Privy Council Appeal No. 53 *of* 1964

Mobil Oil Australia Limited – – – – – – – *Appellant*

v.

The Commissioner of Taxation of the Commonwealth of Australia – – – – – – *Respondent*

FROM

THE HIGH COURT OF AUSTRALIA

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 27TH JULY 1965

Present at the Hearing:
LORD REID
LORD MORRIS OF BORTH-Y-GEST
LORD PEARCE
LORD UPJOHN
LORD WILBERFORCE

[*Delivered by* LORD PEARCE]

The question in this appeal is whether sums amounting to £192,701 are allowable as deductions from the assessable income of the appellant (referred to as " Mobil Oil ") for the year ended 30th June 1953. Taylor, J. held that they were not. He was affirmed in the Full Court of the High Court by a majority (McTiernan J., Windeyer J., Owen J.; Dixon C. J. and Kitto J. dissenting). The arguments in all the Courts have been similar to those in the case of B.P. Australia Limited since the facts of the two cases are very similar. They arise out of the same trade situation, namely, the development of solo sites in the business of marketing petrol. Mobil Oil did not, however, follow its rivals by compulsion as did B.P. It had tentative plans for instituting the solo site system but it was forestalled by the announcement of the Shell company in August 1951. It then instituted among its customers a " Trading Agreement " for a period of years. It agreed to paint with its own colours the retailers' service stations, to reimburse retailers for the reasonable cost of minor alterations to their stations (and to provide skilled advice on this subject), to pay half their advertising costs, and to help them to obtain loans for their businesses. It also agreed to sell to the retailers at the ruling market price and deliver to their service stations all motor fuels which they might from time to time require for resale at the service stations. The retailers covenanted to purchase from Mobil Oil at the ruling market price all motor fuels intended for resale at the service stations and not to purchase them otherwise than from Mobil Oil nor to sell at the service stations any motor fuels other than those purchased by them from Mobil Oil. This Agreement did not ptove a sufficient attraction to retailers and there was superimposed on it in most cases another agreement either in form SS1-B or form SS1-C. In each of those it was an express term that the retailer should execute and carry out the terms of the trading agreement for a period of years.

The SS1-B agreement (of which there was the larger number) was as follows: It recited that the retailer had requested Mobil Oil to lend him a specified sum of money and that Mobil Oil had agreed to do so upon the terms set out in the deed. The retailer covenanted to repay the amount of the loan together with interest at a fixed rate per annum by equal monthly instalments comprising both principal and interest. He also covenanted during the term of the " Trading Agreement " not to dispose of his interest in the service station without first offering to sell it to Mobil Oil. If such

offer was not accepted by Mobil Oil the retailer undertook not to dispose of his interest otherwise than by sale unless Mobil Oil approved of the person to whom he proposed to dispose of it and unless that person executed Mobil Oil's form of " Trading Agreement " to run for a term not less than the unexpired term of the original retailer's " Trading Agreement ". It was also provided that unless and until the retailer should have disposed of his interest in the station he would, during the term of the " Trading Agreement " continue to remain personally in occupation of it. Further the retailer granted to Mobil Oil the sole and exclusive advertising rights on the station. Mobil Oil on the other hand covenanted to pay the retailer (so long as he remained personally in occupation and observed the provisions of the agreement) a specified sum of money each month, payment of which might, at Mobil Oil's option, be made by crediting the retailer in its books with the amount payable to him. In fact the amount of these monthly payments which were to be made by Mobil Oil to the retailer was calculated so as to coincide with the amount of the monthly payments of principal and interest which the retailer had covenanted to make in repayment of the loan made to him. In the event of any breach by the retailer of any of the covenants, it was provided that the whole of the principal money or so much thereof as was then owing to the company together with interest thereon should become immediately payable to Mobil Oil.

The SS1–C agreement (of which there was a smaller number) differed from SS1–B in that it had no provision for the loan of money by Mobil Oil to the retailer, nor did it provide for monthly payments by Mobil Oil to the retailer. It provided for a specified sum to be paid annually by Mobil Oil to the retailer in respect of each period of twelve months during which he remained personally in occupation of the service station and observed the terms of the agreement.

The overall cost of the sums paid under these agreements was very substantial but when applied to the whole of the company's turnover it amounted, their Lordships were told, to no more than about ½d. per gallon.

Mobil Oil originally intended that the amounts paid by it under either agreement should amount to ·3 of a penny per gallon on the estimated gallonage which the retailer was likely to sell over the period in question. But under both agreements the amounts paid varied since the retailers soon realised that they were in a strong bargaining position. In some cases, where there was competition to secure a particular station—Mobil Oil had to pay on the basis of as much as 1½d. per gallon. In the words of Owen J. (agreeing with the findings of Taylor J.) " the estimated gallonage demand by a particular 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 ".

The form of the agreements was not attacked as a sham at first instance, nor was there cross examination to that effect but that suggestion was made on appeal. Owen J. there expressed the view (which their Lordships share) that all the evidence pointed to the opposite conclusion. " The arrangements were without question " he said, " real transactions intended to be and in fact carried out according to the terms of the documents ". Nor did the trial judge nor the Full Court accept the suggestion that the payments under SS1–B were merely book entries which should not be treated as outgoings at all. Their Lordships agree with that view. The cross entries constituted notional payments even in the cases where no counter balancing cheques passed (see per Mellish L.J. in *Spargo's* case 8 Ch. App. 407 at 414 and per Knox C.J. and Dixon J. in *Commissioner of Stamp Duties* (*N.S.W.*) *v. Perpetual Trustee Co. Ltd.* 43 C.L.R. 247 at 263).

It was argued by Mr. Menhennit that these agreements were void as against the Commissioner under section 260 of the Income Tax and Social Service Contribution Assessment Act 1936–1960 which reads as follows:

> " 260. Contracts to evade tax void.—Every contract, agreement, or arrangement made or entered into, orally or in writing, whether before

or after the commencement of this Act, shall so far as it has or purports to have the purpose or effect of in any way, directly or indirectly—

(*a*) altering the incidence of any income tax;

(*b*) relieving any person from liability to pay any income tax or make any return;

(*c*) defeating, evading, or avoiding any duty or liability imposed on any person by this Act; or

(*d*) preventing the operation of this Act in any respect, be absolutely void, as against the Commissioner, or in regard to any proceeding under this Act, but without prejudice to such validity as it may have in any other respect or for any other purpose."

In *Newton v. Commissioner of Taxation* [1958] A.C. 450 at 466 Lord Denning said—

" In order to bring the arrangement within the section you must be able to predicate—by looking at the overt acts by which it was implemented—that it was implemented in that particular way so as to avoid tax. If you cannot so predicate, but have to acknowledge that the transactions are capable of explanation by reference to ordinary business or family dealing, without necessarily being labelled as a means to avoid tax, then the arrangement does not come within the section."

The learned trial judge found that " for reasons which no doubt seemed proper to the appellant it was not prepared to pay in advance and unconditionally a lump sum for a trade tie extending over a period of years. It was however prepared to pay that sum by instalments spread over the relevant period and in the meantime to make available to the operator an amount equal to the lump sum involved." Under the circumstances existing it is not surprising that Mobil Oil took that line. From a commercial point of view it was a sensible arrangement. And it is not easy to see by what other equally convenient method it could have been achieved. In the one case (SS1–C) the retailer received his payments annually so long as he carried out his obligations during periods appropriate to the payments. In the other case (SS1–B), where it was desired that the retailer should have in his hands the whole sum at the beginning of the transaction, the sum was advanced as a loan on which the obligation to repay dwindled at a regular rate while the retailer was earning his reward. Thus the transaction is capable of explanation by reference to an ordinary sensible business arrangement. It does not therefore come within the section.

What then is the nature of these payments? Under each agreement they were periodic payments of a sum calculated as a lump sum for the total number of years. Under SSIC the annual payment was such a part of the total as accorded with the annual benefit. Although the total was a lump sum it was worked out by reference to the number of years which it represented. Admittedly the mere fact that a capital sum is payable by instalments does not convert it into an income payment in the hands of the payer. (See *Green v. Favourite Cinemas Ltd.* 15 T.C. 390.) In that case however the sum considered was a premium payable by instalments in addition to current rent on premises which were necessary if the taxpayer was to carry on his business at all. That case turned on the distinct difference between the premium and the rent where both were payable and the premium was identifiable as such. Once a sum is identified as being a premium in respect of a capital expenditure it does not easily lose its capital identity and mere payment by instalments is not enough to cause it to do so.

In the present case however the number of years was partly decisive of the total sum and the annual instalments under SS1–C were calculated through a division of the total sum by the number of years so that the periodical reward was commensurate with the portion of the services attributable to the period. The lump sum element in the case of SS1–C is not sufficiently cogent to destroy the indication of an income expenditure given by the fact of periodic payment corresponding with a periodic benefit. This aspect

of the matter is only one indication but it adds to the other considerations set out in the case of B.P. Australia Ltd. and makes the present case *a fortiori* so far as agreement SS1–C is concerned.

As to agreement SS1B there are two possible views. First, one might regard the monthly payments as being the substance of the outgoing, in which case it would have the same effect as agreement SS1C. Secondly, one might regard its total effect as being an advance payment of a lump sum intended as consideration for the benefits over the number of years. This seems perhaps, the better view, since it was at the beginning that the actual money changed hands although the agreement provided machinery for emphasising to the retailer the fact that he must continue his services over the total number of years if he was to retain the money and for the recovery of it *pro tanto* if at a later stage he failed in his obligation. Even if the agreement be so regarded, the payments are income outgoings for the reasons set out in the case of B.P. Australia Ltd.

Again, in those transactions where the Trading Agreement simpliciter was used without the addition of any other agreement, Mobil Oil's expenditure was income expenditure for the reasons given in the case of B.P. Australia Ltd.

Their Lordships will therefore humbly advise Her Majesty that the appeal should be allowed, the orders of the Full Court and of Taylor J. set aside with costs and the assessments for income tax and social services contribution for the year ending 30th June 1953 remitted to the respondent for him to allow the appellant's objections thereto. The respondent must pay the costs of this appeal.

(92484) Wt. 8052/124 100 8/65 Hw.

In the Privy Council

MOBIL OIL AUSTRALIA LIMITED

v.

THE COMMISSIONER OF TAXATION OF
THE COMMONWEALTH OF AUSTRALIA

DELIVERED BY

LORD PEARCE

Printed by HER MAJESTY'S STATIONERY OFFICE PRESS,
HARROW

1965