amounts constituted losses or outgoings incurred partly in the year of income ended 30 June 1984 and partly in the year of income ended 30 June 1985 and that therefore the loss ought to be apportioned on a straight line basis in accordance with generally accepted accounting practice. The case was conducted on:[18]

> ... the agreed footing that the relevant loss on the bills and notes was incurred in gaining or producing the taxpayer's assessable income or was necessarily incurred in carrying on a business for the purpose of gaining or producing such income, and was not a loss or outgoing of capital or of a capital, private or domestic nature. It seems that this agreement regarding the net loss was reached in order to forestall the argument which lay at the centre of the decision in *Avco Financial Services Ltd v. FCT*[19] that is, whether gains and losses on exchange transactions were on revenue account.

The Commissioner's argument was that the gross amounts received and paid were on capital account whereas the discounts or losses were on revenue account and, therefore, deductible. The Commissioner reformulated his argument before the High Court as follows:

(a) the gross amounts received and paid by the taxpayer were of a capital nature;

(b) the gross amounts were received and paid on revenue account or for revenue purposes, that is, for the purposes of and in the course of the taxpayer's income-earning business as a finance company;

(c) the cost to the taxpayer of obtaining the gross receipt (i.e. the discount) was therefore a deductible loss or outgoing, just as the inter-

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18 (1992-93) 112 ALR 322 at 326 per Mason CJ, Brennan, Dawson, Toohey and Gaudron JJ.

19 (1981-82) 150 CLR 510; (1982) 41 ALR 225.

est earned by it through the use of the proceeds in the business was assessable income.

The Majority Judgements - Mason CJ, Brennan, Dawson, Toohey and Gaudron JJ.

The taxpayer's liability under the Bills of Exchange

What was the liability of the taxpayer in regard to the accepted bills drawn by the various banks with which it had accommodation arrangements? The primary case relied upon was *K.D. Morris & Sons Pty Ltd (in liq) v. Bank of Queensland Ltd.* Their Honours referred to the comments of Stephen and Wilson JJ that:[20]

> Had the Bank been only a casual acceptor of the Company's bills, bound by no agreement to accept them and only doing so in each case as an isolated transaction, there would be no continuing liability. Instead there would be a series of unconnected relationships whereby the Bank became surety for the Company for particular accommodation bills and the Company assumed a liability to the Bank accordingly, which liability would be discharged when the Company put the bank in funds to retire the bills on maturity. The acceptance of each new bill would give rise to a fresh liability.

Aickin J (with whom Mason J agreed) said:[21]

> The liability of the Company was not dependent upon any contingency once the bills had been discounted. On the Bank paying each bill on presentation, the liability to indemnity arose by reason of the inherent characteristics of an accommodation bill. The liability of the Company under the agreement was to provide funds to the Bank in advance of the maturity date by discounting replacement bills but that was a mere consequence of the liability to indemnity the Bank. It was rather a means of satisfying the primary liability to indemnity than a separate and independent liability.

Their Honours therefore rejected the view of the Full Court of the Federal Court in the case under appeal, that the drawer of an accommodation bill does not come under a liability to the acceptor until

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20 (1980-81) 146 CLR 165 at 175; (1979-80) 30 ALR 321 at 327.

21 *Id* at CLR 165 at 202; ALR 321 at 349-50.

the acceptor makes payment under the bill because '[t]he judgments in *Morris* were clearly inconsistent' with such a proposition which 'the Federal Court should have recognised.'

The taxpayer's liability under the promissory notes

With respect to the promissory notes they concluded that when one makes a promissory note 'the maker engages that he will pay it according to its tenor[22].' This was an obligation to pay at a future time, which was clearly 'a present liability' because there was 'no necessity for presentment of the note for the maker to be liable to pay out the note at maturity[23].' The maker of the note promises to pay:[24]

> ... a fixed amount to the payee at a future date in consideration of the immediate payment by the payee of the lesser sum.

Even though that amount is not payable until the date of maturity, when the maker receives the payment of the lesser sum he immediately owes the note's face value. This was the basis of the decision of the High Court in *David v. Malouf*[25] as 'the amount of the note being due, though it was not payable until some future time.'

Their Honours then considered the High Court's decision in *W. Nevill & Co. Ltd v. FCT*[26] where it was held that the taxpayer had not incurred an outgoing under section 51(1) until the notes were paid.[27] However, *Nevill* did not deal with the case of notes issued at a discount. The reasoning in *Nevill* was, in their Honours' opinion, not expressed. They stated that:[28]

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22 Relying on *Bills of Exchange Act*, s. 94(a).

23 *Bills of Exchange Act*, s. 93(1).

24 (1992-93) 176 CLR 640 at 660; 112 ALR 322 at 329.

25 (1908) 5 CLR 749.

26 (1936-37) 56 CLR 290.

27 In *Nevill* the consideration for an early termination of an employment contract was agreed to be £2,500. This was to be satisfied by the payment of £1,500 in cash and the remainder to be paid in monthly instalments of £100. These instalments were covered by promissory notes.

28 (1992-93) 112 ALR 322 at 329.

> Latham CJ expressed the view, though 'not as a concluded opinion', that the amount was deductible in the year in which it is paid out rather than in the year in which the note is made. Rich J agreed with the result but declined to express an opinion on the question of law. Dixon J concluded that the amounts due under notes which would mature in the next income year could not be deducted during the income year in question. His Honour gave no reasons for this conclusion. McTiernan J agreed with the answer to the question given by Latham CJ and stated that the deductions in the year of income should be limited to £1900, being the amounts paid in that year. Again, his Honour gave no reasons for his conclusion.

Their Honours did not consider that *Nevill* should be regarded as overruling *David v. Malouf.* Whatever the reasons were for the decision in *Nevill*, they do not apparently 'relate to the time when the liability of the maker arises under a promissory note.' This approach was supported by the later cases of *Commissioner of Taxation (NSW) v. Ash* and *Nilsen Developments* cases which suggest *Nevill* was based on the view that:[29]

> ... in the particular circumstances of that case, the liability to make the payments was an outgoing properly referable to the years of income in which the payments were made rather than the year in which the liability to make the payments was actually incurred.

Their Honours also referred to Dixon J's comment in *Commissioner of Taxation (NSW) v. Ash* that:[30]

> Where the reason for allowing a deduction is that it is a normal or recurrent expenditure or an expenditure which is fairly incident to the carrying on of the business, it is evident that it can seldom be associated with any particular item, on the revenue side against which to set it, and, as the ground of its allowance is that it is an incident or accident, something concomitant to the conduct of the business, it follows that to deduct it in the year when it falls to be met is consistent with the reason for deducting it and conforms with business principles. Thus, in *[Nevill]*, where, although the matter was not argued, the Court found it necessary to say whether the payments ... should be deducted in the period when they were agreed upon or that in which they were made, it was considered

29 (1992-93) 112 ALR 322 at 330.

30 (1938-39) 61 CLR 263 at 282, quoted at (1992-93) 112 ALR 322 at 330.

> that the deductions should be made from the assessable income of the periods of account in which the payments were made.

In the decision in *FCT v. James Flood Pty Ltd*, 'the Court (Dixon CJ, Webb, Fullagar, Kitto and Taylor JJ) said that nothing that was decided in *Nevill* was intended to imply that a liability to pay an ascertained sum is never incurred until the sum becomes due and payable'.[31] Their Honours in *Flood* explained the judgment in *Nevill* that the judges had:[32]

> ... looked upon the monthly payments not so much as deferred instalments of an accrued liability in a lump sum but as an attempt to spread over a period of trading an outgoing parallel with the salary that had been saved. But whatever be the rationale of the decision of the point, clearly enough it is not based on a view that no outgoing could be incurred until actual payment was made.

It was noted by their Honours that in *Flood* the Court had pointed out that to come within section 51(l) the taxpayer did not need to 'come under an immediate obligation enforceable at law whether payable presently or at a future time'.[33] This however must be understood in the context of the decision in that case. The Court in *Flood* held that a provision for employees' annual holiday leave was not deductible under section 51(1) because:[34]

> ... [i]n respect of those employees there was no debitum in praesenti solvendum in futuro. There was not an accrued obligation, whether absolute or defeasible. There was at best an inchoate liability in process of accrual but subject to a variety of contingencies.

The condition precedent which the entitlement of the employees depended had not occurred. *Flood*:[35]

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31 (1953) 88 CLR 492 at 507, quoted at (1992-93) 112 ALR 322 at 330.

32 *Ibid.*

33 *Id* at 506.

34 *Id* at 507-508.

35 (1992-93) 112 ALR 322 at 331.

> ... therefore stands as authority for the proposition that a liability must presently be existing in order to be 'incurred' within the meaning of s. 51(1).

This approach was 'accepted' in *Nilsen Development Laboratories Pty Ltd v. FCT,* where the High Court held that provisions for long-service leave 'were not outgoings "incurred" within the meaning of s. 51(1)' as there was no liability to make such payments 'until the employees either took the leave entitlements or ceased employment.'[36] *Flood* and *Nilsen Developments* proceeded on:[37]

> ... the footing that the Court, in determining entitlement to a deduction under s. 51(1), accepted the legal or jurisprudential analysis rather than the commercial view as the correct one. In other words, the Court concluded that the liability was the ordinary liability to pay wages to an employee in respect of a period of employment in preference to the commercial view that the liability was a progressive one, being part of the cost of labour employed from day to day.

Their Honours then quoted the comment of Barwick CJ, Kitto and Taylor JJ, in *Arthur Murray (NSW) Pty Ltd v. FCT*, with respect to *Flood* where they noted that 'commercial and accountancy practice' may assist when applying 'the test laid down in the Act for allowable deductions' noting however that 'it cannot be substituted for the test.'[38]

This resulted from the High Court taking a 'legal or jurisprudential analysis in determining entitlements to a deduction under s. 51(1) in preference to the commercial view.' Their Honours noted that in this case the 'parties did not contend in the present case for a different approach to the question.'

Was the loss revenue or capital?

Having found that a loss had been incurred the Court went on to consider the nature of the loss. Was it a revenue loss, in which case it came within the provision of section 51(1), or was it a capital loss and therefore excluded under section 51(1)? As noted above both the taxpayer and Commissioner had accepted that the losses were incurred in gaining

36 *Ibid.*

37 *Ibid.*

38 (1965-66) 114 CLR 314 at 320, quoted at (1992-93) 112 ALR 322 at 331.

or producing assessable income and were not a capital loss or of a capital nature. Despite this their Honours went on to consider the matter.

Their Honours then considered the decision of the High Court in *Avco Financial Services Ltd v. FCT* which contained statements that proceeded on the basis that borrowing transactions of a finance company were 'properly ... regarded' as being 'on capital account':[39]

> ... the relevant gains and losses are nevertheless to be regarded as revenue gains and losses.

The exchange gains and losses had been incurred by Avco 'in the course of and as an incident of making repayments of the borrowed money with which the taxpayer carried on its business as a finance company'. As such they had been 'incurred in the day-to-day conduct of the business'. Even though the Court considered the borrowings to be capital:[40]

> ..it was working or circulating capital from which the taxpayer derived its profits by turning the borrowed money to account at higher rates of interest than those paid to the taxpayer's lenders. The borrowing, as much as the lending, was an integral part of the day-to-day conduct of the taxpayer's profit-earning business.

Therefore, as in the *Avco case,* this case was an example of 'a loss or outgoing incurred for the purpose of securing working or circulating capital which is clearly deductible.' The taxpayer derived its income from the profits which it made from various classes of financial transactions. The bills and notes were used:[41]

> ... for the purpose of its business as a finance company, using the moneys raised by discounting the bills and notes for the purpose of providing finance, from which it earns its income. ... The taxpayer's business is therefore similar to that of a finance company which borrows moneys for lending, the rates of interest which it pays being significantly lower than those payable to it by those who have the moneys on loan. In effect, the

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39 (1981-82) 150 CLR 510; Joint judgment of Mason, Aickin and Wilson JJ, discussed at (1992-93) 112 ALR 322 at 332.

40 (1992-93) 112 ALR 322 at 332.

41 *Id* at 333.

> discount offered by the taxpayer is the cost of acquiring the funds which it turns over in its business, the amount of the discount serving the same purpose as the amount of interest on borrowed moneys; the amount of the discount is the cost of those moneys.

As a result the amount of discount on the bills and notes 'is a loss or outgoing made in the ordinary course of conducting the business for the purpose of profit-making.'[42]

In which year was the loss incurred?

Their Honours noted that while 'the legal liability to pay' was incurred in the 1984 year of income, it was not payable until the next income year. More importantly:[43]

> ... the net loss or outgoing represents the cost of acquiring funds which the taxpayer puts to profitable advantage in both years of income. ... As between the drawer and the holder of a note or bill, the burden of the liability incurred by the drawer increases with the passage of time between the discounting of the note or bill and its maturity.

Therefore, when attempting to ascertain the taxpayer's 'net income or profit' for the year of income, it is necessary to set off against the 'taxpayer's gross income or profit for that period the net losses or outgoings referable to that period.' However under section 51(1) losses or outgoings are only deductible to the extent to which they are incurred in gaining or producing the assessable income. Their Honours noted that it:[44]

> ... has been described as, 'a statutory recognition and application of the accountancy principle which all the accountants who gave evidence referred to as the matching principle', to use the words of Menhennitt J in *RACV Insurance Pty Ltd v. FCT.* **Apportionment of the cost over the two years of income therefore accords with both accounting principle and practice and the statutory prescription**.

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42 *Ibid.*

43 *Ibid.*

44 *Ibid* (emphasis is added).

No authority is given for this last statement. Their Honours merely provided an example showing that without apportionment there would be a 'distortion':[45]

> ... of the taxpayer's **operations on revenue account** in the year of income in which the bills are drawn and would open the way to inflating very considerably the amount of allowable deductions under s. 51 for that year.

Their Honours, having rejected the approach adopted by the Full Court of the Federal Court and the primary argument of the taxpayer, concluded that it necessarily followed that 'the total cost should be apportioned'.[46] Because of the 'relatively short life of the bills and notes' this apportionment 'should be on an accounting straight line basis over the term of the relevant note or bill' and both parties agreed on this method of apportionment.[47]

Comment:

With due respect, the reasoning used leading to the apportionment of the loss by their Honours is a nonsense. It ignores the structure of the ITAA, which offsets assessable income against allowable deductions as provided in section 48. Sections 25 and 51(1) have independent operations. It ignores all the principles that have been developed to ascertain when an allowable deduction has been incurred under section 51(1). It also ignores the difference between taxable income under section 48 and the concept of accounting profit. There is no such thing as 'operations on revenue account' in tax accounting under the ITAA. There are allowable deductions and assessable income alone. Where this notion arose from is a total mystery. If there is a distortion it is because that is the way the ITAA works and not due to the particular transaction.

The example given runs contrary to all the decided cases. It supposed that:[48]

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45 *Id* at 334, the emphasis is added.

46 *Ibid.*

47 *Ibid.*

48 *Ibid.*

> ... the taxpayer raises finance by long term rather than short term bills, drawing bills which mature 10 years after the date on which they are drawn and discounting them immediately. The amount of the discount would be very substantial having regard to the very long life of the bills so that the deduction of the difference between the face value of the bills in the year in which they are drawn and the amount realised by discounting the bills ...

The Courts have let such policy consideration override the express words of section 51(1) used in the ITAA in *Flood* and *Nilsen Developments*. If interest had been paid in advance, rather than issuing the notes and bills at a discount, there would have been no question of apportioning it under section 51(1).

Concurring judgment of Deane J

Deane J agreed with the joint majority judgment and expressed the view that the decision of the High Court on the subsidiary question of the promissory notes in *W. Nevill & Co. Ltd v. FCT* should 'be treated as turning on its own particular facts' and did not support the 'general proposition that the maker of a promissory note cannot incur a loss or outgoing for tax purposes until the date of maturity.'[49] His Honour then commented with respect to the *Avco* case that it was important in the present context because the decision provided 'strong support' for the proposition that:[50]

> ... taxpayer's net losses or outgoings, resulting from the discount on the face value allowed upon sale, are the kind of recurrent expenditure which is deductible pursuant to s. 51(1) of the Act as a loss or outgoing incurred in gaining or producing assessable income.

In Dean J's opinion the result in this case would have been the same even if the taxpayer's liability were a contingent one. As:[51]

> .... for practical purposes, always inevitable that any theoretical contingency, which existed at the end of the tax year and affected the taxpayer's liability to make the payment of the face value of the notes and

49 *Ibid.*

50 *Id* at 336.

51 *Ibid.*

> bills, would be satisfied, unless the taxpayer subsequently repurchased the bills or notes in the market place. Even if the taxpayer had subsequently purchased the bills or notes in the market place - and it did not - the purchase price would presumably have exceeded their 'value' as at the end of the tax year since the appropriate 'discount' on face value would be expected to decrease as the time of maturity approached.

With respect to *Flood* and *Nilsen Developments* Deane J states that it did not follow:[52]

> ... that the fact that jurisprudential analysis discloses that a particular liability to make a future payment of money is contingent necessarily means that such a contingent liability cannot constitute or found a 'loss or outgoing' which has been 'incurred' for the purposes of s. 51(1). To the contrary, the weight of authority supports the conclusion that, depending upon the circumstances, a liability to pay money can constitute, or give rise to, a 'loss or outgoing' which is 'incurred' within the meaning of that subsection notwithstanding that the money is not payable until a future time and that the obligation to pay it is theoretically defeasible or contingent in that it is subject to a condition which remains unfulfilled.

The 'critical question' to be determined when using the accruals method for determining whether an existing liability to make a future payment represented a loss or outgoing which has been 'incurred' under section 51(1) was whether 'the liability is theoretically contingent or defeasible'? This question was answered on the basis of a legal analysis. As a 'practical' matter, is the taxpayer 'definitively committed' or 'completely subjected' to the particular obligation to make a future payment:[53]

> ... even though it has not come under 'an immediate obligation enforceable at law" to do so. As Dixon J (with the concurrence of McTiernan J) stressed in *New Zealand Flax Investments Ltd v. FCT*, in a passage subsequently adopted by the court in *FCT v. James Flood Pty Ltd*:[54]
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> > To come within that provision there must be a loss or outgoing actually incurred. 'Incurred' does not mean only defrayed, discharged, or borne, but rather it includes encountered, run into, or fallen upon. It is

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52 *Id* at 337.

53 *Ibid.*

54 (1938-39) 61 CLR 179 at 207.

> unsafe to attempt exhaustive definitions of a conception intended to have such a various or multifarious application. But it does not include a loss or expenditure which is no more than impending, threatened, or expected.

In his view when ascertaining 'taxable income on an accruals basis' it will be 'decisive against deductibility' unless:[55]

> ... in the circumstances of the particular case, the contingency or defeasibility precludes the liability from constituting, or giving rise to, a 'loss or outgoing' which has been 'incurred' in the sense explained by Dixon J in the above passage, that is to say, 'encountered, run into, or fallen upon' as [338] distinct from being 'no more than impending, threatened, or expected'. In that regard, it is important to bear in mind that Dixon J's explanation of the import of the words 'loss or outgoing ... incurred' in a taxation provision which relevantly corresponded with s. 51(l) was propounded by his Honour in the context of determining the deductibility of a liability to pay interest at a future time which his Honour expressly recognised as being theoretically 'contingent'. Indeed, the actual decision of the Court in *New Zealand Flax* was that so much of that contingent liability to pay money in the future as was 'referable' or 'properly attributable' to the tax year in question was deductible as a 'loss or outgoing' which had been 'incurred'.

Deane J agreed with orders proposed in the joint judgment but did not say how they follow from his findings of law as to when the taxpayer became liable to pay the bills and notes, merely agreeing with the joint judgment.

Dissenting judgment of McHugh J

McHugh J said that if one were to look at section 51(1) afresh, one of two interpretations of its operation were possible.[56] Firstly by placing emphasis on the words 'losses or outgoings'. If that were done 'the section might be interpreted so as to require an actual disbursement of money or loss of property before a deduction was allowable.' The alternative would place the emphasis on the words 'incurred in gaining or producing the assessable income, or are necessarily incurred in

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55 (1992-93) 112 ALR 322 at 337-338.

56 *Id* at 340-341.

carrying on a business for the purpose of gaining or producing such income'. If this were done, it might be interpreted:[57]

> ... so as to require the allowance of all or part of the expenses directly related to the earning of income during the relevant financial year and to require the courts to apply the 'matching principle' of accounting doctrine. That principle seeks to ascertain the net gain of a business during a particular year by matching against the income earned during that period the expenses and losses which, from a business point of view, were directly related to the earning of income during that period.

However, both of these approaches have been rejected. The approach which has been adopted would seem to be:[58]

> ... more appropriate for determining the assets and liabilities of the taxpayer at the end of the income period than ascertaining what expenses and losses were really incurred by the taxpayer in earning income during that period. The court has insisted that ... a loss or outgoing is not incurred until there is a presently existing liability to pay a pecuniary sum, no matter how certain it is from a business viewpoint that an expense was incurred or accrued during the year of income.

As such, accountancy and business practices are only a guide as to whether a loss or outgoing has been incurred under the section. The High Court has taken a 'jurisprudential approach' in interpreting section 51(1). McHugh J then discussed the decisions in *James Flood* and *Nilsen Development Laboratories*. He noted that a distinction has been drawn in the cases between the incurring of the liability and its quantification. It may have been incurred for the purposes of s. 51(1) even though the actual amount in that period can only be estimated.[59] Such an approach was also taken by the Courts in *RACV Insurance Pty Ltd v. FCT*[60] and *Commercial Union Assurance Co. of Australia Ltd v.*

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57 *Id* at 341.

58 *Ibid.*

59 See *Commonwealth Aluminium Corp Ltd v. FCT*, (1977) 7 ATR 376.

60 (1974) 3 ALR 600 in which it was held that an insurer was entitled to a deduction in respect of amounts put aside in the income year to meet compulsory third party claims that had been reported but not met. Additionally the insurer was entitled to a deduction in respect of amounts put aside to meet claims which, on the basis of

FCT.[61] These cases seemed to McHugh J to be 'eminently sensible'. However, they were:[62]

> ... reached only by a strained application of the rules laid down in *James Flood* and *Nilsen Development Laboratories*. That a sensible result can only be achieved by a strained application of those decisions must throw doubt on the validity of the principles which decided them.

The Promissory Notes

McHugh J was of the opinion that when the promissory notes were sold and delivered to the successful tenderers, the taxpayer had come 'under an unconditional liability' to pay their face value on their due dates. This was because the delivery of the notes created 'a presently existing debt payable at a future time.'[63]

The sale and delivery of the notes created debts and therefore the taxpayer incurred liabilities in the year of income in which the debts were created. This result followed from the application of principles expounded in *New Zealand Flax*, *James Flood* and *Nilsen Development Laboratories*. Whatever approach one took to the application of section 51(1) it 'seems impossible to deny ... a deduction ... in respect of the year when the debts were created.' McHugh J noted, however, that in *Nevill*, the High Court held that:[64]

> ... a promissory note is not 'incurred' in the income year of its creation if it matures after the expiration of that year.

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actuarial calculations, must have been incurred by, although not yet reported to the insurer.

61 (1976-77) 14 ALR 651 where it was held that an insurer was entitled to a deduct amounts set aside to meet claims incurred during the financial year whether reported or not, even though the claims were in breach of a condition precedent as to notice. This being the long established policy and practice of the insurer. It was noted that this 'Was a matter of commercial certainty, and was not subject to any contingency which would be regarded as such in the world of ordinary business affairs'.

62 (1992-93) 112 ALR 322 at 344.

63 Relying upon *David v. Malouf*, (1992-93) 112 ALR 322 at 344.

64 *Ibid.*

What was the status of the Nevill case?
McHugh J noted that in *Nevill*:[65]

> Latham CJ said that the question of timing had not been argued and he would require full argument before deciding the question. Without expressing a concluded opinion upon the point, his Honour held that the amounts represented by the six notes could not be deducted in the year in which they were created. Rich J also said that neither the Commissioner nor his counsel had raised the question as to which years the expenditure should be allocated. Without deciding the point, he said that he was content to follow the course proposed by the Chief Justice. Dixon J said that the retiring allowance was deductible. But, without giving any reasons, he said that he did not think 'that so much of it as was represented by promissory notes payable after 30 June 1931 can be deducted in the assessment for the financial year ending 30 June 1932 [sic]'. McTiernan J said that the deduction for the 1931 financial year should be limited to the amounts represented by the cash payment and the four promissory notes which had been paid in that year. He gave no reasons for this conclusion.

Due to the lack of argument on the issue of the promissory notes his Honour was of the opinion that on this issue *Nevill* should be overruled and that:[66]

> Because the court gave no reasons for its decision, it is an authority only on a materially identical set of facts.

Given the circumstances his Honour saw no reason why the High Court should hesitate to overrule that part of the *Nevill* decision.

Was the loss capital or income?
As the taxpayer in this case came under an immediate liability to pay the face value of the notes once it sold them, what was the nature of the loss? McHugh J noted that in *Avco Financial Services Ltd v. FCT* it was held that a finance company 'was entitled to a deduction under s. 51 in respect of the additional cost of repaying a loan which had been brought

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65 *Id* at 345.

66 *Ibid.*

about by a devaluation of the currency.' He quotes from the judgment of Mason, Aickin and Wilson JJ where they said that:[67]

> Avco's borrowings to obtain funds to finance its lending and hire-purchase business bear a sufficiently close resemblance to the borrowing of funds to purchase physical stock-in-trade and the deferring of payments due to suppliers of such stock to require exchange gains and losses to be treated in the same way, i.e. as being on revenue account.

Clearly the case for treating a loss 'on the sale of promissory notes by a financier as a revenue expense appears just as strong as the case for treating losses on the devaluation of funds borrowed by a financier as a revenue expense.'

It was irrelevant that before the maturity date the taxpayer may have repurchased the notes in the market below their face value. The difference between the face value and the sale value represented a loss which the taxpayer had incurred. Had the taxpayer chosen to repurchase the notes before the due date 'the difference between the face value and the purchase price would be income for the purposes of the Act'.[68]

The same considerations would apply to the bills of exchange.

The Bills of Exchange

Having undertaken an extensive discussion[69] of the relevant case law relating to bills of exchange, he concludes on the fact that 'the only conclusion' which could be drawn was that upon the acceptance of the bills by the banks the taxpayer 'came under an immediate obligation to pay the face value of the bills at a time no later than their maturity date.'[70] This was in the tax year ending 30 June 1984. There was 'a present obligation to pay a definite sum at a future time.'[71] Under

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67 (1982) 41 ALR 225 at 241, quoted at (1992-93) 112 ALR 322 at 346.

68 (1992-93) 112 ALR 322 at 346.

69 His discussion adds nothing to that contained in the majority judgments and follows the same lines of reasoning on this point. It is therefore not discussed here.

70 *Id* at 351.

71 *Ibid.*

section 51(1) when the taxpayer sold the notes he incurred a loss which:[72]

> ... represented by the difference between the proceeds of the sale of the notes and its present liability to pay the face value of the bills.

Using the 'matching principle' it might well be that the losses might have to be spread over the two income years. However, such an approach did not accord with the 'current doctrine' which was used to decide the deductibility of expenses under section 51(1). Therefore the taxpayer was 'entitled to a deduction in the year in which its legal obligation to pay the face value of the bills arose.'

McHugh J's conclusions on the legal effect of the transaction are the same as the majority. However it is the application of those legal principles to the question of deductibility of the loss under section 51(1) which differs.

Conclusion

This case is another clear example of the High Court's inability to deal with matters of tax accounting in a logical and commonsense manner. It will, like *FCT v. Suttons Motors (Chullora) Wholesale Pty Ltd*[73] before it, cause interminable confusion and complexity for practitioners, academics and students. The problem appears to be the preoccupation with accounting concepts and procedures, rather than the legal tests laid down in the specific provisions of the ITAA.

2 Mount Isa Mines Ltd v. Federal Commissioner of Taxation[74]

This case considers the application of revenue capital dichotomy for deductibility of an expense under section 51(1) of the ITAA, whereas the *Coles Myer* case was primarily concerned with the timing of a deduction which was allowable. While the taxpayer did not succeed, the case adds a further insight into the application, in borderline situations, of the tests stated by Dixon J in the *Sun Newspapers* case.

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72 *Ibid.*

73 (1985) 16 ATR 567.

74 (1992-93) 176 CLR 141; (1992) 110 ALR 29; 24 ATR 261; 92 ATC 4755.

The facts

Mount Isa Mines Ltd[75] had some time around 1950 constructed a structure that was used to cool water from an adjacent power station. Constructed mainly from wood it was known as the 'Marley Tower'. The tower was approximately 100 x 40 feet and 30 feet high. According to the evidence it was replaced in the early 1970s because 'it was becoming old and inefficient and because it was in an unsuitable location'. It was decommissioned in 1977. At that time it had a lean of approximately 10 to 20 degrees. The timber had dried and posed a fire risk. There was also a possible danger that winds could blow away parts of the building.

The 'Old Roaster' was constructed some time between 1953 and 1967. It was used in the processing of copper ore. By 1967 it consisted of six roasters. In 1971 after a review of its operations the taxpayer decided to replace the 'Old Roaster' with new equipment. In 1973 the new roasting plant was commissioned and the 'Old Roaster' became redundant and obsolete. After this it deteriorated and became dangerous.

Around 1976 or 1977, the taxpayer undertook a review of its plant at Mt Isa in accordance with its policy 'to maintain the mine site in a safe condition and to reclaim ... parts from obsolete buildings'. As a result of this review 'obsolete and dangerous structures' were demolished at the mine site. These included the 'Old Roaster' and the 'Marley Tower'.

The taxpayer's argument

The taxpayer claimed these demolition costs ($250,608 and $29,975 respectively) as deductions under s. 51(1) of the *Income Tax Assessment Act 1936*[76]. By time the case reached the High Court the taxpayer had abandoned its alternative claims for deduction of these amounts under sections 122(1) and 122A of the Act.

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75 Hereafter referred to as the taxpayer.

76 Section 51(1) provides:

> '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.'

The taxpayer claimed that these costs were incurred as part its continuing policy of maintaining the mine site in a safe and efficient condition. The taxpayer claimed that the demolition costs formed part of its repetitive operations and this indicated that the demolition costs were a recurrent expenditure of a revenue nature. Therefore they were an allowable deduction under section 51(1) of the Act. The amounts involved were quite substantial ($280,683). Even so, given prior judicial opinion, and the short shrift of judgments on this issue in the lower Courts[77], it is difficult to envisage how the taxpayer could have believed that it could succeed.

The joint judgment[78]

In a joint judgment the High Court dismissed the taxpayer's appeal. The leading case relied upon was *FCT v. Broken Hill Pty Co. Ltd.*[79] In that case Kitto J had said of the demolition of such structures that:[80]

> They were all part of [BHP's] 'profit-yielding subject'. Each of the demolitions in question was, in my opinion, effected to obtain a lasting improvement to [BHP's] complex 'instrument for earning profits', and was not carried out as part of "the continuous process of (the) use or employment (of the instrument) for that purpose".

Apart from minor references to *Sun Newspapers Ltd v. FCT; Associated Newspapers Ltd v. FCT*,[81] *Hallstroms Pty Ltd v. FCT*[82] and

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77 (1990) 21 ATR 159 at 179-180 Northrop J; (1990) 21 ATR 1294, at 1305-1306 Pincus and Ryan JJ (Sheppard J agreeing on this issue).

78 Mason CJ, Brennan, Deane, Dawson, Toohey, Gaudron and McHugh JJ.

79 (1969-70) 120 CLR 240 at 262.

80 (1992) 110 ALR 29 at 31.

81 (1938-39) 61 CLR 337 at 359 where Dixon J identified three matters which will assist in determining whether a particular expenditure is of capital or revenue nature. They are:

(1) the character of the advantage sought and, in this respect, its lasting qualities and recurrence may play a part; (2) the manner in which the advantage is to be used, relied upon or enjoyed and, in this respect as well, recurrence may play a part; and (3) the means adopted to obtain the advantage, that is, whether a periodical reward or outlay is provided to cover its use or enjoyment for periods

John Fairfax & Sons Pty Ltd v. FCT,[83] the entire judgment centred upon the *BHP* case. The High Court rejected the Full Federal Court's view of Kitto J's judgment in the *BHP case*. The Full Court of the Federal Court had said that the principle enunciated by Kitto J was that:[84]

> ... demolition of obsolete structures for the purpose of improvement of the premises on which a business is conducted is ordinarily just as much a capital matter as the erection of the structures in the first place.

The High Court was of a different view. It was noted by their Honours that Kitto J in the *BHP* case had:[85]

> ... correctly characterised the expenditure by reference to the character of the advantage sought by each of the demolitions, not by reference to the purpose served by the demolished structures. His conclusion that the purpose of the expenditure was, in all categories of demolitions, including category 5, 'to obtain a lasting improvement to the appellant's complex "instrument for earning profits"' followed an acknowledgment that demolitions of one sort or another naturally and occasionally became necessary in the conduct of an efficient steelworks.

The same issue arose in the present case as in relation to the category 5 demolitions in the *BHP* case. Furthermore, this was not a situation analogous to repairs of plant, on the contrary, it was an improvement to the mine site as a whole. The expenditure in this case was correspondingly:[86]

> ... expenditure on the improvement of an asset, expenditure on the acquisition of an asset or on the removal of a disadvantageous asset, generally speaking, will constitute capital expenditure.

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commensurate with the payment or whether a final provision or payment is made so as to secure future use or enjoyment.

82 (1945-46) 72 CLR 634.

83 (1959-60) 101 CLR 30.

84 (1992) 110 ALR 29 at 34.

85 *Ibid.*

86 *Id* at 35.

Thus it was envisaged that there may be some cases where such expenditure may be on revenue account. Such a case arose in *Johns-Manville Canada Inc. v. R*[87] where the Supreme Court of Canada held that:[88]

> ... the cost of acquiring land adjacent to an open pit mine for the purpose of enlarging the sloping sides of the pit as it became deeper in the course of the taxpayer's mining operations was an operating and not a capital expense. Similarly, where demolition is undertaken in the course of the day-to-day conduct of a business, the cost of it will be a revenue expense.

Where, however, the expenditure was incurred 'for the purpose of improving land as the site' for the purpose of carrying on the business, it 'must be regarded as a capital item' unless the money is 'spent merely on maintenance or upkeep.' These factors underlie the decision of Kitto J in the *BHP* case. It was not because BHP did not acquire a tangible asset through the expenditure for it was sufficient that BHP had obtained 'an enduring advantage' in the form of the improvement.[89]

Their Honours noted that:[90]

> ... the more frequent the recurrence, the more nearly it will correspond to an annual accounting period and the less likely it is that the expenditure will generate a benefit enduring beyond such a period. But, in the ultimate analysis, this case, like any other case, falls to be determined by reference to its own facts.

In the present case there was nothing to suggest that the 'Old Roaster' or the 'Marley Tower' had a very short life and therefore 'that their demolition is a frequent occurrence in the mining operations'. They both played a part in the mining operations over a long period until they became 'obsolete and redundant'. Demolition followed a review, as they were found to be 'obsolete and dangerous.' It is noted however that:[91]

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87 (1986) 21 DLR (4th) 210.

88 (1992) 110 ALR 29 at 35.

89 *Ibid.*

90 *Ibid.*

91 *Id* at 36.

> [i]n some situations, the demolition of structures and plant which have a very short life may well be capable of being treated as a matter of maintenance or upkeep or as an incident in the day-to-day conduct of a business.

Here the purpose of the demolition was to eliminate a disadvantageous asset. It conferred 'a positive and enduring advantage on the premises on which the taxpayer's business was carried on.'[92]

It was suggested in argument that the taxpayer might have had a stronger case if the 'Old Roaster' and the 'Marley Tower' had been depreciable assets under section 54, or had come within Division 10 of Part III of the ITAA.[93] The Full Court of the Federal Court found they were not and the taxpayer had not appealed on this matter. There was no finding that these structures were, in themselves, 'plant' as defined in section 54. Nor was there any evidence to suggest such a finding. Their Honours postulated that if there had been such evidence:[94]

> ... there appears to be two approaches by which demolition expenditure could reduce the taxpayer's assessable income. The first would be to regard the demolition costs as an element of the total cost of the structure and include them in the amount depreciated over the lifetime of the building. There are formidable obstacles in the path of such an approach. The second approach is as a deduction at the time of demolition. And that directs attention back to s. 51.

Conclusion

While on the facts this case adds little to this area of law, the recognition that demolitions may in some cases be on revenue account rather than capital is an important development. This approach is consistent with Dixon J's tests in the *Sun Newspapers* case. Too often the Courts have misapplied the tests laid down by Dixon J.[95]

92 *Ibid.*

93 Division 10 of Part III of the ITAA contain special provisions for the deduction of certain capital expenditures by mining and quarrying operations.

94 (1992) 110 ALR 29 at 37.

95 See Spry, I.F.C. 'Confusion Relating to Sources of Trading Stock', 21 *Australian Tax Review*, March 1992, pp. 9-11.

3 *Registrar of the Accident Compensation Tribunal v. Federal Commissioner of Taxation* (M50, M51 and M52 of 1992)[96]

The two previous cases considered the application of section 51(1) of the ITAA to particular taxpayers. The primary question in this third case dealt with the arguments put forward by the Registrar of the Accident Compensation Tribunal of Victoria[97] that he was not subject to the provisions of the ITAA, in particular sections 95—99. This was an appeal concerning three assessments on the Registrar of the Accident Compensation Tribunal by the Commissioner of Taxation. The primary question was whether 'the Registrar' was liable to pay tax under section 99 of the ITAA. Section 99 provides that where there is income of a trust estate to which no beneficiary is presently entitled, the trustee is liable to pay tax on that income at punitive rates of tax. The cases were removed to the High Court pursuant to section 40(1) of the *Judiciary Act 1903* (Cwlth) because the Registrar's case included an issue concerning the application of section 114 of the Constitution. The Registrar contended that he was not liable to pay the assessed tax for one or all of the following grounds:-

(1) The moneys held, and interest earned by him, were not in the capacity of a trustee as defined in section 6(1) of the ITAA and therefore he was not liable to pay tax on the interest.

(2) That the Registrar was a 'public authority' within section 23(d) of the ITAA and therefore the interest income was exempt from taxation.

(3) That the Registrar was not bound by the ITAA because the ITAA only taxes the Crown where the Crown is expressly made liable.

(4) That to impose tax on the Registrar would contravene section 114 of the Constitution which prohibits the Commonwealth from taxing property of the States.

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96 (1993) 178 CLR 145; 117 ALR 27; 26 ATR 353; 93 ATC 4835.

97 Hereafter referred to as the registrar.

(5) That if the Registrar was liable the income was earned in the 1988 tax year when it was credited to the individual accounts and not the 1987 tax year when the Registrar received the interest.

The facts

Interest income was received by the Registrar on money invested and held by him with respect to awards of compensation made under the *Workers Compensation Act 1958* (Vic.). Section 34(2) of that Act provided that:

> In the case of death if the worker leaves more than one dependant the Board having regard to the circumstances of the various dependants and variations in such circumstances from time to time may:
>
> (a) apply or otherwise deal with any sum so paid into its custody in such manner as in the opinion of the Board will for the time being be most beneficial to the dependants;
> (b) provide for any two or more dependants collectively;
> (c) exclude any dependant from participating in any benefit.

Pursuant to this provision, accounts were held on behalf of the various dependants or groups of dependants. In 1987 the funds held by the Board were transferred to the Registrar under section 37 of the *Workers Compensation Act 1958* (Vic.).

On 10 July 1987 $2,718.69 was credited to the 'Payne account' as 'interest' for the year ended 30 June 1987. It was not disputed that the 'interest' was calculated on the basis of the proportionate share of income earned by the total fund for the year ended 30 June 1987. The major part of the fund held by the Registrar comprised of referable 'compensation payments made under the Workers Compensation Act or Accident Compensation Act'. Originally the Commissioner had issued an assessment on this amount for tax year ended 30 June 1988 and at a later stage an alternative assessment was issued for the year ended 30 June 1987.

The Registrar claimed that, because of the provisions of the Acts under which he held the funds, he was not a trustee within the extended definition of the term in section 6(1) of the ITAA. The Commissioner argued that the Registrar was a trustee either by operation of law, or a trustee under paragraph (b) of the extended definition of 'trustee' in section 6(1) of the ITAA because he had the administration or control of

income affected by an implied trust (which was 'identified' as a 'trust for statutory purposes') or because he was acting as a fiduciary in relation to the moneys in question. The section 6(1) definition provides that:

> 'trustee' in addition to every person appointed or constituted trustee by act of parties, by order, or declaration of a court, or by operation of law, includes:
>
> (a) an executor or administrator, guardian, committee, receiver, or liquidator; and
> (b) every person having or taking upon himself the administration or control of income affected by any express or implied trust, or acting in any fiduciary capacity, or having the possession, control or management of the income of a person under any legal or other disability.

Difficulty arose however because section 35 of *Workers Compensation Act* provided that:

> (1) Except as otherwise provided in section 34, any amount of money administered by the Registrar under this Act may be invested, applied or otherwise dealt with in any manner that the Registrar thinks fit for the benefit of the person entitled to that money.
> (2) The Registrar shall not in administering any amount of money under this Act be bound by any law relating to the administration of trust funds by trustees but shall act in good faith.
>
> ...
>
> (4) If the amount of money administered by the Registrar on behalf of any person becomes less than an amount of money determined by the Registrar the amount shall be paid out to that person.
> (5) All expenses incurred by or on behalf of the Registrar in the administration of any amount of money under this Act shall be paid by the Registrar out of the [Fund]

The Registrar argued that the intention of the *Workers Compensation Act 1958* (Vic.) and the *Accident Compensation Act 1985* (Vic.) was that he was not 'subject to trust obligation' for these moneys. They were dealt with on 'a government or administrative basis'. The argument was based mainly on the provisions of sections 35(2) and

131(2)[98] of those Acts. Additionally it was argued that because it was a mixed fund that included not just compensation payments the Fund could not be considered to be a trust fund. The Fund also included funds which were apparently intended to defray the costs associated with general operations of the Tribunal and Registrar.[99] Furthermore it was argued that the Registrar was the Crown or a servant or agent of the Crown. Therefore, even if he were described as having a 'trust obligation' it will not be treated as a trust according to ordinary principles or, as it is sometimes called, a 'true trust', unless clear words are used to create that obligation.[100] It was contended that in the absence of clear words, the obligation is to be characterised as a 'governmental' or 'political obligation'.[101]

The Majority View (Mason CJ, Deane, Toohey and Gaudron JJ)

Was the Registrar a trustee?

Their Honours formulated the issue as 'whether the Registrar is a trustee of the balance of the compensation awarded in consequence of the death of Alexander Joseph Abela and standing in the Payne account, and not whether he is trustee of the fund.' They noted that:[102]

> ... *Kinloch* does no more than state a rule of construction to be applied in ascertaining whether an intention to create a trust according to ordinary principles is to be discerned from the [37] language of the instrument involved.

98 Section 131(2) is to same effect as 35(2).

99 See section 36 of the Workers Compensation Act.

100 *Kinloch v. Secretary of State for India* (1881-82) 7 App Cas 619.

101 Sometimes referred to in the decided cases as a trust 'in the higher sense' or 'a political trust'. Reliance was placed on *Kinloch v. Secretary of State for India* (1882) 7 App Cas 619 at 625-6, per Lord Selborne LC; *Tito v. Waddell (No 2)* [1977] Ch 107, at 211, 216-17, 219 per Megarry V-C; Hogg, P.W. 1989 *Liability of the Crown*, The Law Book Company, Sydney (2nd edn), 186-8. See also *New South Wales v. Commonwealth (No 3)* (1931-32) 46 CLR 246 at 260-1 per Rich and Dixon JJ; at 268, per Starke J.

102 (1993) 117 ALR 27 at 36-37.

Important factors in this context were the 'subject matter and context' which in some cases may be more revealing of the intention of Parliament than the language actually used. Nor is there any rule of law or equity to prevent the imposition of ordinary trust obligations on a person who is a servant or agent of the Crown in other regards.

Given the context of this case, it was not conducive to approach it on the basis 'that there is a trust in the ordinary sense on the basis that the person who owes the obligation in question is a servant or agent of the Crown.' The correct approach to the question was on the footing that the person concerned holds a statutory office and has a number of functions, not all of which are 'necessarily governmental in nature'. Little significance could be given to the fact that the obligation was imposed upon the Registrar as a 'statutory office holder' or 'in his official capacity.'[103] There must be some governmental interest or function involved for the particular role to come within the rule in *Kinloch v. Secretary of State for India.*

After discussing the relevant cases they noted that no special words are necessary to create a trust in the 'ordinary sense'. Therefore sections 35(1) and (4) of the *Workers Compensation Act*:[104]

> ... would, in the absence of some provision to the contrary, suffice to constitute the Registrar a trustee, in the ordinary sense, of compensation moneys paid to him pursuant to the Workers Compensation Act. They would suffice because they indicate that he has or holds that money for the benefit of the person or persons entitled to the compensation involved.

The Fund as a whole was a general fund of a kind not ordinarily identified as a trust fund[105]. However the issue here did not concern the Fund as a whole 'but with the nature of compensation moneys paid to the Registrar for payment into that fund.'[106]

The intention to impose a trust upon the Registrar flows from the duties imposed on those moneys and not those imposed upon the Fund as a whole:[107]

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103 *Id* at 37.

104 *Id* at 39.

105 Taking into considering the provisions governing the fund quoted above.

106 (1993) 117 ALR 27 at 39.

> ... s. 36 confers a wide discretionary power to apportion between dependants. That power is entirely consistent with the existence of a discretionary trust for the benefit of the class constituted by the dependants of a deceased worker. It does not, in our view, tell against the imposition of an ordinary trust obligation.

Their Honours then considered the provisions of section 35(2) which freed the Registrar from 'any law relating to the administration of trust funds by trustees' merely requiring him to 'act in good faith'. This did not deny that a trust existed in relation to the compensation moneys 'in the ordinary sense'. On the contrary it assumed there was or would otherwise have been 'a trust of that kind to be administered in accordance with the general law of trusts.' The section then:[108]

> ... proceeds to exclude not the entire body of that law, but only laws 'relating to the administration of trust funds by trustees'.

It was noted that neither the *Workers Compensation Act* nor the *Accident Compensation Act* made provision as to distribution of income referable to the compensation moneys paid into the fund and therefore the 'compensation moneys paid to the Registrar are trust moneys in the ordinary sense.' The Registrar holds those funds 'in trust' for the persons entitled to the compensation involved. He holds them subject to the applicable legislative provisions and they:[109]

> ... must be administered by the Registrar in accordance with the general law of trusts. Accordingly, the Registrar holds such moneys as trustee in the strict sense and there is no need to consider the alternative arguments based on the extended definition of 'trustee' in s. 6(1) of the Income Tax Assessment Act.

Was the Registrar exempt under section 23(d) of the Income Tax Assessment Act?

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107 *Id* at 40.

108 *Ibid.*

109 *Ibid.*

The majority view was that this issue could not be determined on the basis that this was income of the Registrar as holder of a 'public office' because:[110]

> [t]he income received from the investment of compensation moneys by the Registrar is, in equity, the income of the persons entitled to the benefit of those compensation moneys.

That income was not income available to defray the operating costs of the Fund and the Registrar had not treated it as such. It did not come within section 23(d) of the ITAA because 'the expression "revenue" signifies annual or other periodic income from which operating expenses for that period are to be paid.'

Is the Registrar subject to Div. 6 of Part III of the Income Tax Assessment Act?

It was argued by the Registrar that the Crown was only bound by the ITAA where the Crown is expressly made liable for taxation and that words such as 'person' in section 17 or 'trustee' in Division 6 of Part III of the ITAA do include the Crown or its servants or agents. Therefore, even if the Registrar received the monies as trustee in the ordinary sense, he was not subject to Division 6.

There was no doubt that certain functions of the Registrar were functions that were performed on behalf of the government of Victoria. For those, the Registrar could be described as the agent or servant of the Crown. The Registrar's functions which related to the administration of the Tribunal were a clear example, as was the administration of the Fund. The Registrar's functions 'in administering the ordinary trusts constituted by payment of compensation money "for the benefit of the person entitled to that money" are of a different kind.' These trusts were for the benefit of 'private citizens' and the duties attaching to them were 'owed to individual beneficiaries' even though the trusts arose by virtue of the *Workers Compensation Act.*[111] This was an example of a case where there was a discrete function undertaken by 'a statutory office holder as the servant or agent of the Crown' which involved no interest or purpose of the Crown and 'which [was] separate and distinct from

110 *Id* at 41.

111 *Id* at 42.

other functions which serve a Crown purpose'. There was no Crown 'interest or purpose' or 'governmental interest or purpose' in relation to the Registrar's duties with respect to the trust funds. The Registrar was a trustee 'pure and simple' and therefore:[112]

> ... even if the relevant provisions of the Income Tax Assessment Act do not bind the Crown, its servants or agents, they bind the Registrar in his separate capacity as trustee for private individuals.

Was section 114 of the Constitution infringed?

Section 114 had no application here as Division 6 of Part III in this case is taxing the beneficiaries' trust fund. Those beneficiaries were 'private citizens'. Property of the State of Victoria was neither 'in substance nor form' being taxed.[113]

In which year did the income arise?

The income was derived in the year in which it 'was earned by the mixed fund' and not when allocated to the various 'trust funds' or accounts. The income was 'earned in the financial year ended 30 June 1987, notwithstanding the fact that it was not actually credited to the Payne account until July 1987.'[114] This approach accords with normal taxation principles. This was not the case of a trustee applying funds to a beneficiary under a discretionary power.

Dissenting view of Brennan, Dawson and McHugh JJ

The dissenting judgment is based upon a very legalistic and narrow view of what a trust is. The dissenting judgment concluded that there can be no trust unless 'unless the obligation is enforceable in equity' and that the right of dependants of deceased workers under the *Workers Compensation Act 1958* were:[115]

> ... not enforceable in a court of equity. The remedies available to dependants are designed to enforce the performance of statutory, not equitable, duties.

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112 *Id* at 43.

113 *Id* at 44.

114 *Id* at 45-46.

115 *Id* at 46-47.

Therefore the Registrar 'does not hold the money paid as compensation for the dependants of a deceased as trustee for the dependants as beneficiaries'. The dependants have no equitable rights. Their rights arose under the *Workers Compensation Act 1958* alone[116]. Furthermore:[117]

> It is erroneous to conclude that, because property is held by one person but the fruits are ultimately to be enjoyed by others, there is a relationship of trustee and beneficiary between the holder of the property and those who will ultimately receive it. When the remedies of those entitled to benefit from property are statutory, equity does not need to call an equitable interest into existence to control the administration of the property by the person in whom it is vested.

Moreover, the limitations that equity would impose on the 'exercise of a trustee's power to invest' were inconsistent with the type of 'broad discretion' which was conferred upon the Registrar under section 35(1) of the 1958 Act and section 73(4) of the 1985 Act. If the Registrar were a 'true trustee' then 'an equitable jurisdiction' would be inconsistent with the right of appeal to the Tribunal from 'any determination made by the Registrar' under section 35.[118]

The difficulty in finding that the Registrar was a trustee was, in their view, reinforced by the fact that:[119]

> ... s. 35(2) of the 1958 Act expressly releases the Registrar from 'any law relating to the administration of trust funds'. ... . Section 35(2) exposes the true character of the Registrar's discretionary powers: they are statutory powers amenable to judicial review but not amenable to control by a court of equity. It is immaterial that the Registrar, though compensation payments are paid to or are under the control of or are vested in him, has no beneficial interest in those moneys.

A person is not, in their view, a trustee where that person holds property where the 'fruits' of that property will be 'ultimately to be enjoyed by others' and where the remedies of 'those entitled to benefit from such

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116 *Id* at 49-50 relying on the provision of sections 35 and 36 of the *Workers Compensation Act 1958*.

117 *Id* at 53.

118 *Id* at 52.

119 *Ibid.*

property are statutory'. Equity is not needed 'to control the administration of the property by the person in whom it is vested.'[120]

For all these reasons the Registrar was not a trustee as conceived by the laws of equity.

Was the Registrar a trustee under Division 6 of Part III of the Income Tax Assessment Act?

The dissenting judgment then considered the definition in section 6(1) of ITAA and quoted the observations of Knox CJ on the definition in the 1922-25 ITAA, that:[121]

> Wide as this definition is, it requires at least as an essential ingredient in the position of 'trustee' under the Act the existence of a fiduciary obligation towards some other person. ...

They say that paragraph (b) of the definition also 'comprehends persons who owe a fiduciary duty, but the duty must relate to the administration or control of property.'[122] They also reject the notion that there was in this case a 'trust for statutory purposes'. Their Honours believed that section 34(2) of the Act had been inserted to overcome the decision in *Fouche v. Superannuation Fund Board*[123] and to remove the liability of the person as a fiduciary. In the *Fouche* case the words 'trust for statutory purposes' were:[124]

> ... concerned to identify the terms on which the board held the superannuation fund. The fiduciary duties of the board were stated in reference to the fund as an entirety but not in reference to the amounts received from or in respect of individual contributors ...

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120 (1993) 117 ALR 27 at 53.

121 In *Manning v. FCT* (1927-28) 40 CLR 506 at 509 quoted at (1993) 117 ALR 27 at 55-56. That definition is identical to the one found in the current ITAA. It is interesting to note that they do not point out the Knox J was sitting as a single judge at first instance and that other issues concerning the interpretation of the definition of 'trustee' were addressed before the court.

122 (1993) 117 ALR 27 at 56. That is they are reading the last 'or' in the definition as 'and'.

123 (1953-54) 88 CLR 609.

124 (1993) 117 ALR 27 at 56-57.

In any case, their Honours came to the conclusion that the question for determination in this case was 'whether the Registrar holds a compensation payment in trust for the dependants of a deceased worker or is under a fiduciary duty to those dependants in respect of that money.' It was not 'whether the Registrar holds the tribunal fund on trust for statutory purposes or is under a fiduciary duty in respect of that fund'. They were unable to:[125]

> ... regard that income as 'income of a trust estate' because we do not regard the amounts standing to the credit of the account as a 'trust estate' for the purposes of Div 6, the dependants' rights being statutory. There being no trust estate of the kind on which the Commissioner has relied, the interest attributed to the amounts standing to the credit of the account is not 'income of a trust estate' within the meaning of that term in Div 6.

Therefore they would have set the assessment under section 99 aside. Having found that the Registrar was not a trustee under general concepts, nor under the extended definition of trustee under section 6(1) of the ITAA, it was not necessary to deal with the other arguments raised by the Registrar.

Comment

It is the author's opinion that the decision of the majority is the correct one. Although some might at times find their reasoning, that there was a trust in the normal sense created, rather laboured. Be that as it may, it was clearly a trust because the Registrar was a 'trustee' under the extended definition in section 6(1) of the ITAA. Although this might at first sight appear to contradict Knox J in *Manning v. FCT*[126] it is the author's opinion that as there was little argument on this point nor were reasons given for his assertion on the interpretation of the word 'trustee' in section 4 of the 1922 ITAA, that therefore, the statement has little authoritative status. It is noted that Knox J was sitting as a judge at first instance and therefore is of limited authority. Indeed there is some ambiguity in the second to last paragraph of his judgment.[127] The

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125 *Id* at 58.

126 (1927-28) 40 CLR 506; (1928) 34 Argus Law Reports 165; (1928-30) ITD(Aust) 8.

127 (1928-30) ITD (Aust) 8 at 10.

dissenting judgment seems to deny the right of parliament to define terms for the purposes of the ITAA in a manner different to their normal judicial meaning. They fail to note that the Trustee Acts in the various States modify and change the duties of trustees but this does not alter the fact that they are trustees. If the Trustee Acts can change the position of trustee why not the *Workers Compensation Act* and *Accident Compensation Act*? Similarly, to disregard the extended definition in section 6(1) of the ITAA cannot be justified.

The case does throw new light upon the circumstances in which a person holding an office under the Crown will be subject to income tax and the application of section 23(d) of the ITAA. The comments on section 114 add little to the existing law in this area.

4 *Commonwealth of Australia v. Genex Corporation Pty Ltd; Kodak (Australasia) Pty Ltd v. Commonwealth of Australia*[128]

This final case concerned the taxpayers' liability with respect to sales tax under the now repealed Sales Tax legislation[129]. The judgment is the latest, and hopefully final, of a number of cases dealing with the application of Australian sales laws with respect to development and printing of photographs.[130]

The facts

Genex operated 'mini-labs' in shops within retail complexes with machines used for the development of exposed photographic film. They used separate machines for the printing of photographs from negatives that had already been developed. The only difference in the *Kodak* case was that the development and printing processes took place on a larger scale at Kodak's factory premises.

For both taxpayers the majority of their customers requested to have their exposed films developed and prints made from those developed

128 (1992-93) 176 CLR 277; (1992) 110 ALR 154; 24 ATR 328; 92 ATC 4764.

129 This sales tax legislation consisted of 27 separate Acts: 11 Assessment Acts; 14 Acts which imposed the various taxes; an Act dealing with exemptions and classification of goods; and an Act dealing with procedural matters. This legislation was replaced by a new set of Acts, most of which commenced operation on 28th October 1992.

130 See for example *Pacific Film Laboratories Pty Ltd v. FCT* (1970) 1 ATR 771; *McKay v. FCT* (1978) 7 ATR 432

negatives. Some customers merely presented negatives to have prints made from them. Few customers requested the development of negatives only. The customers were charged according to the service performed.

The final result is somewhat bizarre. Where prints were made from negatives provided by customers, sales tax was to be paid on the full cost. Where the only service provided was development of negatives, sales tax was to be paid on the full cost.[131] However, where both development and printing were provided, only the cost of printing was subject to sales tax. This result arose due to various definitions contained within the legislation.

The Commissioner assessed the taxpayers as being liable to sales tax on the manufacture of negatives in the development process under section 17(1) which provided that:

> Subject to, and in accordance with, the provisions of this Act, the sales tax imposed by the Sales Tax Act (No 1) 1930 shall be levied and paid upon the sale value of goods manufactured in Australia by a taxpayer and sold by him or treated by him as stock for sale by retail or applied to his own use.

To come within that section the negatives were required to be 'goods manufactured' and to have crossed one of the three taxing points.[132] Since 1986, section 3(1) of the Act defined 'manufacture' to include:

> (d) the processing or treatment of exposed photographic or cinematographic film to produce a negative, transparency or film strip.[133]

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131 (1992) 110 ALR 154 at 166 it was said that:

> ... the liability to sales tax in respect of negatives not employed for the production of photographic prints does arise by reason of a deemed manufacture and a deemed sale.

132 (1) sale; (2)treatment as stock for sale by retail; or (3) application to own use by the taxpayer.

133 An almost identical provision is to be found in section 5 of the *Sales Tax Assessment Act (1992)* (Cwlth). It provides:

> (d)processing or treating exposed photographic film or cinematograph film so as to produce a negative, transparency or film strip

The negatives therefore satisfied the requirement in section 17 in that they were 'manufactured'. The issue to be determined was whether they were 'goods' so that both limbs of the concept of 'goods manufactured' could be satisfied. It is to be noted that the negatives themselves were at all times the property of the taxpayers' customers. Therefore a 'sale' in the normal sense of the word did not occur. As a result a taxing point would only be crossed if there were a 'deemed sale' under the Act. Section 17A(1) of the Act provided such a deeming provision.[134]

> Where:
> (a) goods have been manufactured in Australia by a person for another person (in this sub-section referred to as the 'customer'); and
> (b) the goods were manufactured in whole or in part out of materials supplied by the customer,
>
> the manufacturer of the goods shall, for the purposes of this Act, be deemed to have sold the goods to the customer at the time when the goods were delivered to the customer, or were delivered under an agreement with the customer to some other person, and the customer shall, for the purposes of this Act, be deemed to be the purchaser of the goods.

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134 This is now dealt with in section 22 of the *Sales Tax Assessment Act (1992)* (Cwlth) and specifically includes 'photographic negatives' with in the definition of material supplied and therefore is a 'taxable dealing' under section 16:

22(1) This dealing involves assessable goods that are manufactured by a person, in the course of a business, for another person ('the customer') wholly or partly out of materials that:

(a) were supplied by the customer (or by someone else at the request of the customer); or

(b) were purchased from the manufacturer by the customer (or by someone else at the request of the customer).

22(2) The dealing consists of the delivery of the goods either to the customer or to someone else at the direction of the customer or under an agreement to which the customer is a party.

22(3) In this section:

'materials' includes exposed photographic film or cinematograph film that is to be processed or treated so as to produce a negative, transparency or film strip.

The High Court, in a joint judgment,[135] endorsed the view expressed by Hill J in the Full Court of the Federal Court that development:[136]

> does not amount to the bringing into existence of new goods. It is a service which involves a modification of existing goods, from a film which is still light sensitive to one where the latent image has been brought out and stabilised. To say that a modification is involved is not determinative of the issue of manufacture, for matters of fact and degree may be involved.

Their Honours found that there was 'little assistance' in the decided cases. Noting that:[137]

> Decisions of this Court establish that the compound process of the production of prints from exposed film is manufacture but do not examine the question in relation to the intermediate step relevant in this case.

They concluded however that an 'exposed film' was not a different item from the 'developed negative'.[138] Therefore, in the absence of paragraph (d), negatives were 'not relevantly different things' from the exposed photographic film from which they came. Development was not, therefore, 'manufacture' without the paragraph. The process was 'more aptly described as treatment' of the negatives. The plastic film base remains unaffected by the processes. The negatives remained:[139]

> ... in the relevant sense the same goods as the unexposed film which went into use or consumption on sale to and use by the purchaser.

The principal question therefore was, whether the negatives (the developed photographic film) were 'goods'? Section 3(1) of the repealed Act defined 'goods' in the following terms:[140]

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135 Mason CJ, Brennan, Deane, Dawson, Toohey, Gaudron and McHugh JJ.

136 (1991) 101 ALR 161 at 173, quoted at (1992) 110 ALR 154 at 158.

137 (1992) 110 ALR 154 at 158.

138 *Id* at 159.

139 *Ibid.*

140 Section 5 of the *Sales Tax Assessment Act (1992)* (Cwlth) defines goods in the following terms:

'goods' means any form of tangible personal property, but:

> 'Goods' includes commodities, **but does not include**:
>
> (a) goods which have, either through a process of retailing or otherwise, **gone into use or consumption** in Australia; or
> (b) goods which are sold as second-hand goods and are manufactured exclusively or principally from goods which:
> (i) have, whether alone or as parts of other goods, gone into use or consumption in Australia; and
> (ii) in the opinion of the Commissioner, in their condition as parts of the goods so manufactured, retain their character as goods or parts of goods which have gone into use or consumption in Australia. [The emphasis is added.]

As such, the term 'goods' assumes its ordinary English meaning, subject to the exclusion contained in section 3(1). Because of the definition of manufacture which included the development of negatives, the 'negatives are goods' even though they would not be goods if paragraph (d) were absent.[141]

The taxpayer sought to rely on the reasoning of Fisher J in *FCT v. Comber*[142] that such a result would require a 'statutory fiction'. This argument was rejected because:[143]

> This is not a case of impermissibly extending the scope of deemed manufacture. The statutory notion of goods is wide enough to catch the product of that which the statute defines as manufacture.

(a) does not include property that is sold as second-hand and is manufactured exclusively or principally from goods that:

(i) were already Australian-used goods before the manufacture began; and

(ii) in their condition as parts of the property so manufactured, retain their character as Australian-used goods; and

(b) has a meaning affected by section 12;

141 (1992) 110 ALR 154 at 160.

142 (1985-86) 64 ALR 451 at 458.

143 (1992) 110 ALR 154 at 161.

Nor could it be argued, as the taxpayers did, that this was a case of 'legislative mistake'.[144]

Section 17A was a provision which only deemed manufacture to have taken place. It was section 17 which assessed the liability for sales tax by reason of the crossing of a taxing point. The relationship between these sections was explained as follows:[145]

> Section 17 requires 'goods manufactured' to be 'sold'. That requirement will, of course, be satisfied if the goods are deemed to have been sold. But, in order that goods should fall within the concept of s. 17A as goods which are deemed to have been sold, there must be delivery to a customer or to another person under an agreement with the customer of some article or thing which falls within the statutory concept of goods at the time of such delivery. In view of the terms of the definition of 'manufacture', there can be no doubt that goods (negatives) are manufactured in whole or in part out of materials (exposed film) supplied by the customer. However, if, as is the usual case, photographic prints are produced for the customer, the negatives go into use or consumption in that production before they are delivered to the customer and are then no longer goods. Therefore, no 'goods' are deemed by s. 17A to have been sold and thus to cross the taxing point. Only if the exposed photographic film is given to the taxpayer under a contract for development only and not for the production of prints is there a deemed sale of the developed film.

The Act, however, did not provide, 'that entry into use or consumption is contingent on a prior crossing of a taxing point.' Such would normally be the case, but there may be an entry into 'use or consumption' without the crossing of a taxing point. They endorsed the view expressed by Hill J in the Full Court of the Federal Court that:[146]

> 'The legislation has always been, at least in concept, a tax on sales. It is a necessary prerequisite of a sale that title to the goods sold passes to another person, that is to say that the title is, at the moment before sale, in the person who sells it. Difficult cases where no title then existed but where there is a 'feeding of the estoppel' may be put to one side. The

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144 *Ibid*, referring to *Cooper Brookes (Wollongong) Pty Ltd v. FCT* (1981) 35 ALR 151.

145 *Id* at 162.

146 (1991) 101 ALR 161 at 175-176, quoted at (1992) 110 ALR 154 at 163-164.

> case of goods treated by the manufacturer as stock for sale by retail, another taxing point in the case of manufacturers, equally requires title in the goods to be in the manufacturer who is proposing to sell them by retail. The sale deemed to occur by s. 3(4) again must be one where title in the goods passes, albeit other than under a contract for the sale of goods. As the earlier discussion of the scheme of the legislation makes clear, it was necessary in ensuring that the taxation base was not eroded to provide that a liability for sales tax would arise where goods were not sold, but were applied by the manufacturer or wholesale merchant to his own business use. In other words, the plain legislative purpose of dealing with application to own use was to deal with the case where, although title to the goods was held by the taxpayer, he had not subjected those goods to a transaction involving the transfer of title (sale or deemed sale) or prospective sale by treating them as retail stock.

Therefore 'notwithstanding the difficulty presented by the language' there was an 'employment' of the negatives by the taxpayers for their own purposes and that 'therefore, the literal words of the section could be satisfied.' There would be 'insuperable difficulty' in holding that a taxing point was crossed in a case where the negatives were at all times the property of their customer.[147]

If, contrary to their conclusion, the negatives were 'applied to [the taxpayers'] own use' the question arose as to whether or not the negative were 'aids to manufacture' under items 113B and 113C of Schedule 1 of the *Sales Tax (Exemptions and Classifications) Act (1935)* (Cwlth). Section 5(1) of that Act and items 113B and 113C provide an exemption from liability to sales tax for 'aids to manufacture or as auxiliaries to aids to manufacture'. The definition 'aids to manufacture' for the purposes of items 113B and 113C are identical and provide in part that:

> 'aids to manufacture' means goods for use by a manufacturer in the course of carrying on a business (where that use is exclusively, or primarily and principally, for the purposes of that business), being:
>
> ...
>
> (d) goods (other than those specified in paragraph (a) or (b) or those excluded from this definition by paragraph (f) or (k)) for use as specified in paragraph (a).
>
> but does not include the following goods ...

147 (1992) 110 ALR 154 at 164.

> (k) goods for use in connection with the manufacture for sale of goods, if the first-mentioned goods are to be sold to the purchaser of the goods to be so manufactured, except where the goods to be so manufactured
> (i) are covered by an item in this Schedule; or
> (ii) are to be sold by the manufacturer to a person who quotes his certificate of registration in respect of the purchase of those goods and who furnishes to the manufacturer a certificate in writing that the first-mentioned goods are not for resale to a person to whom the goods to be so manufactured are also to be sold.

Were the negatives 'goods [which] are to be sold', in the terms of paragraph (k), to the purchaser of goods in connection with the manufacture which the negatives are used for? Having already held that there was no 'deemed sale' within section 17A of the Act there was 'clearly no other sale.' Therefore:[148]

> ... even if the reference to 'sale' in the definition of 'aids to manufacture' is to be read as including a deemed sale under s. 17A, which we are not to be taken as accepting, the negatives do not fall within the exception to the exemption and, if, there is an application to own use, the negatives are exempt.

Their Honours therefore did not come within the definition. It was however, not necessary to finally decide the question because 'the negatives are not "applied to [the taxpayers'] own use" '.

The reasoning of the Court can be summarised as follows:[149]

> ... films lodged with the taxpayers by their customers, which have been exposed by the customers and are processed by the taxpayers, are, after the point of processing (but not before), 'goods' within the meaning of and for the purposes of the Act. The processed films or negatives go into use or consumption in Australia when they are used by the taxpayers to produce photographic prints and thereupon cease to be 'goods' within the meaning and for the purposes of the Act. They are neither sold nor deemed by s. 17A(1) of the Act to be sold by the taxpayers to their customers. Therefore, on the facts stated or agreed, the taxpayers are liable

148 *Id* at 165.

149 *Ibid.*

to pay sales tax in respect of negatives processed by the taxpayers for their customers only where, pursuant to the contract between the taxpayers and their customers, the negatives are not employed for the production of photographic prints.

Comment

The definitional problems in the repealed Act led to a substantial amount of sales tax being legally avoided by film processors. It is fortunate that the *Sales Tax Assessment Act (1992)* (Cwlth) has overcome the problems highlighted by this case.