CASE NOTES

B.P. AUSTRALIA LTD. v. COMMISSIONER OF TAXATION OF THE COMMONWEALTH[1]

Income Tax—Claim for Deduction—Expenditure—Whether of Capital or Income Nature—Amounts paid by Oil Companies to secure Trade Ties—Income Tax and Social Services Contribution Assessment Act 1936-1952 (*Cth*) *section* 51 (1.).

The most fundamental problem in Income Tax Law is to distinguish between income and capital. It is this problem that raised itself before the Privy Council in the instant case. Though this case but adds itself to the multitude already decided on this point, its significance lies in the fact that it once again illustrates the judicial confusion that stands in the path of a coherent explanation of the distinction between capital receipts or expenditure and income receipts or expenditure.

The issue raised in the instant case was the determination of the nature of the expenditure undertaken by the appellant, B.P. Australia Ltd. This company had since 1951 adopted and pursued a scheme to combat the collapse of the formerly free competitive system for the marketing of petrol and oils. Formerly garage proprietors would market several brands of petrol at their stations. In 1951 the Shell Company began to obtain sole rights to sell petrol and oils from service stations thus threatening a gradual extinction of B.P.'s major trade outlets. To combat this crisis, B.P. joined in the struggle for solo site outlets. A method chosen (amongst others) was the promise of lump sum payments to service station proprietors as part of consideration for a covenant by them to sell for a fixed period only the petrol and oils approved by B.P. The factors determining the payment included gallonage but also included such items as the profitability of the site and other intangibles relating to the expected advantage to be gained by B.P.

The Privy Council[2] held that these lump sum payments were deductible income expenditure. The decision of the High Court appealed from was reversed. The High Court had affirmed the judgment of Taylor J.[3] holding that the expenditure was of a capital nature.

Taylor J. was of opinion that the payments were in no real way related to gallonage, though this was a factor, and were not in the nature of a discount or trade rebate. The advantages obtained by B.P. were of considerable value and, in His Honour's view, constituted an asset, being of enduring benefit and securing freedom from competition on the selected sites.

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[1] (1965) 39 A.L.J.R. 190.

[2] Lord Reid, Lord Morris of Borth-y-Gest, Lord Pearce, Lord Upjohn and Lord Wilberforce. Judgment delivered by Lord Pearce.

[3] (1961) 8 A.I.T.R. 263.

On appeal to the High Court[4] this judgment was affirmed.[5]

McTiernan J. simply affirmed the judgment of Taylor J. Windeyer J. also concurred in affirming Taylor J. and added:

> By making each arrangement that it did the appellant obtained for a substantial period . . . something that was to become a part of the structure, organisation or framework within which and by means of which, the appellant carried on its business.[6]

Owen J. also affirmed the judgment of Taylor J. and referred to his own judgment in *Vacuum Oil Co. Pty Ltd v. Federal Commissioner of Taxation*[7] for the reasons for his concurrence. In that case, which was regarded as indistinguishable, Owen J. pointed out that the object of the appellant was, admittedly, to find exclusive outlets for its motor spirit. ' But it does not follow that all expenditure made for such purposes is chargeable for income tax purposes against revenue.'[8]

If the means chosen to the desired end had been the purchase of service stations, it would clearly have been capital expenditure ; if, on the other hand, rebates on prices had been allowed, it would clearly have been a revenue expenditure. On balance, Owen J. found that though the payments, viewed as a whole, were recurrent, the enduring nature of the advantage obtained was such as to tilt the balance in favour of the view that they were capital payments.

Dixon C.J. (dissenting) regarded the expenditure as revenue, looking at the solo site agreements as merely a part of the appellant's ' continual attempt to establish its product in a consumers' market and to meet all the obstacles which arose in a long and rather troubled period to obtaining a reputation for its product '.[9]

The judgment of Kitto J. (also dissenting) was substantially that adopted by the Privy Council. The view taken of the case by His Honour was that the appellant was simply making payments to customers in order to secure their custom.[10]

The Board discussed the many cases dealing with the instant problem and seemed satisfied to find no decisive means for distinguishing between capital and income expenditure. However, to allay fears that the matter was therefore being decided by the spin of a judicial coin, the Board proceeded at length to explain and apply the tests repeated and applied regularly in nearly every other case of this kind. It is, however, interesting

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[4] (1964) 9 A.I.T.R. 225.

[5] McTiernan, Windeyer and Owen JJ. (Dixon C.J. and Kitto J. dissenting).

[6] (1964) 9 A.I.T.R. 225, 235.

[7] (1964) 9 A.I.T.R. 237.

[8] *Ibid.* 243.

[9] (1964) 9 A.I.T.R. 225, 230.

[10] *Ibid.* 232 : ' What in truth happened in August 1951 was that an era began in which continuing competition among oil companies for blocks of orders, each block consisting of the whole of the orders from a service station in a period would be a permanent feature of the trade.'

to note that the application of these tests does not seem to have led to any such regularity or, indeed, to any certainty in result.

The English decisions now look upon the case of *British Insulated and Helsby Cables v. Atherton*[12] as the prime source of enlightenment. However, the Lord Chancellor in that case simply held that expenditure on purchase of an asset either tangible or intangible is a capital expenditure. It was then decided that establishing a pension fund for staff as it obtains for the company ' the substantial and lasting advantage of being in a position throughout its business life to secure and retain the services of a contented and efficient staff,' is a capital expenditure.[13]

Lord Atkinson expounded this approach more clearly by describing a contented and stable staff as an ' asset '.[14]

It is, however, clear that staff could be made happy and contented by many means, some of which would be capital expenditure, others of which would be revenue expenditure. To describe the ultimate object of the expenditure as an ' asset ' is clearly misleading for it is the means used to achieve that object that would make the expenditure capital or income in nature. Lord Carson and Lord Blanesburgh, in dissenting, pointed out that the money paid was not invested but was to be consumed in the fund and that the fund itself was not an asset of the company in any sense of the word and, being simply a payment of pension to staff through the fund, was an income expenditure.

The general approach in Australia and that applied by the Privy Council in the instant case, is laid down by Dixon J. in *Sun Newspapers Ltd v. Federal Commissioner of Taxation*.[15] But this test does not make clear what the essential elements of capital or income are. ' Endurance ' of the advantage is a question of degree. A permanent advantage gained by the dismissal of an unsatisfactory servant[16] or a redundant agent[17] has been held to be an income expenditure. On the other hand, the acquisition of rights to win gravel, a process lasting about 9 months,

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[11] (1965) 39 A.L.J.R. 190, 194: ' As each new case comes to be argued felicitous phrases from earlier judgments are used in argument by one side and the other. But those phrases are not the deciding factor, nor are they of unlimited application. They merely crystallise particular factors which may incline the scale in a particular case after a balance of all the considerations has been taken.'

[12] [1925] A.C. 205; [1925] All E.R. 623, 629; ' But when an expenditure is made, not entirely once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade I think that there is a very good reason (in the absence of special circumstances leading to the opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital '. *Per* Viscount Cave.

[13] [1925] All E.R. 623, 630.

[14] *Ibid.* 634.

[15] (1938) 61 C.L.R. 337, 363: ' There are, I think three matters to be considered, (a) the character of the advantage sought, and in this its lasting qualities may play a part, (b) the manner in which it is to be used, relied upon or enjoyed and in this and under the former head recurrence may play its part, and (c) the means adopted to obtain it, that is by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payment so as to secure future use or enjoyment.'

[16] *W. Nevill and Co. Ltd v. Federal Commissioner of Taxation* (1937) 56 C.L.R. 290.

[17] *Anglo-Persian Oil Co. Ltd v. Dale* [1932] 1 K.B. 124; [1931] All E.R. 725.

was held a capital acquisition.[18] Indeed in *Anglo-Persian Oil Co. Ltd v. Dale*[19], Romer L.J. held that by enduring is meant 'enduring in the way that fixed capital endures.' It is, therefore, apparent that this test must rely on some other test to decide how fixed capital endures and therefore to decide what is an advantage in the nature of a capital asset.

The question of 'recurrence' is also advanced as relevant in determining the nature of an expenditure. Again, however, recurrent payments have been held to be capital expenditure[20] and lump sum payments made once and for all, held to be income payments[21]. Thus to rely on the generalisation that income expenditure is usually recurrent and capital expenditure usually does not assist to determine the distinction between the two where there is doubt.

Yet it is obvious that to say that there is a distinction between capital and revenue expenditure is not a meaningless assertion, so that a distinction must exist and if a distinction does exist, a criterion for it. The problem is not that there are not enough cases on the topic but rather the confusion of occasional characteristics of 'income' and 'capital' with the essential meaning of those terms.

The concept of 'capital' and of 'income' has been stated many times. Perhaps the pastoral allusions to 'the fruit' and 'the tree' are less suited to our industrial age than allusions to a machine and the costs of operating and maintaining it. Whatever the mode of expressing the concepts, however, it is clear that expenditure on the machine is capital and the cost of running and maintaining it is income. How then to distinguish the two? Surely, the question is simply whether what is purchased, be it a physical thing or an incorporeal advantage, is part of the machine, or the cost of running or maintaining it. The means to determine this cannot be foolproof, certainly, but if, as a basic premise, it is accepted that certain things are unquestionably income expenditure and other things unquestionably capital expenditure, the identity of the item in question must be ascertained by a judgment as to whether it is more like a capital item than an income item. In other words, the only cogent test is analogy and despite confusion with 'endurance' and 'recurrence' this has been the basic method used.

In *John Fairfax and Sons Pty Ltd v. Federal Commissioner of Taxation*[22] the question was as to the nature of legal expenses incurred in defending title to shares in a competitor.

Fullagar J. stated:

> If one looks at the substance of the matter it would accord more with reality to describe that expenditure as incurred in the course of and as incidental to the acquisition of a new asset.[23]

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[18] *Stow Bardolph Gravel Co. Ltd v. Poole* (1954) 34 Tax Cas. 459; [1954] 3 All E.R. 637.

[19] [1931] All E.R. 725, 735.

[20] *H. J. Rorke Ltd v. Inland Revenue Commissioners* (1960) 39 Tax Cas. 194: [1960] 3 All E.R. 359.

[21] *Mitchell v. B. W. Noble Ltd* [1927] I K.B. 719; [1927] All E.R. 717.

[22] (1959) 101 C.L.R. 30.

[23] *Ibid.* 42.

Thus, the substance of the advantage obtained by the expenditure must first be found and its nature then judged by comparison with known classes of capital or income expenditure. In essence the distinction is between acquiring, or defending the acquisition of, the means to earn income and the cost of earning it.[24]

In endeavouring to draw this distinction the Privy Council referred to numerous cases only to reject the majority as unhelpful. The cases concerned with buying off competition[25] were distinguished on the grounds that in the present case, B.P. was not achieving a monopoly, nor was it buying off competition, nor was it obtaining any substantial area for its own domain.[26]

No analogy was found by the Board in cases dealing with removal of personnel[27], the establishment of pension funds[28], or the purchase of machine parts.[29]

The Board then looked to cases of the purchase of contractual rights for guidance. In *John Smith and Son v. Moore*[30] a son bought his father's business of a coal exporter for an overall figure. One item comprised forward contracts with colleries for delivery of coal at a low price. The rise in price of coal enabled the son to make large profits and he sought to deduct the value of the contracts from the profit. It was held that these contracts were part of the assets of the business, irrespective of the sale to the son, which was disregarded. The Board distinguished this case on the ground that the amounts there sought to be deducted had not been paid to the collieries to obtain the contracts. However, if the contracts were capital assets, as was decided, it would seem strange if money paid to obtain similar rights, as in the instant case, were not likewise capital expenditure.

In the case of *Stow Bardolph Gravel Co. Ltd v. Poole*[31] a company expended money in acquiring the rights to enter upon and win gravel from lands. This gave the company the exclusive right to work such gravel deposits. It was held, by the Court of Appeal[32] that the sums

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[24] *Ibid.* 48. Per *Menzies* J.: ' To make a payment to acquire or to defend the aquisition of a favourable position from which to earn income or to enter into arrangements that will yield income is not in general an outlay incurred either in gaining or in carrying on business for the purpose of gaining assessable income . . . To be deductible an outlay must be part of the cost of trading operation to produce income '.

[25] *Sun Newspapers Ltd v. Federal Commissioner of Taxation* (1938) 61 C.L.R. 337.
United Steel Co. Ltd v. Cullington (No. 2) (1939) 23 Tax Cas. 71.
Collins v. Joseph Adamson [1938] K.B. 477.
Associated Portland Cement Manufacturers Ltd v. Inland Revenue Commissioners (1946) 27 Tax Cas. 103.
Van Der Berghs Ltd v. Clark [1935] A.C. 431.

[26] (1965) 39 A.L.J.R. 190, 194.

[27] *Mitchell v. Noble* [1927] 1 K.B. 719; *W. Nevill & Co. Ltd v. Federal Commissioner of Taxation* (1936-1937) 56 C.L.R. 290; *Smith v. Incorporated Council of Law Reporting* [1914] 3 K.B. 674; *Hancock v. General Reversionary & Investment Co.* [1919] 1 K.B. 25.

[28] *British Insulated & Helsby Cables v. Atherton* [1926] A.C. 205.

[29] *Hinton v. Maden & Ireland* (1959) 38 Tax Cas. 391.

[30] [1921] 2 A.C. 13.

[31] (1954) 35 Tax Cas. 194; [1954] 3 All E.R. 637.

[32] Sir Raymond Evershed M.R.: Jenkins and Birkett L.JJ.

so expended were capital. The court drew a distinction between obtaining stock in trade, in this case, gravel, and obtaining a right to win stock in trade only. The latter is a capital asset and moneys expended to obtain the same capital expenditure. This case was followed in *H. J. Rorke Ltd v. Inland Revenue Commissioners*[33] in which mining leases were acquired by the company for periods of one to two years. Actual working of each site was six to nine months and three to four such sites were constantly needed to keep the company's plant occupied. Cross J. observed the above distinction between obtaining a right to obtain stock in trade and the stock in trade itself, and rejected the elements of transience and recurrence in the payments as pointing to income expenditure.[34] However, the Board rejected both these cases on the grounds that they were within ' the difficult area of mining cases and the principles governing extraction industries have little relation to the present case '.[35] It does seem, however, that it is possible to draw a meaningful analogy between obtaining stock in trade and orders for petrol and oil. The view of the Board may therefore seem rather strange, particularly in view of the fact that the Board relied strongly on *Commissioner of Taxes v. Nchanga Consolidated Copper Mines Ltd*[36] which was both a mining case and a case of buying off competition. In the latter case the company bought the contractual right to have another company out of production for 12 months and it was held that this was more analogous to an operating cost than the acquisition of a business, the whole transaction being designed to cut back over-all production to raise copper prices.

In the ultimate analysis, however, the Board seemed to abandon this analogy and returned to regarding the arrangement as payments made to particular customers to secure their particular custom[37] and reference was made to *Bolam v. Regent Oil Co. Ltd*[38] and *Usher's Wiltshire Brewery Ltd v. Bruce*.[39] Neither of these cases could be regarded by the Board as decisive, the former being in essence a form of trade rebate and the latter not calling into question whether the expenditure was capital or income. However, the Board seemed of opinion that such payments were of an income nature.

A basic distinction in this type of case seems to be whether the taxpayer is enhancing or preserving the value of a capital asset, which is clearly a revenue expense or whether the taxpayer is acquiring or defending title to a capital asset. This seems the principle behind such cases as *Sun Newspapers Ltd v. F.C.T*,[40] *Hallstroms Pty Ltd v. F.C.T.*,[41] *Broken*

[33] (1960) 39 Tax. Cas. 194: [1960] 3 All E.R. 359.

[34] (1960) 3 All E.R. 359, 366.

[35] (1965-1966) 39 A.L.J.R. 190, 197.

[36] [1964] A.C. 948.

[37] (1965) 39 A.L.J.R. 190, 197.

[38] (1956) 37 Tax. Cas. 56.

[39] [1965] A.C. 433.

[40] (1938) 61 C.L.R. 337:—Moneys paid by the taxpayer to prevent the emergence of a competitive newspaper were held capital. In essence this was regarded as adding a right to the goodwill.

[41] (1946) 72 C.L.R. 634:—Moneys paid by the taxpayer to prevent a competitor from extending a patent on goods were held revenue expenditure, being the gain of

Hill Theatres Pty Ltd v. F.C.T.[42] and *John Fairfax and Sons Pty Ltd v. F.C.T.*[43] It should be noted however, that the English view is to the contrary.[44] The dissenting opinion in *Morgan v. Tate and Lyle*[45] appears to represent the view taken by the Australian Courts.

The Board appears to have finally rested on the fact that the purpose of the expenditure was to obtain ' bundles of orders '. With respect, however, it is not logical to draw the conclusion that the expenditure is therefore revenue. What may be said is that it is therefore expended for the purposes of earning the assessable income, but no further conclusion is possible from this finding. The same confusion between the end and the nature of the means is to be observed in the judgment of Dixon J. in the High Court.[46] The real issue is whether the means adopted to obtain bundles of orders was capital or revenue expenditure. Kitto J. did not consider that the right to obtain blocks of orders was capital but *Rorke's* case and the *Stow Bardolph* case are contrary to this proposition. It is, further, generally true that acquisition of a right or means to enable the earning of income is an asset. Thus to regard the rights obtained in the instant case as a capital means to gain income does not seem unreasonable. Indeed the same conclusion was reached in *Vacuum Oil Co. Pty. Ltd v. F.C.T.*[47] and *Atlantic Refining Company of Africa Pty Ltd v. Inland Revenue Commissioner.*[48] The instant decision is, however, contrary to both of these decisions.

The present case, therefore, must represent a continuation of an apparent judicial policy to refuse to lay down any coherent set of principles in this area of the law, making the following words of Dixon J. in

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a common not an exclusive right. Dixon J. dissented, holding at 646: ' The purpose of expending the money upon the opposition proceedings was to enable the taxpayer company to complete and carry into effect plans for re-organising its manufacturing and selling business for the production and sale of an entirely different refrigerator. This appears to me to go to the character and organisation of the profit earning business and not to be an incident in the operations by which it is carried on '.

[42] (1952) 85 C.L.R. 423—The taxpayer expended money to prevent a competitor from becoming established. *Held* that expenditure for the purpose of preserving and protecting the nature of the company's business, i.e. a monopoly, was capital expenditure.

[43] (1959) 101 C.L.R. 30 :— The taxpayer was put to expense defending a suit attacking its title to shares acquired in a competitor. *Held* that this was protecting and so incidental to, the acquisition of an asset. It was not a part of trading operations.

[44] *Southern v. Borax Consolidated Ltd* (1940) 23 Tax. Cas. 597. (1940) 4 All E.R. 412: An asset was purchased for taxpayer's business. It defended a challenge to its title. Lawrence J. held that the expenditure did not alter or add to any capital asset and so was revenue expenditure. This decision was affirmed in *Morgan v. Tate & Lyle Ltd* (1954) 35 Tax Cas. 367; (1954) 2 All E.R. 413. The taxpayer conducted a campaign against nationalisation of its assets. The cost thereof was held revenue expenditure. Lord Morton said: ' I can see no distinction between a payment made to preserve the status and dividend earning power of the company and a payment made to prevent seizure of the companies profit earning assets.' ((1954) 2 All E.R. 413, 418). Lord Keith, however, dissented holding that such a distinction was necessary (see p. 435).

[45] [1954] 2 All E.R. 413, 434 per Lord Keith.

[46] *B.P. Australia Ltd v. F.C.T.* (1964) 9 A.I.T.R. 225, 230.

[47] (1964) 9 A.I.T.R. 237.

[48] (1957) 21 S.Af. T.C. 203.

Hallstrom's Case[49] seem more like a pious hope than a statement of the law.

> For myself however, I am not prepared to concede that the distinction between an expenditure on account of revenue and an outgoing of a capital nature is so indefinite and uncertain as to remove the matter from the operation of reason and place it exclusively within that of chance or that it must be placed in the category of an unformulated question of fact.

T. J. HIGGINS

PARKER v. THE COMMONWEALTH OF AUSTRALIA[1]

Commonwealth—Liability in tort—Negligent act of member of defence forces in peacetime—Injury on high seas—Judiciary Act 1903-1960 *(Cth), ss.* 79, 80—*Wrongs Act* 1958 *(Vic.), section* 18.

This action arose out of the tragic collision between two ships of the Royal Australian Navy, H.M.A.S. Melbourne and H.M.A.S. Voyager. The plaintiff, the widow of a person who lost his life as a result of the collision, brought an action against the Commonwealth in the Admiralty jurisdiction of the High Court on the basis that her husband's death was caused by the negligence of the officers and crew of the two ships and of other servants of the Commonwealth. The Commonwealth admitted the allegations of negligence. The action was heard in Melbourne before Windeyer J.

On a preliminary point Windeyer J. held that, since the repeal, in 1939, of section 30 (b) of the Judiciary Act, 1903-1960 (Cth) the sole source of the Admiralty jurisdiction of the High Court had been the Colonial Courts of the Admiralty Act, 1890 (Imp.). As the plaintiff's rights were perhaps less in an action in the Admiralty jurisdiction than they would be in an ordinary action in the original jurisdiction of the Court, His Honour considered the case as if it were an ordinary action at law.[2] Thus the difficult questions concerning the extent of the Admiralty jurisdiction of the High Court were avoided.

The liability of the Commonwealth in tort depends upon the provisions of the Constitution and sections 56 and 64 of the Judiciary Act 1903-1960 (Cth). His Honour mentioned the vexing question whether the ' vicarious ' liability of a master for the tortious acts of his servant arises because the master is answerable for his servant's torts, or because

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[49] (1946) 72 C.L.R. 634, 646.

[1] (1965) 112 C.L.R. 295; (1965) 38 A.L.J.R. 444. High Court of Australia; Windeyer J.

[2] See *Huddart Parker Ltd v. The ' Mill Hill '* (1950) 81 C.L.R. 502, 508.