IN THE HIGH COURT OF AUSTRALIA
MELBOURNE REGISTRY

No M139 of 2014

BETWEEN:

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

and

THE COMMISSIONER OF TAXATION OF THE COMMONWEALTH OF AUSTRALIA
Respondent

APPELLANT'S SUBMISSIONS

Part I – Publication

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

Part II – Issue on the Appeal

2. The Appellant is a transmission company deriving assessable income from providing access to the electricity transmission network in Victoria. For that purpose, it must hold a licence to transmit electricity. By virtue of an Order in Council made under s 163AA of the *Electricity Industry Act 1993* (Vic) ("**EIA**"), the Appellant, as "holder" of such a licence, was liable to pay, and did pay, to the Treasurer of the State of Victoria, for payment into the Consolidated Fund, certain imposts for the financial years ending 30 June 1998, 30 June 1999, 30 June 2000 and for the 6 months ending 31 December 2000 ("**s 163AA imposts**").

3. The issue is whether the Appellant was entitled to a deduction under s 8-1 of the *Income Tax Assessment Act 1997* ("**1997 Act**") for the s 163AA imposts incurred by it in those years.

Part III – Section 78B of the Judiciary Act

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

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Part IV – Judgments below

5. The decision of the Full Court of the Federal Court (Edmonds, McKerracher and Davies JJ) is reported at *SPI PowerNet Pty Ltd v Federal Commissioner of Taxation* (2014) 220 FCR 355.

6. The decision of the Federal Court (Gordon J) is reported at *SPI PowerNet Pty Ltd v Federal Commissioner of Taxation* 2013 ATC 20-416.

Part V – Factual matters

7. The facts are not in dispute and are set out in full in the judgment of the primary judge: pars [3] to [37]. Essentially they are as follows.

8. In 1993, the State Electricity Commission of Victoria was disaggregated into three new businesses to undertake respectively the generation, transmission and distribution of electricity.[1]

9. In 1994, eight new companies were established by the State of Victoria, namely:[2]

   (a) Victorian Power Exchange ("**VPX**"), an independent company to operate the wholesale electricity market and ensure the security of supply;

   (b) Power Net Victoria ("**PNV**") which owned, maintained and operated the existing high voltage transmission network system or "grid" in Victoria;[3]

   (c) Generation Victoria ("**GenVic**"), an interim generation structure comprising groups of power stations; and

   (d) five regionally based distribution companies. Each comprised a retail arm and a regulated local geographic distribution or wires business. During a transition phase to 31 December 2000, each distribution company was the sole retailer of electricity to franchise customers in a defined franchise area until those customers were able to choose their retailer. The decision of the Full Federal Court in *United Energy Ltd v FCT*[4] concerned one of these companies during this transition phase.

10. In 1995, amongst other things, the distribution and generation companies were privatised.[5]

11. Although at the time of the initial reforms it had been intended that PNV would remain state-owned, in April 1997, the State Government announced its intention to privatise PNV.[6]

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[1] TJ [9]

[2] TJ [11]

[3] TJ [4]

[4] (1997) 78 FCR 169

[5] TJ [12]

Tariff Regime

12. Whilst the Government's aim was that prices in the industry would come to be determined by market forces, there were several areas of the industry in which price and service controls were applied during, and in some cases, after, the reform process. One of these was a regulatory regime designed to control the costs of connections to, and use of, the distribution and transmission systems.[7]

13. The mechanism by which these price controls were to be applied was a Tariff Order made under s 158A of the EIA.[8] Amongst other things, the Tariff Order regulated retail tariffs (especially for the transition period),[9] and imposed a pre-determined cap on the revenue which PNV could derive from the provision by it of certain "Prescribed Services",[10] being network services provided to VPX and connection services to distribution businesses, generators, traders and some large customers.[11] The "Prescribed Services" were defined in clause 3.1 of the Tariff Order.[12] PNV's gross revenue in respect of the provision of Prescribed Services for a financial year was not to exceed the Maximum Allowable Revenue ("**MAR**").[13] The MAR was calculated as a product of the Maximum Allowable Charge ("**MAC**") and the forecast Summer Maximum Demand ("**SMD**").[14]

14. The revenue cap was calculated to reflect three matters[15] – efficient levels of operating and maintenance costs,[16] a return on capital (a notional amount calculated using the Optimised Depreciated Replacement Cost value of assets multiplied by a weighted average cost of capital)[17] and straight line depreciation at rates reflecting estimated useful lives on Current Cost Accounting asset base.[18] To ascertain the

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[6] TJ [13]

[7] TJ [14]

[8] TJ [15]

[9] TJ [16](1)

[10] TJ [17]

[11] TJ [16](3)

[12] TJ [17]

[13] TJ [18]

[14] TJ [18]; Cohen [16]; clause 3.2 of the Tariff Order GRM-9

[15] TJ [19]

[16] TJ [19]; IM p 24 RHK-1

[17] TJ [19]; IM p 24 RHK-1

[18] TJ [19]; IM p 24 RHK-1

tariff for each relevant year, the initial tariff was adjusted by "CPI minus X",[19] where the X factor was a proxy for the expected real rate of improvement in efficiency.[20]

15. Between the time when the X factor was initially calculated (and the Tariff Order determined in 1995) and the time that PNV was privatised in 1997, the State Government decided to extend the tariff order applicable to PNV for a further two years in order to promote price certainty for prospective purchasers of PNV.[21] KPMG, as advisers to the Victorian Government, undertook a review of the assumptions adopted in the tariff model and determined that some of them were no longer correct.[22] As a result of changes in the rate of inflation, operational costs and the cost of capital, the level of MAR was higher than that required to provide a reasonable return on capital.[23] Accordingly, the X factor used in the tariff order needed to be reset.[24]

16. Simply resetting the X factor would have resulted in a reduction in PNV's transmission charges, and thus its revenue.[25] However, this solution was not pursued for the transition period because it would have led to the making of windfall gains by the distribution companies who would have paid PNV less, but whose own retail tariffs could not be altered during this phase.[26] Passing the lower transmission charges on to the ultimate consumer was not considered practical given the number of customers and the small savings per customer.[27]

17. Yet, in the absence of a change to the existing tariff order, PNV would earn more revenue than was considered appropriate.[28] It was therefore proposed that the difference in gross revenue that would accrue to PNV under the Tariff Order and the MAR that the modelling concluded should have been derived in the period up to December 2000 would be recovered from PNV by way of a "special licence fee"

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[19] TJ [19]; Clause 3.2.5 of the Tariff Order GRM-9; IM p 23 RHK-1

[20] TJ [19]; see too the definition of "X-factor" at p 91 "Victoria's Electricity Supply Industry – Towards 2000" GRM-1

[21] TJ [21]

[22] TJ [21]; Cohen [24]

[23] TJ [21]; Cohen [24]

[24] TJ [21]; Cohen [24]

[25] TJ [22]; Cohen [24]

[26] TJ [22]; Cohen [25]; IM p 27 RHK-1

[27] TJ [22]; Cohen [25]

[28] TJ [22]; Cohen [24]

that would be separately levied by s 163AA of the EIA.[29] The effect of this solution was to reset PNV's revenue cap for Prescribed Services.[30]

Privatisation of PNV

18. As part of the PNV privatisation process, an Information Memorandum was provided to potential bidders.[31] It disclosed that the X factor for the year from 1 January 2001 to 31 December 2002 was to increase to 11%[32] and that before then it was intended that an order would be made under s 163AA of the EIA imposing the following specified imposts on the holder of the PNV transmission licence (referred to as "licence fees"):

    (a) $50m per annum for each of the years ending 30 June 1998 to 30 June 2000;

    (b) $40m for the year ended 30 June 2001.

19. GPU Inc. submitted its bid to the Victorian Government for the acquisition of the PNV assets on 10 October 1997.[33] Following further negotiations which resulted in an increase in its bid price, GPU's bid was successful.[34]

20. An "Asset Sale Agreement" between PNV (as the seller) and a new subsidiary of GPU, Australian Transmission Corporation Pty Ltd (as the buyer) (later renamed and now the Appellant) was executed on 12 October 1997.[35] The State was a party to that agreement.

21. Recitals E and F of the Asset Sale Agreement provided:

    E. The total value attributed by the parties to the sale of Assets (net of Creditors and Contract Liabilities) the subject of this agreement is $2,555,000,000 made up of:

Total Purchase Price	*$2,502,600,000*
Estimated Duty	*$ 52,400,000*
	$2,555,000,000

    F. The parties agree that the total payments to the State in connection with the privatisation of [PNV] are $2,732,500,000 (including future licence fees of $177,500,000 payable by [the Appellant], which the

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[29] TJ [23]; Cohen [26], [27]; This was depicted diagrammatically in the Information Memorandum at p 27 RHK-1; TJ [23]

[30] IM p 27 RHK-1

[31] TJ [26]; RHK-1

[32] TJ [26]; IM pp 24, 27; RHK-1

[33] TJ [28]; Keller [21]

[34] TJ [28]; Keller [23], [24]

[35] TJ [29]; Keller [24]; DGB-2

State values in net present value terms at approximately $161,000,000).

22. On the Completion Date, PNV sold, and the Appellant bought, defined "Assets" (of PNV's transmission business), the Appellant assumed certain creditors and contract liabilities and it paid the "Total Purchase Price": see clause 2.1. The phrase "Total Purchase Price" was defined in cl 1.1 of the Asset Sale Agreement to mean:

> *"$2,502,600,000* ***being the sum of the price of the Assets*** *(including the Land) net of Contract Liabilities and Creditors ... assumed under this agreement and, for the avoidance of doubt, does not include the Estimated Duty. The sum of $2,502,600,000* ***is fixed****, notwithstanding that the components referred to above may be shown collectively to have a different value"* (our emphasis)

23. Clause 4.3 of the Asset Sale Agreement set out the conditions precedent to completion. They included an obligation on the State to procure the approval of the transfer of the Transmission Licence and the publication in the Government Gazette of the Licence Fee Order.

24. The Agreement also contained certain warranties. Clause 13.3(d),[36] relied upon by the Respondent, provided, amongst other things (the reference in it to the "Licence Fee Order" is to the s 163AA impost):

> *"The Buyer acknowledges and agrees with the State and [PNV] that:*
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> *(1) the amounts to be payable by the Buyer pursuant to the Licence Fee Order are an integral part of the regulatory framework of the industry and the Buyer accepts that it must pay the amounts set out in the Licence Fee Order in order to carry on the Business transferred from [PNV];*
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> ...
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> *(3) the Buyer agrees to pay to the Treasurer the amounts specified in the Licence Fee Order in accordance with the terms of, and at the times specified in, the Licence Fee Order, whether or not the Licence Fee Order is valid or enforceable; and*
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> *(4) the Buyer must not transfer the Transmission Licence or allow any person to become a licensee under the Transmission Licence unless the proposed licensee has first delivered to the State a covenant (in form and substance satisfactory to the State) agreeing to be bound by this clause 13.3(d) as if it were the Buyer"*

25. After the parties entered into the Asset Sale Agreement, on 28 October 1997, but before the Completion Date, the Governor in Council made an Order pursuant to s 163AA declaring that:[37]

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[36] Clause 13 is entitled "Seller's Warranties"

[37] FC [86]

"The Governor in Council acting on the recommendation of the Treasurer under section 163AA of the Electricity Industry Act 1993 declares that the amounts payable as an impost by Power Net Victoria, ***as the holder of a licence*** *(the "Transmission Licence") to transmit electricity issued under Pt 12 of the [EIA] to the Treasurer for payment into the Consolidated Fund under section 163AA(2) of the [EIA] are as* follows:

(a) $37,500,000 in respect of the financial year ending 30 June 1998, payable in arrears in two instalments, being $25,000,000 on 31 March 1998 and $12,500,000 payable on 30 June 1998;[38]

(b) $50,000,000 in respect of each of the financial years ending 30 June 1999 and 30 June 2000, payable in arrears in four equal instalments on 30 September, 31 December, 31 March and 30 June in each relevant financial year; and

(c) $40,000,000 in respect of the 6 months ending on 31 December 2000, payable in arrears in two equal instalments on 30 September 2000 and 31 December 2000." (our emphasis)

26. By its terms, the Order applied "*to any person or persons ... to whom the Transmission Licence is transferred or any subsequent holder of the Transmission Licence or any person or persons ... who acquire all or substantially all the business of* [PNV] *and who is or are issued with a licence to transmit electricity under Part 12 of the* [EIA]."

27. Section 163AA of the EIA[39] at all relevant times was in the following terms:

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

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

(our emphasis)

28. The s 163AA imposts were not paid to obtain the Transmission Licence. A separate and ongoing licence fee was paid for the benefit of holding the licence.[40]

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[38] The s 163AA impost payable for the year ended 30 June 1998 was adjusted downwards from the amount disclosed in the Information Memorandum by $12.5 million to take into account the fact that the order would not take effect until after the first quarter of that financial year: TJ [28]

[39] Enacted by s 13 of the *Electricity Industry (Further Amendment) Act 1995* (Vic)

[40] TJ [83]

Part VI – Argument

29. All members of the Full Federal Court found that the s 163AA imposts were outgoings incurred by the Appellant in the ordinary course of its business and so satisfied s 8-1(1)(b) of the 1997 Act, the so-called 'positive limb'. The majority nonetheless decided that the s 163AA imposts were "*a loss or outgoing of capital, or of a capital nature*" within s 8-1(2)(a) of the 1997 Act (the 'negative limb').

30. The only issue raised by the Appellant's notice of appeal concerns the correctness of the conclusion reached in relation to the negative limb. By Notice of Contention dated 24 December 2014, the Respondent disputes the correctness of the decision reached in relation to the first limb. The Appellant will address that contention in its reply. These submissions are confined to issues raised by the second limb of s 8-1.

Capital or of a Capital Nature

31. There are five principles relevant to the determination here as to whether the s 163AA imposts are capital or of a capital nature.

32. *First*, this Court has long held that the starting point[41] in the determination of this issue is the statement of Dixon J in *Sun Newspapers Ltd and Associated Newspapers Ltd v Federal Commissioner of Taxation*:[42]

> *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.*

33. *Secondly*, it is the character of the advantage sought by the making of the expenditure, which is critical,[43] and this must be determined from the perspective of the payer, not the recipient.[44] That characterization depends on what an outgoing "is calculated to effect", to be judged from "a practical and business point of view".[45]

34. *Thirdly*, the issue of characterization must be determined at the time the expenditure is "incurred". A liability is incurred when it is more than impending, threatened or

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[41] *Commissioner of Taxation (Cth) v CityLink Melbourne Ltd* (2006) 228 CLR 1 at [147]

[42] (1938) 61 CLR 337 at 363

[43] *GP International Pipecoaters Pty Ltd v Federal Commissioner of Taxation* (1990) 170 CLR 124 at 137 per Brennan, Dawson, Toohey, Gaudron and McHugh JJ; *CityLink* at [148]

[44] *Federal Commissioner of Taxation v The Midland Railway Co of Western Australia Ltd* (1952) 85 CLR 306 at 313; *Federal Commissioner of Taxation v Ashwick (Qld) No 127 Pty Ltd* (2011) 192 FCR 325 at [104]

[45] *Hallstroms Pty Ltd v Federal Commissioner of Taxation* (1946) 72 CLR 634 at 648 per Dixon J

expected,[46] and is a liability to which the taxpayer is definitely committed.[47] Generally, a liability which is conditional is not incurred until the condition is fulfilled.[48]

35. *Fourthly*, determination of the character of the advantage sought by the taxpayer in incurring a liability is not necessarily answered by asking whether it formed part of the consideration that moved the transfer of a capital asset. That is so whether that consideration is understood in a contractual sense, or more broadly, as in the case of some State Acts imposing Duty.[49] Rather, the question to be asked is – what the outgoing, when incurred, was really "for". Or to use the language of *Hallstroms* – what was it calculated to effect from a practical and business point of view.[50]

36. In the usual case, an outgoing which forms part of the consideration of the acquisition of a capital asset will, when incurred, be also "for" the advantage of securing, on an enduring basis, that asset. It will thus be an affair of capital. But it will not always be so. A payment which forms part of the consideration that moves the transfer of a capital asset may nonetheless, when incurred, not be "for" any advantage of an enduring nature from the perspective of the acquirer. The facts and result in *Cliffs International Inc v FCT*[51] are illustrative of just such a case. So is the decision of this Court in *FCT v Morgan*[52] where a payment made as part of the consideration for a transfer of land, viz an amount on account of rates reimbursed to the vendor and apportioned to the taxpayer as purchaser, was held to be deductible.

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[46] *New Zealand Flax Investments Ltd v Federal Commissioner of Taxation* (1938) 61 CLR 179 at 207

[47] *Coles Myer Finance Ltd v Federal Commissioner of Taxation* (1993) 176 CLR 640 at 670-671

[48] *Nilsen Development Laboratories Pty Ltd v Federal Commissioner of Taxation* (1981) 144 CLR 616 at 624-5 (Barwick CJ), 627-8 (Gibbs J) and 631-2 (Mason J)

[49] *Commissioner of State Revenue v Lend Lease Development Pty Ltd* [2014] HCA 51 at [18]. In *Chief Commissioner of State Revenue v Dick Smith Electronics Holdings Pty Ltd* (2005) 221 CLR 496, the test applicable for the purpose of s 21(1) of the *Duties Act 1997* (NSW) was expressed to be the identification of that "total sum" in return for which a vendor is "willing" to transfer the dutiable property. The focus is upon "what was received by the Vendors so as to move the transfers..." (at 518). See also *Archibald Howie Pty Ltd v Commissioner of Stamp Duties (NSW)* (1948) 77 CLR 143 at 152 (Dixon J) and 157 (Williams J). See also *Commissioner of Taxation v Qantas Airways Ltd* (2012) 247 CLR 286 at [14] in the context of GST. In any event, it is noted that the imposts here did not form part of the sum on which duty was payable: FC [35] per McKerracher J

[50] *FCT v Morgan* (1961) 106 CLR 517 at 521.5: "In the first place neither under the contract nor under the statutory provisions does the apportioned part of the rates really represent a payment **for** the land..." (our emphasis)

[51] (1978-1979) 142 CLR 140

[52] (1961) 106 CLR 517

So is this matter, if the liability here to pay the imposts formed part of the consideration which moved the transmission business.[53]

37. It follows that no *a priori* categorization of an outgoing – be it "consideration" or be it, for example, "rent" – is necessarily on capital or revenue account. In each case one must identify the particular advantage sought by the incurrence of the outgoing: *FCT v South Australian Battery Makers Pty Ltd.*[54]

38. *Fifthly*, the dictum of Fullagar J in *The Colonial Mutual Life Assurance Society v FCT,*[55] which was largely dispositive of the second limb issue below,[56] should be either clarified or qualified to ensure conformity with the fourth proposition above. That dictum (at 454.5) is as follows:

> "*It does not matter how they are calculated, or how they are payable, or when they are payable, or whether they may for a period cease to be payable. If they are paid as parts of the purchase price of an asset forming part of the fixed capital of the company, they are outgoings of capital or of a capital nature.*"

39. As a description of the usual outcome, the dictum is unexceptional. But it is not, with respect, a correct legal test. Unlike, for example s 21 of the *Duties Act 2000* (Vic), the application of the second limb of s 8-1 is not determined by asking whether a payment is or is not "*paid as part of the purchase price of an asset.*" As Barwick CJ observed in *Cliffs International* at 150.2:

> "*As I have indicated, the fact that the promise to make the payments formed part of the consideration for the transfer of the shares does not mean that, when made, they were paid **for** the shares.*" (our emphasis)

40. Consistently with this statement of principle:

(a) the fact that a payment is made in fulfilment of a condition precedent to obtaining a transfer of a capital asset does not make the payment on capital account.[57] This is particularly so where the price under the contract is fixed. Rather, the question is whether or not the payment "really represent[ed] a payment for … the capital asset" and whether "it is in form or substance part of the consideration for the property"[58]; and

(b) interest on borrowed money does not have a capital nature merely because the borrowed money is used to acquire, or cause the acquisition of, a capital

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[53] As distinct from the promises made in relation to the imposts contained in the agreement. For the reasons set out below (at [49]), the agreement did not contain any promise to pay the imposts in substitution for the Order in Council.

[54] (1977-78) 140 CLR 645 at 655.2

[55] (1953) 89 CLR 428

[56] FC [12] per Edmonds J and [56] per McKerracher J

[57] *FCT v Morgan* (1961) 106 CLR 517 at 520-1

[58] *FCT v Morgan* (1961) 106 CLR 517 at 521

asset. The fact that a taxpayer might incur interest to borrow money in order purchase a capital asset does not mean that the advantage sought by the payment of interest is of a capital nature.[59]

41. A correct expression of principle appears in a subsequent passage in the judgment of Fullagar J, when his Honour said at 454.8:

> *The questions which commonly arise in this type of case are (1) What is the money really paid for? - and (2) Is what it is really paid for, in truth and in substance, a capital asset?*

42. With great respect, those questions were not correctly addressed by the majority in the Full Federal Court (as to which, see below).[60]

Application of the general principles to the present facts – Six Propositions

43. The inquiry into the character of the advantage sought by the Appellant in incurring the obligation to pay the s 163AA imposts must begin at a point anterior to the execution of the Asset Sale Agreement. To focus only, or even primarily, on the terms of that agreement would be to mischaracterise the obligation. With respect, that is where the trial judge and the majority in the Full Court fell into error. In contrast, Davies J in the Full Court began with the s 163AA impost,[61] which is the correct starting point.

44. The Appellant relies upon the following propositions.

45. *First*, the effect of the s 163AA imposts was to reset the Appellant's revenue cap with respect to the provision of Prescribed Services. The originally ascertained "X" factor in the Tariff Order permitted the Appellant to earn a level of gross revenue that was considered by the Victorian Government to be too high. The purpose and effect of the s 163AA imposts was to recover from the Appellant that excess amount of gross revenue during the transition period.[62] Those matters necessarily inform the inquiry into the character of the advantage sought, from the perspective of the Appellant.

46. *Secondly*, the particular means adopted to achieve this outcome was to create a special tax. That tax is imposed – not by contract – but by an Order in Council

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[59] *Steele v Deputy Commissioner of Taxation* (1999) 197 CLR 459 at [29]

[60] *Tata Hydro-Electric Agencies Ltd, Bombay v Commissioner of Income Tax, Bombay Presidency and Aden* [1937] AC 685, an advice of the Privy Council, on appeal from the High Court of Judicature at Bombay, does not require any contrary conclusion. Whether correctly decided or not, that case concerned a different legislative test, namely, whether "expenditure (not being in the nature of capital expenditure) [was] incurred solely for the purpose of earning" profits or gains of a business under s 10(2) of the *Indian Income Tax Act*, 1922. For that purpose, the Privy Council, looked to determine whether the promise given there, was one of the "terms of the purchase" of a business: see 695.6.

[61] FC [105] per Davies J

[62] TJ [23]; FC [84], [97] and [107]

authorised by s 163AA of the EIA. That section states that the charges thereunder are "payable **as an impost** by the holder of a licence" (our emphasis). These words manifest Parliament's will to levy a tax upon an identified person. That person was "[PNV] as the holder of a licence…to transmit electricity…or any subsequent holder of the Transmission Licence." Liability was thus *not* imposed upon the Appellant as such. Indeed, the Appellant is not named in the Order at all.[63] Rather, the only entity identified is referred to in its capacity "as the holder of a licence".

47. *Thirdly*, the liability to pay the s 163AA imposts did not arise upon execution of the Asset Sale Agreement on 28 October 1997. Rather, each liability to pay arose upon the dates specified in the Order in Council. Thus, the first liability arose when the two instalments of $25,000,000 and $12,500,000 became "payable", viz "on 30 June 1998". Instalments of $12,500,000 thereafter became "payable in arrears" on "30 September, 31 December, 31 March and 30 June in each relevant financial year", namely the years ended 30 June 1999 and 2000. The final liabilities of $20,000,000 each became "payable in arrears" on "30 September 2000 and 31 December 2000." The Order in Council expressly recognised that these liabilities might be borne, when they arose, upon someone other than PNV, namely the holder at each relevant time of the Transmission Licence. That is why the Order includes this language: "[t]*his Order applies to any person or persons (jointly and severally) to whom the Transmission Licence is transferred or any subsequent holder of the Transmission Licence …, etc.*"

48. *Fourthly*, by its terms, the Asset Sale Agreement identified the payment which was "for" the acquisition of the transmission business. It was the sum of "$2,502,600,000" defined by the parties as the "Total Purchase Price", being "the sum of the price of the Assets" which "is fixed": see the definition above. This was the sum payable to PNV as "Seller": see cl 2.1. In contrast, the s 163AA imposts of $177,500,000 in aggregate, are *not* described in the Agreement as forming part of the total value to be attributed to the Assets sold (Recital E), and were *not* defined to be part of the "Total Purchase Price." They were, instead, described in Recital F as a payment to be made in the "future", "in connection with the privatisation of [PNV]". Moreover, it was payable to the Treasurer, and not to the "Seller". The Respondent has never challenged the correctness of these statements or definition. To use the language of this Court in *Morgan* at 521.6: "*The price remains fixed. The payment of the* [s 163AA imposts] *is separate…*"

49. *Fifthly*, and contrary to the conclusion of the Full Court (as to which see below), the Asset Sale Agreement did not impose upon the Appellant a further contractual liability to pay the s 163AA imposts. That contract did not supplant the Order in Council as the source of the Appellant's then future, and conditional, liability (as to which see proposition six below). In amplification:

    (a) The mere reference to the "future licence fees" in Recital F created no separate liability to pay those fees.

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[63] See [25] and [26] above

(b) Nor did the warranty at clause 13.3(d)[64] (reproduced at par 25 hereof): subparagraph (1) itself confirms the source of the liability by its statement that the amounts to be payable are "pursuant to the Licence Fee Order". Subparagraph (2) is a statement that the Appellant must not challenge the validity of the "Licence Fee Order". Again, this identifies the source of the liability as the Order, not the Agreement. Subparagraph (3) is a promise to comply with the Licence Fee Order, irrespective of whether it is valid or enforceable.[65] This promise is given in aid of the Order as the source of the Appellant's future liability. It was only operative in the event that the Order was found to be invalid or unenforceable (inferentially as an excise), which event never took place. Its purpose was to expand the State's ability to enforce the terms of the Order. Subparagraph (4) concerns the transfer of the licence and was designed to ensure that any transferee gave the same comfort to the State as the Appellant.

(c) The condition precedent to the Asset Sale Agreement relied on by the majority in the Full Court[66] did no more than require the State of Victoria to procure the making and publication of the Licence Fee Order. It thus imposed an obligation upon the State, and not upon the Appellant.

(d) While the Asset Sale Agreement gave the State rights against the purchaser's parent company as a Guarantor of the Appellant's obligations,[67] that guarantee related to all of the Appellant's obligations "under this agreement", and for the reasons set out above, those obligations did not include a contractual promise to pay the imposts in substitution of the Order in Council.

50. *Sixthly*, the liability to pay the imposts was contingent (in a legal as well as a business or commercial sense)[68] upon the Appellant remaining the holder of the licence at the particular times in which the imposts were due for payment. It was not disputed below that the imposts here were incurred by the Appellant in the years of income in which they became due for payment in accordance with terms of the Order in Council.[69] At no stage has the Respondent submitted that a deduction was not allowable because all of the imposts were incurred in the year of entry into the Asset Sale Agreement. Until the times mandated by the Order in Council, the

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[64] FC [107] per Davies J

[65] It was only in that sense that "various warranties were secured from SPI under the Asset Sale Agreement which were additional to any statutory liability it would incur": FC [66] per McKerracher J

[66] FC [15] per Edmonds J and [67] per McKerracher J

[67] Clause 19.1

[68] *CityLink* at [137]

[69] TJ [41]. The Appellant claimed deductions in the years of income in which the imposts were paid: TJ [37]

imposts were no more than outgoings which were "impending, threatened or expected",[70] to which the Appellant was not "definitively committed."[71] Prior to those times, at any stage, it could transfer the Transmission Licence and thereby avoid the future liability to pay the imposts.

Application of Propositions

51. The foregoing propositions justify the conclusion that the s 163AA imposts did not, and were not capable of, securing any lasting advantage for the Appellant. The imposts were not incurred "for" the acquisition of the Transmission Business sold by PNV. Like the facts in *Morgan*, the payment made *for* the Transmission Business at all times remained "fixed" being the "Total Purchase Price". Indeed, an examination of the statutory framework and background to the imposition of the s 163AA imposts[72] demonstrates that the need for the imposts predated the negotiation of the Asset Sale Agreement.[73] The imposts originated in a problem that was identified prior to sale: but which concerned the correct maximum allowable revenue of part of the business in the years following the sale. The imposts did not form part of the value of the Assets sold. They were a separate matter altogether.

52. From the perspective of the Appellant, the imposts were a mechanism to recapture gross revenue which took the form of a tax ~ required to be paid in each year of the transition period ~ and imposed upon the Appellant as the holder of a licence needed for the carrying on of its transmission business. The warranties in cl 13.3(d), in that respect, support the Appellant. Clause 13.3(d)(1) accurately records the fact that the Appellant "must pay the amounts set out in the Licence Fee Order **in order to carry on the Business transferred**..." (our emphasis). By the time liability to pay each impost arose, the Appellant had already acquired the Transmission Business by the payment of the "Total Purchase Price". By paying the imposts the Appellant acquired nothing further. Indeed, to suggest otherwise would be antithetical to the very *raison d'etre* of the impost – namely to deny the Appellant the benefit of the gross revenue which exceeded its correctly calculated MAR, and not to confer upon it some advantage, whether enduring or otherwise.

53. With very great respect to the judges below:

    (a) The learned primary judge erred in deciding that the s 163AA imposts bore a capital nature because they "were specifically included in the Asset Sale Agreement as an element of the acquisition of the transmission business,

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[70] *New Zealand Flax Investments Ltd v Federal Commissioner of Taxation* (1938) 61 CLR 179 at 207

[71] *Coles Myer Finance Ltd v Federal Commissioner of Taxation* (1993) 176 CLR 640 at 670-671

[72] As undertaken by Davies J at [105]-[107] but which the majority of the Full Court failed to undertake.

[73] TJ [21]-[23]

although not part of the Purchase Price."[74] This conclusion may correctly identify a connection between the imposts and the privatisation of the business, but it addresses neither what each amount was paid "for" nor what was paid "for" the transmission business.

(b) McKerracher J erred in concluding that the liability to pay the impost arose independently and separately from the Licence Fee Order and the licence.[75] This led his Honour to conclude that because the Asset Sale Agreement "imposed a separate contractual liability to pay the Imposts in order to acquire the Assets...[t]he payment was therefore a capital amount".[76] With respect, even if the Agreement created an independent liability to pay the imposts, by its very terms, for the reasons given above, the imposts were not incurred to "acquire the Assets". Rather, the "Total Purchase Price" was paid to acquire those assets.

(c) Edmonds J erred in concluding that the liability to pay the s 163AA imposts was an existing liability of PNV as the vendor, and that that liability was assumed by the Appellant on the transfer of the Transmission Licence.[77] For the reasons given above, this cannot be correct. Liability to pay the imposts had yet to arise at that time, and would only be incurred by whoever held the licence on the dates nominated in the Order. At best, upon execution of the Agreement, the Appellant became subject to a future contingent liability.

(d) Nor, contrary to the conclusion of Edmonds J at par [13], did that future contingent liability render the State a "Creditor" of the Appellant for the purposes of Recital E (and for that matter cl. 4.4(a)). The term "Creditors" – as defined by cl 1.1 – is confined to liabilities "currently owed or prospectively or contingently owing **by the Seller**" (our emphasis). At the time of execution of the Asset Sale Agreement, the Order in Council had not been made so there was then no liability to pay the imposts owing, whether prospectively or contingently, by PNV as "the Seller". Nor, following the entry into and completion of that Agreement, would PNV become liable to pay the imposts, as it had ceased by then to be the holder of the Transmission Licence, which it had sold to the Appellant. And for the reasons expressed above, upon the making of the Order in Council, the liability to pay the imposts was not an "obligation **of the Seller existing** before or after Completion" (our emphasis) – refer cl 7.

(e) Both Edmonds and McKerracher JJ erred, in deciding that the imposts bore a capital nature because they were "part of the cost"[78] of acquiring the assets of

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[74] TJ [88]

[75] FC [70] per McKerracher J

[76] FC [71]

[77] FC [18] per Edmonds J

[78] FC [12] per Edmonds J

the business, or to "[p]ut [it] another way, on the face of the Asset Sale Agreement, the Assets could not have been acquired unless contractual liability to make the payments including the Imposts was also incurred."[79] With respect, identifying the occasion for the imposts in this way was incorrect. But even if it was correct, whether a promise to pay the money or incur the expenditure is part of the purchase price or consideration for the sale of a capital asset is not the fulcrum on which the character of the outgoing turns. Neither judge went on to identify what each impost, when incurred in 1998 to 2000, was "really for" and what advantage was secured by its payment in those years.

54. In contrast, Davies J correctly recognised that in paying the imposts, the Appellant was discharging a statutory liability that fell upon it as the licence holder.[80] Her Honour thus correctly concluded that the "thing that produced the assessable income was the thing that exposed SPI to the liability discharged by the expenditure"[81] and that it followed that in each of the years the imposts were incurred they were a working expense in the business operations of the Appellant and on revenue account.

55. It must follow that the conclusion of the majority of the Full Court cannot stand.

Payment of tax is not capital, or of a capital nature

56. As submitted above, the language of s 163AA supports the conclusion that the s 163AA imposts are "payable as an impost by the holder of a licence". Furthermore, unlike the fees the subject of the decision in *United Energy,* these charges were not imposed in respect of some statutorily conferred period of exclusivity.[82] They could not be regarded a fee for a service. Nor was the genesis of the s 163AA impost to be found in the bargain struck for the sale of the business. This is not a case where the parties sought to either disguise or label part of the purchase price as an impost.[83] The s 163AA imposts are a true tax.

57. A payment in the nature of a true tax will almost never bear a capital nature because it will not secure to the taxpayer any capital advantage; nor, indeed, any advantage at all. That is because by definition a tax is a compulsory exaction which is not paid to acquire anything. Taxes are paid by the taxpayer simply because they are required by law to be paid. As Griffiths CJ said of the land tax paid in *Moffatt v Webb* (1913) 16 CLR 120 at 130:

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[79] FC [67] per McKerracher J

[80] FC [106]

[81] FC [107]

[82] cf *United Energy* at 192

[83] cf *FCT v Star City* (2009) 175 FCR 39 at [63]

"It is impossible to say that land tax is paid for the purpose of acquiring anything. It may secure the taxpayer against being disturbed in his possession, but it certainly adds nothing to his capital—some people might think it diminishes it."

Part VII – Legislation

58. Income Tax Assessment Act 1997 (Cth), s 8-1

59. Electricity Industry Act 1993 (Vic) (incorporating amendments as at 31 December 2000), s 158A, s 163AA

Part VIII – Orders sought

60. The appeal be allowed.

61. The Orders of the Full Court of the Federal Court of Australia made 7 April 2014 be set aside and in lieu thereof the following orders be made:

    (a) the appeal be allowed;

    (b) the Respondent's objection decision issued to the Appellant dated 15 August 2012 be set aside and the objection be allowed in full; and

    (c) the Respondent pay the Appellant's costs of the appeal and of the trial at first instance.

62. The Respondent pay the Appellant's costs of this appeal.

Part IX – Estimate

63. The Appellant estimates that it requires 2 hours to present its oral argument.

Dated: 21 January 2015

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IN THE HIGH COURT OF AUSTRALIA
MELBOURNE REGISTRY

No. M139 of 2014

BETWEEN:

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

and

THE COMMISSIONER OF TAXATION OF THE COMMONWEALTH OF AUSTRALIA
Respondent

APPENDIX A: LEGISLATION

(A) RELEVANT PROVISIONS IN FORCE AT RELEVANT TIME

Income Tax Assessment Act 1997

Act No. 38 of 1997 as amended to 24 December 1998

8-1 General deductions

(1) You can ***deduct*** from your assessable income any loss or outgoing to the extent that:
  (a) it is incurred in gaining or producing your assessable income; or
  (b) it is necessarily incurred in carrying on a *business for the purpose of gaining or producing your assessable income.

(2) However, you cannot deduct a loss or outgoing under this section to the extent that:
  (a) it is a loss or outgoing of capital, or of a capital nature; or
  (b) it is a loss or outgoing of a private or domestic nature; or
  (c) it is incurred in relation to gaining or producing your *exempt income; or
  (d) a provision of this Act prevents you from deducting it.

For a summary list of provisions about deductions, see section 12-5.

(3) A loss or outgoing that you can deduct under this section is called a ***general deduction***.

Note: If you receive an amount as insurance, indemnity or other recoupment of a loss or outgoing that you can deduct under this section, the amount may be included in your assessable income: see Subdivision 20-A.

Filed on behalf of the Appellant by:

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Date of this document: 21 January 2015

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Electricity Industry Act 1993

Act No. 130/1993

Extracted from Reprint No.4 as at 8 June 1999

158A.Tariff order

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

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

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

(c) unless an Order is in force under section 158(2), charges for connection to, and the use of, the transmission system;

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

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

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

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

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

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

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

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

(d) specifying pricing policies or principles;

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

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

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

(3) An Order under sub-section (1)—

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

* * * * *

(4) In the Order made under sub-section (1) on 20 June 1995 and published in the Government Gazette on 30 June 1995, clause 4.4 is revoked.

(5) Despite the revocation of clause 4.4 of the Order referred to in sub-section (4), the revocation does not have effect for the purposes of the Order as a retailing change in taxes, a PowerNet change in taxes, a network change in taxes or a generator change in taxes within the meaning of the Order.

163AA. Charges payable to Treasurer

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

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

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

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

(B) WHETHER PROVISIONS STILL IN FORCE IN THIS FORM

Sections 158A and 163AA of the *Electricity Industry Act 1993* (Vic) were repealed by the *Electricity Industry Legislation (Miscellaneous Amendments) Act 2000* (Vic) as follows:

Electricity Industry Legislation (Miscellaneous Amendments) Act 2000
Act No. 69/2000

2. ***Commencement***

(1) Sections 1 and 13 and this section come into operation on the day on which this Act receives the Royal Assent.

(2) Section 16 is deemed to have come into operation on 14 December 1995.

(3) Section 17 is deemed to have come into operation on 22 March 1994.

(4) The remaining provisions of this Act come into operation on 1 January 2001.

14. ***Repeal of certain provisions of Part 12***

Sections 155A, 157A, 158, 158AA, 158A, 158C, 159, 160, 161, 162, 163, 163AAA, 163AAB,163AA, 164, 164A, 165, 165A, 166, 167, 168, 169, 169A, 169B, 169C, 169D, 169E, 170, 170A,170B and 170C of the **Electricity Industry Act 1993** are **repealed**.

Section 8-1 of the *Income Tax Assessment Act 1997* (Cth) was amended by the following legislation which is set out below:

(a) *A New Tax System (Indirect Tax and Consequential Amendments) Act 1999*

(b) *New Business Tax System (Integrity Measures) Act 2000*

(c) *New Business Tax System (Simplified Tax System) Act 2001*

(d) *Taxation Laws Amendment Act (No. 4) 2003*

(e) *Tax Laws Amendment (2004 Measures No 7) Act 2005*

A New Tax System (Indirect Tax and Consequential Amendments) Act 1999

No. 176, 1999

2 Commencement

...

Schedule 3—Income Tax Assessment Act 1997

(9) Schedule 3 commences immediately after the commencement of the *A New Tax System (Goods and Services Tax) Act 1999*.

...

3 Schedule(s)

Subject to section 2, each Act that is specified in a Schedule to this Act is amended or repealed as set out in the applicable items in the Schedule concerned, and any other item in a Schedule to this Act has effect according to its terms.

Schedule 3—Income Tax Assessment Act 1997

Part 1—General

2 At the end of section 8-1

Add (before the note):

For the effect of the GST in working out deductions, see Division 27.

3 Schedule(s)

Subject to section 2, each Act that is specified in a Schedule to this Act is amended or repealed as set out in the applicable items in the Schedule concerned, and any other item in a Schedule to this Act has effect according to its terms.

Schedule 1—Losses from non-commercial business activities

Income Tax Assessment Act 1997

1 At the end of subsection 8-1(1)

Add:

Note: Division 35 prevents losses from non-commercial business activities that may contribute to a tax loss being offset against other assessable income.

4 Application of amendments

The amendments made by this Schedule apply to assessments for the 2000-01 income year and later income years.

3 Schedule(s)

Subject to section 2, each Act that is specified in a Schedule to this Act is amended or repealed as set out in the applicable items in the Schedule concerned, and any other item in a Schedule to this Act has effect according to its terms.

Schedule 2—Consequential amendments

Income Tax Assessment Act 1997

3 Subsection 8-1(3) (note)

Omit "Note", substitute "Note 1".

4 At the end of section 8-1

Add:

Note 2: A cash accounting regime applies for general deductions, and some other deductions, incurred by STS taxpayers: see Division 328.

24 Application of amendments

The amendments made by this Schedule apply to assessments for the first income year starting after 30 June 2001, and for later income years.

3 Schedule(s)

Each Act that is specified in a Schedule to this Act is amended or repealed as set out in the applicable items in the Schedule concerned, and any other item in a Schedule to this Act has effect according to its terms.

Schedule 3—Non-assessable non-exempt income

Income Tax Assessment Act 1936

57 Paragraph 8-1(2)(c)

After "*exempt income", insert "or your *non-assessable non-exempt income".

140 Application

(1) Subject to this item, the amendments made by this Schedule apply to assessments for the 2003-04 income year and later income years.

(2) The amendment made by item 71 applies to things done on or after 1 July 2000.

(3) The amendments made by items 92, 93 and 95 apply to assessments for the 1997-98 income year and later income years.

(4) The amendments made by items 91 and 94 apply to assessments for the 2000-01 income year and later income years.

(5) The amendments made by items 41, 42, 43, 44, 45, 126, 127 and 128 apply to amounts derived on or after 1 July 2000.

(6) The amendments made by items 109 and 110 apply to events that occur on or after 1 July 2002.

(7) The amendment made by item 46A applies to distributions that are made or that flow indirectly after 30 June 2002.

(8) The amendments made by items 70A and 128A apply to an assessment for the income year including 1 January 2003 or a later income year.

3 Schedule(s)

Each Act that is specified in a Schedule to this Act is amended or repealed as set out in the applicable items in the Schedule concerned, and any other item in a Schedule to this Act has effect according to its terms.

Schedule 2—STS accounting method

Income Tax Assessment Act 1997

2 Subsection 8-1(3) (note 1)

Omit "Note 1", substitute "Note".

3 Subsection 8-1(3) (note 2)

Repeal the note.

11 Application

The amendments made by this Schedule apply to assessments for the first income year starting on or after 1 July 2005 and later income years.