~~P.C.~~
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Judgment
24.1.1965

IN THE PRIVY COUNCIL No. 53 of 1964

ON APPEAL

FROM THE HIGH COURT OF AUSTRALIA

B E T W E E N

MOBIL OIL AUSTRALIA LIMITED (formerly called Vacuum Oil Company Proprietary Limited) Appellant

- and -

THE COMMISSIONER OF TAXATION OF THE COMMONWEALTH OF AUSTRALIA Respondent

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C A S E FOR THE APPELLANT

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1. This is an Appeal (by special leave granted by Her Majesty in Council on the 3rd day of July 1964) from an Order of the Full Court of the High Court of Australia made on the 25th day of February 1964 dismissing the Appellant's appeal from the Order of His Honour Mr. Justice Taylor made on the 8th day of May 1961 whereby His Honour dismissed the Appellant's appeal under Section 187 of the Income Tax and Social Services Contribution Assessment Act 1936-1953 from the decision of the Respondent disallowing the Appellant's objection against an assessment and an amended assessment to income tax and social services contribution in respect of income derived in the year of income ended on the 30th day of June 1953 (hereinafter called "the said year of income").

pp.135-6
pp.134-5
pp.116-118
p. 163
p. 172

2. The issue in the case is whether the whole or part of certain expenditure made by the Appellant in the said year of income and falling within three general categories is allowable to it as a deduc-

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tion from its assessable income in calculating its taxable income for the purposes of the Income Tax and Social Services Contribution Assessment Act 1936-1953 of the Commonwealth of Australia (hereinafter referred to as "the Act"). The Appellant carries on business throughout the Commonwealth of Australia as a marketer of motor spirit and other petroleum products. A substantial part of such business consists of selling motor spirit and other petroleum products to retailers who operate service stations. Such retailers (hereinafter referred to as "service station operators") conduct at their respective premises the business of reselling motor spirit and other petroleum products and of providing related services to members of the public. The three categories of expenditure referred to consist of -

(a) expenditure on minor structural alterations to service stations, the operators of which had agreed to purchase supplies of motor spirit exclusively from the Appellant, together with small associated outgoings;

(b) periodical payments made or credited monthly to service station operators who observed the terms of agreements made by them with the Appellant whereby they agreed to purchase all their requirements of motor spirit from the Appellant, which payments the Appellant set off or credited against the operators' liability to make monthly payments to it in repayment of principal moneys and interest due in respect of loans made by the Appellant to such operators;

(c) periodical payments paid annually to service station operators who observed the terms of agreements made by them with the Appellant whereby they agreed to purchase all their requirements of motor spirit from the Appellant.

3. By Section 6 of the Act the following terms are defined as follows :-

"allowable deduction" means a deduction allowable under the Act;

"assessable income" means all the amounts

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which under provisions of the Act are included in the assessable income;

"taxable income" means the amount remaining after deducting from the assessable income all allowable deductions.

Section 17 of the Act provides that income tax and social services contribution shall be levied and paid "upon the taxable income derived during the year of income".

Section 25(1) of the Act provides that the assessable income of a taxpayer who is a resident shall include "the gross income derived directly or indirectly from all sources" which is not exempt income.

Section 51(1) of the Act provides as follows :-

"All losses and outgoings to the extent to which they are incurred in gaining or producing the assessable income, or are necessarily incurred in carrying on a business for the purpose of gaining or producing such income, shall be allowable deductions except to the extent to which they are losses or outgoings of capital, or of a capital, private or domestic nature, or are incurred in relation to the gaining or production of exempt income".

4. In its return of income for the said year the Appellant, which was a resident within the meaning of the Act, claimed as allowable deductions from its assessable income (inter alia) a sum of £192,701 made up of the three categories of expenditure referred to in paragraph 2 hereof, as follows :- p. 138

structural alterations etc. to service stations	£121,299
monthly payments to service station operators	£ 57,265
and	
annual payments to service station operators	£ 9,637

The balance of £4,500 is, pursuant to agreement

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between the Appellant and the Respondent, to be treated as apportioned rateably to those three categories and dealt with accordingly.

It also claimed as a deduction the sum of £124,849 expended by it in having painted in a uniform colour scheme the premises of service station operators who had agreed to purchase all their requirements of motor spirit from the Appellant.

5. The Appellant was on the 12th day of May 1955 assessed to tax by the Respondent in
p. 163 respect of income of the said year of income and by that assessment the Respondent disallowed as an allowable deduction the greater part of the said sum of £192,701 and the whole of the said sum of £124,849. By a subsequent amended assessment dated 10th
p. 172 April 1959 the Respondent disallowed the balance of the said sum of £192,701 as an allowable deduction but allowed as a deduction the whole of the said sum of £124,849 expended by the Appellant in painting service stations and the deduction of which the Respondent had previously disallowed.

6. The Appellant duly objected against the
pp.165-7 said assessment and amended assessment and
pp.175-8 claimed (inter alia) that they should be reduced by the allowance of the said sum of £192,701 as an allowable deduction pursuant to Section 51 of the Act. The Respondent
pp.173-4 disallowed the Appellant's objections in so
pp.178-9 far as they related to the said sum of £192,701 and the Appellant thereafter
p. 174 appealed to the High Court of Australia in
pp.179-80 its original jurisdiction pursuant to Section 187 of the Act. The appeals came before His Honour Mr. Justice Taylor and were dismissed by him on 8th day of May
pp.116-118 1961. The Appellant thereupon appealed to
pp.118-121 the Full Court of the High Court of Australia which on the 25th day of February 1964 dis-
pp.134-5 missed the appeals. The majority of the
p. 122 Court consisting of McTiernan, Windeyer and
pp.124-5 Owen JJ. held that the deductions claimed
pp.125-134 were incurred on capital account and were properly disallowed by the Respondent while
pp.121-2 the minority, consisting of Dixon C.J. and
pp.123-4 Kitto J., would have allowed the appeals,

holding that the expenditure was incurred on revenue account and should have been allowed as a deduction by the Respondent. Record

7. The facts giving rise to the issues on this Appeal appear from the oral and documentary evidence tendered at the hearing before Taylor J. and set out in the transcript of such evidence. These facts are summarized in paragraphs 8 to 20 of this Case.

10 8. The Appellant is one of a number of Companies which are and were at all relevant times engaged in marketing petroleum products in Australia. A substantial proportion of all such products sold by the Appellant and its competitors was then and still is sold to the operators of service stations who in turn sell by retail to members of the public. Until the year 1951 the course of trade in the sale and distribution of such products was characterized
20 by the existence of a large number of service stations each of which purchased supplies of petroleum products from a number of different marketers whose pumps and tanks were by arrangement installed at the operator's service station. Each operator thus offered for sale to the public a number of different brands of petroleum products. In December 1950 the Appellant had pumps and tanks installed at over 7,000 service stations. p. 7, l.21

30 9. After the end of petrol rationing in about 1949 the Appellant initiated a merchandising plan which involved establishing training courses for service station operators, the improvement of facilities at selected service stations (not the property of the Appellant) and, in cases where the Appellant was satisfied that the operator was providing first class service to the public and was purchasing a substantial part of his requirements from the Appellant, it painted p. 8
40 the service station at its own cost in a standard colour scheme associated with its products. This merchandising plan was intended to be preparatory to the Appellant introducing at some appropriate future date what came to be called in the trade a "solo site service station scheme" under which certain service station operators would purchase and sell to the public the products of the Appellant exclusively and the Appellant would

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make the greater part of its service station sales to such operators.

10. Immediately before the introduction of this merchandising plan a situation existed in the marketing of petroleum products which the Appellant sought to correct by the carrying out of the plan. With increasing competition among marketers the number of pumps and associated tanks at individual service stations was, in the case of many service stations, excessive. The cost to the Appellant of delivering to each of a large number of service station customers relatively small quantities of petrol, sometimes as little as 100 gallons at a time, was unduly high. Further, the Appellant was unable to exercise control over the manner in which its products were dealt with by operators; price-cutting occurred and instances arose in which the products of other marketers were delivered into tanks connected to the Appellant's pumps and sold by the service station operator through those pumps. One effect of the wartime and immediate post-war system of distribution of petrol in Australia which was adverse to the interests of the Appellant was that motorists came to believe that the petrol marketed by each marketing company was much the same as all other brands of petrol. A further cicumstance requiring correction was the high cost incurred by the Appellant in employing the large numbers of salesmen needed to sell the Appellant's products to service station operators.

p.8, l.33
p.8, l.37
p.7, l.25
p.7, l.40
p.9, l.2

11. This merchandising plan was introduced as a first step towards the eventual establishment of a solo site service station scheme and was designed to increase sales of the Appellant's products and overcome the undesirable features of the trade referred to in paragraph 10 hereof. This merchandising plan itself encouraged operators of participating service stations to buy most of their petroleum products from the Appellant.

p.11, l.25

12. Having put into effect this merchandising plan the Appellant was, by 1951, making all arrangements preparatory to the next step of instituting a solo site service station scheme

p.24, l.17
p.12, l.1

when, in August 1951, one of the Appellant's competitors which supplied a substantial part of the market announced that it would thenceforward supply its products only to service station operators who purchased their requirements exclusively from it. The Appellant decided very shortly thereafter to adopt and put into effect a similar policy and others of the Appellant's competitors announced that they likewise were adopting such a policy. Record p.13, l.5 p.14, l.17

13. The carrying out of this policy involved, and still involves, the Appellant in making agreements with service station operators by which they undertake to purchase the whole of their requirements of petroleum products exclusively from the Appellant and to sell on their premises those products only. The Appellant took immediate steps to induce selected service station operators to enter into such agreements and its competitors likewise sought to make similar arrangements.

14. In the first stage the Appellant, as an inducement to service station operators to agree to buy all their requirements of petroleum products from it, offered at its own expense to paint the service station in its standard colours, to carry out minor alterations to their premises so as to improve access and general appearance and to provide certain equipment. In consideration of the Appellant bearing those costs, the service station operator entered into an agreement for a term of years by which he agreed to buy petroleum products exclusively from the Appellant. These agreements (called "trading agreements") were in a standard form (see Exhibits A (xxxiv) (b) and A (xxxiv) (c)). Certain immaterial alterations were made in this form from time to time. The amounts expended by the Appellant in this manner in the said year of income were as follows :- p.15, l.36 p.26, l.13 pp.185, 188

Alterations to concreting of driveways	£29,558
Structural alterations and repairs to buildings	£78,239
Purchase and installation of equipment	£ 4,900

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Miscellaneous expenditure £8,602

In addition the amount of £124,849 was expended in painting service stations.

15. By early in the year 1952 it was apparent to the Appellant that to offer these inducements was not sufficient to persuade an adequate number of service station operators to enter into
p.26, l.33 trading agreements with it. It was by then known
p.61, l.1 to the Appellant that certain of its competitors were offering substantial cash payments to service station operators to induce them to purchase only those competitors' products. The Appellant then decided that in order to induce the requisite number of service station operators to sign trading agreements and buy exclu-
p.27, l.40 sively from it, it too would have to offer to make payments to them. It was, however, not prepared to make outright lump sum payments to such operators. It, therefore, decided to offer to make periodical payments to operators as an inducement to sign trading agreements. It was found, however, that many operators were not prepared to sign such agreements without receiving a sum in ready cash, and the Appellant met this situation by lending money to them
p.27, l.44 repayable, with interest, by instalments. At the same time the Appellant agreed to make monthly payments to them. In a small number of cases the Appellant agreed to pay annual sums in respect of each year in which the operator
p.28, l.8 carried out his obligations and no loans of money were involved.

16. These new forms of inducement were embodied in standard forms of agreement called "SS1-B" and "SS1-C" agreements respectively which were executed together with the trading agreements (see Exhibits A (xxxiv) (d) and A
pp.192,196 (xxxiv) (e)). The SS1-B agreement provided in substance for a loan to the operator repayable with interest by monthly instalments over a period of years; so long as the operator observed the covenants of that agreement and of the trading agreement the Appellant agreed to pay to him or credit him with amounts monthly, which amounts were in fact equal to the said monthly instalments. During
pp.213-220 the said year of income a total of 257 SS1-B agreements were current and monthly sums were

being paid or credited pursuant to them. The SS1-C agreements provided for annual payments to the operator over a period of years so long as the operator observed the covenants of the agreement and of the trading agreement. During the said year of income a total of 29 SS1-C agreements were current and annual payments were being paid pursuant to them. Each of these agreements contained covenants by the operator to purchase and resell at his service station only the Appellant's products. There were about 1,850 trading agreements current during the said year of income, including those associated with SS1-B and SS1-C agreements. The trading agreements and the SS1-B and SS1-C agreements were expressed to be for various terms of years; the range was 3-15 years, the average term of SS1-B agreements being seven years.

Record p. 221

p. 85, l. 24

17. Initially the Appellant's practice was to offer to an operator in the form of a loan under an SS1-B agreement or in the form of annual payments under an SS1-C agreement an amount not exceeding a fixed amount (in fact 0.3 pence) per gallon on the volume of petrol expected to be sold by the Appellant to that operator at his service station during the period of the agreement. However, due to increasingly large cash offers or payments made by its competitors to operators to induce them to purchase exclusively such competitors' products, it became necessary in many instances during 1952 and 1953 to lend amounts equivalent to more than the amount of 0.3 pence per gallon in order to induce operators to enter into SS1-B agreements with the Appellant. The agreements were not expressed in terms of amounts per gallon. Due to altering conditions of competition, which affected both the extent of operators' demands and also the number of operators available to negotiate with, the Appellant's limit per gallon was increased from time to time according to the competitive situation and rose to amounts much in excess of 0.3 pence per gallon. The Appellant's instructions to its branches did not authorise the making of agreements involving payment in excess of the limit. All recommendations from branches to make such payments were reviewed by the Appellant's Head Office in Melbourne in the light of the cost per gallon. In hundreds of cases the Appellant failed to secure agreements with operators because they required payments in

p. 63, l. 18

p. 63, l. 32

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excess of its limit. In the calculation of the amount to be paid to an operator the duration of the agreement was a necessary factor and the Appellant was prepared on occasions to exceed its then current limits if an operator would agree to an agreement
p.64, l.1 for a longer term than was usual. The Appellant had for years been accustomed to grant price concessions to particular customers and was accordingly familiar with the
p.88, l.8 concept of concessions and with the need to vary the extent of concessions from time to time.

18. The effect of this new system of trading upon the Appellant's business was that, whereas the Appellant in December 1950 had
p.32, l.14 pumps and tanks installed at over 7,000
p.33, l.6 service stations throughout the Commonwealth, this number was reduced to under 4,000 by December 1953 by which time the Appellant had secured agreements whereby over 2,000 service station operators had agreed to
p.33, l.14 purchase and resell only the Appellant's products. This reduction in the number of service stations to which the Appellant sold its products and the greatly increased quantities sold to each of such operators reduced its costs of distribution; thus as a result the volume delivered by the Appellant to any one operator in a single delivery increased from an average of 262 gallons
p.34, l.21 in 1950 to an average of 1,491 gallons in 1953.

19. By the year 1952 the "solo site" system was firmly established. An inherent feature of the system was the need, as agreements expired, to negotiate new agreements with service station operators and to do this it was necessary to offer them fresh monetary inducements in order to secure once again that they would purchase the whole of their requirements of products for resale at their service stations from the Appellant rather than from one of its competitors which also sought to obtain their orders for a period of years. Accordingly the inducement offer by the Appellant had to compare favourably with those offered by competing marketers if the agreement was to be renewed. The

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experience of the Appellant was that where new agreements were negotiated on the expiration of the term of an original agreement, the renewal was more costly than the original agreement. p.92, l.17

20. The sum of £192,701 which the Appellant expended during the said year of income and which was disallowed by the Respondent was made up as follows :-

Amounts paid pursuant to SS1-B agreements	£ 57,265
Amounts paid pursuant to SS1-C agreements	£ 9,637
Amounts expended on items set out in paragraph 14 above	£121,299

There was also included an amount of £4,500 expended in legal costs incurred in relation to the introduction of the "solo site" system. The parties agreed that the latter sum should be deemed to be attributed to the other items of expenditure proportionately and that it should be treated as deductible or not according as such items were treated.

21. Both before Taylor J. and on appeal before the Full Court the principal arguments submitted on behalf of the Appellant were as follows :-

(a) The whole of the expenditure in question arose in the ordinary course of carrying on the Appellant's business of selling petroleum products and was part of the cost of marketing its products.

(b) Part of the day to day business of the Appellant was the obtaining of orders for its products and the expenditure in question was part of the cost of obtaining such orders.

(c) The expenditure gave rise to no assets of an enduring nature but was part of the ordinary recurring expenditure which by July 1952 had become an accepted feature of the business of marketing petroleum products.

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(d) The payments were not made once and for all, and all such payments were a recurrent feature of the conduct of the Appellant's business.

(e) The purpose and effect of the expenditure was to maintain and increase the volume of sales and to reduce distribution costs.

(f) The character of the payments in the hands of the recipient operators is irrelevant in determining the character of those payments as expenditure by the Appellant.

(g) Periodical payments made pursuant to SS1-B agreements were payments made monthly to obtain transitory advantages, namely the observance month by month of the obligations undertaken by the recipient operator. They were recurring payments made in exchange for advantages which at most would not endure for longer than the term of the agreement under which they were paid. Being arrived at substantially (though not exclusively) by reference to the amount of business to be expected from an operator's orders for products, they are analogous to rebates. Being costs of sale, they operated to reduce the profit derived from wholesale sales.

(h) The like features apply a fortiori to periodical payments made pursuant to SS1-C agreements which were simply payments made in return for annual performance of contractual obligations, the chief of which was the obligation to purchase exclusively the Appellant's products.

(i) Expenditure under both SS1-B and SS1-C agreements was recurrent in two senses; not only did it consist of periodical payments to particular service station operators made in return for the performance of obligations over short periods of time but, in addition, the nature of the business of petroleum

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marketing was such that there was then established a constantly recurring need for further like expenditure as agreements came to an end and new agreements, involving new financial inducements to be paid to service station operators, were entered into.

(j) The whole of the expenditure possessed features characteristic of outgoings of a revenue nature in that it was recurring, created advantages which were only transitory in character and not of an enduring nature and was, particularly in the case of SS1-B and SS1-C agreements, closely analogous to rebates on the price of products sold.

22. On behalf of the Respondent the following principal arguments were submitted before Taylor J. and before the Full Court :-

(a) The whole of the expenditure in question was expended in the acquisition of capital assets in the form of a new business structure or a new form of goodwill or an enlargement of goodwill. The trade ties were themselves capital assets. Alternatively the Appellant, by its arrangements with service station operators, entered into a number of joint trading ventures with those service station operators thereby creating new assets of enduring character.

(b) The expenditure resulted in the exclusion of competitors from the sites of service stations and procured for the Appellant security of outlets for its products for terms of years, and these were advantages of an enduring character. The Appellant was buying off competition and meeting the threats to its business constituted by the activities of its competitors; once such competition was bought off the resultant freedom from competition was an enduring condition. The payments were to protect and extend the business structure.

(c) Expenditure in respect of SS1-B agreements did not in any real sense consist of

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a series of periodical payments; the only real payment was the so-called loan which was on proper analysis a lump sum payment. Further, the fact that periodical payments were not actually paid in cash but merely credited to service station operators' accounts deprived them of the character of a loss or outgoing within Section 51 of the Act. The effect of Section 260 of the Act was to require the transactions embodied in SS1-B agreements to be regarded as simply payments of lump sums, being the alleged loans; when so viewed the payments were of a capital nature. Alternatively the expenditure was incurred in relation to the loans which were capital transactions.

(d) Each payment under an SS1-C agreement amounted to an instalment of a lump sum and did not, in any material respect, differ from payments under SS1-B agreements.

(e) Expenditure under both of those agreements bears no analogy to rebates since payments were not in any real sense related to a service station operator's purchases from the Appellant; the service station operator was under no obligation to purchase any particular quantities of products and there was no communication to service station operators of the fact of any relationship between payments and anticipated purchases. The fact that payments under those agreements were made periodically did not, of itself, establish their character.

(f) Expenditure in cases where only trading agreements were entered into by service station operators, was incurred in consideration of the entry into such trading agreements and was simply the expenditure of lump sums with no recurring element. In so far as such expenditure was incurred in structural improvements this is itself an indication that it was expenditure

on capital account. Record

(g) The whole of the expenditure was, in the recipients' hands, of a capital nature and if, in addition, such expenditure conferred an enduring benefit to the Appellant the consequence was that it was capital expenditure.

23. Thehearing of this case before His Honour Mr. Justice Taylor followed immediately after the hearing by His Honour of an appeal by BP Australia Limited (hereinafter referred to as "BP") against its assessment to income tax for the year of income ended on the 30th day of June 1952. The question involved in that appeal was whether or not the Commissioner of Taxation was correct in disallowing in whole as an allowable deduction from the assessable income of BP a sum of £271,240 which it had claimed as a deduction. That sum was, as to £270,569 expended by it during that year of income principally in making individual payments to service station operators which formed part of the consideration for the service station operators undertaking that they would for a fixed term of years deal exclusively in certain brands of motor spirit approved of by it and partly also in making payments to other marketers of petroleum products for the purpose of adjusting as between the members of a group of such marketers, of which BP was a member, the total amounts paid as aforesaid by each member to service station operators. The balance of the sum of £271,240, namely £671, was expended by BP in structural alterations to the service station premises of certain of such service station operators.

24. His Honour in his Reasons for Judgment in the Appellant's appeal delivered on the 8th day of May 1961 referred to and relied on his Reasons for Judgment in the appeal by BP in which he had delivered judgment on the same day and applied to the facts in the Appellant's appeal the conclusions arrived at by him in that other appeal. The judgment of Taylor J. in that appeal is reported in 35 Australian Law Journal Reports 77. pp.115-116

25. An outline of the judgment of Taylor J. in the appeal by BP, so far as relevant to the

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Appellant's appeal, and of the Appellant's submissions thereon is as follows :-

> (a) After stating the facts in that case and analysing the various forms of agreements which had been entered into between BP and various service station operators His Honour stated that their purpose and effect was to secure for the agreed period a re-selling outlet for BP's products and those of the companies co-operating with it from time to time.

It is submitted that a taxpayer's "purpose" in incurring expenditure is of little assistance in determining the nature of that expenditure if purpose is used in the sense of motive or object - see Commissioner of Taxes v. Nchanga Consolidated Copper Mines Ltd. 1964 2 W.L.R. 339 at 344 per Lord Radcliffe and the judgment of Dixon C.J. in the appeal by BP in 37 A.L.J.R. at 367. It is further submitted that in any event His Honour erred in describing the purpose and effect of those agreements as he did. Neither their purpose nor their effect was to secure reselling outlets but rather to maintain and increase the volume of sales of BP's products by ensuring that its customers, the service station operators, would for a given term purchase from it all their requirements of petroleum products.

His Honour's erroneous description of the purpose and effect of the agreements played a dominant part in his ultimate characterisation of the outgoings in question as being on capital account; it led His Honour wrongly to regard such outgoings as incurred in the acquisition of assets of an enduring nature in the form of "reselling outlets".

> (b) His Honour stated that the inevitable need for BP to incur the expenditure threw little light upon its nature as having been incurred on income or capital account. He did not accept the submission that the then current market situation resulted in the ex-

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penditure becoming an ordinary incident of the conduct of the business and discounted the value of the recurring nature of such expenditure as an indication of its character.

It is submitted that the expenditure in question amounted to no more than a cost of selling BP's products and that the fact that the new sales methods employed at that time by BP, due to unexpected incidents of marketing, resulted in a new type of expenditure did not control the nature of the expenditure or make it expenditure on capital account. The fact that such expenditure was of a recurring nature, while no more than an indication of its character, is nevertheless an important indication that it was of a revenue nature.

(c) His Honour found that the substance of the arrangements between BP and service station operators was not the obtaining of a promise by the latter to remain as customers for a fixed period, but rather the obtaining of a trade tie thereby excluding from sale on operators' service stations for a period of years brands of motor spirit not approved of by BP and thus obtaining freedom from competition on that site. This, said His Honour, was an asset or advantage for the enduring benefit of BP's trade.

It is submitted that in so finding His Honour was giving effect to his initial erroneous characterisation of the purpose and effect of BP's agreements with service station operators referred to in (a) above. The correct view was, it is submitted, expressed in the dissenting judgment of Kitto J. in the Full High Court when he said (37 A.L.J.R. at 369) that the transaction differed in an important respect from one in which a trader takes from a potential competitor an agreement in restraint of trade; in such a case there is created for the promisee a more favourable situation in which to carry on his business, the elimination of the competitor being anterior to and not part of the trading and constituting the cost of a capital asset. The present case, said

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His Honour, was not one involving the creating of a situation in which to set about selling motor spirit, instead the expenditure secured the particular sales necessary for the satisfaction of a service station's requirements over a period.

(d) His Honour then examined the character of the expenditure which he described as incurred in securing these trade ties and concluded that it was of a capital nature because the quantum of each payment was determined by reference to competition between marketers of petroleum products and not by the trading potentialities of particular service stations. His Honour concluded that such payments were therefore not the equivalent of trade rebates, on that ground distinguishing Bolam v. Regent Oil Co. Ltd. 37 T.C. 56, but were rather capital sums outlaid to secure trading ties for fixed periods.

His Honour, in the Appellant's appeal, also adverted to this subject of the determination of quantum of payments by reference to competition and the Appellant's submissions thereon appear in paragraph 26 (c) hereof. It is submitted that even if the quantum of payments were in some degree affected by competitive factors this is not in itself an indication that payments were on capital account. It is further submitted that His Honour misunderstood the basis of the decision in Bolam's case and that it is not capable of being distinguished either from the appeal by BP or from the Appellant's appeal.

26. An outline of the judgment of Taylor J. in the Appellant's appeal and of the Appellant's submissions thereon is as follows :-

pp.104-116

pp.104-6
pp.106,l.43-111,l.16
p.111,l.16-1.30

(a) His Honour reviewed the facts and set out the substance of the three types of agreements pursuant to which payment had been made by the Appellant to service station operators. His Honour then referred to the Appellant's contention that the circumstances of

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the trade had become such that the payments were ordinary incidents of the Appellant's business and constituted ordinary marketing costs and said that the problem could not be resolved without a closer examination of the character of the payments.

It is submitted that the Appellant's contention was correct and that, as Kitto J. said in his judgment on the Appellant's appeal to the Full High Court, "the Appellant had embarked upon a course of securing orders by making payments to its customers and every payment that it made must necessarily, it seems to me, be regarded as having diminished the profit from the orders obtained".

(b) His Honour regarded the case as a close parallel to the BP case, differing only in the fact that the Appellant's expenditure was principally by way of periodical payments to service station operators and not lump sum payments and, as to the balance, was incurred in the improvement of the premises and equipment of service stations. His Honour, however described the SS1-B agreements as providing for payment by instalments of a lump sum which was paid to secure a trade tie for a fixed period. pp.115, l. 38 - 116, l. 45

It is submitted that in so describing the agreements His Honour misconstrued their nature. In fact each payment in question was not an instalment of a lump sum but was "a reward separately related to the operator's due performance of his agreement during the relevant month ....; it was expended by the Appellant for recurring periods of enjoyment of the benefits of the agreement" - per Kitto J. (37 A.L.J.R. at 373).

(c) His Honour described the quantum of the payment as depending not on a service station operator's need for borrowed capital nor upon an estimate of the quantity of petrol expected to be purchased, but solely upon the "price" which competition from other marketers pp.113, l. 13 - 115, l. 10

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made it necessary for the Appellant to pay to secure the advantages it sought although he said that he did not doubt that the potential "gallonage" at any particular station was always an important business consideration.

It is submitted that His Honour misunderstood the evidence tendered on behalf of the Appellant on this matter. In emphasising the effect of competition upon the quantum of loans made by the Appellant, His Honour confused the measure of the payment with its nature; even if, contrary to the evidence, there has been no relationship between "gallonage" and the quantum of a loan, this would not be an indication that the payments associated with the loan were on capital account but would amount to no more than the absence of one indication of the revenue nature of the payments. In fact, however, there was a real and important commercial relationship between the amount of the loans and the estimated gallonage. The absence of a constant mathematical relation and the influence of competition do not operate to negate the real connexion - the fact that gallonage was a guiding consideration is a strong indication that the payments were in truth part of the cost of obtaining orders. His Honour wrongly treated the absence of a precise and constant arithmetic relationship between the gallonage and the amount of the loan as a positive reason for regarding the periodical payments as capital outgoings.

p. 115, l. 11-37

(d) His Honour also regarded the annual payments under SS1-C agreements as being merely an annual instalment of a lump sum and as not distinguishable from payments under the SS1-B agreements. His Honour said that the fact that the Appellant's payments were made by instalments did not distinguish the case from the payments dealt with in the BP case.

It is submitted that in the case of the SS1-C agreements the annual payments are even more clearly distinguishable from instalments of

a lump sum than in the case of SS1-B agreements. The nature of the payments in question in the Appellant's appeal is, it is submitted, such as to render them, when properly analysed, even more clearly of revenue nature than is the case in the appeal by BP.

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(e) His Honour also held that the sums expended on structural alterations to and the supply of plant for service stations were not deductible since the offer to make such expenditure was one of the inducements offered to operators to obtain a trade tie.

P. 116, l. 5 - 32

His Honour accordingly characterised all of the expenditure in issue as of a capital nature and therefore disallowed the appeal.

27. An appeal was instituted by the Appellant and also by BP against the two above mentioned judgments and those appeals came on for hearing before the Full Court of the High Court of Australia constituted by Dixon C.J., McTiernan, Kitto, Windeyer and Owen JJ. The appeal by the Appellant was heard first and the hearing of the appeal by BP followed immediately thereafter. Certain of Their Honours in giving their separate reasons for judgment in the Appellant's appeal referred to and relied on their reasons for judgment in the BP appeal which is now reported in 37 A.L.J.R. 365.

pp.118-121

28. In each of these two appeals there was a division of the Full Court of the High Court. The majority consisting of McTiernan, Windeyer and Owen JJ. held in each appeal that the deductions claimed were incurred on capital account and were properly disallowed by the Respondent and accordingly dismissed the appeals. Dixon C.J. and Kitto J. took a contrary view in each appeal and held that the deductions were incurred on revenue account and should have been allowed by the Respondent and accordingly they would have allowed the appeals.

p. 122
pp.124-5
pp.125-134
pp.121-2
pp.123-4

29. In each appeal McTiernan J. stated that

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the judgment of Taylor J. was right but did not express any separate reasons.

p. 124, l. 40-44

30. In the Appellant's appeal Windeyer J. stated that the case differed little, in what he regarded as essentials, from the BP case and he dismissed the appeal without giving any lengthy additional reasons. An outline of his judgment in the BP case and the Appellant's submissions thereon is as follows :-

> (a) His Honour said that as he agreed with Taylor J's. conclusion he need add very little. He said that the character of a questioned item of expenditure must depend primarily on its purpose and that regard ought therefore to be had to what was sought to be acquired rather than to the form or mechanics of the transaction.

It is submitted that, for the reasons stated in paragraph 25 (c) hereof, this emphasis upon purpose in the sense of motive is erroneous and that it led His Honour to a mistaken view of the character of the Appellant's expenditure. It is submitted that the manner in which an advantage is acquired may properly be decisive in determining whether the cost of acquisition is a capital cost or is, instead, an outgoing on revenue account.

> (b) His Honour agreed with Taylor J. that the payments (which were all lump sum payments) made by BP were made to secure for agreed periods a reselling outlet for its products, and that by each arrangement it obtained for a substantial period, and he supposed with a prospect of renewal thereafter, something which was to become part of the structure within which and by reason of which it carried on its business.

It is submitted that, in common with Taylor J., His Honour wrongly characterised the transaction involved in the arrangements in question as the obtaining of an "outlet" whereas in fact what was obtained was a certainty of customers' orders for a period in the future

His Honour's view involves confusing the service station operator's retail trade with the wholesale trade of marketers such as BP and the Appellant. Record

31. Owen J. in the Appellant's appeal did not refer to the BP case. The following is a summary of his judgment and of the Appellant's submissions thereon :-

(a) After reviewing the facts and summarising the provisions of the various documents, His Honour agreed with Taylor J. that the estimated "gallonage" for any particular service station was no more than a factor, and no doubt an important factor, in deciding what sum it would be economically sound to lend or pay to the particular operator. p. 129, l. 30-5

It is submitted that His Honour's recognition of "gallonage" as an important factor in determining the amount to be lent or paid to service station operators should have constituted for him a strong indication that such amounts were expended on revenue account; the Appellant refers to its submissions in paragraph 26 (c) hereof.

(b) His Honour considered that the fact that the obtaining of trade ties became necessary because of the circumstances of the trade did not assist in characterising the nature of the expenditure. p. 132, l. 1-31

In this regard the Appellant refers to its submissions in paragraph 25 (b) hereof and says that this circumstance assists in characterising the payments as an ordinary outgoing in the conduct of the trade.

(c) His Honour said that the difficulty in characterising an outgoing as being on capital or revenue account lay in the fact that no criterion had been or could be laid down which would enable the question to be answered with certainty in all circumstances. He said that a number of tests had pp.132, l. 32 — 134, l. 7

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been suggested, none of which could be conclusive; they were indications rather than tests. His Honour regarded all types of outgoing in issue in the Appellant's appeal as of a recurring nature, but said that when the nature of the advantages gained by the Appellant as a result of such expenditure was examined the balance seemed to him to tilt in favour of the view that the outgoings were of a capital nature. The Appellant's payments were made in return for the operators undertaking to deal exclusively in its products and to give it exclusive advertising rights on the sites for a substantial period and the carrying into effect of those undertakings. The purpose or effect of the expenditure seemed to His Honour to have been to add valuable, even if intangible, assets of a lasting character to the profit earning organisation.

It is submitted that His Honour should have regarded the recurring nature of the outgoings as a further strong indication that these outgoings were on revenue account and that in common with Taylor J. he was led into error in his ultimate characterisation of those outgoings as on capital account for the reasons submitted in paragraph 25 (a) hereof, and because he overlooked the fact that procuring orders from customers is part of the ordinary day to day conduct of a wholesaler's business.

32. Dixon C.J., in his judgment in the Appellant's appeal, stated that it was governed by the same considerations as those governing the appeal in the BP case. He stated that the Appellant's expenditure appeared to him clearly to have been incurred in the process of marketing a commodity and to be expenditure which was not made once for all but was likely to be repeated, and was not to be sufficiently identified as outside the ordinary conduct of business. He, therefore, thought that for the reasons more fully given in his

p. 122, l. 9-12

p. 122, l.14-19

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judgment in the BP case the appeal should be allowed. In the BP case His Honour reviewed the evidence and stated that the actual nature and amount of expenditure was more important in determining its character than were the motives leading to the adoption of the particular course of business. He said that the decision should depend upon an understanding of what the various items of expenditure represented rather than upon general considerations. Since the expenditure was incurred in promoting sales of petrol, it prima facie formed part of the year's marketing expenditure and was an allowable deduction. BP, His Honour said, had always been and would in the future be engaged in a continuous process of business expenditure which involved the cost of selling its petrol in whatever way seemed suitable from time to time. In all the unexpected incidents of marketing throughout the pre-war, war time and post war years it was clear that BP, in the course of conducting its business, was trying, by various means, to obtain a definite public market for its products and was not acquiring a capital asset nor doing more than so conducting its business on revenue account as to increase it and to make as certain as it could that its business was expanding and would continue to expand. The particular methods of BP in question in the appeal did not change the character of its transactions from those of a continual attempt to establish its product in a consumer's market and to obtain a reputation for that product; no expenditure in increasing any element in the profit earning instrument under its control was involved.

33. Kitto J. applied to the Appellant's appeal his conclusions expressed in his reasons for judgment in the BP appeal (37 A.L.J.R. at 365) but discussed separately two additional features of the Appellant's case which tended to reinforce his views as expressed in the BP case - p. 123, l. 4-8

(a) in the BP case His Honour stated the choice was between treating the expenditure in question as expenditure in establishing, replacing and

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enlarging the profit yielding subject or profit making machine or as being for a purpose falling within the conduct of the trade. The former view could be supported either by regarding the expenditure as the purchase of freedom from competition at particular service stations or as the cost of purchasing a new market to replace one being threatened by the actions of competitors, it being assumed that a service station once acquired as an exclusive customer would be likely so to continue at the expiration of the term of the agreement. His Honour did not regard the Respondent's contention as justified on either of these two bases.

(b) A marketing company was not eliminating competition so as to create a future favourable trading situation as does a trader who purchases from a potential competitor an undertaking not to compete. On the contrary an operator's undertaking not to purchase competitors' products was only the negative side of the positive advantage which the marketer secured by its expenditure, namely that the operator's custom would, for a given period, go to the marketer. The expenditure was thus part of the process of effecting sales of its products and was prima facie part of the cost of selling those products and not a capital outlay.

(c) As to the second basis, His Honour said that, while there had been a radical change in the wholesale trade in petrol and while the payments in question formed part of BP's endeavour to cope with the resulting threat to its trade, he did not find any justification for regarding the payments as final in character, having the practical effect of providing a new basis of operation. The change in the whole-

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sale trade to the new "solo site" system meant that every oil company if it wanted to sell petrol to service stations had to accept the necessity of spending money, not at the beginning once for all, but at the beginning and from time to time to ensure that it would receive from as many service stations as possible the whole of their orders for limited periods.

(d) It was significant that monopoly rights were acquired only for limited periods and by its expenditure the marketer would not secure any enduring share of the total market for its products. The need to obtain renewals or extensions of agreements with operators would be continuous, involving continual effort and expenditure to which thenceforth the marketer was committed as a regular feature of its selling activities. Accordingly His Honour concluded that BP neither acquired a new market or a new framework within which to carry on business for the future; nor did it add to goodwill by buying off competition, but it was instead, by its expenditure, buying future orders for its products. The fact that the trading potentialities of particular service stations was a guiding, though not a governing, factor in fixing the quantum of payment to operators supported the view that the expenditure was from the marketer's viewpoint a cost of obtaining orders for the marketer's products. Such expenditure would, as a matter of accounting, be a marketing cost.

(e) For these reasons he concluded that the outgoings by BP were not of a capital nature but were of the nature of trading expenses and accordingly allowable as deductions.

34. Of the two additional matters to which

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p. 123, l. 9-36

Kitto J. referred to in the Appellant's appeal, the first was the very specific evidence of the need constantly to obtain new and renewed agreements with operators; this emphasised that the giving of concessions (i.e. payments of money) to obtain these agreements formed part of the process of selling the Appellant's products; therefore the cost of obtaining these agreements was properly deductible in ascertaining the profits of the business. The second matter was the fact that payments by the Appellant under the agreements were not truly instalments of a principal sum but rather individual rewards separately related to an operator's due performance of his agreement during the relevant month or year. His Honour said the Appellant has embarked on a course of securing orders by making payments to its customers and every payment that it made must necessarily be regarded as having diminished the profit from the orders so obtained.

p. 123, l. 37 - 124, l. 14.

35. The Appellant refers to the submissions set out in paragraph 21 of this Case and submits that the conclusions of Taylor J. and of the majority of the Full Court are erroneous for the following main reasons :-

(1) Their Honours failed to pay proper regard to the nature of the various items of expenditure.

(2) Each of the items of expenditure was incurred in the course of and for the immediate purpose of promoting the sale of the Appellant's products.

(3) Each of the items was a means of assuring a regular flow of orders for the Appellant's products from a large number of its customers.

(4) Their Honours wrongly regarded

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the expenditure as directed to acquiring an asset of an enduring character in the form of a restraint on service station operators preventing them from purchasing supplies from the Appellant's competitors. They thus confused a payment to a competitor to induce him not to compete with a payment or concession to a customer to induce him to buy or to continue buying or to buy more. There is no relevant difference where the payment or concession to the customer is to induce him to buy all his requirements from the Appellant.

(5) No asset of an enduring character in any relevant sense was obtained.

(6) The advantage obtained was in the nature of orders for products for future delivery over an agreed period to a regular customer. As expenditure to secure such orders it was a revenue outgoing.

(7) The payments were not made wholly for the undertaking to deal exclusively with the Appellant, but were partly for such undertaking and partly as periodic reward for due observance of the undertaking in the relevant month or year. No monopoly rights or freedom from competition in any relevant sense were obtained by the Appellant.

(8) The majority wrongly concentrate on the restraint on the operator from buying from others, whereas the true significance of the agreements is to be found in the positive obligation to buy all his requirements from the Appellant, and that reveals the revenue nature of the payment.

(9) The absence of a constant arithmetic relationship between the amount expended in respect of any one service station operator and the esti-

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mated gallonage to be sold to him does not provide a reason for regarding such payments as of a capital nature.

(10) The amount of payments made to each service station operator was determined, having regard to the value to the Appellant of the orders for its products which such expenditure would purchase and the existence of a real business connexion between the payments and the estimated gallonage is a strong indication that the payments are of a revenue nature.

(11) The expenditure is not one to be made once and for all, but is of a recurring nature and part of the ordinary expenses of marketing.

(12) The period of the agreements or any individual agreement provides no indication of an asset of an enduring character in any relevant sense. The majority were wrong in attributing significance to this aspect and in not regarding the system of trading as a whole as showing the recurring need for such expenditure.

(13) The majority's conclusion that the expenditure was directed to obtaining "outlets" which were capital assets, involves a confusion between the wholesale trade of the Appellant and the retail trade of its customers, the service station operators. They wrongly treated the service stations as sites from which the Appellant sold its products.

(14) The expenditure was incurred in the course of and for the purpose of

securing sales of the Appellant's products and formed part of the cost of such sales.

(15) Payments under SS1-B and SS1-C agreements were recurring payments forming part of the regular cost of marketing. They were recurrent both in the sense of being monthly or annually to each individual and in the sense that there was the recurring necessity to make and to undertake to make some such payments to operators generally.

(16) Section 260 of the Act has no application to any relevant agreement or transaction of the Appellant and neither SS1-B agreements nor any part thereof is by virtue of that section or otherwise to be treated as void as against the Respondent. Section 260 provides no reason for treating any of the payments as other than a revenue outgoing.

(17) The submissions referred to in paragraph 21 are correct and should have been accepted by the High Court.

(18) The case is not distinguishable from the decision in Bolam v. Regent Oil Co. 38 T.C. which was rightly decided.

(19) The reasons of the majority are inconsistent with the decision of the Privy Council in Commissioner of Taxation v. Nchanga Consolidated Copper Mines Ltd. 1964 2 W.L.R. 339.

(20) The judgments of Dixon C.J. and

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Kitto J. are correct for the reasons which they give.

K.A. AICKIN

N.M. STEPHEN

No. 53 of 1964

IN THE PRIVY COUNCIL

ON APPEAL FROM

THE HIGH COURT OF AUSTRALIA

BETWEEN :

MOBIL OIL AUSTRALIA LIMITED (formerly called Vacuum Oil Company Proprietary Limited)

Appellant

- and -

THE COMMISSIONER OF TAXATION OF THE COMMONWEALTH OF AUSTRALIA

Respondent

C A S E

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