CAPITAL OR CURRENT: THE TAX TREATMENT OF EXPENDITURES TO PRESERVE A TAXPAYER'S TITLE OR INTEREST IN ASSETS

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INTRODUCTION

When the current/capital expenditure distinction was absorbed into income tax law, few example principles had been articulated and accounting concepts were still evolving. The legislature left the responsibility for distinguishing the two types of outlays to the courts and the resulting case law often appeared to be a large collection of ad hoc irreconcilable decisions with little or no theoretical underpinnings.[1]

As the body of capital/current expenses case law grew, the courts sought to extrapolate guidelines and develop principled tests for separating the two types of expenditures. Those tests evolved through three distinct stages, each of which built upon its predecessor and incorporated elements of the current/capital tests used in the previous stage.

In the first stage, current/capital distinction tests classified expenditures by reference to their *form*, distinguishing between recurrent and single outlays.

A second generation of tests were concerned with the *effect* of expenses and classified outlays by reference to the type and longevity of the benefits acquired by taxpayers as a consequence of the expenditures.

The third stage of current/capital distinction tests saw the evolution of tests that looked to the *purpose* for which an expenditure was made. These tests distinguished between outlays related to an *income-earning process* and those related to an *income-earning structure.*

The development of the *expenditure purpose* approach, fundamental to the third stage of current/capital distinction tests, was largely the work of Dixon J. (as he then was), who strongly advocated its adoption in *Sun Newspapers Ltd.* v. *Federal Commissioner of Taxation.*[2] The process/

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[1] One is reminded of the oft-quoted (usually out of its proper context) comment by Lord Greene M.R. on the capital/current expense distinction: "There have been many cases which fall on the border-line. Indeed, in many cases it is almost true to say that the spin of a coin would decide the matter almost as satisfactorily as an attempt to find reasons." *Inland Revenue Commissioners* v. *British Salmson Aero Engines Ltd.* [1938] 2 K.B. 482, at p. 498.

[2] (1938) 61 C.L.R. 337.

structure distinction formulated by Dixon J. has been cited and followed throughout the British Commonwealth. However, in almost all jurisdictions outside of Australia, its application has been tempered by policy considerations. Applied without reference to those policy concerns, the test is capable of imposing unnecessary and undesirable burdens on taxpayers in certain situations.

This article examines one of those situations in which the application of the *expenditure purpose* approach championed by Dixon J. leads to an unsatisfactory result. The example studied is expenditures incurred to preserve a taxpayer's title or interest in her assets. These expenses were originally characterised as current expenses by the U.K. courts. In Australia, the application of the *expenditure purpose* approach led courts to criticise the eventually reject the U.K. rule. In this country, expenditures incurred to preserve title or interest in assets are capital (non-deductible) outlays. Recently, this rule was affirmed by the Supreme Court of N.S.W. in *PBL Marketing Pty. Ltd.* v. *Federal Commissioner of Taxation.*[3]

The article commences with a review of the U.K. and Australian jurisprudence in this area and explores the reasons Dixon J. sought to replace the *expenditure effect* approach with the *expenditure purpose* tests. The soundness of the resulting Australian characterisation of expenditures incurred to preserve title or interest in assets is analysed by reference to the *PBL Marketing Pty. Ltd.* case. It will be suggested that U.K. jurisprudence on this point is preferable.

DEVELOPMENT OF THE U.K. RULE

At the heart of the first widely accepted approach to distinguishing current and capital outlays, the *expenditure form* approach, was a distinction between recurrent and single outlay expenditures. That distinction is generally attributed to the decision of Lord Dunedin in *Vallambrosa Rubber Co. Ltd.* v. *Farmer.*[4] Lord Dunedin said:

> "... capital expenditure is a thing that is going to be spent once and for all, and income expenditure [i.e., current] is a thing that is going to recur every year."[5]

Lord Dunnedin's distinction was later modified by Rowlatt J. who believed the emphasis on *annual* payments was misleading. He suggested, in *Ounsworth* v. *Vickers Ltd.*,[6] that the distinction should be made between those outlays incurred to meet continuous expenses and those made once and for all.[7]

While the recurrent/single outlay test enjoyed many advantages, most not-

[3] [1985] 2 A.T.C. 4416; 16 A.T.R. 679.
[4] (1910) 5 T.C. 529; [1910] S.C. 519.
[5] 5 T.C. at p. 536.
[6] [1915] 3 K.B. 267; 6 T.C. 671.
[7] [1915] 3 K.B. at p. 273.

ably that of simplicity, it enjoyed no firm conceptual foundation and, not surprisingly, proved vulnerable to critical examination. Only a decade and a half after it had become accepted as the basis for distinguishing current and capital outlays, the test was reviewed and criticised by Viscount Cave L.C. in *British Insulated and Helsby Cables Ltd.* v. *Atherton*.[8] As Viscount Cave L.C. pointed out, there may be cases in which payments, although made once and for all, are current expenses which should be deductible in the year incurred.[9] He concluded that although the fact that a payment was made once and for all was a material consideration, it was not necessarily a persuasive criterion.

To avoid the rigour of the recurrent/single outlay test, Viscount Cave L.C. offered an *expenditure effect* approach, utilising a new benefit-oriented test that looked at the consequence of an outlay, rather than its form. Viscount Cave L.C. explained,[10]

> "[W]hen an expenditure is made, not only 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 . . . for treating such an expenditure as properly attributable not to revenue [i.e., current expenses] but to capital."[11]

In light of the criticism of the single outlay/recurrent outlay approach offered by Viscount Cave L.C., later courts placed little emphasis on the 'once and for all' portion of the test, instead concentrating on the existence or absence of an enduring benefit resulting from the outlay. The test was prima facie simple: if an outlay was made for a current benefit, i.e., one that would expire during the tax period or shortly thereafter, it was treated as a current expense. On the other hand, if the expense purchased an asset conferring an enduring benefit on the taxpayer (i.e., lasting significantly past the tax period), it was a capital expense.

The application of the test was, admittedly, more difficult than its formulation. It was often not easy to determine whether an asset or advantage wasted away quickly or provided an enduring benefit. It was often also unclear whether the expenditure in question played a direct role in the acquisition of the asset or long-term benefit or was coincidently incurred at the same time an asset was acquired.

[8] [1926] A.C. 205; 10 T.C. 155.

[9] He said, "Instances of such payments may be found in the gratuity of £1,500 paid to a reporter on his retirement, which was the subject of the decision in *Smith* v. *Incorporated Council of Law Reporting for England and Wales* ([1894] 3 K.B. 674), and in the expenditure of £4,994 in the purchase of an annuity for the benefit of an actuary who had retired, which, in *Hancock* v. *General Reversionary and Investment Co.* [1919] 1 K.B. 25, was allowed, and I think rightly allowed, to be deducted from profits." ([1926] A.C. 205, at p. 213).

[10] [1926] A.C. 205, at pp. 213–14.

[11] The taxpayer in *British Insulated and Helsby Cables Ltd.* v. *Atherton* had made a lump sum payment to establish a new pension scheme for its employees. Applying his test, Viscount Cave L.C. concluded the expenditure was capital in nature, obtaining for the company the benefit of a harmonious relationship between the company and its employees from that period on.

Because the nature of the benefit and its life expectancy were often difficult to ascertain, the courts looked for characterisics that would help flag the nature of the benefit and thus the outlay incurred to acquire it. A number of criteria emerged as useful, though never conclusive, guides to the capital or current nature of an expenditure. These included the regularity or frequency of payments, the relation of the outlay to the "circulating" or "fixed" capital of the taxpayer[12] and the possible finality of this type of expenditure in light of the likelihood that the taxpayer might need to incur similar expenses in the future.

Application of the *expenditure effect* approach to outlays incurred to preserve a taxpayer's title or interest in assets resulted in a rule that such expenses were current, deductible expenditures. The leading U.K. authority was (and remains) the *Southern* v. *Borax Consolidated Ltd.* decision.[13]

The taxpayer in this case, Borax, was a U.K. company whose wholly owned subsidiary operated out of a harbour front property in the city of Los Angeles. At the time, wholly owned subsidiaries were treated as branch operations for the purposes of U.K. income tax law. The city of Los Angeles brought action against the subsidiary, claiming the company's title to the harbour land was invalid and the city was the true legal owner. The city's objective was not so much to secure possession of the land as to be in a position to retroactively collect tolls for it use.

Borax incurred substantial legal fees attempting to defend its title (the matter had not been fully resolved in the California courts at the time of the U.K. tax case arising out of it) and sought to treat those expenses as deductible outlays for U.K. tax purposes. Inland Revenue claimed the U.S.A. action concerned the capital assets of the company and the claim was contested by the taxpayer to preserve the existence of those assets. It asserted that the resulting costs must, therefore, be capital expenditures.

In support of its argument, the government invoked a number of traditional tests,[14] all of which will be familiar to tax advisors today. The tests were based on these questions:

1. Does the expense relate to the main framework of the taxpayer's business?

[12] The distinction between circulating and fixed capital was first offered by Adam Smith in *Wealth of Nations.* (See, for example, the Penguin edition (Harmondsworth, England: Penguin, 1983), at p. 374). Circulating capital was said to represent the taxpayer's capital that was turned over (used) in the income earning process, while fixed capital was the framework or structure within which circulating capital worked. The difference was relied upon by some courts seeking to distinguish capital and revenue outlays after it was adopted by Lord Haldane in *John Smith & Son* v. *Moore* [1921] 2 A.C. 13. It largely fell from favour after Lord Macmillan suggested in *Van den Berghs Ltd.* v. *Clark* [1935] A.C. 431 that the distinction was not helpful in deciding the issue for tax purposes. Nevertheless, it is often revived, particularly in Australia. See, for example, the dissenting judgment of Barwick C.J. in *London Australia Investment Co.* v. *Federal Commissioner of Taxation* [1974] A.T.C. 4213.

[13] (1940) 23 T.C. 597.

[14] (1940) 23 T.C. 597, at p. 601.

2. Was the outlay made by the taxpayer in its capacity of trader or property owner?
3. Was the payment recurrent in nature?
4. Was the expense connected with fixed or circulating capital?
5. Did the outlay bring into existence an asset for the enduring benefit of the trade?

When the case came before the High Court (K.B. Division), Lawrence J. noted that with the exception of the final test, possibly, the expenses in *Southern* v. *Borax Consolidated Ltd.* appeared to satisfy almost all of the traditional hallmarks of capital outlays. Nevertheless, he concluded the outlays were current expenses, analogous to other expenses such as repairs, fire insurance premiums, and rates and taxes that help preserve a landlord's interest in her property. Like these other expenses, he suggested, expenses incurred in defending an action against title were needed to preserve the taxpayer's interest in its assets.[15] He said,

> "[T]he principle which is to be deduced from the cases is that where a sum of money is laid out for the acquisition or the improvement of a fixed capital asset it is attributable to capital, but that if no alteration is made in the fixed capital asset by the payment, then it is properly attributable to revenue, being in substance *a matter of maintenance, the maintenance of the capital structure of the capital assets* of the Company."[16]

As Lawrence J. pointed out, the taxpayer had in effect gained nothing from the expense that it did not have before its title was impugned.[17] If the company were successful, the City of Los Angeles was apparently removed from the category of possible litigants who might challenge the Company's title. But the title is not absolute subsequent to the litigation; it could still be subject to attack by an infinite number of other parties.[18]

Five years after Lawrence J. delivered his judgment in *Southern* v *Borax Consolidated Ltd.*, his decision was considered first in the Kings Bench Division and later by the Court of Appeal in *Associated Portland Cement Manufacturers Ltd.* v. *Kerr*.[19] The taxpayer in that case had made large payments to retiring directors in return for covenants not to compete with the company in the future. The taxpayer sought to invoke *Southern* v. *Borax Consolidated Ltd.* as support for its contention that the amounts in dispute

[15] This argument was similar to those utilised earlier in the Australian state courts – see text, *infra*, at notes 28–38.

[16] (1940) 23 T.C. 597, at p. 602, emphasis added.

[17] He said (at (1940) 23 T.C. 602), "The title of the Company, which must be assumed, in my opinion, to have been a good title, remains to the same; there is nothing added to the title or taken away, and the title has simply been maintained by this payment."

[18] In support of his conclusion, Lawrence J. relied on the judgment of the Court of Appeal in *B.W. Noble Ltd.* v. *Mitchell* (1927) 11 T.C. 372; [1927] 1 K.B. 719 where the Court of Appeal permitted the taxpayer a deduction for a lump sum payment made to terminate the services of a director. In that case Lord Hanworth M.R. said (at p. 421), "[The payment] was made not in order to secure an actual asset to the Company but to enable them to continue, as they had in the past, to carry on the same type and high quality of business ... The object ... was that of preserving the status and reputation of the Company."

[19] (1945) 27 T.C. 103; [1945] 2 All E.R. 535 (K.B.); 62 T.L.R. 115; [1946] 1 All E.R. 68 (C.A.).

were revenue in nature. In the King's Bench Division, Macnaghten J. indicated his approval of the *Southern* v. *Borax Consolidated Ltd.* holding.[20] At the same time, he held it to be inapplicable to the fact situation in the case he was deciding and found for the Revenue authorities, characterising the expenditure as a capital outlay.

At the Court of Appeal, Lord Greene M.R. also examined the *Southern* v. *Borax Consolidated Ltd.* decision. He, too, approved of the result and went on to apply Lawrence J.'s distinction between capital and current expenditures to the situation in the *Associated Portland Cement Manufacturer's Ltd.* case. Lord Greene M.R. pointed out that the taxpayer in *Southern* v. *Borax Consolidated Ltd.* had merely preserved an asset and concluded that "The money that you spend in *defending* your title to a capital asset, which is assailed unjustly, is obviously a *revenue* expenditure."[21] He distinguished the facts at hand by pointing out the taxpayer in that case had, in fact, acquired a new capital asset as a result of its expenditure, namely a covenant that augmented its goodwill. The fact that the newly acquired asset may have been difficult to value and would not appear on the company's balance sheet was unimportant.[22]

Southern v. *Borax Consolidated Ltd.* established the U.K. rule that money expended with a view to preserving an asset was a deductible current expenditure.[23] The decision and the doctrine it stood for received their strongest endorsement in the *Morgan* v. *Tate & Lyle Ltd.* decision,[24] although the holding in that case remains controversial to this day.[25] The taxpayer in the *Tate & Lyle Ltd.* case had incurred substantial expenses to ward off a perceived threat of nationalisation of its assets. Had the assets been nationalised, the company would have received cash in return for its former assets. The company claimed the campaign it waged against nationalisation was

[20] (1945) 27 T.C. 103, at 113.

[21] (1945) 27 T.C. 103, at 118, emphasis added.

[22] Ibid. The asset may not, in fact, have been too difficult to value. Presumably it was worth the cost of the covenant to the company. That price would have been set at the market price that the retired directors could have commanded for their knowledge, had the taxpayer not made the offer to secure the covenant.

[23] An interesting example of its application was the decision of Croom-Johnson J. in *Cooke* v. *Quick Shoe Repair Service* (1949) 30 T.C. 460, at 465. At first sight, the outlays in the case appeared not to satisfy the deductibility test. The taxpayers had paid money to satisfy all the debts of the previous owner of a business they had just purchased. Revenue authorities had, in effect, treated the expenses as part of the purchase price of the business, i.e., the obligation to pay off the former owner's debts came with the asset. The taxpayers were successful when they showed that the purchase price had been negotiated on the basis that the former owner would pay all outstanding debts prior to the business transfer and their expenses, when he failed to live up to the agreement, had not been offset in the purchase price. They were not made under legal compulsion, but rather to preserve the value of the business by ensuring a continuing supply of raw materials, continuance of labour and a continuing right to rent premises. (at p. 466.) Furthermore, each expense considered separately (wages, raw materials, rent, etc.) was usually deductible without arousing controversy.

[24] [1953] 1 W.L.R. 145 (H.C.); [1953] 3 W.L.R. 1 (C.A.); [1954] 3 W.L.R. 85 (H.L.).

[25] See, for example, J. Tiley, *Revenue Law* (3rd ed) (London: Butterworths, 1981), p. 230.

designed to preserve the value of its assets in their current form and not in a less desirable form of cash.

When the matter reached the House of Lords,[26] Lord Morton (with whom Lord Asquith agreed) and Lord Reid relied on the *Southern* v. *Borax Consolidated Ltd.* holding and the doctrine that expenditures made to preserve assets were revenue in nature to decide in favour of the taxpayer, while the dissenting Lords Tucker and Keith also accepted the logic of that decision but distinguished the case and doctrine from the facts before them. The doctrine that sums paid to preserve a capital asset are revenue expenses has continued to the present in the U.K.[27]

EARLY AUSTRALIAN DECISIONS

In Australia, the evolution of current/capital expenditure distinguishing tests and their application to expenses incurred to preserve title or an interest in assets paralleled developments in the U.K. One important aspect of the Australian cases was the continued advocacy of counsel for various commissioners of taxation (state and federal) for a new approach to the current/capital expense distinction, an approach similar to the *expenditure purpose* approach later adopted by Dixon J.

The first case on the issue heard by the High Court was based on a State income tax act and pre-dated the introduction of federal income taxation by two years. In the 1913 case of *Moffatt* v. *Webb*,[28] counsel for revenue authorities had argued that land taxes were capital outlays. Counsel did not rely on the traditional *expenditure form* test because, given their recurrent nature, land taxes were clearly current expenses under the then prevalent test. Instead, they noted the undeniable connection between the taxes and the underlying capital asset of land. The purpose of the outlay was to preserve an interest in a capital asset and, it was argued, the expense should be treated as a capital outlay related to a capital asset. The High Court rejected that reasoning and concluded the outlays were deductible current expenses that merely preserved the taxpayer's interest in his property. It reached that conclusion by adopting a benefit-oriented approach based on the nature of the benefit acquired as a result of the outlay. To ascertain the temporal qualities of the benefit, the High Court compared the position of the taxpayer before the need for the outlay arose and his position immediately after the expenditure had been incurred. As the Court noted, the taxpayer was in no better

[26] The taxpayer's argument was successful before the Commissioners of Taxes and the Revenue authorities' attempts to appeal the decision failed before the Chancery Division and Court of Appeal prior to the appeal to the House of Lords.

[27] See generally J. Tiley, *Revenue Law* (3d ed) (London: Butterworths, 1981), pp. 229–230 and P. Whiteman and D. Milne, *Whiteman and Wheatcroft on Income Tax* (2d ed) (London: Sweet & Maxwell, 1976), pp. 379–80.

[28] (1913) 16 C.L.R. 120; R. & McG. 245.

a position after paying the taxes than he was before being presented with the tax bill. While the taxes clearly related to an important capital asset, the Court pointed out that the taxpayer had acquired no benefit from the outlay except the same right to quiet enjoyment of his property that he enjoyed before the tax became due.[29]

State courts hearing State income tax cases relied on similar benefit-oriented tests. Three cases from this period illustrate the approach of the State courts in N.S.W., South Australia and Queensland.

Tooheys Ltd. v. *Commissioner of Taxation for N.S.W.*[30] was the earliest of these examples. In the *Tooheys Ltd.* case, the taxpayer was a brewery that distributed part of its production through tied houses. Parliament had ordered a reduction in the number of pub licences pending an expected referendum on a total prohibition and the taxpayer had incurred expenses appearing first before the licence reduction board to argue that it should not be deprived of its licences in the reduction process and second before a compensation board responsible for setting compensation in case of prohibition. In this case, counsel for the Commissioner based his argument on two grounds. Because the expenses were incurred only once, he was able to rely on the recurrent/single outlay test, under which the expenses would be considered capital. Alternatively, he suggested, the purpose of the expenses should govern and the outlays should be considered capital because they were incurred to preserve the taxpayer's interest in its assets and were not consumed in the process of producing income with those assets.

The N.S.W. Supreme Court[31] rejected the *expenditure form* approach as the basis for an appropriate test to distinguish current and capital expenses. Accordingly, the fact that the expenditures in dispute were not recurrent did not establish the outlays as capital expenses. To illustrate the potential problems that could arise if form alone were used to characterise expenses, Ferguson J. used the example of property insurance premiums. If an insurance premium incurred in year one was current in nature, the failure of the policy holder to renew the insurance in year two could not transform the outlay into a capital expenditure. Similarly, he explained, the character of the outlay in dispute in the *Toohey's Ltd.* case should not turn on whether the taxpayer appeared before the Licences Reduction Board every year or only on one occasion.

The court also declined to accept the *expenditure purpose* approach advocated by the Commissioner, relying instead on an *expenditure effect* approach.

[29] Griffith C.J. dismissed the N.S.W. Taxation Commissioner's claim in the following words: "The cases relied upon in support of [the Commissioner's argument] were cases in which money or money's-worth was paid or given as the price of something to be used in order to earn income. 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." 16 C.L.R. at p. 130.

[30] (1922) 22 S.R. (N.S.W.) 432; R. & McG. 169.

[31] Per Ferguson, J.; James J. concurring, Wade J. dissenting.

What mattered, the Court thought, was the benefit the taxpayer acquired as a consequence of the expenditure, not the reason the expenditure was incurred. As Ferguson J. explained, the expense, "could not result in an addition to the company's capital ... it was money spent with the object of *preserving their business as it existed.* I can see no justification for treating it as capital expenditure."[32]

A similar benefit-oriented approach was used by the Supreme Court of South Australia in *Central Broadcasters Ltd.* v. *Deputy Federal Commissioner of Taxation for South Australia.*[33] The taxpayer in this case had incurred expenses to negotiate an agreement to pay royalties for any copyrighted material it used in its future broadcasts. Counsel for the Deputy Commissioner pointed out that without the copyrighted material, and the related royalty payments agreed to in the arrangement, the taxpayer's radio broadcasting business could not operate. The essential nexus between the expense and the capital structure of the busines made the expense one of capital, he claimed. Napier J. readily conceded that the agreement would be used by the taxpayer long after the tax year in which the expenses of reaching it were incurred.[34] The fact that the expenditure was necessary for the operation of the underlying business was not sufficient reason for treating the expenditure as a capital outlay, however.[35] The agreement permitted the taxpayer an opportunity to carry on business in the future by incurring royalty expenses as needed. It did not secure an asset for the company[36] and, he concluded, was therefore a current expense.

The Queensland Supreme Court encountered a similar argument based on the *expenditure purpose* approach in *Re Income Tax Acts (No. 2)*[37] where the taxpayer was a racing club that had incurred legal expenses relating to its appearance before a Royal Commission. The bona fides and constitution of the taxpayer had previously been attacked before the Commission and the taxpayer successfully defended the attack, thus allowing it to continue its operations. The (Queensland) Commissioner of Taxes had argued that the outgoing was capital in nature, inexorably tied to the taxpayer's underlying capital assets, since the expense was incurred in protecting the whole of the club's property. Douglas J. dismissed that argument. The payment, he said, was "not an outgoing of capital. It was not the price of anything

[32] Per Ferguson, J., 22 S.R. (N.S.W.) at p. 443, emphasis added.

[33] [1934] S.A.S.R. 50.

[34] He said, "In the ordinary course of business it is impracticable to confine the operations, for any particular period, into watertight compartments, or so strictly that the current expenditure for any particular period has no influence upon the income of the future." [1934] S.A.S.R. at p. 53.

[35] Ibid.

[36] Ibid. Presumably the right to pay future royalties had no value other than providing the taxpayer with the means to keep in business. It was not assignable or transferable and would have no market value to other taxpayers who would have to enter into similar arrangements on their own.

[37] (1936] St.R.Qd. 370.

to be used in order to earn income, although it was in part money *expended for preserving the existing income and business.*"[38]

SUN NEWSPAPERS LTD. AND THE EMERGENCE OF THE PROCESS/STRUCTURE-ORIENTED TEST

The *expenditure purpose* approach advocated by tax authorities in each of the above cases would have led to opposite conclusions from those reached by the courts using an *expenditure effect* approach. Using an *expenditure purpose* analysis, tax authorities argued that the purpose of expenses such as land taxes or legal fees is to preserve capital assets rather than to carry out the process of exploiting them, a fact that they suggested meant preservation-type expenses were capital outlays. That distinction was irrelevant to the *expenditure effect* analysis adopted by the courts, however. In terms of the courts' benefit-oriented approach, the expenditures in dispute clearly did not result in the acquisition of any long term advantages and, therefore, were current outlays. The courts were prepared to recognise the clear nexus between the expenses and underlying capital assets and their crucial importance to the capital structure of a business. They were not prepared to accept an argument that this *ipso facto* imbued the outlays with capital characterisation.

Despite the reluctance of the courts to endorse the *expenditure purpose* approach, revenue authorities continued to pursue the process/structure characterisation strategy. The campaign finally met with some success in the 1938 High Court decision in *Sun Newspapers Ltd.* v. *Federal Commissioner of Taxation*.[39] The taxpayer in the *Sun Newspapers Ltd.* case was a newspaper publisher that had a history of amalgamating with or purchasing companies producing competing papers and then closing down the competing papers. In 1932, the *Sun* newspaper's principal competitor was another evening paper called the *World*. The *Sun* management had weathered the *World*'s competition but the threat of future competition posed by the rival paper became intolerable when the publisher of the *World* announced plans to replace the *World* with a successor called the *Star*. The publisher proposed selling the *Star* for two-thirds the price of the *Sun*. To forestall the appearance of an inexpensive successor to the *World*, the publishers of the *Sun* approached the proprietors of the *World* and purchased all their rights to that paper. The owners of the *Sun* also acquired the right to use the plant and equipment used in the publication of the *World* for a three year period, as well as an undertaking that the former publisher of the *World* would not establish a new newspaper during that three year period. As soon as the agreement was finalised, the new owners ceased publication of the *World*.

[38] Id., at p. 376, emphasis added.
[39] (1938) 61 C.L.R. 337; 5 A.T.D. 87; 1 A.I.T.R. 353.

Most likely with an eye to favourable tax consequences for the purchaser, the deal was structured in a form designed to mask the economic substance of the transaction, that is, a sale and purchase of an existing newspaper. While the agreement stipulated that the vendor's entire interest in the *World* would pass to the purchaser, the actual payments were tied to the use of the vendor's equipment for three years and its three year covenant not to compete. The agreement attributed no part of the consideration to the transfer of interest in the asset really sold, the *World*. The taxpayer then attempted to depreciate the purchase price over the three years of the subsidiary agreements. The taxpayer claimed the outlays were for a limited period (three years) and were not made to secure an asset but rather to increase profits by reducing competition during the life of the agreement and forestalling the appearance of the *Star*.

When the case first came before a single judge of the High Court, Rich J. relied upon the traditional benefit-oriented test to find in favour of the Commissioner. The purpose of the transaction, Rich J. noted, "was to buy out opposition and secure so far as possible a monopoly."[40] The benefit of the expenditure had an indefinite lifetime and the acquisition was, in his eyes, clearly a capital outlay.

Latham C.J. similarly concluded that the taxpayer had acquired a new capital asset as a result of the purchase when the matter was appealed to the full High Court.[41] He stated that the acquisition payments "did not result in obtaining a new capital asset of a material nature, but they did obtain a very real benefit or advantage for [*Sun*]."[42]

An alternate approach to the problem was offered by Dixon J.[43] who adopted the *expenditure purpose* approach to distinguish current and capital outlays. The basis of that test had been stated many times before: the *expenditure purpose* approach was built on a distinction between the income-earning *process* and the income earning *structure*.[44] Outlays related to the income-earning process were to be treated as current expenses incurred for an income production purpose and expenditures relating to underlying busi-

[40] (1938) 61 C.L.R. 337, at p. 347.

[41] He pointed out that had the taxpayer not ceased publication of the *World*, it would have been easy to identify the purchase price as a capital outlay (61 C.L.R., at p. 356). By immediately shutting down the *World*'s operations after its purchase, the *Sun* had nothing to show for the expenditure. But in economic terms it is irrelevant whether or not the *World* ceased publication. Presumably the new owners made a rational business choice and compared the effective rate of return they would enjoy on their investment if they continued selling the copies of the *World* with the increased profits they would earn by closing down a second newspaper and increasing circulation of their first publication to fill the resulting market gap. As it turned out, their predictions of increased profits through the second alternative were accurate — see 61 C.L.R. p. 347. English authorities confirmed that the purchase of a business remains a capital expenditure even though the owner then shuts down the business. See, for example, *Collins* v. *Joseph Adamson & Co.* [1938] 1 K.B. 477; 21 T.C. 400, cited by all members of the High Court.

[42] (1938) 61 C.L.R. 337, at p. 355.

[43] McTiernan J. delivered a brief judgment in which he agreed with the results of both his brethren.

[44] (1938) 61 C.L.R. 337, at p. 361.

ness structure were to be categorised as capital outlays incurred for a capital purpose. For the first time, a High Court judge relied upon that distinction as the basis for a judicial characterisation of an actual expenditure. More importantly, Dixon explained the criteria courts could take into account when applying the *expenditure purpose* test.

The three criteria set out by Dixon J. as the basis for his process/structure-oriented test had been previously utilised in the *expenditure form* approach (with its recurrent/single outlay test) and *expenditure effect* approach (with its benefit-oriented test). The three things he suggested should be considered when ascertaining whether an expenditure related to an income-earning process or an income-earning structure are:

> "(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."[45]

The factors were to be used as guidelines only; Dixon J. considered none to be definitive.[46] As for what previously had been the most important question, the longevity of the benefit acquired, Dixon J. asserted, "the lasting character of the advantage is not necessarily a determining factor."[47]

Why did Dixon J. rely on a new approach to reach the same decision as his brethren when fellow High Court judges had already shown a satisfactory result could be achieved with the traditional benefit-oriented test on the facts in this case? Dixon J. offered two reasons for his initiative, the need for a practical test and the need for a principled test. Neither rationale is fully capable of explaining his strong belief in the need for a fundamental change. The explanation most likely lies with a third concern not clearly articulated by Dixon J., his belief that precedence should be given to the legal form of a transaction, not its economic substance.

The first concern of Dixon J. was that of practicality. Although they appeared conceptually well defined, the existing benefit-oriented tests often proved difficult to apply. As explained earlier,[48] identifying the effects of an outlay and ascertaining the life of any benefit acquired as the result of an expenditure are often difficult exercises. As Dixon J. later noted, the approach of the courts prior to the *Sun Newspapers Ltd.* case often amounted to little more than "stating what positive factor or factors in each given case led to a decision assigning the expenditure to capital or to income as the case may

[45] Id., at p. 363.

[46] He said, for example, "Recurrence is not a test, it is no more than a consideration the weight of which depends upon the nature of the expenditure." (1938) 61 C.L.R. 337, at p. 362.

[47] Id., at p. 362.

[48] See text, *supra*, following note 11.

be" without any conspicuous attempt at analysis.[49] Dixon J. sought to devise a logical test that would provide clear guidelines to courts and taxpayers and eliminate much of the uncertainty that surrounded the existing tests.[50] Unfortunately, the carefully enumerated criteria set out by Dixon J. have not achieved the certainty and predictability that he sought. Although they sound conceptually attractive, when applied to real world situations they often offer little more guidance than the flip of a coin approach that Dixon J. rejected. As Dixon J. himself conceded, none of the factors in his test are determinative. The test is applied by the majority and dissent in the same case and by original jurisdiction courts and appellate courts overruling the lower level decisions.[51]

The second major concern of Dixon J. was one of principle. He sought to establish a current/capital expenditure test based on sound income tax principles which would further the policy objectives of the income tax legislation. Dixon J. later suggested that "in excluding as deductions losses and outgoings of capital or of a capital nature, the income tax law took for its purposes a very general conception of accountancy, [and] perhaps of economics"[52] and he wished to develop tests based on the general principles underlying the current/capital expenditure dichotomy.

Ironically, the process/structure-oriented test advocated by Dixon J. accorded neither with accounting nor economic principles. The accounting and economics sciences are concerned with the accurate measurement of profits (in the former case) and ability-to-pay based on those profits (in the later case). Unlike income tax law, which is based on strict statutory confines, accounting and economic standards are flexible. The distinction between current and capital outlays for accounting and economics purposes is not an absolute black and white issue as in income tax law, but is, rather, one of timing. Wasting expenditures are depreciated or amortised over their useful lives, as a result of which there is no absolute prohibition on the deductibility of 'capital' expenditures as there is in the income tax legislation. And the question of whether an outlay was incurred in relation to a business's regular ongoing operations or its structure is unimportant. Dixon J. himself would later concede the process/structure-oriented test could well lead to

[49] *Hallstroms Pty. Ltd.* v. *Federal Commissioner of Taxation* (1946) 72 C.L.R. 634, at p. 646.

[50] He later said, "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 the *discrimen* is so unascertainable that it must be placed in the category of an unformulated question of fact." Ibid, at 646.

[51] In their leading text on Australian income tax law, N. E. Challoner and C. M. Collins commented on the principal tests applied to courts to distinguish current and capital expenses: "The conclusion to be drawn from all of the foregoing is that there is probably no test for determining whether or not expenditure is of a capital nature which is capable of application to all cases." *Income Tax Law and Practice* (Sydney: Law Book Company, 1953), p. 247.

[52] *Hallstroms Pty. Ltd.* v. *Federal Commissioner of Taxation* (1946) 72 C.L.R. 634, at p. 646.

a capital classification of outlays that were clearly current expenses "on the soundest principles of accounting".[53]

The most logical explanation for the approach of Dixon J. is not to be found in the rationale he articulated in his decision. It becomes evident only when the basis of his judgment is contrasted with that of the judgment by Latham C.J. and the earlier decision of Rich J.

Fundamental to the latter two judgments was an explicit recognition of the economic reality of the transaction giving rise to the disputed tax liability, that is, the purchase by the taxpayer of a rival newspaper. This approach was essential to the application of the benefit-oriented test utilised by both these judges, given the taxpayer's characterisation of the transaction as a protection move designed to forestall the appearance of a competitor by means of a fixed term agreement of limited duration. Adoption of the taxpayer's characterisation of the transaction would have revealed no on-going benefit from a transaction that was, in fact, clearly a capital investment.

While the economic reality approach was by no means out of step with traditional Australian tax jurisprudence, it no longer accorded with the attitude of the U.K. courts, which were gradually shifting to an approach that favoured recognition of legal form over judicial reconstruction of economic substance in tax cases. The U.K. doctrine, designed to ensure certainty and consistency in tax litigation, reached its high water mark in the House of Lords decision in *the I.R.C.* v. *Duke of Westminster*[54] case, decided two years prior to *Sun Newspapers Ltd.*[55]

The certainty and consistency that the literal approach of the U.K. *form over substance* doctrine appeared to offer found a sympathetic supporter in the person of Dixon J. It was an approach that he would, as Chief Justice, later extend to many areas of the law. In the case at hand, this approach meant starting with the taxpayer's labelling of the expenditure as one intended to "preserve from immediate impairment and dislocation the existing business organization,"[56] a characterisation deliberately intended to circumvent the probable consequences of the benefit-oriented current/capital expenditure test.

Once Dixon J. had adopted this portrayal of the transaction and thereby precluded application of the benefit-oriented test (unless he wished to arrive at an unsatisfactory conclusion), the adoption of an alternative *expenditure*

[53] *John Fairfax & Sons Pty. Ltd.* v. *Federal Commissioner of Taxation* (1959) 101 C.L.R. 30, at p. 36.

[54] [1936] A.C. 1.

[55] Both English and Australian courts originally looked to the substance of a transaction to ascertain its tax consequences – see, for example, Lord Halsbury L.C. in *Secretary of State in Council of India* v. *Scoble* [1903] A.C. 299, at p. 302: "[I]t is agreed on all sides that we must look at the nature of the transaction and not be bound by the mere use of the words." For an interesting look at the gradual shift to an approach that paid attention primarily to the form of the transaction, see generally, M. Squires, "The Concept of Form and Substance in U.K. Tax Legislation" (1983) 17 *Taxation in Australia* 635, esp. 642 ff.

[56] (1938) 61 C.L.R. 337, at p. 363.

purpose approach was a logical step. By the taxpayer's own admission, the expenditure was incurred to protect the profitability of the newspaper and was not consumed in the day-to-day operating costs of running a newspaper business.[57] As a result, application of a rule that distinguished between current and capital expenses depending on their relation to the profit-earning process or the profit-earning structure would achieve the same result as would a benefit-oriented rule that was based on an explicit recognition of the true economic substance of the transaction in question.

The taxpayer in *Sun Newspapers Ltd.* had not incurred true preservation of title or interest expenses. It had merely characterised the outlays as preservation costs in an attempt to minimise taxes. But the willingness of Dixon J. to decide the case on that basis opened the door to the application of the process/structure-oriented test to situations involving real preservation expenditures. As it turned out, subsequent decisions continued to confirm the original Australian rule that expenditures incurred to preserve title or interest in assets were current outlays[58] and it was only in cases where alleged preservation expenses actually resulted in the acquisition of new assets by taxpayers that the remarks of Dixon J. in the *Sun Newspapers Ltd.* case were cited as support for the opposite conclusion.[59]

It was not until eight years after *Sun Newspapers Ltd.* v. *Federal Commissioner of Taxation* that the High Court had an opportunity to consider the applicability of that decision to the Australian treatment of expenditures incurred to preserve title or an interest in assets. The taxpayer in the case in which the issue arose, *Hallstroms Pty. Ltd.* v. *Federal Commissioner of Taxation*,[60] had incurred legal expenses opposing a competitor's application for renewal of an expired patent on a refrigerator design. The taxpayer had incorporated the previously patented design into its production soon after the design entered the public domain. When the former owner applied for a renewal of the patent four months after its expiry, the taxpayer intervened in the renewal process and, as a result of evidence it produced, the renewal application was unsuccessful. The taxpayer subsequently sought to deduct the legal expenses as current expenditures incurred to preserve its right to continue utilising the design that had been freely available to it after the original owner's patent had expired.

There were three possible resolutions of the fact situation open to the judges of the High Court hearing the *Hallstroms Pty. Ltd.* case. The obvious possibility would have been to affirm the traditional Australian benefit-oriented test and the existing rule that preservation expenditures such as those incurred by the taxpayer were current outlays. The test and consequent rule had been

[57] Id., at p. 364.

[58] See, for example, *Case 43* (1940) 9 C.T.B.R. 375, decided almost contemporaneously with *Southern* v. *Borax Consolidated Ltd.* where the taxpayer was permitted to deduct expenses incurred in an unsuccessful attempt to protect his patent rights.

[59] See, for example, *Case 54* (1942) 10 T.B.R.D. 162.

[60] (1946) 72 C.L.R. 635; 8 A.T.D. 190; 3 A.I.T.R. 436.

strongly affirmed in the U.K. in *Southern* v. *Borax Consolidated Ltd.*, a decision of significant persuasive value.

Alternatively, the Court could have adopted the process/structure-oriented rule advocated by Dixon J. in *Sun Newspapers Ltd.*, a course which almost certainly would have led to a capital characterisation of the expenses. This option was improbable given the fact that it would have led to a virtual reversal of the Australian jurisprudence and would have flown in the face of a long line of Australian authorities on preservation expenses.

Finally, a compromise option was open to the Court. The Court could have affirmed the benefit-oriented test *and* endorsed the structure/process test of Dixon J. but restricted its operation to those cases in which it would have led to the same result as would the benefit-oriented test once the economic reality of a transaction was taken into account. This last approach would have set the stage for a reconciliation of the two tests and helped explain how the two doctrines led to the same result in the *Sun Newspapers Ltd.* case.

No compromise emerged in the *Hallstroms Pty. Ltd.* decision and the Court divided 3–2, the majority finding in favour of the taxpayer. Latham C.J., Starke and Williams J.J. each delivered separate opinions affirming the benefit-oriented test and declaring expenses incurred to preserve title or interest in assets to be non-capital deductible expenditures. Latham C.J. and Williams J. both relied on the authority of the *Southern* v. *Borax Consolidated Ltd.* precedent to support their conclusion and rejected the attempts by counsel for the Commissioner to limit its reach.[61] They approached the problem from a benefit-oriented perspective and concluded the outlay was not capital in nature when they were unable to find any enduring advantage acquired as a result of the expenditure that did not already belong to the taxpayer before the need for the expenditure arose in the first place. As Latham C.J. explained, the taxpayer in the *Hallstroms Pty. Ltd.* case had:

> "gained nothing – it merely succeeded in maintaining an existing position. The prevention or avoidance of a loss is not a gain of anything. The prevention of subtraction is not the same thing as addition. Occasional legal proceedings are incidental to many businesses. They may result in the acquisition of a new right as, for example, where a person successfully applies for and obtains a patent. But expenditure in the defence of a right enjoyed in common with all His Majesty's subjects is not expenditure incurred in obtaining anything. It is an outgoing of the business incurred in keeping the business going on the same basis as in the past, without any change in the constituent elements of the profit-yielding structure."[62]

Dixon J. delivered a forceful dissent (with which McTiernan J. agreed). He began by dismissing the relevance, if any, of the rights or assets secured

[61] The arguments raised by the Commissioner are found at (1946) 72 C.L.R. 635, at p. 639. Central to the Commissioner's position was the claim that *Southern* v. *Borax Consolidated Ltd.* had been read far too widely and it did not stand for the conclusions commonly attributed to it, i.e., "that because nothing is added to one's title it is not a capital payment" or that "money spent in repelling an attack against a company's title to property is not capital expenditure."

[62] Id., at p. 641–42.

by a taxpayer with any particular payment[63] and instead declared that the nature of the expense can be determined from the purpose for which it was incurred.[64] He explained once again how the purpose could be ascertained by means of a process/structure-oriented test and sought to demonstrate why the expenditures in question were related to the structure of the taxpayer's business. That conclusion largely rested on the significant impact on the taxpayer's business to which a failure to oppose the patent application would have led. Renewal of the patent, and the taxpayer's subsequent loss of enjoyment of the rights it then enjoyed, would have affected "the company's plant, its product, its course of selling and its business organization."[65] Thus, Dixon J. asserted,

> "The legal expenses incurred in the final removal of this obstacle [i.e., the threat posed by the loss of the taxpayer's rights], or in preventing its continuance, ought not, therefore, to be regarded as an outgoing in the course of and as an incident to the carrying on of the profit-earning operations of the business, that is working the plant and organization according to an existing form and arrangement."[66]

As a result of the *Hallstroms Pty. Ltd.* decision, a clear split had emerged in the High Court over the appropriate approach to adopt when distinguishing current and capital expenditures and, consequently, over the preferable treatment to be accorded preservation expenses. The Australian courts were not alone in their confusion; while the English position appeared strong, the issue led to conflicts in many other jurisdictions.[67]

[63] Id., at p. 648.

[64] It is, at best, a confusing approach. Taxpayers may incur capital and revenue expenses for similar purposes; the choice between using money to acquire a capital asset (for example, buying a machine) or using funds to secure the use of someone else's capital asset (for example, renting a machine) is unlikely to turn on the ultimate purpose for which the machine will be used, that is to earn assessable income.

[65] (1946) 72 C.L.R. 639, at p. 649.

[66] Id.

[67] The South African courts, for example, originally treated these expenses as current. See *C.I.R.* v. *Stellenbosch Farmers' Winery* [1945] C.P.D. 377; 13 S.A.T.C. 381 where the taxpayer's expenses incurred in opposing the application of competitors to register a trade name already used by the taxpayer was considered a current outlay. The position was later reversed by an appeal court in *S.I.R.* v. *Cadac Engineering Works (Pty.) Ltd.* [1945] (2) S.A. 511 (A.D.); 27 S.A.T.C. 61, where the court held that the costs of protecting a design (and thereby opposing competition) were capital. The Canadian experience was almost the opposite. In *M.N.R.* v. *Dominion Natural Gas Co. Ltd.* [1941] S.C.R. 19; [1940-41] C.T.C. 155; 1 D.T.C. 499-133 the Canadian Supreme Court characterised expenses incurred to protect an exclusive franchise as capital outlays. While it has not been explicitly reversed, the decision has been subject to much criticism and most later cases have distinguished the result. See N. Brooks, "The Principles Underlying the Deduction of Business Expenses" in B. G. Hansen, V. Krishna and J. A. Rendall, *Canadian Taxation* (Toronto: Richard De Boo, 1981) 189 at p. 221; Verchere, "Deductible Expenses", (1975) *Corporate Management Tax Conference* (Cdn. Tax Foundation) 55, at 61. The *Dominion Natural Gas Co. Ltd.* decision contains an interesting judicial slip. Kerwin J. referred to the judgment of Viscount Cave L.C. in the *British Insulated and Helsby Cables Ltd.* case as authority for his decision. Kerwin J. first (correctly) quoted Viscount Cave L.C. as saying a capital expense was one made "with a view to *bringing into existence* an asset or an advantage for the enduring benefit of a trade" and later (incorrectly) as saying it was capital if incurred "with a view of *preserving* an asset or advantage for the enduring benefit of a trade" ([1941] S.C.R. 19, at p. 31 (emphasis added).

BROKEN HILL THEATRES PTY. LTD. – APPLICATION OF THE PROCESS/STRUCTURE-ORIENTED TEST

The divergence between the viewpoints of the majority of the High Court and that of Dixon J. that emerged in the *Sun Newspapers Ltd.* case did not lead to conflicting results until the *Hallstroms Pty. Ltd.* decision, where for the first time the expenditures in dispute were preservation outlays in fact, as well as in the taxpayer's characterisation. Given the failure of Dixon J.'s approach to prevail in the *Hallstroms Pty. Ltd.* case, it is not surprising that the taxpayer in the next preservation case to reach the High Court, *Broken Hill Theatres Pty. Ltd.* v. *Federal Commissioner of Taxation*,[68] based his argument on the *Southern* v. *Borax Consolidated Ltd.* and *Hallstroms Pty. Ltd.* precedents.

The taxpayer in the *Broken Hill Theatres Pty. Ltd.* case had incurred legal costs in successfully opposing a potential competitor's application to obtain a licence to operate a cinema in Broken Hill. Under the applicable licencing act, further applications could proceed a year after an unsuccessful application. This meant that it was not unlikely that the taxpayer would have had to oppose applications quite regularly, perhaps on an annual basis. As it turned out, this was the sixth time in nine years that the taxpayer had successfully opposed a potential competitor's application.

The dispute over the appropriate characterisation for tax purposes of the legal expenses incurred in opposing the application first came before Williams J., sitting as a single judge of the High Court. Williams J. distinguished his own judgment in the *Hallstroms Pty. Ltd.* case and found in favour of the Commissioner. His judgment was based largely on a benefit-oriented approach, although he noted that the test proposed by Dixon J. would lead to the same result following his reasoning. The benefit acquired by the taxpayer, according to Williams J., was a quasi-monopoly place in the market, an asset that would greatly augment the taxpayer's goodwill, he felt. There was no discussion of the fact that the taxpayer already enjoyed that asset before expenditure was made.

The taxpayer appealed to the full High Court. The three members of the majority in *Hallstroms Pty. Ltd.* v. *Federal Commissioner of Taxation* were no longer on the High Court but the two dissenting members remained. Most importantly, Latham C.J. had been replaced by Dixon C.J. Dixon C.J. seized the opportunity to apply his dissent in *Hallstroms Pty. Ltd.* v. *Federal Commissioner of Taxation* in an attempt to reverse the application of the *Southern* v. *Borax Consolidated Ltd.* doctrine in Australia.

The majority decision by Dixon C.J., McTiernan, Fullagar and Kitto J.J. (Webb J. delivered a separate, concurring judgment) suggested that, had the taxpayer been unsuccessful in opposing a competitor's licence, the costs

[68] (1951) 9 A.T.D. 306, 5 A.I.T.R. 130 (single judge of the High Court); (1952) 9 A.T.D. 423, 5 A.I.T.R. 296 (Full High Court).

involved would have been deductible as a current expense.[69] But, the Court felt, the costs of a successful opposition were capital in nature. The Court relied on both the benefit-oriented and the process/structure-oriented approaches to reach that conclusion. For both tests to produce similar results, it had to be shown that by opposing the licence application, the taxpayer acquired a capital asset or enduring benefit. The Court found that benefit in "the advantage of being free from [the applicant's] competition and of all other competition for twelve months," an advantage which, the Court stated, "is just the very kind of thing which has been held in many cases to give to moneys expended in obtaining it the character of capital outlay."[70]

It is not readily apparent which were the 'many cases' that supported this conclusion. The judgment did not cite them. Instead, it acknowledged that the conclusion was inconsistent with the decisions in *Southern* v. *Borax Consolidated Ltd.* and *Hallstroms Pty. Ltd.* v. *Federal Commissioner of Taxation*, the two cases on which the taxpayer based most of its argument. The inconsistent precedent proved not to be a problem. The decision of Lawrence J. in the first case was dismissed as unsupportable.[71] As for the majority decision of the High Court in *Hallstroms Pty. Ltd.* v. *Federal Commissioner of Taxation*, it was ignored, in preference to the dissent of Dixon J.

While the decision in the *Broken Hill Theatres Pty. Ltd.* case specifically rejected the reasoning in *Southern* v. *Borax Consolidated Ltd.*, it did not immediately result in a new Australian rule on preservation expenses. The *Broken Hill Theatres Pty. Ltd.* decision was based on both a benefit-oriented and a process/structure-oriented approach and the outlay was not treated as a pure preservation outlay *per se*. It was arguable that the comments in that decision directed towards *Southern* v. *Borax Consolidated Ltd.* and the preservation expenditure rule were not central to the *ratio decidendi* of that judgment. Judges continued to treat preservation outlays as current expenses on occasion. They were, however, careful not to rely on the *Southern* v. *Borax Consolidated Ltd.* precedent as authority for their decisions and instead rationalised the holdings in terms of the *expenditure purpose* approach advocated by Dixon J. in *Sun Newspapers Pty. Ltd.* v. *Federal Commissioner of Taxation*.

An important example of a judge successfully doing just that may be found in the judgment of Taylor J. in *Federal Commissioner of Taxation* v. *Duro Travel Goods Pty. Ltd.*[72] In that case, Taylor J. concluded that expenditures incurred to protect the taxpayer's interest in its exclusive trademark were

[69] (1952) 9 A.T.D. 423, at p. 425.
[70] Id., at p. 424.
[71] Ibid.
[72] (1953) 87 C.L.R. 524, affirming the decision of the No. 1 Board of Review in favour of the taxpayer (See *Case 92*, (1951) 2 C.T.B.R. (N.S.) 510). For another exception to the trend see *Case 75* (1953) 3 C.T.B.R. (N.S.) 460 where the taxpayer was permitted to deduct legal expenses incurred to defend its exclusive rights to cut timber when the vendor sold the same rights to another party.

current (and hence deductible) outlays. Although the facts were essentially similar to those in *Southern* v. *Borax Consolidated Ltd.*, Taylor J. did not rely on a benefit-oriented test to decide the matter and instead skillfully used the process/structure distinction to achieve the same result. While it is arguable that the expenses incurred in this case related to the underlying business structure, that is, the company's goodwill, and not directly to its income-earning process, Taylor J. concluded that the expenses were operating costs incurred in the process of exploiting the taxpayer's rights in its capital asset. At the same time, Taylor J. asserted that the expenditure was *not* incurred to preserve the profit-yielding subject,[73] thus avoiding the preservation expenses rule suggested in *Broken Hill Theatres Pty. Ltd.* v. *Federal Commissioner of Taxation.*

Another example of a Court avoiding that rule is found in the High Court decision in *Federal Commissioner of Taxation* v. *Snowden & Willson Pty. Ltd.* [74] The taxpayer in the *Snowden & Willson Pty. Ltd.* case was a property developer whose business practices were attacked by a member of State Parliament, leading to a Royal Commission investigation into the allegations. The taxpayer incurred substantial legal costs fighting the allegations before the Commission and through the media by way of newspaper advertisements. Counsel for the Commissioner argued that the expenses were incurred only to preserve the maintain the goodwill of the business and its profit-making structure.[75] Nevertheless, the majority of the High Court allowed the taxpayer to deduct the expenses as incurred.[76]

The expenses incurred by the taxpayer in the *Snowden & Willson Pty. Ltd.* case were preservation and maintenance outlays in a most unambiguous manner. Applying the income-earning process/income-earning structure distinction, the outlays appear to have been capital in nature since they were directly related to the capital structure of the taxpayer (especially its goodwill) and played no part in the taxpayer's income-earning operations. As is the case with almost all preservation or maintenance expenditures, the taxpayer in that case acquired no ongoing benefit from the expenditure, however. At best, it preserved the goodwill it had before the allegations were first made. To avoid the result suggested in the *Broken Hill Theatre Pty. Ltd.* case, the majority of the judges deciding in favour of the taxpayers simply ignored the preservation nature of the outlays. Only Fullagar J. discussed the divergence between English and Australian law on expenses incurred to protect,

[73] (1953) 87 C.L.R. 524, at p. 528.
[74] (1958) 99 C.L.R. 431; 7 A.I.T.R. 308; 11 A.T.D. 463; (1958) 5 A.L.R. 523.
[75] 7 A.I.T.R. 308, at 322.
[76] Dixon C.J., Fullagar and Taylor, J.J. delivered separate judgments allowing the deduction. Williams J. agreed with Fullagar J. Only Webb J. held in favour of the Commissioner. He concluded the expense was not deductible under either limb of the principal business deduction section. He therefore found it unnecessary to decide whether the outlay was a current or capital expense. The decision of Webb J. is difficult to support. If the expense was not incurred for business purposes (be it current or capital), then it must have been made for personal consumption reasons, clearly not the case here.

as opposed to augment, capital. But his conclusions made it unnecessary to reopen the question and discuss the effect of the preservation expenditure doctrine on the case at hand.

JOHN FAIRFAX & SONS PTY. LTD. – CONFIRMATION OF THE AUSTRALIAN RULE

Decisions such as *Federal Commissioner of Taxation* v. *Duro Travel Goods Pty. Ltd.* and *Federal Commissioner of Taxation* v. *Snowden & Willson Pty. Ltd.*, which avoided the preservation expenditure rule suggested in the *Broken Hill Theatre Pty. Ltd.* case, proved to be short lived anomalies and critics who hoped the High Court would alter the path on which it embarked[77] were to be disappointed. Seven years after the *Broken Hill Theatres Pty. Ltd.* v. *Federal Commissioner of Taxation* decision, the rule suggested in that case was explicitly adopted in *John Fairfax & Sons Pty. Ltd.* v. *Federal Commissioner of Taxation*.[78]

In the *John Fairfax & Sons Pty. Ltd.* case, the taxpayer, a Sydney newspaper publisher, incurred legal costs in connection with a challenge to its acquisition of shares in another newspaper. The challenge was mounted by a shareholder in the target company who had sought a declaration that the allotment was void and an order for rectification of the register by removal of the names of the new shareholder (that is, the taxpayer) and its nominees. The matter was eventually settled and the taxpayer attempted to deduct the legal expenses it had incurred.

The taxpayer readily conceded that the costs incurred to acquire the shares were capital amounts. But the taxpayer claimed that before commencement of the suit, it had become the owner of the shares. Thus, it argued, any further costs incurred after the acquisition of the shares were outlaid entirely to protect the entitlement and accordingly were current expenses on the basis of *Southern* v. *Borax Consolidated Ltd.*

The taxpayer's argument rested on a distinction between the outlay in dispute, which it claimed was made only to preserve the value of an already purchased asset, and the original acquisition of the asset. The Court rejected that contention on the basis of the economic and legal reality of the transactions, however. The dissident shareholder's suit that led to the expenditure relied on a claim that the original allotment was not valid. Had the dissident shareholder succeeded in his action, the court hearing the case would have ordered a rectification of the register by removal of the taxpayer's name. In other words, the dissident shareholder had alleged that as a matter of law the taxpayer never was the owner of the shares. Therefore, the issue being decided was the taxpayer's right to the shares in the first place, albeit after

[77] See, for example, R. E. O'Neill "Expenditure in Protecting or Preserving Capital Assets", (1956) 29 *Australian Law Journal* 561, at 567.

[78] (1959) 101 C.L.R. 30; 11 A.T.D. 510; 7 A.I.T.R. 346.

the impugned acquisition had taken place. Members of the High Court made it quite clear that they viewed the expenditure as "an inseverable part" of the acquisition.[79]

This recognition that the expenses were incurred in the process of acquiring a new capital asset should have been enough to dismiss the taxpayer's case on the basis of the traditional benefit-oriented test. But instead of basing their decision on the actual nature of the expenditure, the judges of the High Court accepted the taxpayer's characterisation of the transaction and treated the outlay as an expense incurred to preserve the taxpayer's interest in an asset. The judges then relied on the distinction between a profit-making process and a profit-earning structure to show that preservation payments were capital in nature.[80] They specifically rejected the U.K. rule to the contrary.

The conclusion was supported by the entire Court.[81] Dixon C.J. stated that the litigation expenses must be on capital account because they were "concerned with the organization and structure of the profit-earning enterprise."[82] He acknowledged a "judicial difference of opinion" had "arisen over the correctness of the decision of Lawrence J. in *Southern* v. *Borax Consolidated Ltd.*"[83] In Australia, Dixon C.J. claimed, the decision had been seen as "erroneous" because it was clear "that the litigation obviously [had] concerned nothing but an affair of capital".[84]

Menzies J., reaching the same conclusion, asserted, "the outgoing ... [was incurred as] part of the expense of adding to the appellant's capital [rather] than as an expense of maintaining a capital asset *but even if it be assumed that its true character was a payment to protect a capital asset that had already been acquired I would still be disposed to regard it as of a capital nature.*"[85] Fullagar J. pointed out that the facts in *Southern* v. *Borax Consolidated Ltd.* differed substantially from those in the *John Fairfax & Sons Ltd.* case because the taxpayer in the latter case was acquiring a new asset. Nevertheless, he felt it important to assert once again that the Court had declared that the decision in *Southern* v. *Borax Consolidated Ltd.* could not be supported.[86]

The rule that expenses incurred in the preservation of assets are necessarily

[79] Per Dixon C.J. ((1959) 101 C.L.R. 30, at p. 37). See also the comments of Fullagar J. that the outlay was "incidental to the acquisition of a new asset" (at p. 42) and further that it was "really part of the cost of acquiring the shares" (at p. 43).

[80] As Dixon C.J. explained, "To my mind it would not matter if the suit had been instituted only as an attack on a title to shares after the title had been acquired. For not only was it all an inseverable part of the main transaction but in any case such an attack necessarily concerned a matter of capital." (1959) 101 C.L.R. 30, at p. 37.

[81] Of the five members of the Court hearing the appeal, Dixon C.J. and Fullagar and Taylor J.J. had also participated in the *Snowden & Willson Pty. Ltd.* case.

[82] Per Dixon C.J., (1959) 101 C.L.R. 30, at pp. 36–37.

[83] (1959) 101 C.L.R., at p. 34.

[84] Id., at p. 35.

[85] Per Menzies J., id., at pp. 51–52, (emphasis added).

[86] Per Fullagar J., id., at p. 41.

capital expenditures, first suggested in dissent in the *Hallstroms Pty. Ltd.* case and then (perhaps) in *obiter* in the *Broken Hill Theatres Pty. Ltd.* case, was thus unambiguously adopted in Australia in the *John Fairfax & Sons Pty. Ltd.* case. It has since been reaffirmed on many occasions by courts[87] and Boards of Review.[88]

In the 13 years from the *Hallstroms Pty. Ltd.* v. *Federal Commissioner of Taxation* case to the *John Fairfax & Sons Pty. Ltd.* v. *Federal Commissioner of Taxation* decision, Dixon C.J. had effectively shifted the attention of the court in capital/current expenditure controversies from the use to which the expense was put to the process in which it was being used. The resulting doctrine regarding expenditures incurred to preserve or maintain assets is clearly at odds with the U.K. jurisprudence out of which it evolved. It is also out of step with the law in those jurisdictions such as New Zealand[89] and Canada[90] that rely upon the same English precedents. It is quite anomalous

[87] One important decision, delivered less than a year after the *John Fairfax & Sons Pty. Ltd.* case, was that of *Richard James Pye* v. *Federal Commissioner of Taxation* (1959) 12 A.T.D. 118; 33 A.L.J.R. 337. The taxpayer in this case had incurred legal expenses in contesting the efforts of the N.S.W. government to compulsory acquire his grazing land, from which he earned his assessable income. Taylor J. of the High Court denied the taxpayer a deduction for the expenses on two grounds. To begin with, he found, surprisingly, that the outlay did not fall within the basic parameters of the business expense deduction provision, that is, it was not incurred in earning assessable income or in carrying on a business earning such income. He further asserted that even if he had accepted that the outlay was a legitimate business expense, it was incurred in the *'protection and preservation'* of the taxpayer's capital assets and thus a non-deductible capital expense (12 A.T.D. 118, at 121, emphasis added).

[88] See, for example, *Case 65* (1984) 27 C.T.B.R. (N.S.) 543 (expense incurred in opposing a milk vendor licence application by a potential competitor held to be a capital expense); *Case 14* (1975) 20 C.T.B.R. (N.S.) 99 (expense incurred by a hotel in opposing new hotel licence applications in same area held to be a capital outlay); *Case 75* (1976) C.T.B.R. (N.S.) 751 (expense incurred by bottle shop in opposing other liquor licence applications in the same market area held to be capital expenditure).

[89] See, for example, *Murray Equipment Ltd.* v. *I.R.C. (N.Z.)* (1961) 8 A.I.T.R. 611 where the taxpayer sought to immediately deduct expenses incurred opposing patent applications by competitors for a process used by the taxpayer in its operations. Coates S. M. decided in favour of the taxpayer, concluding the expenses were incurred, not to obtain a new asset, add to any existing asset, or obtain any enduring advantage, but to "safeguard or protect its existing business and investment and enable it to continue its operations as in the past without interference or hindrance from a trade competitor. It was an expenditure made in the course of a business in dealing with a difficulty which had arisen." 8 A.I.T.R. 618.
In the course of his decision, Coates S. M. declined to follow the inconsistent early N.Z. decision of *Commissioner of Taxes* v. *Ballinger Co. Ltd.* (1903) 23 N.Z.L.R. 188 where Cooper J. had concluded expenses incurred defending an attack on a patent were capital outlays. Coates S. M. concluded that in light of later authorities, the *Ballinger Co. Ltd.* decision was of 'doubtful' authority. In Australia, it had long been assumed the *Ballinger Co. Ltd.* case was of little authoritative value – see, for example, the comments in *Case 43* (1940) 9 C.T.B.R. 375, at 376. Dixon J. did attempt to resurrect the decision, however, as support for his dissenting opinion in *Hallstroms Pty. Ltd.* v. *Federal Commissioner of Taxation.*

[90] The important exception to the rule in Canada was the *Dominion Natural Gas Co.* decision, *supra,* note 67. As mentioned above, the case was somewhat of an anomaly and is generally thought to be inconsistent with the mainstream Canadian jurisprudence. Not long after the decision the Supreme Court of Canada allowed a taxpayer a deduction for expenses incurred in defending its right to use a trade name to which another party claimed exclusive rights

in the context of the structure of the *Income Tax Assessment Act* and the distinction made in tax law between capital and current expenditures. How did it happen that Australia forged a unique doctrine in this area?

The answer appears to lie in the unique fact situations encountered in the two most important cases connected with the Australian rule on expenditures incurred to preserve or maintain assets, *Sun Newspapers Ltd.* v. *Federal Commissioner of Taxation* and *John Fairfax & Sons Pty. Ltd.* v. *Federal Commissioner of Taxation*. In both these cases, the process/structure oriented rule was applied to achieve a satisfactory result; the outlay in each case was held to be capital, which has never been subsequently disputed. The problem arose not with the results, but with the manner in which the courts dealt with the taxpayers' arguments. In both situations the taxpayers sought to portray their outlays as temporary preservation-type expenditures designed to achieve limited short-term goals only. In fact, the taxpayer in *John Fairfax & Sons Pty. Ltd.* deliberately portrayed the outlays in that case as "preservation of title" expenses in a vain attempt to fit within the *Southern* v. *Borax Consolidated Ltd.* precedent. In *Sun Newspapers Ltd.* v. *Federal Commissioner of Taxation* one judge and in *John Fairfax & Sons Pty. Ltd.* v. *Federal Commissioner of Taxation* the full High Court accepted the taxpayers' characterisations instead of confronting the economic reality of the situations and explicitly recognising that the taxpayers had actually acquired new assets in each case, a newspaper in the *Sun Newspapers Ltd.* case and shares in a newspaper in the *John Fairfax and Sons Pty. Ltd.* case. Once the High Court adopted the taxpayers' characterisations in these cases, the resulting rule that preservation and maintenance expenditures are capital outlays was inevitable. The Court failed to perceive that the Australian cases were fundamentally different from those English decisions in which the U.K. doctrine had developed and was forced to reject that U.K. doctrine in its entirety.[91]

in *Kellogg Co. of Canada Ltd.* v. *M.N.R.* [1942] C.T.C. 51; C.T.C. 548. The test was liberalised in *Canada Starch Co. Ltd.* v. *M.N.R.* [1968] C.T.C. 466; 68 D.T.C. 5320 when Jackett J. permitted the taxpayer a deduction for an amount paid to a company opposing the taxpayer's trade mark registration on the grounds that it already had exclusive rights to a similar name. It was argued that the expenditure was capital because it purchased the opponent's rights to the name. Jackett J. concluded, however, that the taxpayer had already created the name and property rights associated with it such as design, logo, etc. and this payment was merely an outlay incurred in putting the name to productive use. A similar fact situation was encountered by an Australian Board of Review in *Case H108* (1957) 8 T.B.R.D. 493 (also reported as *Case 28* (1957) 7 C.T.B.R. (N.S.) 148). Relying on the *Sun Newspapers Ltd.* and *Broken Hill Theatres Ltd.* cases, the Board concluded the expenses were capital outlays.

[91] It is important to note that the Australian test has not been rejected in the U.K. – quite to the contrary, the *Sun Newspapers Ltd.* is often cited with approval in U.K. courts. The test is applied within the context of prior U.K. jurisprudence, however, which accounts for the opposite result in preservation expenditure cases. As for the *Sun Newspapers Ltd.* decision itself, the holding is regarded as correct in the U.K. where the case is seen as simply another incidence of a taxpayer buying out the competition – see, for example, the Privy Council decision in *B.P. Australia Ltd.* v. *FCT* [1966] A.C. 224, at p. 262 and the House of Lords decision in *Strick (Inspector of Taxes)* v. *Regent Oil Co. Ltd.* [1966] A.C. 295 at p. 344.

PBL MARKETING PTY. LTD. AND THE SOUNDNESS OF THE AUSTRALIAN RULE

The application of the process/structure oriented test, used without reference to other important considerations, leads to a less than optimal result when true preservation of title or interest expenditures have been incurred. The most recent case involving a dispute over a preservation-type expenditure, the Supreme Court of N.S.W. decision in *PBL Marketing Pty. Ltd.* v. *Federal Commissioner of Taxation*,[92] illustrates the problem well.

The taxpayer in the *PBL Marketing Pty. Ltd.* case was a member of a group of companies responsible for organising the World Series Cricket matches that competed with some success against the Australian Cricket Board matches. As a result of the success of the World Series Cricket matches, the Australian Cricket Board commenced negotiations with the World Series Cricket group. The parties eventually entered into an agreement whereby the World Series Cricket group ceased organising cricket matches in competition to the Australian Cricket Board series, in return for which the Australian Cricket Board granted to the taxpayer the right to organise the televising, merchandising and sponsorship of all Australian Cricket Board tests, international one day series matches and other matches to be agreed upon. In addition, the Australian Cricket Board granted to a television company broadcast rights to Australian Cricket Board matches.

The exclusivity feature of the agreement, particularly as they pertained to television broadcast rights, was opposed by the Australian Broadcasting Commission (A.B.C.) in submissions to the Trade Practices Commission. The Trade Practices Commission concluded the agreement did not lessen competition and agreed to let it stand. The A.B.C. then sought interlocutory relief. Court proceedings were eventually dropped when the taxpayer and the A.B.C. reached an out-of-court settlement in which the taxpayer granted to the A.B.C. rights to televise certain Australian cricket matches.

The taxpayer sought to deduct as current expenses the legal expenses it had incurred to oppose the action by the A.B.C. and reach a settlement with it. Yeldham J., applying the Australian rule on legal expenses incurred to preserve an asset, concluded the outlays were capital in nature and denied the taxpayer the deduction it sought.

The expenditure in the *PBL Marketing Pty. Ltd.* case merely enabled the taxpayer to enjoy the asset (a contract) it had before the dispute over its property arose. True, unlike many other maintenance expenses, it was a single outlay, which would tend to indicate capital characterisation. But it was a single outlay only in the sense of the particular dispute in which it was incurred. Although the expenses may have preserved the taxpayer's interest in the asset from further attack by the A.B.C., there are other television networks that may contest the validity of the contract in the future. The expense

[92] [1985] 2 A.T.C. 4416; 16 A.T.R. 679.

did not immunise the taxpayer from further litigation; it merely resolved one particular attack. In essence, it was of no more value than the annual land taxes incurred by owners of real property or the insurance and registration fees incurred by taxpayers who own cars and trucks. Each payment of taxes or licence fees is a single outlay – but they are clearly current if viewed in the context of one in a long stream of outlays that enable the taxpayer to continue exploitation of a capital asset. It is suggested that legal expenses incurred to preserve or maintain a taxpayer's interest in assets should be treated for tax purposes in the same manner as these analogous expenditures.

Applying the benefit-oriented capital/current expenditure test originally used in Australia would lead one to conclude that the expenses incurred in the *PBL Marketing Pty. Ltd.* case should have been treated as current deductible expenditures in light of the limited life of any benefits acquired as a result of the outlays. Dixon C.J. thought the question of an enduring asset was irrelevant. He claimed that even where the taxpayer obtained nothing of an enduring nature, the expenditure might be an outgoing of capital.[93] What was important, he believed, was the nexus or lack thereof between the outlay and the underlying capital structure of a business operation. If an outlay related to the "organisation and structure of the profit-earning enterprise" it, too, was capital in nature.[94] The test shifted from what expenses were buying to how they were being used.

How would *Southern* v. *Borax Consolidated Ltd.* be decided today in Australia? There should be little doubt that an Australian court would find against the taxpayer in that case. It will be recalled that the expenses in *Southern* v. *Borax Consolidated Ltd.* were incurred to ward off an attack on the taxpayer's title to land. At the end of the day, if it were ultimately successful, the taxpayer would have been in exactly the same position it had been before the dispute with the City of Los Angeles arose. Certainly it would be no better off – although the City of Los Angeles was removed from the list of litigants who might lay claim to the taxpayer's assets, there remained an infinite number of other potential challengers who might appear and make similar claims. The taxpayer acquired no on-going asset or benefit from the expenditure and, accordingly, Lawrence J. had decided the expenses were current outlays. But in terms of the income-earning process/income-earning structure test, it is apparent that the expenses bore little relation to the usual profit making activities of the Borax company and had a clear nexus to the company's structure since they were directly tied to its title to the land on which it conducted its operations. Applying the Australian test, the outlays in that case would almost certainly have been found to be capital outlays.

If the tests of Dixon C.J. were taken to their logical conclusion, virtually all expenses would be found to be capital. Taxes, insurance, maintenance

[93] *John Fairfax & Sons Pty. Ltd.* v. *Federal Commissioner of Taxation* (1959) 101 C.L.R. 30, at p. 36.

[94] Id., at pp. 36-37. See also *Hallstroms Pty. Ltd.* v. *Federal Commissioner of Taxation* (1946) 72 C.L.R. 634, at p. 648.

and so forth all preserve underlying capital assets. Furthermore, none of these outlays are consumed directly in the income earning process of, say, printing and selling newspapers or manufacturing vacuum cleaners or showing motion pictures or distributing borax. Instead, they all relate to the structure or assets that allow the taxpayers to carry on their business. As such, (applying the criteria of Dixon C.J.), they could conceivably be capital. It is for this reason that the Australian current/capital distinguishing process must be applied within the context of the actual economic reality of the outlays in question. In most cases it is; preservation of title or interest in assets outlays remain an unfortunate exception to this pattern.[95]

CONCLUSION

Tax law is concerned with measuring gains or losses; ultimately any capital/current cost distinction test must be evaluated by the degree to which it contributes to the accurate measurement of net gains on which an ability-to-pay income tax is to be imposed. The process/structure-oriented test relied upon by courts in this country for the past half century has proved remarkably apt for that purpose. But there are situations in which it may work unfairly and seriously prejudice taxpayers. In such cases, it is important that the test be modified to take into account the nature of the benefit, if any, acquired by the outlay in question. If it appears the value of the expenditure has been consumed in the tax year (or in a reasonably short time thereafter), that expense should be treated as a current, deductible expenditure. To do otherwise imposes an unreasonable and inequitable burden on taxpayers who are not permitted to take true losses into account when calculating gains.

Dixon C.J. readily conceded that his doctrine might lead to a capital classification of outlays that were clearly current expenses "on the soundest of principles of accounting".[96] It is suggested that expenditures incurred to preserve or maintain assets are one type of outlay for which this statement would be true. There may be many situations in which there are sound reasons for a divergence between income tax law and accounting principles. This is not such a case. The present rule needlessly penalises taxpayers and contradicts the usual tests and policies employed by the courts when confronting the capital/current dichotomy.

[95] As Professor Ross Parsons explains, "... United Kingdom law on the matter of capital outgoings has come to differ from the Australian law, and United Kingdom authorities may need to be received with caution. The Australian law may nonetheless be thought the less desirable as a matter of policy. Where an expense gives rise to a structural asset that is a wasting asset, there may be available depreciation or amortisation provisions which will provide for deductions. Where no asset is acquired, or the expense does not relate to a wasting structural asset in a way that attracts the available depreciation or amortisation provisions, the expense, though consumed in a process of income derivation, will at no time be deductible. See R. Parsons, *Income Taxation in Australia* (Sydney: Law Book Company, 1985), p. 447.

[96] (1959) 101 C.L.R. 30, at p. 36.

Perhaps the most fitting manner in which to state the case for rethinking the present rule is to simply repeat the words written thirty years ago by a great Australian tax scholar, R. E. O'Neill:

> "Whilst it is hardly conceivable that the High Court would now abandon the profit-yielding subject v. profit-yielding process test, it may be that future decisions on the nature of 'protection' expenditures will bring about a closing of the existing gap between the views of the High Court and those of the English courts on this important matter. If so, a move will have begun to make the test of Dixon C.J., supplementary to that of Viscount Cave."[97]