FEDERAL COURT OF AUSTRALIA

Commissioner of Taxation v Sharpcan Pty Ltd [2018] FCAFC 163

Appeal from:	*Sharpcan Pty Ltd and Commissioner of Taxation (Taxation)* [2017] AATA 2948
File number:	VID 22 of 2018
Judges:	**GREENWOOD ACJ, MCKERRACHER AND THAWLEY JJ**
Date of judgment:	27 September 2018
Catchwords:	**TAXATION** – appeal from a decision of the Administrative Appeals Tribunal – were taxpayer incurred expenditure to acquire gaming machine entitlements under *Gambling Regulation Act 2003* (Vic) – whether Tribunal erred in finding that expenditure was on revenue account and deductible under s 8-1 of the *Income Tax Assessment Act 1997* (Cth) – whether expenditure was "outgoing of capital, or of a capital nature" – whether expenditure was incurred to provide a necessary component of the profit-making structure of the taxpayer's business **TAXATION** – whether expenditure on gaming machine entitlements was "capital expenditure" deductible over 5 years in accordance with s 40-880(2) of the *Income Tax Assessment Act 1997* (Cth) – whether expenditure was "incurred to preserve (but not enhance) the value of goodwill" within the meaning of s 40-880(6)
Legislation:	*Gambling Regulation Act 2003* (Vic) Ch 3, Divs 5, 8, 9, 10; ss 3.4.1(1)(ab), 3.4.2(d), 3.4A.1(1)(a), 3.4A.2(1), 3.4A.7(1), 3.4A.8(2), 3.4A.16(1), 3.4A.27, 3.6.6, 3.6.6(2)(b), 3.6.6A, 3.6.6A(7) *Gambling Regulation Amendment (Licensing) Act 2009* (Vic) *Income Tax Assessment Act 1997* (Cth) ss 8-1, 40-880, 40-880(2), 40-880(5), 40-880(5)(f), 40-880(6); Part 3-1, ss 100-25, 108-5, 108-5(2)(b), 100-25, 110-25(5), 110-25(5A) *Tax Laws Amendment (2006 Measures No 1) Act 2006* (Cth) Explanatory Memorandum, Tax Laws Amendment (2006 Measures No 1) Bill 2006 (Cth)

Cases cited:

Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue (2009) 239 CLR 27

Ausnet Transmission Group Pty Ltd v Commissioner of Taxation (2015) 255 CLR 439

BP Australia Ltd v Federal Commissioner of Taxation (1965) 112 CLR 386

Certain Lloyd's Underwriters v Cross (2012) 248 CLR 378

Cliffs International Inc v Federal Commissioner of Taxation (1979) 142 CLR 140

Colonial Mutual Life Assurance Society Ltd v Federal Commissioner of Taxation (1953) 89 CLR 428

Commissioner for Railways (NSW) v Agalianos (1955) 92 CLR 390

Commissioner of Taxation v Citylink Melbourne Limited (2006) 228 CLR 1

Commissioner of Taxation v Montgomery (1999) 198 CLR 639

Commissioner of Taxation v Roberts & Smith (1992) 37 FCR 246

Federal Commissioner of Taxation v Consolidated Media Holdings Ltd (2012) 250 CLR 503

Federal Commissioner of Taxation v Cooper (1991) 29 FCR 177

Federal Commissioner of Taxation v Murry (1998) 193 CLR 605

Federal Commissioner of Taxation v Pine Creek Goldfields (1999) 91 FCR 263

Federal Commissioner of Taxation v South Australian Battery Makers Pty Ltd (1978) 140 CLR 645

Federal Commissioner of Taxation v Unit Trend Services Pty Ltd (2013) 250 CLR 523

GP International Pipecoaters Pty Ltd v Commissioner of Taxation (1990) 170 CLR 124

Hallstroms Pty Ltd v Federal Commissioner of Taxation (1946) 72 CLR 634

Henriksen v Grafton Hotel Ltd [1942] 2 K.B. 184

Herring v Federal Commissioner of Taxation (1946) 72 CLR 543

ICM Agriculture Pty Ltd v Commonwealth (2009) 240 CLR 140

Jeffrey v Rolls-Royce (1962) 40 TC 443

Lacey v Attorney-General (Qld) (2011) 242 CLR 573

Life Insurance Co of Australia Ltd v Phillips (1925) 36 CLR 60

Minister for Immigration and Border Protection v SZVFW

(2018) 92 ALJR 713

Momcilovic v The Queen (2011) 245 CLR 1

Ounsworth v Vickers Ltd (1915) 3 K.B.

Pascoe v Federal Commissioner of Taxation (1956) 30 ALJR 402

Project Blue Sky Inc v Australian Broadcasting Authority (1998) 194 CLR 355

Sun Newspapers v Federal Commissioner of Taxation (1938) 61 CLR 337

SZTAL v Minister for Immigration and Border Protection (2017) 91 ALJR 936

The Commissioner of Taxes (South Australia) v Executor Trustee and Agency Co of South Australia Ltd (1938) 63 CLR 108

Thiess v Collector of Customs (2014) 250 CLR 664

Tyco Australia Pty Ltd v Federal Commissioner of Taxation (2007) 67 ATR 63

Visy Packaging Holdings Pty Ltd v Federal Commissioner of Taxation (2012) 91 ATR 810

Western Gold Mines NL v Commissioner of Taxation (W.A.) (1938) 59 CLR 729

Date of hearing:	11 May 2018
Registry:	Victoria
Division:	General Division
National Practice Area:	Taxation
Category:	Catchwords
Number of paragraphs:	344
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Solicitor for the Applicant:	ATO Review and Dispute Resolution
Counsel for the Respondent:	Mr T P Murphy QC and Mr D J McInerney
Solicitor for the Respondent:	Rigby Cooke Lawyers

ORDERS

VID 22 of 2018

BETWEEN:	**COMMISSIONER OF TAXATION OF THE COMMONWEALTH OF AUSTRALIA** Applicant
AND:	**SHARPCAN PTY LTD** Respondent
JUDGES:	**GREENWOOD ACJ, MCKERRACHER AND THAWLEY JJ**
DATE OF ORDER:	**27 SEPTEMBER 2018**

THE COURT ORDERS THAT:

1. The appeal is dismissed.

2. The appellant pay the costs of the respondent of and incidental to the appeal.

Note: Entry of orders is dealt with in Rule 39.32 of the *Federal Court Rules 2011*.

REASONS FOR JUDGMENT

GREENWOOD ACJ:

Background

1 In the immediately relevant financial years ending 30 June 2010 and 30 June 2012, Spazor Pty Ltd ("Spazor") was the Trustee for the Daylesford Royal Hotel Trust ("the Trust"). Spazor, as Trustee for the Trust, acquired the business undertaking of the Royal Hotel located in the main street of Daylesford in the Hepburn Shire of Victoria, on 8 August 2005 for $1,025,000.00. The Trustee conducted that business until it sold the business on 9 November 2015. The activities undertaken by Spazor relevant to the appeal and described in these reasons were undertaken at all times on behalf of the Trust.

2 The respondent, Sharpcan Pty Ltd ("Sharpcan") is the beneficiary of the Trust. Sharpcan was, in the financial year ending 30 June 2012, presently entitled to 100% of the income of the trust estate.

3 At the date of acquisition by the Trustee, the business undertaking of the Royal Hotel involved deriving revenue from a number of integrated activities including: providing accommodation in its 11 guest rooms; sales of food and drink at its restaurant, café and public bar; gaming on 18 electronic gaming machines onsite; and wagering (on racing and keno).

4 As to the *gaming activities*, it will be necessary to explain the legislative and structural arrangements under which those activities were undertaken onsite as those matters bear on the questions in issue in the appeal. However, for present purposes, it is sufficient to note that from 2005 until 15 August 2012, the Trustee engaged in gaming activities onsite, consistent with the *Gaming Regulation Act 2003* (Vic) (the "Act"), on the footing that Spazor had been granted a "venue operator's licence" (s 3.4.8; s 3.4.12(1) of the Act) as the operator of the *venue* on which gaming occurred on 18 machines, and Tattersalls Gaming Pty Ltd ("Tattersalls") had been granted a "gaming operator's licence" (s 3.4.29; s 3.4.31; s 3.4.32 of the Act) enabling it to *conduct gaming* at the Royal Hotel by and through those 18 machines at the venue, taken together with a venue operator's agreement made between Tattersalls and the Trustee for that purpose which commenced on 8 August 2005 for a period of six years. That agreement was extended on 15 April 2009 to 15 August 2012.

5 Section 3.4.1 of the Act conferred authority on Spazor, relevantly, to "possess [approved] gaming equipment" (s 3.4.1(b)) and to "manage and operate an approved venue" (s 3.4.1(c)). Section 3.4.2 of the Act conferred authority on Tattersalls to "obtain ... approved gaming machines"; to "supply approved gaming machines"; and to "conduct gaming at an approved venue", among other things: s 3.4.2(a), (c) and (d).

6 Under these arrangements, Tattersalls was the gaming operator from 8 August 2005 until the expiration of its gaming operator's licence on 15 August 2012, of 18 gaming machines which it owned and operated at the Royal Hotel as an approved venue. The venue was operated by the Trustee as an approved venue operator, under the Act. Revenue derived from conducting gaming was derived by Tattersalls as the gaming operator. The Trustee, however, derived income in respect of gaming conducted on the site of the Royal Hotel (by Tattersalls) in the form of a percentage of the *net* revenue from gaming, that is, the gross receipts less returns (payouts) to those persons playing the 18 machines. This was, in effect, the method of quantifying the fee payable by Tattersalls to the Trustee.

7 Mr David Canny, a director of Spazor and Sharpcan and an experienced hotel operator responsible for the operation of the Royal Hotel, gave uncontested evidence that the machines were designed to return 90% of the "amounts played", to players. The machines, by the 2010 financial year, turned over $44,000.00 *per day*, that is, patrons/customers attracted to the Royal Hotel by one or more or all of its activities described at [3] of these reasons, paid into the 18 gaming machines $44,000.00 each and every day.

8 Mr Canny gave evidence that daily gaming revenue after payouts to players, was $4,400.00 (10%) each and every day, on average. The evidence is that, of that sum, Tattersalls paid the Trustee 24.7% or $1,086.80. This is the quantification of the amount the Tribunal described as "commissions" paid by Tattersalls to the Trustee: Tribunal Decision ("TD"), para 6. On these figures, the State of Victoria in the form of the *Victorian Commission for Gambling Regulation* (the "VCGR") received (in effect, as a tax on gambling) 33.3% or $1,465.20 of that sum. Tattersalls also received 33.3%, and 8.3% or $365.20 was paid to a fund called the "Community Support Fund" (the "Fund"): Canny Witness Statement, 28 April 2017, paras 34 and 66; Canny Witness Statement, 13 September 2017, paras 1 and 2.

9 As to the pre-16 August 2012 statutory arrangements, s 3.6.6 of the Act addresses the topic of "Taxation".

10 Section 3.6.6(1) provides that a gaming operator (Tattersalls) must ensure that amounts are paid in accordance with subsection (2), in respect of the periods determined by the Commission. Section 3.6.6(2)(b)(ii) provides for payment of 25% of the "total daily net cash balances of gaming machines of the gaming operator" at the Royal Hotel, during the relevant period, to the Trustee as venue operator (in the event that GST not be payable on a relevant supply, or 27.5% if GST is payable on the relevant supply). Section 3.6.6(2)(c) provides for payment of 8.33% of those daily net cash balances to the VCGR (and thus to the Fund) and s 3.6.6(2)(d) provides for payment to the VCGR of 24.24% of those total daily net cash balances to the VCGR. However, during the relevant period, the percentage to be paid to the VCGR was, it seems, 33.33%. Mr Paul Foley is a consulting accountant who was responsible for supervising the input of data into the accounting system used by the Trustee (in the operation of the Royal Hotel business). He says in his Witness Statement that for the financial years 2006 to 2012 net gaming revenue was distributed as follows: 33% to Tattersalls; 33% to the VCGR; 8.33% to the Fund; and the balance (which on these figures is 25.67%) to the Trustee. No doubt, these figures are rounded up.

11 These daily amounts as described in [8] of these reasons, projected over 365 days of the 2010 financial year (assuming trading every day of the year), suggests that gaming revenue or so-called "commissions" paid to the Trustee as its gross income from gaming activities conducted on the site of the hotel amounted to $396,682.00.

12 However, the Commissioner took the Full Court to a document described as "Key Financial Statistic Summary" for the Royal Hotel being Attachment "PF1-1" to the Witness Statement of Mr Foley. That document shows a range of statistics. The annual total of the net daily balances available for distribution for the years 2006 to 2012 were as follows:

	2006	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Annual total of the net daily balances available for distribution	$1,261,031	$1,490,772	$1,612,331	$1,513,211	$1,527,781	$1,451,431	$1,273,854

13 The following statistics drawn from the Key Financial Statistic Summary show the gross income in each financial year for each segment of the hotel business (which, in the case of gaming, is the Trustee's percentage of net daily balances received as commissions).

Business Segment	2006	2007	2008	2009	2010	2011	2012
Accommodation	$118,885	$134,034	$113,935	$110,472	$143,386	$181,643	$188,565
Bar	$420,555	$616,039	$624,340	$618,720	$657,207	$644,821	$650,942
Food	$598,537	$693,386	$683,511	$670,033	$725,428	$706,581	$770,608
Gaming "commissions" paid to the Trustee @ 25.01% of net daily balances	$315,384	$372,842	$403,244	$378,454	$381,973	$363,003	$318,591
Wagering	$48,582	$59,478	$60,900	$65,620	$67,550	$67,047	$67,606
Total	$1,501,943	$1,875,321	$1,885,930	$1,843,299	$1,975,544	$1,963,095	$1,996,312

14 The following table sets out the total gross revenue from the hotel undertaking from all sources, the gaming revenue derived by the Trustee and the percentage that gaming revenue represents as a proportion of total gross revenue:

Year	Gross Revenue	Gaming Revenue	%
2006	$1,501,943	$315,384	20.9984%
2007	$1,875,321	$372,842	19.8815%
2008	$1,885,930	$403,244	21.3817%
2009	$1,843,299	$378,454	20.5313%
2010	$1,975,544	$381,973	19.3351%
2011	$1,963,095	$363,003	18.4914%
2012	$1,996,312	$318,591	15.9589%

15 Since the total annual net daily distributable balances were those set out in the schedule at [12] (which represent 10% of the money paid into the 18 machines), the total annual money paid *into* the 18 gaming machines in each year and the *daily* total payments into those machines was as follows:

Amounts	2006	2007	2008	2009	2010	2011	2012
Total amounts paid into the 18 gaming machines each year	$12,610,310	$14,907,720	$16,123,310	$15,132,110	$15,272,810	$14,514,310	$12,738,540
Daily payments assuming 365 days of trading	$34,548.79	$40,843.06	$44,173.45	$41,457.83	$41,843.31	$39,765.23	$34,900.10

16 The total amounts paid into the 18 gaming machines each year for the financial years ending 2013, 2014 and 2015 were, $10,537,610, $9,974,880 and $11,423,190 resulting in daily payments into those 18 machines (assuming a 365 day year) of $28,870.16, $27,328.43 and $31,296.41, respectively. The statistics at [12] and [15] of these reasons give an indication of the extent of the financial outcomes derived from the custom of patrons of the Royal Hotel in

each segment of the business and overall for the financial years 2006 to 2012, being the financial years before the new regime commenced on 16 August 2012.

17 Although it will be necessary to turn to the evidence in some detail, it is sufficient to note for present purposes that Mr Canny gave evidence, which is not challenged, that the income derived by the Trustee from gaming in the form of payments made to it by Tattersalls was an essential component of the income of the business of the Royal Hotel.

18 All of these pre-16 August 2012 structural arrangements changed, however, by reason of amendments made to the Act in 2009 by the *Gambling Regulation Amendment (Licensing) Act 2009* (Vic) (the "2009 Amending Act"), the relevant provisions of which commenced on 16 August 2012 upon the expiration of the Tattersalls licence.

19 The "main purpose" of the 2009 Amending Act is recited in s 1 of that Act as including amendments to "substantially restructure the gaming industry" by providing for the creation and allocation of "gaming machine entitlements under which gaming by means of gaming machines will be authorised" and by "providing for a new licence for the monitoring of the conduct of gaming" and by "imposing certain ownership and related person restrictions in relation to licensees and persons registered on the relevant Roll". As a result of these amendments, gaming on the 18 machines onsite became gaming *conducted* by the Trustee rather than Tattersalls. In order to conduct gaming in respect of those 18 machines on the site of the Royal Hotel, the Trustee had to acquire a gaming machine entitlement (a "GME") in respect of each machine. In the absence of such an entitlement, the Trustee could not conduct gaming and, as a result, could not generate income from gaming as part of the business of the Royal Hotel. In the period after 16 August 2012, the obligations of the Trustee, put simply, were these.

20 *First*, the Trustee had to ensure that the 18 machines on the premises were "approved machines" (an approval for the existing 18 machines). As to that, the Trustee entered into an agreement with PVS Australia Pty Ltd ("PVS") which held a licence to provide approved machines and granted the necessary approval for those existing 18 gaming machines.

21 *Second*, the Trustee had to ensure that gaming operations on the site of the Royal Hotel were "monitored" and it engaged a company holding a monitoring licence under the Act (as amended) to provide those services for which it paid a fee.

22 *Third*, it became liable to the State of Victoria for ongoing taxes from income it generated from conducting gaming and the new provision addressing that obligation became s 3.6.6A of the Act, as amended.

23 It will be necessary to briefly examine the new statutory structure later in these reasons.

The auction process

24 The mechanism by which the State of Victoria proposed to allocate GMEs to hotels and clubs was by means of an auction process. The process was as follows.

25 The Minister, under the provisions of the Act, as amended, established a maximum of 27,500 GMEs available for allocation in the auction process. There were to be a maximum of 13,750 hotel GMEs State-wide and a maximum of 13,750 club GMEs State-wide. Bidders would compete with each other to receive an allocation of entitlements on the basis of the price they offered for those entitlements by placing orders (unconditional offers) in the auction system. Bidders would compete not only for entitlements in their own geographic area (for example, the Hepburn area) but with other bidders throughout the State. Being the only bidder in a geographic area would not mean that that bidder would be allocated any of the available GMEs in that area. For the purpose of the auction there would be 176 geographic markets made up of 88 hotel markets and 88 club markets. One of those geographic regions was the Hepburn Shire with an allocation of GMEs capped at 112 (although allocations never reached the level of the cap). The auction would be conducted over two rounds. In round one, orders would be submitted through a secure internet site over a period of 10 business days in April/May 2010. In round two, orders would be submitted using State supplied computers at a nominated venue on a single day in May 2010 to complete the auction process, which turned out to be 10 May 2010. A bidder that failed to submit an order in a particular market in round one would not be able to participate in the round two auction. Round one would provide qualified bidder representatives with an opportunity to place and revise their initial orders over a 10 day period. Prior to the start of round two, bidders would be provided with the market prices and details of their own "provisional" winning allocations from round one.

26 All of these matters are contained in a document called "Gaming Auction document 2". The document was available to all potential bidders in the auction. The document tells potential bidders that the sole criteria for determining successful orders in the auction is the price offered "relative to competition, within the constraints of the caps and limits, across the State". The auction system would not take into account "any other factors".

27 The price in each market might differ due to variations in the demand for GMEs across the State and the value placed on GMEs by bidders in each market. The auction system would calculate which orders were successful and the price in each market. Every bidder which had placed an order above or equal to the calculated market price at the end of the auction (round two) would be "eligible" to receive an allocation of entitlements (subject to the completion of the relevant agreements). All bidders in the same market would pay the same price (the market price) for their entitlements. The price offered for GMEs would not necessarily be the price to be paid for those entitlements. However, a bidder would never pay more than their maximum order price.

28 In presenting initial orders, bidders were required to offer a price per GME which was greater than or equal to the "opening bid price". The auction system would not allow an order to be submitted where the price offered was below the opening bid price. An opening bid price had been set for club entitlements and hotel entitlements. For hotel entitlements, the opening bid price was $11,000.00.

29 Although it will be necessary to explain the factors that informed the thinking of Mr Canny (as the guiding mind of the Trustee) and Mrs Canny (as the nominated bidder), as they entered into the auction process and particularly the formulation of the maximum price they could afford to bid in such an auction for each GME having regard to the profitability of the business of the Royal Hotel, it is sufficient for present purposes to note that Mrs Canny, on behalf of the Trustee, participated in the auction to try and secure 18 GMEs, that is, one GME for each of the 18 machines that had been historically located on the site of the Royal Hotel and had, historically, been productive of the gaming income derived by the Trustee in the form of commissions paid by Tattersalls in connection with gaming onsite, as part of the hotel business. Mr Canny was unable to act as the bidder for the Royal Hotel on the day as he was a participant in a bid process for another hotel in which he had an interest, the Red Lion, at Ballarat. Mr Canny says that he knew that the "value [of the Royal Hotel] would fall if it did not have gaming machines – not just through the loss of gaming revenues but also due to a flow on throughout the business": Witness Statement of Mr Canny, 28 April 2017, para 82.

30 In the final round auction conducted on 10 May 2010, the Trustee was successful in its bid for 18 GMEs. The total cost of the 18 GMEs was $600,300.00 including a $10,000.00 non-refundable bond, or $33,350.00 per GME. Mr Canny, for the Trustee, took up the option

of paying the acquisition price by quarterly payments under a deferred payment arrangement over six years commencing in May 2010. In May 2010, the Trustee paid an amount of $60,030.00. From 16 August 2012, to 31 August 2016, further amounts of $30,015.00 were paid quarterly in discharge of the total debt of $600,300.00 for the 18 GMEs.

The pending imperative

31 The Trustee found itself in a position where, on 9 May 2010, the day before the auction, it was (and would be until 15 August 2012), conducting the business of a hotel deriving "commissions" income from gaming activities onsite and deriving income from all of the other activities conducted at the hotel, made in part at least, more robust by reason of the presence of gaming machines onsite. As the evidence shows, patrons or customers of the Royal Hotel were contributing *gross* gaming revenue of a very significant amount each and every day at the hotel and thus significant daily net cash distributable balances arose. The daily net cash distributable balances were 10% of the amounts set out in Item 2 in the table at [15] of these reasons for each year having regard to the evidence of Mr Foley to which the Full Court was taken: 90% of those balances were returned to patrons. As a result of the auction on 10 May 2010, the Trustee now found itself in a position where it was required to pay $600,300.00 for the 18 new "GMEs" which would enable it to "operate", now as the gaming operator, from 16 August 2012, the same 18 machines on the same site albeit for a 10 year period commencing on 16 August 2012 under the new regime. I will return to the specific statutory features of the new regime later in these reasons.

32 Importantly, Mr Canny (and no doubt with Mrs Canny) for the Trustee was confronting, immediately before the auction, a present factual position and a counterfactual possibility. The immediate *factual* position was that the Trustee was conducting the business of the Royal Hotel which secured to it income from gaming activities (through commissions paid by Tattersalls). The forward-looking *counterfactual* possibility was one where the Trustee, should it not be successful in *winning* the auction process with its bids, would have to confront conducting the business of the Royal Hotel *without* any GMEs and thus without any right to conduct gaming through the 18 gaming machines onsite and thus without any gaming revenue *at all*. This, no doubt, as the Commissioner accepts (see [233] to [236] of these reasons) represented a major threat to the revenues and profitability of the hotel and to the value of the goodwill based on the attractive force of gaming for the hotel's custom. That custom would be significantly less in the counterfactual scenario without gaming onsite.

33 Although the evidence does not go this far, it seems to me fair and reasonable to assume as a matter of rationality and practicality in the real world of commercial daily life in Victoria that every club and hotel throughout Victoria which had, prior to 10 May 2010, enjoyed revenue from gaming activities onsite (whatever the legal structure may have been which enabled that activity to occur according to law), and which was unable to obtain GMEs in the auction process on 10 May 2010, would each have been in a position where their custom would have fallen, their revenues and profitability would have fallen, the attractive force for custom would have been less and the value of the goodwill of the enterprise in question would also have fallen.

34 The evidence demonstrates, as described later in these reasons, that the possibility of a failure to secure 18 GMEs for the Royal Hotel's business undertaking was thought to be, by Mr Canny, a strategic threat to the custom and profitability of that undertaking.

The claimed deductions

35 Sharpcan says that the Trustee of the Trust was entitled to a deduction for the amounts paid in acquiring the GMEs in calculating the net income of the Trust estate for the year ending 30 June 2010. It says that on 10 May 2010, the Trustee incurred a liability to make payments totalling $600,300.00 over a six year period from 1 May 2010.

36 For the purposes of s 8-1 of the *Income Tax Assessment Act 1997* (Cth) (the "1997 Act"), there is and has been no dispute between the parties that the outgoing was incurred in gaining or producing assessable income or was necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income. The Commissioner says, however, that the outgoing was of a capital nature and thus its deductibility is precluded by s 8-1(2)(a) of the 1997 Act. The respondent says that the outgoing was a liability properly characterised as a liability on revenue account and therefore deductible.

37 The first question therefore is whether the liability was of a capital nature or on revenue account having regard to all of the relevant considerations in relation to the outgoing.

38 The second question is whether the outgoing of $600,300.00, if it be a capital item, is deductible over five years commencing in the 2010 income year under s 40-880 of the 1997 Act.

39 The Commissioner, before the Tribunal, accepted that if the gaming machine expenditure was deductible either in full under s 8-1 when incurred or deductible over five years under

s 40-880, the net income of the Trust for the 2012 income year would be nil and thus the assessable income for the 2012 income year would be reduced by the whole of the amount of $139,901.00 assessed to Sharpcan by the Commissioner in that income year.

40 Section 40-880(1) provides that the object of the section is to make certain business capital expenditure deductible over five years if the expenditure is not otherwise taken into account and a deduction is not denied by some other provision of the tax law and the relevant "business" is carried on for a taxable purpose. Section 40-880(2)(a) provides for the deduction, relevantly, in these terms: "You can deduct, in equal proportions over a period of 5 income years starting in the year in which you incur it, capital expenditure you incur in relation to your *business". However, s 40-880(5) provides, among other things, that a person cannot deduct *anything* under the section for an amount of expenditure incurred to the extent that "it could, apart from [s 40-880], be taken into account in working out the amount of a *capital gain or a *capital loss from a *CGT event": s 40-880(5)(f).

41 Section 40-880(6), however, limits the application of the exception contained in s 40-880(5)(f) by providing that the exception does not:

> ... apply to expenditure you incur to preserve (but not enhance) the value of goodwill if the expenditure you incur is in relation to a legal or equitable right and the value to you of the right is solely attributable to the effect that the right has on goodwill.

42 So, the second question is whether the prohibition contained in s 40-880(5)(f) upon the availability of the deduction, otherwise available under s 40-880(2) over the period of the relevant five income years, is rendered *inapplicable* to the capital expenditure (if it be in the nature of capital) incurred by the Trustee in acquiring the 18 GMEs for $600,300.00. That turns on whether the expenditure is incurred by the Trustee "to preserve (but not enhance) the value of goodwill" (as those words might be construed) and whether the expenditure is in relation to a *legal* or *equitable right*, and the *value* to the Trustee of the *right* is *solely attributable* to the *effect* that the *right has* on *goodwill*.

43 The parties agreed before the Tribunal and agreed before the Full Court that, *subject* to the operation of s 40-880(6) in the context of the "facts overall" (T, p 7, lns 36-40), s 40-880(5)(f) applies to deny the availability of a deduction under s 40-880(2)(a). In other words, the parties accept that each GME is a CGT asset (s 995-1; s 108-5 of the 1997 Act) and not an exempt asset.

The relevant facts

44 It is now necessary to consider aspects of the findings of the Tribunal and other aspects of the documents and other evidence before the Tribunal to which the Full Court was taken by each of the parties. As to the evidence to which we were taken, it should be noted that there was no challenge by the Commissioner to the evidence of Mr Canny: T, p 7, lns 36-40; T, p 9, lns 31-32; T, p 12, lns 37-43; T, p 15, lns 31-33. The Commissioner relies upon the facts set out in paras 2, 6, 7, 8 and most of paras 9 and 10 of the Tribunal's Decision. I will identify those matters in the course of setting out some aspects of the "facts overall", having regard to the observations at [89] to [93] of these reasons.

45 As already mentioned, Mr Canny is the sole shareholder and director of Sharpcan. He is the sole shareholder and director of Spazor. He has worked in the hotel industry since the 1980s and is an experienced hotel venue operator. In 2004, Mr Canny, together with Mr Wayne Sharp, began investigating the possibility of purchasing the business undertaking of the Royal Hotel. Having regard to his experience in the hotel industry, Mr Canny took the view that the appropriate price to pay to acquire the business of the Royal Hotel was a multiple of four times its net profits adjusted for particular items such as drawings by directors. Mr Canny considered that a multiple of four times net profit was appropriate given that the Royal Hotel had gaming machines, even though those machines did not produce the majority of the Hotel's revenue. The presence of gaming machines at the venue justified a higher multiple than a non-gaming hotel as it meant that the Royal would, in the view of Mr Canny, "generate a steady cash flow and a stable profit margin that could be used to improve other areas of the Royal's operations, such as its food and beverage and accommodation services". Mr Canny understood, from his experience in the hotel industry, that hotels without gaming revenue tended to be sold for around three times their net profit whereas hotels that were "more heavily reliant on gaming machines were commonly sold for six or seven times net profit".

46 Ultimately, Mr Canny agreed with the vendor a sale price of $1,025,000.00 which was approximately four times the net profits of the hotel from all its activities.

47 A goodwill component of the purchase price was calculated by deducting from the total purchase price the value of the chattels transferred including the "liquor licence".

48 The purchase did not involve a purchase of the freehold to the property. The purchase was subject to the mortgagee consenting to the landlord granting Spazor, as and from the

settlement date, a lease over the premises. Spazor's assumption of the lease was important. It had 27 years of its term left to run including extensions. Mr Canny says he would not have acquired a business with a lease for less than 25 years because it would not have provided a sufficient term to recoup investment in the business. Ideally, he says, the term needed to be 25 to 30 years.

49 As part of the purchase, Spazor had to secure a wide-range of approvals relating to the accommodation, the sale of food, the sale of liquor and compliance with other health regulations. It is not necessary to detail all those matters here. Spazor also had to obtain a venue operator's licence from the VCGR, a venue operator's agreement with Tattersalls and premises approval from the VCGR as already mentioned. These were obtained. With effect from 8 August 2008, the Trustee entered into the venue operator's agreement with Tattersalls under which the Trustee was required to conduct gambling activities in accordance with the Act and the conditions of the agreement with Tattersalls. Tattersalls was required to install and maintain the 18 gaming machines onsite and maintain a master computer terminal for processing returns. The Tattersalls gaming machines were already located onsite along with the master computer terminal and monitoring equipment. All gaming revenue, net of payouts to players, was paid into a special purpose bank account with payments made from that bank account in accordance with the distributions described at [8] of these reasons.

50 Mr Canny says that when the Trustee acquired the Royal Hotel, Mr Canny was "acutely aware" that the hotel was located in a small town heavily reliant on tourism, weekend and holiday trade. Mr Canny's intention was to achieve revenue growth by developing the business of the Royal Hotel in a way that attracted more tourists and maximised the amount tourists would spend at the venue during peak tourism times. He says that the peak periods and holidays were the times when the Royal Hotel achieved a significant amount of its trade. He says that this helped to subsidize its ability to provide a local facility to residents of Daylesford and surrounds all year offering reasonable prices. He says that a "key component" of the Royal Hotel's offering to tourists and, more generally, visitors to the Daylesford area, included gaming machines which provided an entertainment option to supplement the other activities on offer at the hotel. He says that, in his view, for the Royal Hotel to be sustainable it needed to maximise its trade during peak tourist periods and, for this reason, the Trustee invested extensively in improving its accommodation offering, general fit-out of the hotel and the fit-out of the kitchens. Mr Canny agreed with the landlord that the Trustee would make extensive improvements to the premises and the lease would be

extended for a further term of eight years. The first major renovation consisted of moving the public and gaming areas to maximise the use of those areas. The Trustee obtained approval from the VCGR to relocate aspects of the equipment used in relation to gaming. The improvements enhanced use of the public bar by patrons of the gaming area. As part of the renovation, the Trustee relocated the "Pub Tab" facility into the old gaming room so as to maximise the social aspect of wagering and also improve bar sales.

51 New kitchen facilities were installed in 2007 by the Trustee enabling the hotel to serve 1,000 meals per week especially during peak tourist periods and weekends.

52 Various promotional activities took place to attract guests to the Royal Hotel including mail-outs and notices about live entertainment and information directed to those who were specifically interested in receiving information about gaming.

53 Other renovations took place to enhance the attractive force of the Royal Hotel in all of its various services. It is not necessary to describe those events aimed at enhancing the integrated services of the Royal Hotel to its patrons, customers and generally within the catchment of the Daylesford area.

54 As to the gaming activities, gaming machines allow patrons to deposit notes or coins into the machine in order to play. The machines are designed to return to patrons a minimum of 90% of the amounts played. The margin retained (10%) is generally described as the "total gaming revenue". Each gaming machine was connected to a telephone line to Tattersalls which monitored each gaming machine and enabled communication to the gaming terminal located at the cashier. Generally, gaming machine payouts of $100.00 or more would not be paid in cash from the machine but would be paid by a staff member at the cashier on production of a ticket produced by the machine. Each day the Royal Hotel was required to reconcile the gaming room cash float, tickets, each gaming machine "hopper" and each gaming machine "drop box", with the Tattersalls reports. On a regular basis, employees of the Royal Hotel would collect the money inserted into each gaming machine and deposit that money in a special purpose bank account. The "Gaming Trust Account" was the account from which Tattersalls each week took its "sweep" so as to obtain its share of the gaming revenue. Tattersalls calculated its share of the gaming revenue by reference to amounts which were recorded as having passed through the gaming machines as transmitted to Tattersalls through the terminal. Both Tattersalls and the VCGR arranged regular visits to the Royal Hotel to monitor compliance with the gaming regulations.

55 In terms of the physical practices after the commencement of the new regime on 16 August 2012, Mr Canny says that the Royal Hotel continued the same practice of banking the receipts from each gaming machine into the account. The gaming revenues from each gaming machine continued to be monitored across telephone lines as before except that the monitoring service was undertaken by Intralot Gaming Services Pty Ltd ("IGS") rather than Tattersalls.

56 Mr Canny says that on 10 April 2008, the Premier of Victoria, Mr Brumby, announced the commencement from 16 August 2012 of a new regulatory and licensing regime under which there would be a transition from Tattersalls as the gaming operator to a "venue operator system". Mr Canny understood that the venue operator would now be directly responsible for the conduct of gaming operations in its venue. That responsibility included acquiring and operating gaming machines and paying a monitoring service fee; the payment of a supervision charge; and the payment of gaming taxes. Mr Canny understood that IGS had been appointed as the monitoring licensee for a 15 year term and monitoring services fees would be paid directly to it. In September 2009, Mr Canny received an information pack from the Victorian government explaining aspects of the new regime.

The factors informing Mr Canny's approach to the auction process

57 Mr Canny understood that a key feature of the new venue operator system, would be the requirement to bid for and hold a GME for each gaming machine in order to continue "gaming activities" albeit within a different legal structure. Mr Canny says that he understood that each GME would have a 10 year term from 16 August 2012 to 15 August 2022. He understood that it would also be necessary for the ongoing operations of the business of the Royal Hotel to continue the existing approvals in terms of a premises approval from the VCGR, a venue operator's licence and the existing food and health approvals.

58 In April 2010, Mr Canny received a further information pack from the Victorian government entitled "Gaming Auction Event Booklet" which described the proposed auction process. In the lead-up to the auction, Mr Canny engaged Mr Richard Whitehouse, an analyst (PVS), to provide advice about the bidding strategy which might be adopted in the auction and the price that the Trustee should pay on behalf of the Trust for the acquisition of the 18 GMEs at the Royal and the price that ought to be paid for GMEs at the Red Lion in Ballarat by the hotel

operator in that case, Bacceney Pty Ltd. Mr Canny had an interest in that company and the operation of the Red Lion.

59 Mr Whitehouse provided a report to Mr Canny for the Red Lion which contained advice about the maximum price that a rational person would bid to acquire GMEs at the Red Lion. The advice set out the assumptions determining the price a rational person would pay. The rational price was understood by Mr Canny to be the maximum price that could be paid in order to acquire the GMEs and yet "broadly maintain" a reasonable rate of return on the assets deployed in the business of the Red Lion. Mr Canny says that based on the report for the Red Lion, he prepared a one page document as a "bidding guide" for the acquisition of the GMEs at the Royal Hotel. He provided the bidding guide to Mrs Canny as she was going to undertake the auction process for the Royal Hotel. Mr Canny would attend the bidding process for the Red Lion. Mr Canny says that there were "sufficient similarities" between the Red Lion and the Royal Hotel to make the Red Lion report a "reasonable basis for determining the most [that the Trustee] should pay for GMEs at the Royal". The degree of similarity is better explained by Mr Canny in his second affidavit. He says that he adapted Mr Whitehouse's report based on his own knowledge of the gaming machine returns achieved at each venue. He says that he calculated that the gaming machines at the Royal Hotel returned approximately 80% of the returns gaming machines achieved at the Red Lion. He says that Mr Whitehouse had calculated a rational bid price for the Red Lion of $81,515.00 per GME. He says that he applied the 80% figure to that amount in order to determine a rational bid price for the Royal Hotel and thus the rational maximum bid price for each GME by the Trustee would be $65,212.00. The total cost to the Trustee for 18 GMEs to enable the Trustee to operate the existing 18 gaming machines onsite would be $1,170,000.00.

60 The one page "bidding guide" prepared by Mr Canny for his wife projected the possibility that the Trustee might bid up to the full amount of $81,515.00 (rather than the 80% discounted amount) for each GME, for 18 GMEs at a total cost, on that basis, of $1,467,270.00. The bidding guide commences with an opening price of $11,100.00. Mr Canny understood that the minimum opening bid price for the auction would be $11,000.00. In the bidding guide, Mr Canny also records a price per GME of $85,000.00 to $100,000.00. However, in respect of these bids, the number of GMEs sought declines from 17 to 15. Mr Canny says that his assessment was that if the price of each GME exceeded $85,000.00, he (speaking for the Trustee) would be unable to finance the acquisition of all 18

GMEs. Mr Canny says that he set an amount of $1.5 million as the maximum amount the Trustee could spend on GMEs. To fall within that cap, the number of GMEs would need to fall to 15 at $100,000.00 per GME. Mr Canny also formed the view that if the price exceeded $100,000.00 for each GME, the burden of the fixed costs of having the machines on the premises (such as the dedicated space, the monitoring obligation and other infrastructure and related costs) meant that it would not be "worthwhile having less than 15 machines" and thus the Trustee should not continue bidding any further in the auction. Mr Canny's assessment was that increases in the price per GME beyond $100,000.00 would result in fewer GMEs being acquired which would fall below the critical mass of 15 GMEs, and thus less than 15 gaming machines onsite generating gaming revenue.

61 The evidence of Mr Canny, as the guiding mind of the Trustee, is that acting on professional advice from PVS, he calculated the maximum price the Trustee could afford to pay to acquire 18 GMEs and, if necessary, the maximum price to be paid for 15 GMEs (at a higher price per GME than that thought possible or desirable for each GME if 18 GMEs were to be acquired in the auction), while at the same time trying, from a trading perspective, to "broadly maintain" a reasonable rate of return on the assets deployed in the business of the Royal Hotel. The calculation of these maximum prices in this way by Mr Canny set out in the bidding document for the auction, makes plain the significance of the income from gaming to the total revenue of the business of the Royal Hotel and the imperative, leading into the auction process, to preserve gaming revenue for the business as a going concern. The bidding schedule, as delivered by Mr Canny to Mrs Canny for the auction, is set out below:

SPAZOR
Hotel – Hepburn

	No.	Price	Total Cost	Deposit
Opening Bid	18	$11,100	$199,800	$19,980
	18	$12,000	$216,000	$21,600
	18	$15,000	$270,000	$27,000
	18	$20,000	$360,000	$36,000
	18	$25,000	$450,000	$45,000
	18	$30,000	$540,000	$54,000
	18	$35,000	$630,000	$63,000
	18	$40,000	$720,000	$72,000
	18	$45,000	$810,000	$81,000
	18	$50,000	$900,000	$90,000
	18	$55,000	$990,000	$99,000
	18	$60,000	$1,080,000	$108,000
	18	$65,000	$1,170,000	$117,000

	No.	Price	Total Cost	Deposit
	18	$70,000	$1,260,000	$126,000
	18	$75,000	$1,350,000	$135,000
	18	$80,000	$1,440,000	$144,000
	18	$81,515	$1,467,270	$146,727
	17	$85,000	$1,445,000	$144,500
	16	$90,000	$1,440,000	$144,000
	15	$95,000	$1,425,000	$142,500
	15	$100,000	$1,500,000	$150,000

62 As events transpired in the course of the auction it proved not to be necessary to bid to the limit of the maximum postulated bids. The Trustee acquired the 18 GMEs at a price of $33,350.00 per GME or $600,300.00 in all.

Financial statistics in the period of the new regime according to Mr Foley's attachment

63 The Key Financial Statistic Summary attached to Mr Foley's Witness Statement also sets out financial information for the trading activity of the Royal Hotel for the financial years ending 2013, 2014 and 2015 in the new regime. The following schedule sets out the gross income received in those financial years in respect of each business segment for the hotel. In the case of gaming income, the following schedule shows the gross income received by the Trustee from gaming after payments made to the VCGR, PVS, IGS and payments in respect of the acquisition of the GMEs.

Business Segment	2013	2014	2015
Accommodation	$176,946	$196,425	$261,946
Bar	$638,167	$685,351	$793,765
Food	$730,555	$816,538	$876,182
Gaming: total annual net daily balances for distribution	$1,053,761	$997,448	$1,142,319
Gaming income derived by the Trustee	$423,504	$365,278	$395,346
Wagering	$70,840	$68,166	$67,971

64 Total gross income from all segments for each of these years was as follows: 2013 - $2,040,012; 2014 - $2,131,758; and 2015 - $2,395,210. Income from gaming represented the following percentages of total income: 2013 – 20.75%; 2014 – 17.13%; 2015 – 16.5%.

65 These statistics, like the statistics at [13] of these reasons represent gross income figures and do not take account of the profitability of each segment of the business. Mr Canny says that each segment of the business was enhanced by the presence of gaming machines and in the period of the new regime, enhanced by the presence of GMEs and thus of gaming machines.

In that sense, the business undertaking of the Royal Hotel was an integrated interdependent business operation.

66 The *net profit* contribution of each segment of the hotel business, and particularly the net profit contribution of the gaming part of the business undertaking for the financial years ending 2006 to 2012 are set out in the schedule below.

Net Profit Contribution by Business Segment	2006	2007	2008	2009	2010	2011	2012
Accommodation	$88,239	$94,330	$80,098	$75,032	$107,893	$140,527	$139,126
Bar	$194,795	$335,750	$340,265	$325,835	$333,486	$236,139	$240,931
Food	$42,954	$64,446	$38,787	$1,553	$12,059	$79,070	$126,573
Gaming	$258,106	$310,235	$342,933	$311,830	$288,226	$277,048	$231,809
Wagering	$3,941	$1,280	$10,931	$2,127	$48,284	$3,552	$5,280

67 The net contribution to net profit from *gaming* can be seen in the schedule for each financial year. The total net profit for each financial year *after* the distribution of all overhead expenses not directly referable to each business segment resulted in the following total net profit for each financial year.

	2006	2007	2008	2009	2010	2011	2012
Total Net Profit	$65,444	$175,164	$124,153	$73,217	$68,989	$154,949	$146,587

68 The *consequence* for total net profit of the business undertaking *overall* arising out of a loss of the net profit contribution from gaming, can readily be seen apart from any question of the extent to which the presence of gaming activities onsite enhanced the revenue and net profitability of the other segments of the business of the Royal Hotel.

69 The *net profit* contribution from gaming after taking into account payments directly related to the new regime in the years 2013, 2014 and 2015 was, $308,806, $250,431 and $274,315 respectively. The net profit overall from all activities in those three financial years after the distribution of overheads not directly referable to each segment of the business, was $11,479, $15,252 and $237,257 respectively. Again, the consequence for total net profit of the business undertaking overall arising out of a loss of the net profit contribution from gaming, can readily be seen apart from any question of the extent to which the presence of gaming activities onsite enhanced the revenue and net profitability of other segments of the business of the Royal Hotel.

70 The factual matters addressed by the Tribunal at paras 2, 6, 7, 8, 9 and 10 upon which the Commissioner relies have already been identified in these reasons. It is now necessary to identify the legal features of the new regime.

The new regime

71 The 2009 Amending Act brought about a "substantial restructure of the gaming industry". Section 3.4A.5 of the Act, as amended, conferred power on the Minister to "create gaming machine entitlements" and "allocate" them to "venue operators". Section 3.4A.5(4), subject to particular matters, requires the Minister to impose conditions on GMEs as to the type of venue in which gaming may be conducted and the geographic regions within which gaming may be conducted. Section 3.4A.1 provides that on and after the relevant day, the conduct of gaming in an approved venue is lawful only if the venue operator "holds a [GME] that authorises the conduct of gaming" and the relevant s 3.4A.5(4) conditions are satisfied.

72 By s 3.4A.2(1), a GME "authorises" the venue operator holding the GME, subject to the Act, related agreements required by the Act, and relevant conditions "to acquire approved gaming machines" and "to conduct gaming on one approved gaming machine in an approved venue operated by the venue operator". A venue operator's licence authorises the licensee to "acquire and transfer" GMEs in accordance with the new Part 4A (s 3.4.1(1)(aa), and s 3.4.1(1)(ab)), authorises the licensee, while holding GMEs, to conduct gaming on approved gaming machines in an approved venue operated by the licensee.

73 The Commissioner says that a GME created under the Act conferring the rights or authorities described in the Act renders a GME an intangible asset of the holder. Section 3.4A.6 provides that despite s 3.4A.5, the Minister may refuse to allocate a GME to a venue operator unless the operator enters into relevant agreements addressing "matters related to the [GME]". A GME remains in force for 10 years (s 3.4A.7) although it may be transferred earlier under the Act (s 3.4A.7(2)) or extended by the Minister (s 3.4A.7(2)) for not more than two years beyond its expiry date otherwise. The details of a venue operator holding a GME (among other information) is to be noted on a Register maintained by the VCGR.

74 A GME is capable of being transferred by a venue operator subject to the specified payment arrangements and "the [GME] transfer allocation and transfer rules" (the "Rules"): s 3.4A.17. However, a venue operator "must not transfer a [GME] to a person who is not a venue operator". An agreement, arrangement or deed that purports to effect a transfer of a GME to someone who is not a venue operator is either "void" or of "no effect":

s 3.4A.16(1)-(3). Thus, there is no general secondary market for GMEs. A GME *only* has use or value in the hands of a venue operator and cannot be held by someone who is not a venue operator, with all of the regulatory controls applicable to venue and venue operators.

75 The Commissioner contends that because a GME is able to be transferred under the Act and Rules, a GME has "extrinsic value" and is portable from one venue operator to another subject to the Act and Rules.

76 Under Part 4A, Div 6 of the Act, the venue operator (Trustee) must commence the conduct of gaming by means of an approved gaming machine under a GME within the statutory period: s 3.4A.23. If the venue operator does not do so, the GMEs held by the venue operator are forfeited to the State: s 3.4A.24. If a venue operator engages in conduct giving rise to forfeiture (on a relevant date) under the conditions of a "related agreement" for the purposes of s 3.4A.6, the GMEs will be forfeited to the State on that date: s 3.4A.27. On and after the day of forfeiture of the GMEs under any of Div 6, Div 7 or Div 8, any amount owed to the State for the allocation of GMEs becomes immediately due and payable: s 3.4A.32.

77 The Commissioner places emphasis upon these provisions about the capacity to transfer GMEs to another venue operator (the "extrinsic value" point) and the "exposure to forfeiture" provisions under Divs 6, 7 and 8, as demonstrating, it is said, aspects of the very different "nature" of the intangible asset in the form of a GME (and the rights attached to it) acquired by the Trustee, as compared with the legal source of the earnings derived and rights exercised, by the Trustee under the earlier pre-16 August 2012 "Tattersalls" regime. These considerations are said to be factors indicating that the obligations cast by the Act on the venue operator under the new regime in relation to GMEs are not simply related to deriving a *revenue stream* from gaming activities and thus the outgoing incurred on 10 May 2010 in acquiring the GMEs is said to be in the nature of capital and not on revenue account.

78 This distinction is said to be made more plain by those new provisions of the Act (s 3.6.6A) which provide for the payment of tax on the amount of "average revenue per GME" derived from gaming (on a machine corresponding to each GME) by a venue operator which conducts gaming in an approved venue for which there is a "Pub Licence" in place, that is, a hotel. The calculation of the tax is directly related to the revenue stream derived from the trading activity of gaming according to the integers of the formula. That section (s 3.6.6A) was not in the Act in the pre-2012 regime. It was not necessary because, in the pre-2012

period, a venue operator could not "conduct" gaming. That conduct and the payment obligation for tax fell to Tattersalls as the entity conducting gaming.

79 In seeking to properly characterise the *nature* of the outgoing incurred on 10 May 2010, the Commissioner says that the fundament of the error by the Tribunal is that it *conflated* the structural statutory and legal arrangements that subsisted in the pre-2012 period concerning the role of the Trustee as a venue operator and Tattersalls as the owner of the machines (and the entity "conducting" gaming), with the very different role of a venue operator *itself* conducting gaming (by acquiring and deploying the new GMEs, as a new statutory creature), to derive income. Because the outgoing of 10 May 2010 secured the acquisition of the GMEs, as a new statutory entitlement, which enabled gaming to be conducted so as to derive income, the outgoing is said to bear the character of capital. Without the GMEs, no business of gaming could be conducted on and from 16 August 2012. The Commissioner says that the outgoing is in the nature of capital because the GMEs exhibit the following characteristics said to be emblematic of capital.

80 *First*, the GMEs are intangible assets created pursuant to statute.

81 *Second*, they can be bought and sold.

82 *Third*, they confer a statutory authority necessary to lawfully conduct gaming on gaming machines.

83 *Fourth*, they last for 10 years.

84 *Fifth*, the outgoing was a sum set at auction and it was a lump sum even though an agreement was reached that it be paid by instalments.

85 *Sixth*, the amount was payable irrespective of the fortunes of the business.

86 *Seventh*, although it is true that gaming continued to be conducted at the premises occupied by the Trustee, the fundamental change in the arrangements involved the Trustee conducting gaming and becoming entitled to the whole of the income generated from the gaming activities and the entitlement would subsist for the entire period of 10 years.

87 *Eighth*, the Trustee became responsible for outgoings in relation to the conduct of gaming such as making payments to PVS for the supply and maintenance of the existing machines; paying a fee for ongoing monitoring of the gaming machines; and becoming responsible for paying the taxes imposed by the Act in respect of the conduct of gaming.

88 The Commissioner says that all of these things are features of the new regime which need to be taken into account in determining the true character of the outgoing of the acquisition cost of the GMEs on 10 May 2010 of $600,300.00.

Consideration of the issues

89 In these reasons, I have attempted to set out the particular facts and circumstances of the Trustee's activities in order to assess the proper context within which the question of whether the outgoing is in the nature of capital or on revenue account arises. In 1938, Dixon and Evatt JJ observed, in determining whether an item was a matter of capital or income, in *Western Gold Mines NL v Commissioner of Taxation (W.A.)* (1938) 59 CLR 729 at 740, that "it is necessary to make both a *wide survey* and an *exact scrutiny* of the taxpayer's activities" [emphasis added]. Their Honours also observed that they had become "only too familiar with the standard or criterion which the law provides for distinguishing between the two" and "it is a most unsatisfactory criterion, and a decision must often be made by reference to matters of degree and by reason of the weight given to particular circumstances affecting the activities of the taxpayer ...". The question in issue in that case, put simply, was not the character of an outgoing but rather the character of a receipt in the form of an unrealised "excess" and whether it gave rise to a profit or was capital in nature. Nevertheless, the observations remain relevant in determining the character of an outgoing.

90 In 1965, Lord Pearce, delivering judgment for the Privy Council in *BP Australia Ltd v Federal Commissioner of Taxation* (1965) 112 CLR 386 at 399 ("*BP Australia v FCT*"), in determining whether expenditure was recurrent, said this:

> Their Lordships agree with *Owen* J. in thinking that if regard was had to "the whole picture" the expenditure was recurrent. To find whether expenditure is of a recurrent nature one must take a *broad view of the general operation under which the expenditure was incurred.* Here it was made to meet a continuous demand in the trade. ...
>
> [emphasis added]

91 In 1979, Barwick CJ in *Cliffs International Inc v Federal Commissioner of Taxation* (1979) 142 CLR 140 at 148 ("*Cliffs International*") said, in relation to the question of whether the payments made in that case were capital payments, "[t]he proper conclusion in each case in this particular area of the law is *peculiarly dependent* upon the particular facts and circumstances of [the] case" [emphasis added].

92 Moreover, I am not assisted by observations that the outgoing in question in this case is either *like* or *unlike* payments made in an entirely different case. In this area of the law, there is little to be gained by defaulting to analogical references or analogical reasoning (*Commissioner of Taxation v Citylink Melbourne Limited* (2006) 228 CLR 1 at 43 [151], Crennan J; see also *Commissioner of Taxation v Montgomery* (1999) 198 CLR 639 at 661 [64], Gaudron, Gummow, Kirby and Hayne JJ), or the outcome of finely balanced evaluative judgments entirely dependent upon the calculus of factors determining that balance in other cases and other circumstances. The outgoing, in this case, either *is in* the nature of capital having regard to the calculus of factors relating to the taxpayer's activities, "exactly scrutinised", *or it is not*. That is not to say that the decision as to characterisation is either black or white; or binary/on or off. In some cases, it may be clear (there are "obvious cases" that "lie far from the boundary": *BP Australia v FCT* at 397) but such cases are unlikely to (or at least ought not to) find their way into the appellate structure of judicial decision-making.

93 Generally, an evaluative judgment must be made in the context of all of the circumstances of the taxpayer's activities taking account of the "whole picture" with an eye to understanding precisely what the outgoing is "calculated to effect from a practical and business point of view" (Dixon J, *Hallstroms Pty Ltd v Federal Commissioner of Taxation* (1946) 72 CLR 634 at 648 (*Hallstroms*") yet taking account of the legal nature of the obligation in question giving rise to the outgoing and the liability discharged by making the payment: *Ausnet Transmission Group Pty Ltd v Commissioner of Taxation* (2015) 255 CLR 439 at 474 [74] ("*Ausnet*"), Gageler J citing *GP International Pipecoaters Pty Ltd v Commissioner of Taxation* (1990) 170 CLR 124 at 137 ("*GP International*"). The inquiry includes "most importantly the commercial purpose of the taxpayer in having become subjected to any liability that is discharged by the making of [the] expenditure": *Ausnet*, Gageler J at [74]. In determining the questions in issue in this appeal, it is important to keep in mind all of these considerations at [89] to [93] of these reasons, especially the need for "exact scrutiny" of the Trustee's activities with a view to understanding the "whole picture" within which the expenditure was incurred.

94 That is not to say, plainly enough, that matters of general principle cannot be distilled from the authorities. Nor is it to suggest that reference to the facts of a particular case are of no value in illustrating a proper understanding of the *principle*. However, there is no utility in

attempting to find in the facts of one case, an analogical answer to the question in issue on the *actual facts* of the particular case as to the contested character of an outgoing.

95 One important statement of principle is to be found in *GP International* at 137 (by the Court; Brennan, Dawson, Toohey, Gaudron and McHugh JJ), in these terms:

> The character of expenditure is ordinarily determined by reference to the nature of the asset acquired or the liability discharged by making the expenditure, for the *character* of the *advantage sought* by making the expenditure is the *chief*, if not the *critical*, factor in determining the character of what is paid: *Sun Newspapers Ltd and Associated Newspapers Ltd v Federal Commissioner of Taxation*; *Colonial Mutual Life Assurance Society Ltd v Federal Commissioner of Taxation*; *Cooper v Federal Commissioner of Taxation*.
>
> [citations omitted; emphasis added]

96 That proposition was affirmed in *Commissioner of Taxation v Citylink Melbourne Limited* (2006) 228 CLR 1 Crennan J at 43 [148], Gleeson CJ, Gummow J, Callinan J and Heydon J each separately agreeing, and also by the plurality in *Ausnet* in the discussion at [15] to [22].

97 The reference by the Court in *GP International* at 137 to *Sun Newspapers* is a reference to the well-known discussion by Sir Owen Dixon of the considerations which help to identify (and remain a "valuable guide" in identifying; *BP Australia v FCT* at 386) the distinction between expenditure on revenue account and on capital account: *Sun Newspapers v Federal Commissioner of Taxation* (1938) 61 CLR 337 at, particularly, 359 to 363. The distinction is often not always easy to draw. At the *threshold*, the distinction might well correspond with the distinction between the business entity, structure or organisation "set up" for earning profits, on the one hand, and the "process" by which an organisation so set up, "operates" or goes about deriving "regular returns" by means of "regular outlays", on the other hand: Dixon J at 359.

98 Sometimes, the business structure may be represented by no more than "intangible elements … constituting goodwill, that is, *widespread* general reputation, *habitual patronage* by clients or customers and an *organised method* of serving their needs" [emphasis added]: Dixon J at 360. The plurality in *Ausnet* at [21] found that "implicit" in this observation is the "uncontroversial proposition" that an intangible asset *might*, according to its *nature* and *function* in the conduct of the business, be properly characterised "as forming part of the structure of the business" and thus "the cost of its acquisition" is a capital cost.

99 Sometimes, there may be a great aggregation of assets deployed in the production of goods or services: Dixon J at 360.

100 But whatever the form, the *source* of the earnings is the "profit-yielding subject": Dixon J at 360.

101 Orthodoxy suggests that outgoings upon "establishing" or "enlarging" or indeed "replacing" the profit-yielding subject matter are "entirely different" in nature from the "continual flow" of working expenses supplied "out of the flow of revenue": Dixon J at 360. But, the "practical application" of such orthodoxy is difficult and the "basal difficulty" lies in the fact that the "extent, condition and efficiency" of the profit-yielding subject is "often" *as much* the product of the "course of operations" as it is of a "clear and definable outlay by way of establishment, replacement or enlargement" of the profit-yielding subject itself: Dixon J at 360. The distinction is "even harder to maintain" in relation to the "intangible elements" forming an important part of many profit-yielding subjects: Dixon J at 360. One illustration of that difficulty may be that in some cases goodwill may have been gradually established by continual advertising over a number of years growing the goodwill of the undertaking as the business proves to be successful. In such a case, the expenditure on advertising might be regarded as an ordinary business outgoing on account of revenue: Dixon J at 361.

102 One standard by which outgoings may be characterised as attributable to capital account or revenue account is whether the outlay is, on the one hand, "recurrent, repeated or continual" or whether it is "final" or made "once and for all".

103 Even greater emphasis has been given to the distinction which might be found in the "nature of the asset or advantage obtained by the outlay": Dixon J at 361. This distinction involves examining the "result or purpose" of the expenditure to determine whether it brings into existence or procures an asset or advantage of a "lasting character" which will "endure for the benefit of the organisation or system or profit-earning subject": Dixon J at 361. If so, the outlay will be distinguished from expenditure to be *recouped* by "circulating capital or working capital": Dixon J at 361.

104 However, the conception of "an asset or advantage for the enduring benefit of a trade" is one which should receive "elastic application": Dixon J at 361.

105 Moreover, the "idea of recurrence" and the "idea of endurance or continuance over a duration of time" both depend on "degree and comparison": Dixon J at 362.

106 As to recurrence, the "real test" is between expenditure made to meet a "continuous demand" as compared with expenditure which is made "once for all": Dixon J at 362, adopting the

observations of Rowlatt J in *Ounsworth v Vickers Ltd* (1915) 3 K.B. at 273, explained his understanding of that notion in this way at 362:

> By this I understand that the expenditure is to be considered of a revenue nature if its *purpose* brings it within the very wide class of things which in the aggregate *form the constant demand* which must be answered *out of the returns* of a trade or its *circulating capital* and that *actual recurrence* of the specific thing need not take place or be expected as likely. ... Recurrence is not a test, it is *no more than a consideration* the *weight* of which depends upon the *nature* of the expenditure.
>
> [emphasis added]

107 The *lasting character* of the advantage gained by the outlay is not necessarily a *determining* factor in the characterisation of the outgoing: Dixon J at 362. Rights and advantages of particular duration and nature may be the subject of recurrent payments which are referrable to capital expenditure or income expenditure "according to the true character of the consideration given", that is, whether on the one hand it is a capitalized sum payable by deferred instalments or, on the other hand, expenditure in the nature of higher payments or rental payments accruing at particular intervals, for the use of the thing: Dixon J at 363.

108 Ultimately, Dixon J synthesised these points of distinction in this way at 363:

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

109 The High Court delivered judgment in *Sun Newspapers* on 23 December 1938. On the same day, the Court also delivered judgment in *The Commissioner of Taxes (South Australia) v Executor Trustee and Agency Co of South Australia Ltd* (1938) 63 CLR 108. In that decision, Dixon J had some further things to say about the difficulty of determining whether a particular expenditure or outgoing falls to capital account or revenue account and the relationship such a distinction bears to commercial practice and principles of accountancy. At 152 to 154, Dixon J made these observations:

> Income, profits and gains are conceptions of the world of affairs and particularly of business. They are conceptions which cover an almost infinite variety of activities. It may be said that every recurrent accrual of advantages capable of expression in terms of money is susceptible of inclusions under these conceptions.
>
> ... But in nearly every department of enterprise and employment the course of affairs and the practice of business have developed methods of estimating or computing in terms of money the result over an interval of time produced by the operations of business, by the work of individuals, or by the use of capital.

> Familiar but striking examples of this necessary reliance upon commercial principles and general business understanding may be found in the case law dealing with expenditure laid out for the purpose of trade, with outgoings on account of capital, with capital profits, and with the question whether items should be taken into consideration for any given accounting period rather than for that which follows or perhaps for that which preceded. ...
>
> The tendency of judicial decision has been to place increasing reliance upon the conceptions of business and the principles and practices of commercial accountancy. ...
>
> But the process by which the principles and practices evolved in business or general affairs are drawn upon for the solution of questions presented to courts of law almost inevitably leads to a development in the law itself. For, under our system of precedent, a decision adopting or resorting to any given accounting principle or application of principle is almost bound to settle for the future the rule to be observed and the rule thus comes to look very like a proposition of law.
>
> But in some matters, particularly in the attribution of expenditure between capital and income, the courts have found it impossible to formulate a principle as an induction from commercial practice and have left the matter almost as much as ever in the realm of fact or discretionary judgment. ...

In *Lothian Chemical Co Ltd v Rogers*, Lord Clyde says this:

> It is according to the legitimate principles of commercial practice to draw distinctions, and sharp distinctions, between capital and revenue expenditure, and it is no use criticising these, as it is easy to do, upon the ground that if you apply logic to them they become more or less indefensible. They are matters of practical convenience, but practical convenience which is undoubtedly embodied in the generally understood principles of commercial accounting.

110 I have examined many of the Accounting Standards adopted and published by the Accounting Standards Body to determine whether those standards deal with factors informing, from a professional standards point of view, approaches to the determination of whether an item of expenditure is in the nature of capital or on revenue account. The Standards do not address that matter directly. This probably reflects a view within the Standards Body that the question is best left to be determined according to the facts of the particular transactions giving rise to the expenditure and the view courts might take about that expenditure as an exercise of judicial power in the context of adversarial proceedings where all aspects of the relevant evidence is properly evaluated.

111 Many of the propositions described at [97] to [108] of these reasons based on the observations of Dixon J in *Sun Newspapers* were expressly affirmed in *Ausnet* by the plurality, French CJ, Kiefel and Bell JJ at [14] to [29].

112 The plurality emphasised at [14] and [15], the "evaluative judgment" required to be made in determining the character of the outgoing by weighing up: the *form* of the expenditure, its

purpose and its *effect*; the *benefit* derived by the taxpayer from the expenditure; and the relationship the expenditure bears to the *structure* of the business as distinct from the *conduct* of the business. Not surprisingly, some of these factors might point in one direction while others point in a different direction: *Ausnet* at [15]; *BP Australia v FCT*, Lord Pearce, 112 CLR 386 at 397.

113 Although a "once and for all" payment might be a criterion, in a rough way, of whether the expenditure is on capital or revenue account, such a rough criterion cannot, obviously enough, be decisive in every case. An outgoing made with a view to (that is the purpose of) *bringing into existence* an asset or an advantage for the *enduring* benefit of a trade, is *likely* to be an outgoing on capital account but *even then* there might be special circumstances which suggest an "opposite conclusion": *Ausnet* at [15].

114 The circumstance that the outgoing is *recurrent* is not determinative of its character: *Ausnet* at [16].

115 In *Henriksen v Grafton Hotel Ltd* [1942] 2 K.B. 184 at 195 ("*Henriksen*"), Du Parcq LJ, in the Court of Appeal, found that recurrent payments of a charge, imposed as a condition upon the grant of a liquor licence, were in each case, when paid, part of a total amount paid "to acquire the right to trade for a period of years" and at the date when the period began, holding the right was "essential before trading could be begun". Thus, each payment when made was considered to be "part of a capital outlay". The plurality in *Ausnet* at [16] note that Lord Pearce in *BP Australia v FCT* (writing for the Privy Council) observed at 112 CLR 386 at 405 that *Henriksen* (which Lord Pearce described as "a special case") was concerned with a business which could not be carried on without a licence and thus, there was "an element of monopoly" involved which informed the decision that the outgoing in question was on capital account. The plurality at [16] affirmed the relevance of that consideration in a contemporary setting but characterise it as one which might be understood, in Australia, as a matter of "enhanced market power" where the requirement for a licence in order to carry on a trade or business for a period of years, not freely given to "all comers", constitutes "a barrier to entry for potential competitors into the relevant market": *Ausnet* at [16].

116 Thus, it seems, that if the circumstances of the payment engage the acquisition of something which would operate as a barrier to entry for potential competitors into the relevant market in which the taxpayer engages (thus enhancing the market power of the taxpayer), that

circumstance weighs in the balance in determining whether the outgoing bears the character of a capital outgoing, consistent with the principle in *Henriksen*.

117 In *Sun Newspapers*, the contested payments also engaged "an element of monopoly" as, for Rich J, the purpose of the outgoing was to "buy out opposition and secure so far as possible a monopoly" (61 CLR 337 at 347) and for Latham CJ, the payments "did obtain a very real benefit or advantage for the companies, namely, the exclusion of what might have been serious competition" (61 CLR 337 at 355). The question of whether the payments engaged an element of monopoly did not loom large in the reasoning of Dixon J although that consideration falls more fundamentally within the first of Dixon J's three points of distinction set out at [108] of these reasons: that is, "the character of the advantage sought and in this its lasting qualities may play a part".

118 The Commissioner says that the considerations at [114] to [116] apply precisely to this case. The Commissioner says that the Trustee made an expenditure in an auction process to acquire GMEs conferring the right to carry on a gaming business which it could not carry on without having acquired the GMEs and which conferred upon it an element of monopoly in the sense described at [114] and [115] of these reasons.

119 Where the contested payment is made as part of the consideration for the acquisition of a business, that circumstance will normally be a "key factor" in the assessment of characterisation. The fact that a payment can be viewed as "part of the consideration for the acquisition of a business or capital asset *weighs heavily* in favour of its character as a capital outlay" [emphasis added]: *Ausnet* at [18].

120 Although, as a matter of principle, such a factor weighs heavily in the balance in deciding whether the outgoing is on capital account, the question to be asked in seeking to resolve the "basal difficulty" identified by Dixon J ([101] of these reasons), in the context of the applied facts giving rise to the outgoing is, was the payment made "for" the acquisition?: *Ausnet* at [18]. But *even then* there is difficulty.

121 In *Cliffs International*, Barwick CJ observed that even though the payments in issue in that case were *plainly* made in the performance of a promise given as *part* of the *acquisition* of what was "subject matter undoubtedly of a capital nature", the payments were not of a capital nature. The particular facts going to the activities of the taxpayer are not the point in issue here. The simple point is that an acquisition expenditure itself does not necessarily bear the

characterisation as an outgoing in the nature of capital. Even though Barwick CJ took that view (and also Jacobs and Murphy JJ), Gibbs and Stephen JJ took a different view.

122 The plurality in *Ausnet* expressly recognise at [19] the *basal difficulty* identified by Dixon J that expenditure which might be regarded, ordinarily, as on capital account in one set of circumstances might be regarded as expenditure on revenue account in another set of circumstances. At [22], the plurality in *Ausnet* affirm the three elements of the synthesis of Dixon J set out at [108] of these reasons.

123 Obviously enough, in deciding whether an outgoing is on capital account or revenue account in the particular circumstances of the taxpayer's activities, much depends upon what the expenditure is "calculated to effect" from "a practical and business point of view, rather than upon the juristic classification of legal rights, if any, secured, employed or exhausted in the process": *Hallstroms* (1946) 72 CLR 634, Dixon J at 648.

124 In *Hallstroms*, Dixon J was in dissent. The plurality held that the expenditure in issue was on *revenue account*. However, at 646 and 647, his Honour re-asserted the principles he had identified in 1938 in *Sun Newspapers* guiding the identification of the distinction to be made. The contested expenditure concerned legal expenses incurred by Hallstroms in successfully opposing a petition by a market rival, Electrolux, for an extension of the term of the patent it held for refrigerators. Dixon J observed that the legal expenses take the *quality* of an outgoing of a capital nature or an outgoing on account of revenue "from the *cause* or the *purpose* of incurring the expenditure" [emphasis added] at 647. Had an extension been granted, it would have been unlawful for Hallstroms to pursue any part of its program of making and selling rival refrigerators embodying the invention and carrying into effect its reorganised productive capacity for manufacture and sale of the new refrigerators.

125 In that context, Dixon J said this at 648:

> The expenditure was directed to ensuring that there should be no renewal of the restriction. This appears to me to go to the *character* and *organisation* of the *profit-earning business* and not to be an incident in the operations by which it is carried on. I think that it is an affair of capital. ...
>
> *What is an outgoing of capital and what is an outgoing on account of revenue depends on what the expenditure is calculated to effect from a practical and business point of view, rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process.* ...
>
> [emphasis added]

And this at 649:

> What *did matter* [in making the expenditure] was that the company should be enabled to place its business on a *fresh foundation*, by turning over to the production of a refrigerator according to the invention, and thus compete with the proprietor of the expired or expiring patent. It was for that *purpose* that the expenditure was incurred.
>
> ... The legal expenses incurred in the final removal of this obstacle [the patent], 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 organisation according to an existing form and arrangement. To adapt and add to some expressions used by the Chairman of the Board, it is concerned with the reform of or the more effective establishment of the organisation by which income will be produced (the profit-yielding subject) and not with the means whereby that organisation will be used for that purpose.
>
> [emphasis added]

126 Although it is, of course, necessary to ascertain the *character* of the expenditure by identifying what the expenditure is "calculated to effect" from a "practical and business point of view" (or put another way, by taking into account "most importantly the commercial purpose of the taxpayer in having become subjected to any liability that is discharged by the making of the expenditure": Gageler J, *Ausnet* at [74], quoting *BP Australia v FCT*), rather than focusing upon a "juristic classification" of the legal rights (if any) secured, deployed or exhausted by making the outgoing, nevertheless, the **content** of the *particular legal arrangements* within which the outgoing is made *must* be properly understood: *Federal Commissioner of Taxation v South Australian Battery Makers Pty Ltd* (1978) 140 CLR 645 at 662, Stephen and Aickin JJ.

127 Indeed, such a consideration is regarded as "essential". Stephen and Aickin JJ put the matter this way at 662:

> An examination of the legal rights obtained is essential to the characterisation of expenditure, notwithstanding that in some cases it may not alone be sufficient to complete the process ...
>
> ...
>
> We do not read Dixon J's judgment in *Hallstroms' Case* as intended to convey that practical business considerations are to be used to the exclusion of any analysis of legal rights.

128 In the present case under appeal, the Tribunal was constituted by Pagone J, a Deputy President of the Tribunal. The Tribunal concluded that the outgoing was on revenue account. At para 13, the Tribunal said this:

> The outgoing for the gaming machine entitlements in the trustee's business is more like a *fee paid for the regular conduct of a business* than the acquisition of a permanent or enduring asset. The payment for a right which is required as a

> condition for trading will sometimes be capital in nature, but the payment for the right to trade will not always be an outgoing on capital account. In [*Henriksen*], a right to trade for three years was described as a capital asset, whereas the payment for an excise licence was regarded as part of the working expenses for the year.
>
> [emphasis added]

129 At para 13, the Tribunal quotes an extensive extract from the reasons of Du Parcq LJ in *Henriksen* at 194-196. Having done so, the Tribunal then notes that the decision in *Henriksen* was referred to with approval by the plurality in *Ausnet* at [18] as an example of a payment on capital account (notwithstanding that the payment was recurrent), "because it reflected the monopoly value of what was acquired". The Tribunal then says this at para 13:

> In the present case, in contrast [to the position in *Henriksen*], the *amount* of the outgoing reflected the *economic value of the income stream* expected from putting other assets to use to derive income from gaming. The gaming machine entitlements had *no intrinsic economic value other than* by reference to the income stream expected from [their] use with other assets to derive gaming income. The amounts paid for the gaming machine entitlements were amounts, like those considered in [*BP Australia v FCT* 112 CLR 386 at 398] "which had to come back penny by penny with every order during the period in order to reimburse and justify the particular outlay". The *close connection* between the amounts paid for the gaming machine entitlements and the income stream expected from the payments was in part reflected, as a practical business and commercial matter, in the amount which the purchaser had been willing to pay for the business when it had included commissions income from 18 gaming machines.
>
> [emphasis added]

130 At para 13, the Tribunal also made these further observations:

> It can also be *assumed* that *any* separate economic value of the gaming machine entitlements would *diminish* over time to "nil" as the period for which they were granted was consumed and decreased by the passage of time. The outgoings were, finally, unlike premiums for a lease which secures, albeit for a diminishing period, a right to occupy and enjoy premises: cf [authorities and references omitted]. The rights attaching to the gaming machine entitlements had *nothing comparable* to the rights to occupy and enjoy real estate.
>
> [emphasis added]

131 At para 14, the Tribunal notes the Commissioner's contention that the outgoing was of capital or of a capital nature, because the outgoing had been incurred for the purpose of preserving and protecting the Trustee's business. As to that contention, the Tribunal said this:

> It is true that the expenditure had an *effect* upon the *income producing structure* of the trustee's business, and it is true that a consequence of the outgoing was to have preserved the trustee's *ability* to derive income from gaming activities at the hotel, but it would not be accurate to characterise the outgoing as "for the purpose of preserving and protecting" the trustee's business. The outgoings were *for* the statutory entitlement to conduct gaming at its premises on gaming machines over time, and the *amount* of the bid reflected the *expected income stream* from the use of

> those other assets which the gaming machine entitlements permitted. An *incident* of acquiring the gaming machine entitlements by the outgoing may have been to have preserved the trustee's income earning structure, but the purpose of the outgoing was to obtain the right to conduct gaming to enable the trustee to derive the future income which was expected from the gaming.
>
> [emphasis added]

132 For these reasons, the Tribunal concluded that the outgoing was on revenue account.

133 At [75] to [88] of these reasons, I identify the criticisms the Commissioner makes of the reasoning of the Tribunal and the contended errors inherent in that reasoning. Before examining those contended errors, it is necessary to contextualise a little further the observations of the Tribunal. At para 5, the Tribunal observes, as a matter of principle, that the distinction between revenue expenditure and capital expenditure may, in general terms, be understood as corresponding, in the context of a business, to the distinction between an outgoing that is consumed *in the business* and an outgoing which substitutes the money expended *for* (quoting the language reflected in *British Insulated and Helsby Cables v Atherton* [1926] AC 205, 213), "an asset or an advantage for the enduring benefit [of the business]". The Tribunal also, of course, had regard to the authority of the statements of principle in *Sun Newspapers* and *Hallstroms*.

134 Importantly, the Tribunal said this at para 6:

> The trustee of the trust in this case acquired the gaming machine entitlements in consequence of a *change to the statutory regime* in Victoria governing gaming operations and in the context of the trustee having a pre-existing business in which gaming revenues formed a significant part of its income. On 8 August 2005 the trustee had acquired a business trading as a hotel for a price of $1,025,000 pursuant to an agreement with Tattersalls Gaming Pty Ltd ("Tattersalls"). The *trustee* became the *venue operator of the hotel* pursuant to the agreement with Tattersalls in respect of a *venue approved* for gaming under the provisions then regulating gaming. *Tattersalls* was the *gaming operator under that regime* in respect of the venue, and between 8 August 2005 and 15 August 2012 Tattersalls *owned* and *operated* 18 gaming machines at the hotel pursuant to *its agreement* with the trustee and its *entitlements* as gaming operator under the relevant state legislation. *Income* from gaming was paid by Tattersalls to the trustee *as commissions* in respect of the gaming undertaken at the premises. The profit and loss statement of the trustee for the year ended 30 June 2006, for example, included income of the trust from accommodation, gaming commissions, rebates, and gross profits from trading as a hotel which included sales of meals and alcohol.
>
> [emphasis added]

135 Having regard to the Tribunal's reasons overall and particularly the observations at para 6, I respectfully disagree with the Commissioner's proposition that the Tribunal either did not properly *understand* the distinction between the pre-August 2012 regime and the new

post-16 August 2012 regime, or proceeded in error upon a *conflation* of the two regimes in undertaking the analysis of the question of whether the expenditure was on revenue account or capital account.

136 It seems to me to be clear that the Tribunal properly understood the role of the Trustee as a venue operator of approved premises and the role of Tattersalls as a gaming operator which owned and operated 18 gaming machines at the hotel pursuant to the relevant statutory arrangements (and its agreement with the Trustee) under the old regime, on the one hand, and the changes earlier described to the legal regime under the new arrangements, on the other hand. It can be seen in para 6 of the Tribunal's reasons that the Tribunal described the income of the Trustee under the old regime, at least as to gaming income, as "commissions". It seems to me perfectly clear that the Tribunal understood the *juristic classification* of the differences between the two regimes.

137 I accept that the new regime brought into existence a statutory "thing" called a gaming machine entitlement. I accept that it arose as a statutory creature under the Act as amended and I accept that it bears the character of an intangible asset created pursuant to statute. Plainly enough, the allocation of a GME, conferred upon the person acquiring it a statutory authority necessary to lawfully "conduct gaming" by means of gaming machines at a relevant venue subject to the applicable regulatory requirements. I accept that in the absence of such a GME, a statutory prohibition arose upon a person conducting gaming. I also accept that the GME conferred authority, subject to the Act, upon the person holding the GME to conduct gaming as described for a period of 10 years subject to either forfeiture according to the Act or an extension of the term for up to two years according to the Act.

138 I also accept that the GMEs are capable of being bought and sold although the limitations inherent in that notion must be properly understood. They can only be transferred to another venue operator. There is no secondary market as such for GMEs as an intangible asset or bundle of rights under the statute. The GMEs, as the Commissioner concedes, only have value (or use) to a *venue operator* capable of conducting gaming according to all of the elements of the regulatory regime established under the Act, as amended, for that purpose.

139 These features of a GME are "factors" which "point" in the direction of a capital outgoing: see, the plurality at [15], *Ausnet*. The expenditure on the GMEs as a consequence of the auction process seems to have affinity with expenditures related to the business *structure* "set up" for earning profits as opposed to an expenditure related to the "process" by which an

organisation so set up "operates" or goes about deriving regular returns by means of regular outlays: see [97] of these reasons.

140 However, there are other factors which also point in a different direction.

141 The Commissioner says that the Tribunal's notion that the expenditure reflected the "economic value of the income stream" expected from putting assets to use to derive income from gaming is misconceived, on the facts. The Commissioner also says that the Tribunal's notion that the gaming machine entitlements had "no intrinsic economic value" other than by reference to the income stream expected from their use with other assets to derive gaming income, is also misconceived, on the facts.

142 I respectfully disagree with these contentions of the Commissioner.

143 It is true that the amount of the outgoing as determined by the auction process at $600,300.00 does not represent something in the nature of a valuation or crystallisation of an amount which bears a relationship to the precise dollar value of the present or future cash flows generated in the business of the hotel undertaking. In that sense, there is no discounted cash flow valuation or determination of the "amount" to be paid for the GMEs by reference to the orthodoxy of attributing a precise present day value to future earnings. There is no attempt to take into account, objectively viewed, specific rates of return which bear some relationship with the carrying value of assets or even the depreciated optimized replacement cost of assets of the business in setting the amount of the outgoing.

144 Nevertheless, the evidence is perfectly plain that the Trustee was conducting a going concern on 9 May 2010 (approaching the auction on 10 May 2010) and had been conducting that going concern for some years in a way which involved generating sustainable *revenue* and *profit* from an *integrated hotel business undertaking* which involved the sale of food and beverages in the restaurant; the sale of food and beverages in the café; the sale of alcohol at the various bars; income derived from gaming activities (as commissions); and income derived from wagering.

145 The evidence is that Mr Canny, for the Trustee, took professional advice about the incremental thresholds at which the Trustee could afford, in a forward-looking way, to bid (and pay) to acquire 18 GMEs. The commercial reality confronting the Trustee was that the expenditure on the cost of acquiring the GMEs would have to be paid for out of the proceeds of the business undertaking of the Royal Hotel over time. That might express itself in the

form of funding the outgoing of $600,300.00 by debt funding with the attendant cost of funds (loan fees, recurrent management fees, interest costs etc). In that event, repayment of the debt and recoupment of the costs of funds would need to be paid out of the cash flows of the hotel undertaking. Alternatively (and as things transpired), the obligation to pay the outgoing might be discharged over time by a sequence of quarterly payments to the State of Victoria (Treasury) either with or without interest costs. As things transpired, the outgoing was paid by paying the State an amount of $60,030.00 in approximately May 2010 and by making further quarterly payments of $30,015.00 across the period from 16 August 2012 to 31 August 2016 with no interest charges payable to the State of Victoria. However, even under those arrangements, meeting the quarterly instalments had to be financed out of the proceeds of the business undertaking of the hotel.

146 The realisation that the cost of the GMEs would need to be funded out of the cash flows of the business meant that in order for the Trustee to continue its going concern at the Royal Hotel deriving income from gaming activities (recognising that in the new environment the legal foundation for that activity would be as a venue operator "conducting" gaming), the Trustee had to form a view (and did so through Mr Canny) about the relationship or relativity between the *cost* of the GMEs and the *capacity* of the business undertaking to fund the acquisition out of future revenue (cash flows), while maintaining an acceptable rate of return in the business. That assessment had to take account of the profitability of the undertaking overall. The relationship was not one just between the cash flows derived from gaming activities but one between the cost of the GMEs and the cash flows generated from the entire business undertaking having regard to the influence gaming activities had upon contributions to revenue in other parts of the integrated hotel business. The Trustee was, after all, "running a Pub" not operating a "gaming parlour".

147 It is true that there is no direct relativity, dollar for dollar, between the amount paid for the GMEs and a particular discount applied to future cash flows evident in an orthodox discounted cash flow sense which might be used to determine a "value" to be paid for the acquisition of the GMEs. There is no express ratio of cost to earnings. However, there is no doubt that the thinking which informed Mr Canny's assessment (for the Trustee) of the amount the Royal Hotel business or could afford to pay for the GMEs was determined, having regard to the bidding schedule, on the basis of the maximum amount which might be paid yet which would leave the business in a position where it achieved a reasonable rate of return on assets having regard to revenues and costs. In that sense, there is no doubt that the

amount of the expenditure bore a very real relationship with the income generated by the business of the hotel and the profits the hotel business would generate in a forward-looking way on the assumption that the cost of the GMEs might fall within the upper limits of the payment scale set out in the bidding schedule: see the discussion as to that matter at [59] to [61] of these reasons and Mr Canny's assessment of the amount the Trustee could afford to pay in the bidding process; see the increments in the bidding schedule set out at [61] of these reasons.

148 That is why the Tribunal at para 13 used the phrase "close connection" to describe the relationship between the amounts paid for the GMEs and the income stream expected from having made the payments, viewed from a practical business and commercial standpoint.

149 The Tribunal was entirely right to do so.

150 If the *character* of the expenditure is to be examined in a way which takes account of what the expenditure is *calculated to effect* from a practical and business point of view (yet taking proper account of the relevant legal rights and obligations), Mr Canny's evidence before the Tribunal *tells* the Tribunal (and the Court) in very plain terms the practical and business point of view considerations which informed both the *making* of the expenditure on the day (10 May 2010) and its *quantification* on the day through the bidding process.

151 To proceed on the basis that there is no *relevant* relationship between the threshold of earnings and the expenditure is, in my respectful view, to displace a proper understanding of the business imperatives confronting the Trustee. It is true, as things transpired, fortuitously for the Trustee and its business at the Royal Hotel, that it was not necessary for the Trustee to bid up to the financial caps which had been set for the bidding process for the acquisition of 18 GMEs corresponding to the 18 gaming machines onsite. That did not mean that the relationship between revenues in the business and the cost of the GMEs suddenly evaporated as a commercial question. It just means that the Trustee did not have to pay as much as it thought it might have to pay in order to acquire 18 GMEs and retain a reasonable rate of return on assets in the business.

152 A recognition that there is, in the scrutinized activities of this particular taxpayer, a relationship between the threshold of earnings and the expenditure made and its quantification, does not mean, however, that the outgoing is necessarily on revenue account.

153 Other factors need to be considered.

154 As an aspect of the notion that the amount of the outgoing reflected something in the nature of the economic value of the income stream expected from putting the relevant assets to use to derive income, the Tribunal placed emphasis upon the method of *recoupment* of the outgoing and took the view that the amount to be paid for the GMEs was an expenditure which had to "come back" to the Trustee cent by cent in the course of the trading operations of the Royal Hotel during the period of the entitlements. The Tribunal's view that there subsisted a "close connection" between the amount paid for the GMEs and the income stream expected from having made the payments, led the Tribunal to a conclusion that the outgoing was an amount "like those" considered by Lord Pearce writing for the Privy Council in *BP Australia v FCT* 112 CLR 386 at 398 "which had to come back penny by penny with every order during the period in order to reimburse and justify the particular outlay".

155 Since the Tribunal regarded the outgoing in question as analogous to the recoupment of the outgoing in *BP Australia v FCT*, it is necessary to reflect a little on the circumstances of that case.

156 In *BP Australia v FCT*, the following considerations had a role to play in determining the character of the outgoing.

157 Prior to the arrangements which led to BP Australia ("BP") incurring the expenditure the subject of the contest, sales of petrol by BP service stations represented a "substantial part" of BP's total sales and thus its revenues. In 1951, put simply, various brands of petrol were sold in competition with each other at each individual service station. In that regime, particular producers owned their own tanks and pumps at each service station with those facilities let to the retailer at a nominal figure. In August 1951, Shell sought to achieve efficiencies in the costs of distribution by implementing a new regime called a "solo site service station plan" on the footing that it would supply petrol to service stations which had agreed to deal exclusively with it. At that time, BP had 4,000 retailers selling its petrol. Immediately after Shell's announcement, 437 of those retailers requested BP to remove its pumps and by December of that year, BP had lost 1,012 sites. Thus, steps had to be taken by BP to arrest the "alarming situation" and make "provision for the future".

158 BP took steps to encourage retailers to deal solely with it and by December of that year it had gained 326 sites to partly offset the 1,012 sites it had lost. However, other producers (rivals) began offering direct financial inducements to retailers to join their particular solo site plans. BP responded by offering lump sum payments to retailers who would tie themselves to BP

for not less than three years and, in some circumstances, depending upon the payments, the tie would be for a period of not less than five years. The financial payments began as £100 for every thousand gallons per month (estimated) with a maximum of £1000 for a three year tie. That sum might be increased to £150 for every thousand gallons provided the tie was extended to five years.

159 By June 1952, BP had lost 1,964 sites but had obtained off-setting trade ties at 791 sites. During the financial year in question, BP expended £270,569 in payments to retailers under written agreements providing for the tie. Lord Pearce at 112 CLR 386 at 391 observes that Taylor J, in the High Court, had concluded that the amounts paid by BP were lump sums for the purpose of securing a trade tie and thus the payments were capital outgoings. Lord Pearce also observes at 112 CLR 386 at 391 that on appeal, McTiernan J agreed entirely with the reasoning of Taylor J; Windeyer J affirmed the judgment of Taylor J and observed that BP had obtained, for a substantial period and with a prospect of renewal thereafter, something that was to become part of the "structure, organisation or framework" within which and by means of which BP carried on its business undertaking; and Lord Pearce notes that Owen J concluded that the *advantage* gained by BP ultimately determined the *character* of the outgoing as a capital outgoing. Lord Pearce also observes that Dixon CJ and Kitto J dissented, holding that the outgoing was on revenue account. The Privy Council also so held.

160 For Dixon CJ, BP was engaged in a "continuous process of business expenditure" which "involved the cost of selling in whatever way might from time to time seem suitable", its product to the public. The changes that BP had to confront in the conduct of its business seemed "to be of a more or less enduring character". Dixon CJ observed that the fact that the changes involved the *securing* of pumps which remained on the premises for use in the sale of BP's petrol and that that petrol *alone* was to be sold had, by the majority (and also Taylor J), "been taken to mean that a resultant advantage possibly covering a long period of years was really purchased by the expenditure". Dixon CJ then said this ((1964) 110 CLR 387 at 410):

> As I have followed the history of the matter it seems clear that in all the unexpected incidents of marketing throughout these years the company was engaged in an endeavour to obtain a definite market among the public by one means or another and was doing so *in the course of conducting* its business of disposing of petrol which it was able to acquire or import. I do not think it was acquiring a capital asset or doing any more than *so conducting its business on revenue account as to increase it and make as certain as it could that its business was continuing and also would continue*, if possible, to expand. For my part, I cannot think that all the course adopted

> changed the character of the transactions of the company from those of a continual attempt to establish its product in a consumers' market and to meet all the obstacles which arose in a long and rather troubled period to obtaining a reputation for its product. There appears to me to be no specific expenditure in increasing its plant, machinery or other element in the profit-earning instrument under its control.
>
> [emphasis added]

161 Kitto J at 110 CLR 387 at 412 notes the Commissioner's proposition that by making the payments in question, BP secured for itself, as a "pre-requisite" to continuing to sell petrol to service stations, "a share of the trade thus newly divided [according to the new horizontal "solo site" arrangement]". The Commissioner contended that BP's payments "bought customers" and the analogy of a purchase of goodwill was sufficient to demonstrate, it was said, that the expenditure was of a capital nature.

162 As to that, Kitto J said this (at 412-413):

> In the first place, while it is true that for each payment made to an operator [BP] obtained an immunity from competition for a period in respect of that operator's service station, the transaction *differed* in an important respect from one in which a trader takes from a potential competitor an agreement in restraint of trade. The effect of a binding promise not to compete is to create for the promisee a more favourable situation in which to carry on his business for the future; it makes an improvement in the conditions in which he may proceed to carry on his profit-making activities. In other words, the elimination of the competitor is *anterior* to, and not part of, the trading in which the benefit of it will be felt; and accordingly, in the ordinary case at least, the cost of it is a cost of *adding* a protective element to the *structure* of the promisee's business. Forming no part of his trading expenses, but being, in effect, the purchase price of a capital asset, it is a capital charge.

At 412-413:

> But a promise by a service station operator not to deal with oil companies other than [BP] or its allies was only the negative side of the substantial positive advantage which it was the *purpose* and *practical effect* of the agreement to produce, namely *the advantage of a practical certainty that the whole of the custom of the service station*, for motor spirit, *would be given to [BP] or its allies for the agreed period*; and what [BP] really paid its money *for* was that positive advantage. The purpose was not to *create* a situation in which to set about selling motor spirit; it was to *secure* the particular sales which would be necessary for the satisfaction of the service station's requirements of the period. The payment ... was part and parcel of the business of effecting sales.
>
> [emphasis added]

163 At 415, Kitto J said this:

> In the view I take of the case, the advantage was not the acquisition of a new market, not a new framework within which to carry on trade for the future, not an extension of the appellant's selling organisation to include a regiment of resellers. It was not such an exclusion of competition as adds to goodwill a negative right and thus increases the value of goodwill. It consisted simply of the practical assurance of

> receiving bundles of orders for motor spirit, the circumstances being such that for the foreseeable future it would be only by getting similar bundles of orders that such a trade as [BP's] could be carried on.

164 Lord Pearce had particular regard to these observations of Dixon CJ and Kitto J and went on to make the remarks to which the Tribunal refers, in these proceedings, as described at [154] of these reasons.

165 Lord Pearce at 112 CLR 386 at 397 and 398 notes that the need or occasion for the payments of the lump sums came from the fact that marketing in the petrol trade in 1951 "changed its nature suddenly" and for sound commercial reasons. The "change" was in accordance with "modern tendencies" in commerce. The trading in petrol had become "a long term trade". The trade under the changes had become diverted "into separate specialised and individual channels" and henceforth the customer gave his "whole loyalty or none at all". The producer, in accordance with the "new market", needed to have its own tied retailers if it was to compete with rivals. Since orders were flowing from tied retailers, and would in the future be *only obtainable* from tied retailers, BP *had* to obtain ties with retailers. To obtain ties, it had to pay out sums for a period of years, the amount of which was dependent upon the *estimated value of the retailer as a customer* and the *length of the period.* The payments were "a necessity of the trade".

166 Lord Pearce then added this at 398:

> The test of whether these sums were payable out of fixed or circulating capital ... tends in the present case in favour of regarding these payments as revenue expenditure. Fixed capital is prima facie that on which you look to get a return by your trading operations. Circulating capital is that which comes back in your trading operations. *The sums in question were sums which had to come back penny by penny with every order during the period in order to reimburse and justify the particular outlay.*
>
> [emphasis added]

167 Lord Pearce regarded the lump sum payment as an "item" in the cost per gallon of the petrol and took the view that it was doubtful that the cost could be regarded as part of "overheads" because it sat at the "forefront" of the wholesaler's selling costs. Lord Pearce said this at 398: "Prima facie therefore the lump sums were circulating capital which is turned over and in the process of being turned over yields a profit or loss; they were part of the constant demand which must be answered out of the returns of the trade".

168 All of these considerations at [165] to [167] of these reasons, against the background of the remarks of Dixon CJ and Kitto J, were influential in the conclusion that the lump sum

expenditure on the ties, over the term of each tie, was on revenue account and not expenditure in the nature of capital.

169 In the period from, in effect, 2005 to 9 May 2010 (the day of the auction when final bidding for the GMEs took place), the Trustee had been conducting a going concern deriving income from gaming activities (as so-called "commissions" from Tattersalls within the legal arrangements already mentioned). Although those particular arrangements would continue until 15 August 2012, Mr Canny, for the Trustee, had to confront the "alarming situation" of the change to the "new arrangements" much in the same way that BP had to take steps to make expenditures to make "provision for the future" so as to "secure future earnings" by obtaining ties for each relevant term in return for lump sum payments. Mr Canny, for the Trustee, wanted to secure earnings from gaming activities in the hotel business (as a venue operator conducting gaming in the new regime) and sustain the overall going concern with the contribution gaming made to trading in other aspects of the hotel business. Thus, he, for the Trustee, had no "commercial" choice other than to bid for, and win the bidding for, the acquisition of the GMEs.

170 Mr Canny could, of course, have elected not to bid at all and thus the Commissioner is right to say that Mr Canny "voluntarily" "chose" to bid and "chose" to acquire the GMEs. No-one was forcing his hand. That conception, with respect, is only true in an abstracted sense which fails to recognise the commercial imperative confronting Mr Canny as the guiding mind of the Trustee in trying to secure into the future the revenues of a going concern made up of the components earlier described, in the face of the impending new regime.

171 Mr Canny plainly thought, as the evidence demonstrates, that he had no choice other than to calculate the maximum cost the business could financially absorb (while retaining a reasonable rate of return on assets) in the bidding process and to bid, if necessary, to the level of the caps (18 GMEs at $81,515.00 each at a total cost of $1,467,270.00) and, in the worst case scenario, to bid for 15 GMEs at $100,000.00 each at a total cost of $1,500,000.00.

172 After that, Mr Canny was not prepared to bid for GMEs at all. At that point, there would be no commercial point trying to preserve gaming activities on the site of the Royal Hotel into the future regime.

173 As things turned out, Mr Canny (through the incremental bidding instructions given to Mrs Canny) had to pay less to preserve those revenues than Mr Canny thought would be necessary.

174 As mentioned earlier, analogues are rarely helpful in this area of the law. However, to the extent that the Tribunal called in aid of its reasoning the circumstances relating to BP's activities as described in Lord Pearce's analysis in *BP Australia v FCT* and the principles reflected in Lord Pearce's reasoning, it may be worth simply noting that the sudden and alarming change in the trading circumstances for the sale of petrol led BP to incur lump sum outgoings to secure ties of three to five years to, in turn, secure future sales and future cash flows by addressing , over the longer term, the changes in the legal structure of solo ties for the sale of product. The payments were not "one-off" payments but they were capped.

175 More relevantly, the Tribunal placed emphasis upon the commercial practicalities of the *recoupment* and likened recoupment confronting the Trustee to the recoupment confronting BP. The Tribunal said that the cost incurred by the Trustee would have to be recouped out of earnings over the term. The outgoing was an expense made to secure future earnings which had to be financially absorbed out of earnings.

176 The Tribunal was right to conclude that the cost of securing future earnings for the going concern of the hotel business would need to be recouped out of, in effect, every day's trading across all facets of the integrated business and especially out of gaming revenues.

177 The Trustee would continue to derive earnings of about 25% of every dollar of net distributable earnings from gaming until 16 August 2012. From then on, the revenue distribution would alter according to the payments as to tax (State Treasury), monitoring (Intralot) and payments to PVS, with the balance of net distributable earnings from gaming flowing to the Trustee.

178 In either regime, the cost of securing the earnings had to be either paid out of or recouped out of daily earnings.

179 To say that the outgoing had to come back to the Trustee "penny by penny with every order [every day's trading over the term]" might be unnecessarily colourful but it is essentially true from a practical business perspective of the operator of a going concern confronting a need to make a largely unplanned for payment to the Victorian State Treasury to acquire 18 GMEs to enable the operator to continue to derive revenue from gaming activities onsite at the hotel

(albeit an activity of a different legal character) conducted in relation to the same 18 machines.

180 One other aspect of the activities of the Trustee should be mentioned.

181 In my respectful opinion, I disagree with the proposition that the Trustee was not deriving gaming income from customers or patrons of the hotel.

182 It is true, as a matter of law, or juristic classification to use the language of Sir Owen Dixon, that the source of the Trustee's earnings from gaming activities in the period prior to 16 August 2012 was the payment of the so-called "commissions" by Tattersalls. The Trustee was not "conducting" gaming. However, from a commercial point of view, can there be any serious doubt that the basis upon which the Trustee derived earnings from gaming was the daily passage of customers or patrons through the front door of the Royal Hotel? The attractive force and reputation of the business and its various component parts caused people to attend the hotel and spend money. The Trustee calculated its earnings from gaming as a percentage of the net distributable revenue. It received a percentage of every dollar so distributed although in truth those amounts, so determined, were properly characterised as payments by Tattersalls for the provision of the relevant service under the agreement.

183 For my part, I would be most reluctant to conclude as a matter of substance, that Mr Canny, acting for the Trustee, was not conducting activities which can rationally and reasonably be characterised as deriving gaming income from customers of the hotel. The contrary proposition seems very odd indeed to me if the underlying activity is to be viewed and assessed as a matter of substance rather than form, perhaps juristic form.

184 Although I accept that there are factors which suggest that the outgoing is in the nature of capital, in my view, the other factors I have mentioned lead me to conclude that the outgoing is on revenue account. All of the factors at [140] to [183] need to be taken together in reaching that conclusion. However, there are three particular considerations to be kept in mind.

185 The *first* is that the outgoing is an outgoing incurred in relation to a business properly understood as an integrated hotel business characterised by the various trading activities earlier described, including gaming, conducted by the Trustee. It seems to me that the Commissioner has, quite artificially, looked *through* and *beyond* the integrated undertaking of the hotel business and *excised* from it that part of it which relates to gaming. The

Commissioner must take the Trustee's business as he finds it. The business is not the business of conducting gaming at a gaming parlour. The business involves conducting an integrated hotel undertaking and it is artificial to excise gaming from the integrated activities and then determine the *character* of the outgoing by reference, in effect, to *only* that activity. Approaching the characterisation question in that way fails to come to grips with the true activities of the Trustee which must be properly scrutinised, and failing to do so distorts the analysis.

186 The *second* important consideration is that on 10 May 2010 when the Trustee went into the auction and incurred the obligation to pay $600,300.00 for the 18 GMEs, the *horizon* the Trustee had to commercially look to was 16 August 2012, not the 10 year term of the GMEs. If the Trustee did not bid for, and win the bidding for, 18 GMEs on that day, it would not have any income from gaming from 16 August 2012. Moreover, on the financial statistics discussed earlier, if the Trustee did not bid for, and win the bidding for, the 18 GMEs, the business of the integrated hotel undertaking would have been significantly at risk. Even if an assumption is made, favourably to the Commissioner, that every dollar of revenue derived in every other aspect of the hotel business had remained the same *without* gaming activities onsite, the loss of profit contribution from gaming would have imperilled the total undertaking. The following table sets out the net profit from gaming activities, the net profit of the business overall and the position, on the face of the financial data, which would have prevailed absent the net profit contribution from gaming, for the financial years ending 30 June 2010, 30 June 2011 and 30 June 2012 (as an indication of the extent to which the business depended upon revenue and profit from gaming activities).

Topic	30 June 2010	30 June 2011	30 June 2012
Net profit from gaming activities	$288,226.00	$277,048.00	$231,809.00
Net profit overall	$68,989.00	$154,949.00	$146,587.00
Net profit overall without the net profit contribution from gaming activities	-$219,237.00	-$122,099.00	-$85,222.00

187 The Trustee incurred the outgoing to preserve the hotel business as a going concern. It incurred the outgoing to preserve revenue from gaming and to preserve the contribution gaming activities made to the derivation of revenue in every other aspect of the hotel business.

188 *Without* having incurred the outgoing on 10 May 2010, the financial horizon of 16 August 2012 would have proved to be a very difficult and alarming one for the Trustee.

189 The Trustee had to spend $600,300.00 on 10 May 2010 to preserve the business undertaking on and after 16 August 2012.

190 The *third* consideration is the importance of keeping in mind that the circumstances which might characterise an outgoing as in the nature of capital in one set of circumstances may not necessarily lead to the same conclusion in the circumstances under consideration. The circumstance that the GMEs would form an asset in the sale of the hotel business as a going concern with the result that the outgoing by the incoming purchaser would be characterised as an outgoing on capital account, does not mean that the outgoing incurred by the Trustee in bidding for the GMEs in the auction, is necessarily an outgoing on capital account. The postulate that the Trustee might have come along in another set of circumstances and have purchased the hotel business including GMEs which would have rendered the purchase outgoing an outgoing on capital account, does not mean that the outgoing incurred by the Trustee on 10 May 2010 is necessarily an outgoing on capital account. There was an acquisition of GMEs but it was not an acquisition in the sense of an arms-length sale and purchase by a willing buyer and a willing seller in the sense in which acquisitions normally occur. The circumstances of this acquisition have been described in these reasons extensively and I will not repeat them here. The Trustee was confronted with the changed circumstances brought about by government intervention and had to respond to the possible loss of the right to derive revenue from gaming activities.

191 The simple fact is that the Trustee could not afford to find itself in the position where it could no longer carry on gaming activities. The interdependence of gaming activities with other activities conducted in the business of the hotel was *critical* to the revenues and ultimately profitability.

192 For all these reasons, although I accept that there are also factors which point in a different direction, I regard the outgoing as an outgoing on revenue account.

Section 40-880 of the 1997 Act

193 However, if the outgoing is in the nature of capital, the second question in this appeal arises for determination.

194 As to that question, to recap the observations at [40]-[43] of these reasons, s 40-880(1) of the 1997 Act provides that the object of the section is to make certain business capital expenditure deductible over five years if not otherwise taken into account and not otherwise denied by a provision of the 1997 Act.

195 Section 40-880(2)(a) provides that a taxpayer can deduct, in equal proportions over five income years starting in the year in which it is incurred, capital expenditure incurred in relation to the taxpayer's business.

196 However, s 40-880(5) provides, among other things, that a person cannot deduct anything under the section for an amount of expenditure incurred to the extent that it could (apart from s 40-880) be taken into account in working out the amount of a capital gain or a capital loss from a "*CGT event": s 40-880(5)(f).

197 Section 40-880(6), however, limits the application of the exception contained in s 40-880(5)(f) by providing that the exception does not: "... apply to expenditure you incur to preserve (but not enhance) the value of goodwill if the expenditure you incur is in relation to a legal or equitable right and the value to you of the right is solely attributable to the effect that the right has on goodwill".

198 So, the second question, assuming the outgoing is in the nature of capital, is whether the prohibition contained in s 40-880(5)(f) upon the availability of the deduction, otherwise available under s 40-880(2) over the period of the relevant five income years, is rendered inapplicable to capital expenditure incurred by the Trustee in acquiring the 18 GMEs. That turns upon whether the expenditure is incurred by the Trustee to preserve (but not enhance) the value of goodwill and whether the expenditure is in relation to a *legal* or *equitable right* and the *value* to the Trustee of the *right* is *solely attributable* to the *effect* that the *right* has on *goodwill*.

199 It is, however, necessary to set out the text of the section.

200 The section begins with a statement of the object of the section at s 40-880(1) in these terms:

> *Object*
>
> **40-880(1)** The object of this section is to make certain *business capital expenditure deductible over 5 years, or immediately in the case of some start-up expenses for small businesses, if:
>
> (a) the expenditure is not otherwise taken into account; and

(b) a deduction is not denied by some other provision; and

(c) the business is, was or is proposed to be carried on for a *taxable purpose.

Note: If Division 250 applies to you and an asset:

(a) if section 250-150 applies – you cannot deduct an amount for capital expenditure you incur in relation to the asset to the extent specified in a determination made under subsection 250-150(3); or

(b) otherwise – you cannot deduct an amount for such expenditure.

201 Thus the object of the section is to make the relevant expenditure deductible if all three recited elements are engaged. The section seeks to fulfil the object first by making provision for a deduction of capital expenditure in these terms:

Deduction

40-880(2) You can deduct, in equal proportions over a period of 5 income years starting in the year in which you incur it, capital expenditure you incur:

(a) in relation to your *business; or

(b) in relation to a business that used to be carried on; or

(c) in relation to a business proposed to be carried on; or

(d) to liquidate or deregister a company of which you were a *member, to wind up a partnership of which you were a partner or to wind up a trust of which you were a beneficiary, that carried on a business.

202 Subsections (2A), (3) and (4) are not relevant for present purposes and they do not aid in the contested construction of the text of s 40-880(6), discussed later in these reasons.

203 The section seeks to give further expression to the object at s 40-880(1)(a) by identifying a sequence of considerations in which the expenditure is otherwise taken up and thus subsection (5) denies deductibility under the section for any expenditure the taxpayer incurs to the extent that any one of 10 nominated considerations apply. Subsection (5) is in these terms:

40-880(5) You cannot deduct anything under this section for an amount of expenditure you incur to the extent that:

(a) it forms part of the *cost of a *depreciating asset that you *hold, used to hold or will hold; or

(b) you can deduct an amount for it under a provision of this Act other than this section; or

(c) it forms part of the cost of land; or

(d) it is in relation to a lease or other legal or equitable right; or

(e) it would, apart from this section, be taken into account in working out:

(i) a profit that is included in your assessable income (for example, under section 6-5 or 15-15); or

(ii) a loss that you can deduct (for example, under section 8-1 or 25-40); or

(f) it could, apart from this section, be taken into account in working out the amount of a *capital gain or *capital loss from a *CGT event; or

(g) a provision of this Act other than this section would expressly make the expenditure non-deductible if it were not of a capital nature; or

(h) a provision of this Act other than this section expressly prevents the expenditure being taken into account as described in paragraphs (a) to (f) for a reason other than the expenditure being of a capital nature; or

(i) it is expenditure of a private or domestic nature; or

(j) it is incurred in relation to gaining or producing *exempt income or *non-assessable non-exempt income.

204 Item (5)(d) denies deductibility for an amount of expenditure "in relation to ... a legal or equitable right". A GME is in the nature of a legal or equitable right. Item (5)(f) is concerned with whether the expenditure could be taken into account in working out the amount of a *capital gain or a *capital loss from a *CGT event.

205 Items (5)(d) and (5)(f) would appear to deny deductibility, consistent with the object, to the contested outgoing, otherwise enabled as a deduction by subsection (2). However, subsection (6) moderates that consequence by denying the application of the exceptions in Items (5)(d) and (5)(f), in the following terms:

> **40-880(6)** The exceptions in paragraphs (5)(d) and (f) do not apply to expenditure you incur to preserve (but not enhance) the value of goodwill if the expenditure you incur is in relation to a legal or equitable right and the value to you of the right is solely attributable to the effect that the right has on goodwill.

206 The precise scope of the subsection is a battleground between the parties and so too is its application to the facts. The precise item engaged by the contest, however, is Item (5)(f). The parties agree that Item (5)(f) operates to deny deductibility to the outgoing subject to the operation of subsection (6). The parties also agree that if subsection (6) is engaged so as to excise the outgoing from the exception in (5)(f), the deduction is otherwise available under subsection (2).

Constructional choice and some aspects of statutory construction

207 Section 15AA of the *Acts Interpretation Act 1901* (Cth) (the "Interpretation Act") contains an "unqualified statutory instruction" (*SZTAL v Minister for Immigration and Border Protection* (2017) 91 ALJR 936 at 944-945 [39], Gageler J ("*SZTAL*")) that in interpreting a provision of a Commonwealth Act, "the interpretation that would best achieve the *purpose* or *object* of the Act (whether or not that purpose or object is expressly stated in the Act) is to be *preferred to each other interpretation*" [emphasis added].

208 Statutory construction involves attributing meaning to statutory text. Words are capable of many different meanings and s 15AA of the Interpretation Act expressly recognises that the text of a provision may give rise to more than one possible interpretation. The resolution of that contest of meaning according to the unqualified statutory instruction in s 15AA is "a particular statutory reflection of a general systemic principle" (*Thiess v Collector of Customs* (2014) 250 CLR 664 at 672 [23] ("*Thiess*"), by the Court: French CJ, Hayne, Kiefel, Gageler and Keane JJ). The "general systemic principle" involves the notion that the task of statutory construction *begins* with a consideration of the text of the provision itself: the particular words selected by the Parliament for conveying meaning: *Thiess* at [22]; *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue* (2009) 239 CLR 27 at 46 [47], Hayne, Heydon, Crennan and Kiefel JJ.

209 Moreover, so must the task of statutory construction *end*: *Thiess* at [22]; *Federal Commissioner of Taxation v Consolidated Media Holdings Ltd* (2012) 250 CLR 503 at 519 [39] ("*FCT v Consolidated Media*"), by the Court: French CJ, Hayne, Crennan, Bell and Gageler JJ.

210 However, the "general systemic principle" also involves construing the statutory text "in its context" which includes taking into account the legislative history and extrinsic materials: *Thiess* at [22]; *FCT v Consolidated Media* at [39]. "Understanding context" has "utility", "if, and in so far as", it assists in fixing the meaning of the text of the provision: *Thiess* at [22]; *FCT v Consolidated Media* at [39]. "Objective discernment" of the statutory purpose is "important" (*Federal Commissioner of Taxation v Unit Trend Services Pty Ltd* (2013) 250 CLR 523 at 539 [47], by the Court: French CJ, Crennan, Kiefel, Gageler and Keane JJ), and "integral" to "contextual construction": *Thiess* at [23]; *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355 at 381 [69]-[71] ("*Project Blue Sky*"), McHugh, Gummow, Kirby and Hayne JJ.

211 In *Commissioner for Railways (NSW) v Agalianos* (1955) 92 CLR 390 at 397 ("*Agalianos*"), Dixon CJ in construing a statutory provision which used, as he observed, "somewhat vaguely perhaps [the] very indefinite present tense of the word 'receives'", famously said this:

> ... but the context, the general purpose and policy of a provision and its consistency and fairness are surer guides to its meaning than the logic with which it is constructed.

212 Those observations were affirmed in *Project Blue Sky* at [69].

213 In *Certain Lloyd's Underwriters v Cross* (2012) 248 CLR 378 at [25] ("*CLU v Cross*"), French CJ and Hayne J said this at 389:

> Determination of the purpose of a statute or of particular provisions in a statute may be based upon an express statement of purpose in the statute itself, inference from its text and structure and, where appropriate, reference to extrinsic materials. The purpose of a statute resides in its text and structure. (*Lacey v Attorney-General (Qld)* (2011) 242 CLR 573 at 592 [44])

214 Statutory text, read in context, can present, however, a "constructional choice" between meanings each of which is derived from seeking to apply the elements of the general systemic principle. In *Momcilovic v The Queen* (2011) 245 CLR 1 at 50 [50], French CJ observed that "constructional choice" reflects the "plasticity and shades of meaning and nuance that are the natural attributes of language and the legal indeterminacy that is avoided only with difficulty in statutory drafting".

215 Gageler J described this notion of constructional choice in this way in *SZTAL* at [38]:

> The constructional choice presented by a statutory text read in context is sometimes between one meaning which can be characterized as the ordinary or grammatical meaning and another meaning which cannot be so characterized. More commonly, the choice is from "a range of potential meanings, some of which may be less immediately obvious or more awkward than others, but none of which is wholly ungrammatical or unnatural", in which case the choice "turns less on linguistic fit than on *evaluation of the relative coherence of the alternatives with identified statutory objects or policies*" (*Taylor v Owners – Strata Plan No 11564* (2014) 253 CLR 531 at [66]).
>
> [emphasis added]

216 Although the statutory text may, read in context, present a constructional choice, the resolution of that choice having regard to an evaluation of the relative coherence of the alternatives with the identified statutory objects or policies can, in the end, result in *only one unique answer*, in the exercise of judicial power: *Minister for Immigration and Border Protection v SZVFW* (2018) 92 ALJR 713 ("*SZVFW*"), Gageler J at [54]. As to construction and the derivation of meaning attributable to text, there is *always* "one and only one true

meaning" to be given to fully expressed words: *SZVFW*, Edelman J at [127]; *Life Insurance Co of Australia Ltd v Phillips* (1925) 36 CLR 60 at 78.

217 I apply these principles in seeking to attribute meaning to the relevant statutory text.

218 The first thing to note about the text of subsection (6) is that the *exceptions* in Items (5)(d) and (5)(f) to *deductibility* of the capital outgoing under subsection (2), do not apply to expenditure "you incur to preserve (but not enhance) the value of goodwill …". The text of the so-called "carve-out" goes on to address other integers to which I will return in a moment.

219 The words "to preserve" are concerned with a mental element informing the incurring of the expenditure. The words in *brackets* immediately after the doing words "to preserve" are, "but not enhance". Those words qualify the action of the mental element "to preserve". Therefore, the words should be read, together with the qualification, in this way: "to preserve (but not *to enhance*) the value of goodwill". In other words, all of the words in that collection of words are focused upon the mental element (or purpose) at the *moment in time* the expenditure *is incurred.*

220 Importantly, the words: "apply to expenditure you incur to preserve (but not enhance) the value of goodwill", do not import a two-fold consideration of, *first*, whether the expenditure was incurred *to preserve* the value of goodwill **and** a *second* disqualifying test or consideration of whether the expenditure, incurred to preserve the value of goodwill, had the *effect* or *consequence* of enhancing goodwill. If the Parliament had intended to introduce such a consideration, it would have used plain words in doing so. It would have adopted words such as: "the exceptions in paragraphs (5)(d) and (5)(f) do not apply to expenditure you incur to preserve, but not having the effect of, enhancing, the value of goodwill …".

221 The text, "(but not enhance)", immediately qualifying the words, "to preserve", is simply not capable of doing that much work. It is asking a lot of those bracketed words, "(but not enhance)" to import a statutory concept that the carve-out is only engaged (at least as to this element) if the expenditure is incurred to preserve the value of goodwill *and* does not have the effect of enhancing the value of goodwill. That construction gives this integer within the section much greater reach than the language conveys. The language is concerned with the mental element at the moment in time of the incurring of the expenditure and is focused upon whether the expenditure was incurred *to preserve* the value of goodwill rather than *to enhance* the value of goodwill.

222 The Commissioner contends, as noted later in these reasons, that the text, "(but not enhance)" immediately adjacent to the words "to preserve", imports the notion that if the consequence of incurring the outgoing is that goodwill is enhanced, the "carve-out" in subsection (6) is not available. The Commissioner construes the text in this way: "the exception [does not] apply to expenditure you incur to preserve (but not having the consequence of enhancing) the value of goodwill". The difficulty with that construction is that the three words in the text, "but not enhance", are encapsulated within brackets immediately and directly qualifying the scope of the action words "to preserve" which suggests the Parliament was trying to make plain that the mental element required at the moment of incurring the expenditure is "to preserve the value of goodwill" rather than an operative mental element "to enhance the value of goodwill".

223 If the Parliament had intended by those brackets, and the words in the brackets, to introduce an "effects" or "consequences" element as well as a particular mental element, it would *not* have encapsulated the words "but not enhance" in brackets but would, as a matter of construction, have adopted words openly in the text giving them their own additional operation, such as: "to preserve but not having the effect of enhancing, the value of goodwill".

224 Simply by way of illustration of the way the Parliament has previously approached the task of framing a purpose and effects proposition, s 45(1)(a) of the *Competition and Consumer Act 2010* (Cth) frames a prohibition upon conduct by reference to whether the relevant provision "has the purpose, or would have or be likely to have the effect of, substantially lessening competition". In this example, the words are self-executing and seek to do the work of extending the scope of the prohibition. In the text under consideration in this case, three words in brackets are asked to do a lot of work if the proper construction is that they import a qualifying or limiting "effects" or "consequences" element. This part of the text in subsection (6) is not directed to a consideration of the consequences of incurring the outgoing but only whether it is incurred to preserve the value of goodwill (rather than to enhance the value).

225 Of course, it is artificial to segment the text in this way. It must be construed in its entirety according to the text and in context. However, at the same time it is necessary to also examine each integer of the provision as an aspect of construing the provision overall.

226 So, as to the *first* integer, at least, of s 40-880(6), the exception in s 40-880(5)(f) does not apply to expenditure you incur to preserve the value of goodwill. The mental element is whether or not the expenditure was incurred *to preserve* the value of goodwill. If the mental element is *to enhance* the value of goodwill, the carve-out from the exception will not be available. If the mental element, on the evidence, is to preserve the value of goodwill but incurring the expenditure has the effect or consequence of enhancing the value of goodwill, the carve-out will nevertheless be engaged, at least as to this element, because this integer focuses upon the mental element of, in this case, the guiding mind of the Trustee ("you") at the moment in time the expenditure is incurred, as described.

227 The *second* integer is whether the expenditure is incurred in relation to a legal or equitable right. The expenditure was incurred in relation to the acquisition of each GME. The earlier examination of the statutory provisions relating to a GME suggests that it is in the nature of a legal or equitable right. I accept that a GME is in the nature of an intangible right. I accept that a gaming machine entitlement is something which satisfies this integer in the text of s 40-880(6).

228 The next integer is whether "the value [to the Trustee] of the right [attaching to each GME] is solely attributable to the effect that the right has on goodwill".

229 At this point it is convenient to identify the position adopted by the Commissioner concerning the first and third integers of subsection (6) and related matters.

230 The Commissioner says that the incurring of the outgoing *enhanced* the value of goodwill. The Commissioner says that if the Trustee's goodwill is valued by reference to *profit* derived from gaming, the Trustee's profit increased simply, for no other reason than that the share of the net distributable revenue from gaming derived by Tattersalls, "disappeared" under the new regime. The Commissioner says that even though other outgoings were incurred by the Trustee such as the payments to PVS and the monitoring fees and the quarterly payments to State Treasury, the Trustee's *profit* from gaming increased as a result of the outgoing and thus *goodwill* was, in fact, enhanced.

231 The Commissioner says that enhancing the goodwill through to the end of the term of the GMEs in 2022 is an "unanswerable" proposition "fatal" to the Trustee in the sense that the carve-out in subsection (6) simply cannot operate in that circumstance: T, p 30, lns 29-46; T, p 31, lns 1-3.

232 The Commissioner accepts that it is "completely true" that if the gaming machine entitlements had not been obtained by incurring the outgoing, there would have been a loss of goodwill: T, p 32, lns 7-9. The Commissioner accepts that that would "clearly" be so because absent the outgoing, the Trustee would not have had the GMEs; it would not have carried on or conducted gaming; and it would not have had the revenue: T, p 32, lns 11-33. The Commissioner says that a "consequence" of having obtained the GMEs and conducting gaming was that the "value of goodwill" was, "in fact, enhanced", but, "without a doubt", the enhancement was a "consequence" of having incurred the expenditure (and exercising the right): T, p 33, lns 14-17.

233 The Commissioner accepts that if the outgoing had not been incurred, the consequence would have been that future gaming would have stopped; the revenue that was conditional on the "custom" for gaming would have "disappeared" which was "a custom that related not only to gaming revenue but to food and liquor sales as well … bar sales, restaurant sales" and "all sorts of things": T, p 34, lns 1-20.

234 The Commissioner accepts that "the whole thing" would have been impacted upon and he accepts that "what stops – what decreases the goodwill is the loss of custom": T, p 34, lns 22-25.

235 The Commissioner also accepts that the Trustee is "running a pub" and the "loss of custom is integrally connected with the capacity to attract custom by reason of the capacity to conduct gaming operations as part of an integrated hotel business": T, p 34, lns 27-33.

236 The point of distinction emphasised by the Commissioner is that the "effect on goodwill is the consequence of how the GMEs are used *together with other assets*" [emphasis added] and "what was acquired here was the GMEs [alone]". The point being made by the Commissioner is that the expenditure incurred in making the acquisition was concerned with "not just the impact upon *goodwill* but, *immediate profits*" [emphasis added] (T, p 34, lns 43-44) and when looking at the notion of "motivation", the Commissioner says that the acquisition, and thus the outgoing, was "motivated not *just* by [the] impact upon goodwill, but on the fact that, if gaming stopped, *income* immediately stopped" [emphasis added]: T, p 35, lns 1-3.

237 What follows from this for the Commissioner is that the subsection requires the addressee to incur the expenditure to preserve the value of goodwill but here the Trustee, it is said,

incurred the expenditure "to acquire the GMEs": T, p 35, ln 32. The "immediate purpose" of the expenditure was to "acquire the entitlements" (T, p 35, ln 32, lns 43-45) and "a gaming machine entitlement ... of its very nature is not something that's *referrable primarily to goodwill*" [emphasis added]: T, p 36, lns 27-29.

238 The Commissioner says that gaming machine entitlements are concerned with "a capacity to carry on a business": T, p 36, ln 29. The Commissioner says that because the expenditure was "incurred to obtain the assets created by the statute", not only is the *character* of the expenditure a matter of capital but it cannot be an expenditure to preserve the value of *goodwill* because it is expenditure incurred "to obtain the GMEs" and such expenditure is not in the nature of or "primarily referable to" goodwill.

239 There are two particular difficulties I have with this line of argument.

240 The first is that it seems odd to rely upon the very characteristic of the expenditure that engages the object of the section to defeat the working utility of the section and its object. The object of the section is to make some capital expenditures deductible within the principles in subsection (1) as enabled by subsection (2) subject to the 10 exceptions in subsection (5), with the impact of, relevantly, subsection (5)(f) on the deductibility of the capital outgoing mitigated by subsection (6). Then, it is said that subsection (6) is not engaged *because* the outgoing is a *matter of capital expenditure* as it was an outgoing incurred to purchase GMEs and since that is so, it cannot also be expenditure incurred to preserve the value of goodwill. However, the section itself (and subsection (6) gives expression to it), recognises the possibility that capital expenditure "you incur in relation to your business" (subsection (2)(a)) might be expended "to preserve the value of goodwill"). So it seems odd to then construe subsection (6) as having no operation once the *character* of the expenditure in question is "capital expenditure" and thus its incurring is not capable of having a relationship with the preservation of the value of goodwill.

241 The second difficulty (which is inherent in the evidence rightly accepted by the Commissioner as described earlier concerning the transparently obvious critical dependence of the integrated hotel business on gaming revenues), is that the making of the acquisition of the GMEs and the incurring of the expenditure was the very *means* of preserving the goodwill. The goodwill of the business would have collapsed absent the GMEs. The "custom" and "patronage" would have fallen significantly. The revenues would have fallen. This business relied on the gaming revenues. The valuation of the business and its goodwill,

without the expenditure in question, would have been diminished a great deal. The valuation multipliers would, at the very least, have been three rather than four. However, the financial evidence on the role of gaming revenues in the viability of the business is very significant.

242 In this case, the evidence is that Mr Canny had to confront the counter-factual possibility that by the end of 10 May 2010, the Royal Hotel might not be successful in acquiring 18 or even 15 GMEs in the auction process. That possibility would have been very damaging to the business. Gaming revenue was critical to it. Mr Canny thought, for the Trustee, he might have to incur an expenditure obligation of up to $1.5 million to retain gaming revenues into the future whilst trying to sustain a reasonable rate of return in the business. The subjective purpose of Mr Canny in bidding was to obtain the GMEs in order to secure the right to conduct gaming. However, that was an expenditure obligation incurred as a means to secure the custom and patronage of the business in order to secure revenue and profits. The *value* to the Trustee (Mr Canny being the guiding mind of the Trustee) of the *right* to conduct gaming (the critical right attached to a GME), was solely attributable to the effect the right had on the custom, patronage, revenue and profits of the hotel business, that is, the effect on the goodwill of the integrated hotel business undertaking.

243 It is important to remember that the relevant comparison in examining the incurring of the contested outgoing, is the comparison confronting Mr Canny, on the one hand, of, the business of a Pub with custom and patronage influenced by gaming across all aspects of the business, and, on the other hand, a Pub business without the outgoing and *no gaming*; no gaming revenues; no contribution to other revenues from the presence of gaming; and significantly diminished custom and patronage in the hotel business.

244 As previously mentioned, the Commissioner says that the incurring of the outgoing enhanced the value of goodwill through to the end of the term of the GMEs in 2022 and that this circumstance is an unanswerable proposition fatal to the Trustee in engaging the carve-out in subsection (6). However, to the extent that goodwill was enhanced, this was a consequence of incurring the outgoing which was incurred to preserve rather than to enhance the value of goodwill. The relevant question is whether the outgoing was incurred to preserve the value of goodwill. The evidence demonstrates that it was so incurred. At para 26, the Tribunal said this relevant to this topic:

> The goodwill referred to in s 40-880 must ... be understood as the right obtained from the use of the gaming machine entitlements with the trustee's other assets to produce income. The evidence in this case was that the *purpose* for incurring the

> expenditure was to secure entitlements for the trustee to continue gaming activities which had previously been carried on by Tattersalls at the trustee's premises. The trustee had previously derived income from Tattersall's gaming activities and the expectation of that income was reflected in the trustee's goodwill. The expenditure on the gaming machine entitlements was to enable the trustee to derive directly the income from gaming activities which the trustee had previously derived indirectly as commissions by the gaming activities carried on by Tattersalls. That purpose of the expenditure (on the assumption that it was of capital) was, from a practical and business point of view *to preserve the value of goodwill and was also reflected in the trustee's goodwill.*
>
> [emphasis added]

245 Thus, there is a finding by the Tribunal, entirely unsurprising on the state of the evidence that the purpose of the expenditure from a practical and business point of view, was to preserve the value of goodwill.

246 At para 27 the Tribunal said this:

> The expenditure must *not*, however, have been *to enhance goodwill* for the expenditure to be deductible, and the expenditure in this case did "enhance" the value of the goodwill because the gaming machine entitlements which were acquired increased the trustee's rights by 10 years longer than it had previously. The trustee had acquired entitlements in 2005 to receive (by way of commissions) income from gaming activities until 2012. The gaming machine entitlements acquired in 2010 necessarily enhanced its goodwill by extending the entitlement by 10 years.
>
> [emphasis added]

247 In this passage, the Tribunal recognises that the relevant mental element in incurring the expenditure is to preserve the value of goodwill and not one of incurring the outgoing "to enhance goodwill". However, the Tribunal, in this passage, wrongly, in my respectful view, is treating the question of enhancement as a matter of "effects" such that if the result or effect or consequence of incurring the outgoing (even though the outgoing was incurred to preserve the value of goodwill) is to enhance the value of goodwill, the deduction is not available because, on that approach to constructional choice, the elements of subsection (6) are not satisfied.

248 The Tribunal's finding as to the subjective purpose of Mr Canny, as the guiding mind of the Trustee, was that he incurred the outgoing of capital (if it be capital), to preserve the value of the Trustee's goodwill and not a purpose of enhancing the value of goodwill.

249 The Trustee acquired 18 GMEs which enabled it to conduct gaming. That right enabled the Trustee to derive gross revenue and profits from gaming. As things transpired, on 9 November 2015, the Trustee sold the Royal Hotel to Jamcoe Pty Ltd ("Jamcoe") for

$2,453,000.00 plus $40,000.00 for stock. That price seems to have been influenced by two factors.

250 The *first* is that Mr Canny had successfully negotiated a new lease with the landlord of the Royal Hotel for a principal term of 10 years from 1 April 2012 plus an option for a further 20 years to **2032**.

251 The *second* is that the Trustee had incurred the outgoing to secure the acquisition of 18 GMEs and on 24 February 2016, those 18 GMEs were transferred to Jamcoe as part of the sale. Of course, those GMEs entitled Jamcoe to conduct gaming. No consideration was attributed to the transfer but Jamcoe assumed the liability for the remaining quarterly payments to be paid for the GMEs.

252 The position in relation to revenue and profits from gaming in the years 2013, 2014 and 2015 are set out in a little more detail in the following table:

Items	2013	2014	2015
Total annual distributable gaming revenue	$1,053,761	$997,448	$1,142,319
Intralot payments	$12,708	$18,815	$22,979
PVS	$150,255	$175,264	$180,642
Gaming tax VCGLR	$317,219	$318,030	$423,293
GME payments	$150,075	$120,060	$120,060
Gross profit from gaming	$423,504	$365,278	$395,346
Net profit from gaming	$308,806	$250,431	$274,315

253 The net profit from gaming in the years 2006 to 2012 can be seen in the table at [66] of these reasons. The net profit from gaming in the years 2013 to 2015, without deduction for the GME payments, would have been: 2013 - $458,881; 2014 - $370,491; 2015 - $394,375.

254 There can be little doubt that the net profit from gaming in the years 2013 to 2015 increased as compared with the years from 2006 to 2012 but, in particular, the years 2010, 2011 and 2012 as a comparative three year period. I accept that the *effect* or consequence of incurring the outgoing was to enhance the value of goodwill. However, I respectfully disagree with the proposition that the *effect* of *enhancing* the goodwill is a matter determinative of Mr Canny's mental element in *incurring* the outgoing. He incurred the outgoing *to preserve* the value of goodwill, not to enhance it. There is a finding about that matter by the Tribunal and it is entirely consistent with the evidence. Thus, I do not accept that the *consequence* that the value of goodwill increased or was enhanced, alters the fact that Mr Canny acted, in incurring

the outgoing, *to preserve* the value of goodwill although, plainly enough, the evidence is that the value of the goodwill ultimately was enhanced. The concluding words of s 40-880(6) are these (see [205] of these reasons for the full text of the section): "and the value to you of the right is solely attributable to the effect that the right has on goodwill". These words do engage the notion of an "effect" but in a particular way and the statutory question arising out of this part of the text is this: Is the ***value*** to the Trustee of the ***right*** to carry on gaming (being the legal right acquired in respect of which the outgoing was incurred) ***solely attributable*** to ***the effect*** that the ***gaming right*** has on ***goodwill***. On the facts of this case at least, the position is that *but for* the *right,* the goodwill of the Trustee's business would have collapsed. That proposition, on the facts, does not seem to be essentially contested by the Commissioner, as described earlier in these reasons. Thus the *value* to the Trustee of the *right* is solely attributable to the *effect* that *the right* had on the goodwill of the business. At the moment in time when Mr Canny incurred the outgoing to preserve the value of goodwill, the expenditure was incurred in relation to a legal or equitable right and the value to the Trustee of the right was solely attributable to the effect that the right had on goodwill because the value to the Trustee of the right was to preserve the gross revenue and net profit of the hotel business which, absent the expenditure, would have been, at the very least, significantly diminished on the financial information in evidence. It is difficult to see how the business undertaking of the Royal Hotel could have survived *at all* without the gross contribution to revenue and the net contribution to profit from gaming, an activity entirely dependent upon "the right". That is why it has been necessary to look closely at the financial statistics in relation to the business undertaking of the Trustee.

255 In my view, the appeal should be dismissed.

I certify that the preceding two hundred and fifty five (255) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Acting Chief Justice Greenwood.

Associate:

Dated: 27 September 2018

REASONS FOR JUDGMENT

MCKERRACHER J:

256 I have had the benefit of reading in draft the reasons of Greenwood ACJ and agree with his Honour's reasons and proposed orders.

I certify that the preceding one (1) numbered paragraph is a true copy of the Reasons for Judgment herein of the Honourable Justice McKerracher.

Associate:

Dated: 27 September 2018

REASONS FOR JUDGMENT

THAWLEY J:

257 The first issue in this appeal is whether an amount of $600,300 paid for 18 gaming machine entitlements (**GMEs**) was an "outgoing of capital, or of a capital nature" and, for that reason, not deductible under s 8-1 of the *Income Tax Assessment Act 1997* (**ITAA 1997**).

258 If the outgoing was an outgoing of capital or of a capital nature, the second issue is whether it was "capital expenditure" deductible over 5 years in accordance with s 40-880(2) of the ITAA 1997.

259 The Administrative Appeals **Tribunal** held that:

(1) the amounts incurred for the acquisition of the GMEs were on revenue account and deductible under s 8-1 of the ITAA 1997;

(2) if it was wrong in that conclusion and the amounts were on capital account, then s 40-880(2) did not provide for a deduction because the exception in s 40-880(5)(f) applied and was not saved by the exclusion to the exception found in s 40-880(6).

260 The applicant (**Commissioner**) contended that the Tribunal erred in finding that the amount incurred by the Trustee for the acquisition of the GMEs was on revenue account and allowable as a deduction. He did not dispute the correctness of the Tribunal's findings in relation to s 40-880.

261 By a notice of contention, the respondent contended that, if the Tribunal was wrong in relation to the deductibility of the expenditure under s 8-1, its decision to set aside the Commissioner's objection and allow the respondent's objection in full should be affirmed on the basis that the outgoings were deductible under s 40-880(2).

BACKGROUND

262 The respondent was the corporate beneficiary of the Daylesford Royal Hotel **Trust**, presently entitled to 100% of the income of the Trust in the year of income ended 30 June 2012. The **Trustee** of the Trust incurred an amount of $600,300, payable by instalments, to acquire 18 GMEs in the year ended 30 June 2010.

263 On 8 August 2005, the Trustee acquired a business trading as the Royal Hotel for $1,000,025. The business derived income from various activities including accommodation, gaming and

sales of meals and alcohol. How the income was derived from gaming requires further explanation.

264 When the Royal Hotel was acquired, the regulation of gaming in Victoria provided for the issue of both a "venue operator's licence" and a "gaming operator's licence". The Trustee held a venue operator's licence. **Tattersalls** Gaming Pty Ltd held a gaming operator's licence. This permitted Tattersalls to own and operate gaming machines at the Royal Hotel: s 3.4.2(d) of the *Gambling Regulation Act 2003* (Vic) (**Gambling Act**). This licence was due to expire in 2012.

265 Tattersalls owned and operated 18 gaming machines at the Royal Hotel. Tattersalls was required by s 3.6.6 of the *Gambling Act* to pay amounts from the gaming machine income to the Trustee and to the Victorian **Commission** for Gambling Regulation. The Tribunal referred to the payments made by Tattersalls to the Trustee (being the "venue operator of an approved venue") as "commission". These payments were made in accordance with s 3.6.6(2)(b) of the *Gambling Act*.

266 In 2008, the Victorian government announced a new regime which would apply from August 2012. Chapter 3 of the Gambling Act was entitled "Gaming Machines". A new Part 4A, entitled "Gaming Machine Entitlements", was introduced. This included a requirement that, from the relevant commencement day, the conduct of gaming in an approved venue was only lawful if "the venue operator [the Trustee] holds a gaming machine entitlement that authorises the conduct of that gaming": s 3.4A.1(1)(a) of the Gambling Act; see also s 3.4.1(1)(ab).

267 Each GME permitted the holder to acquire approved gaming machines and conduct gaming on one approved gaming machine in an approved venue operated by the approved venue operator: s 3.4A.2(1) of the Gambling Act. Subject to the fact that a GME might be terminated early or extended for a period not exceeding two years upon application by a venue operator, a GME had a duration of 10 years: s 3.4A.7(1). This period ran from August 2012. GMEs were recorded by the Commission in the entry in the Register relating to the venue operator to which the GME was allocated: s 3.4A.8(2). The Gambling Act contemplated the sale and transfer of GMEs to another venue operator, but only in accordance with the provisions of the Act.

268 The Trustee acquired 18 GMEs for $33,350 each (a total of $600,300) as a result of a competitive auction process held on 10 May 2010. The Trustee elected to pay for the GMEs in instalments between May 2010 and 31 August 2016. The $10,000 paid by the Trustee to the State to participate in the auction was credited to the amount payable for the GMEs. The amount of $50,030 was paid in May 2010, $60,030 was paid on 16 August 2012 and then further amounts of $30,015 were paid quarterly until 31 August 2016.

269 Under the terms of an agreement between the Trustee and the Minister for Gaming on behalf of the Crown in right of the State of Victoria, if the Trustee defaulted on payment of instalments then the GMEs were forfeited to the State, such forfeiture falling within s 3.4A.27 (Division 8) and being dealt with in accordance with Divisions 9 and 10 of Chapter 3 of the *Gambling Act*. The consequences of this were:

(1) under Division 9, any right or interest in the GMEs would be extinguished without compensation; and

(2) under Division 10, amounts owed by the Trustee in respect of the allocation of the GMEs would become immediately payable and recoverable as a debt due to the State, no compensation would be payable in respect of the forfeiture except as otherwise provided by Division 10, and the proceeds (if any) arising from an allocation of GMEs forfeited would be paid to the venue operator who forfeited the entitlement (the Trustee).

270 The new arrangements resulted in the following changes for the Trustee:

(1) The Trustee became the only entity lawfully authorised to conduct gaming at the Royal Hotel. From August 2012, it derived income from the gaming machines. Tattersalls no longer conducted gaming activities and the Trustee no longer received commission from Tattersalls.

(2) The Trustee came under an obligation to make certain payments to the Commission pursuant to s 3.6.6A of the Gambling Act. These payments are described as a "tax" to be paid into the "Consolidated Fund". The tax was payable within seven days after the end of each calendar month: s 3.6.6A(7). These outgoings of tax were calculated by reference to the income stream ("average revenue per gaming machine entitlement").

(3) The Trustee engaged **PVS** Australia Pty Ltd to administer the gaming operations at the Royal Hotel pursuant to an agreement dated March 2012. The Trustee paid PVS a fee per gaming machine. Under the agreement, PVS provided 18 gaming machines, which PVS acquired from Tattersalls. It was also required to undertake audit and other compliance activities.

271 On 9 November 2015, the Trustee sold the Royal Hotel business, including the GMEs, to **Jamcoe** Pty Ltd for consideration of $2,453,000, plus $40,000 for stock. Jamcoe assumed liability for the remaining quarterly payments owing to the State of Victoria in respect of the GMEs (totalling $90,045).

ISSUE 1: CAPITAL OR REVENUE

272 There was no dispute between the parties that, on undisputed facts, the question of whether an outgoing is on capital or revenue account is a question of law: *Jeffrey v Rolls-Royce* (1962) 40 TC 443 at 490, 496; *Federal Commissioner of Taxation v Cooper* (1991) 29 FCR 177 at 194; ***Hallstroms** Pty Ltd v Federal Commissioner of Taxation* (1946) 72 CLR 634 at 646; *Commissioner of Taxation v Roberts & Smith* (1992) 37 FCR 246 at 251.4 per Hill J.

The applicant's contentions

273 The Commissioner contended that the advantage sought and achieved by the GME expenditure was the acquisition of GMEs. It contended that this advantage, by its very nature, was a matter related to the profit-making structure of the Trustee's business. Before the acquisition of the GMEs, it was Tattersalls which lawfully conducted gaming activities on the Trustee's premises. After the acquisition of the GMEs by the Trustee, and once the new regime became operational in 2012, it was the Trustee which lawfully operated gaming activities on its premises.

274 The means by which the GMEs were obtained was by a one-off acquisition at auction for a fixed price, payable in instalments. The expenditure did not occur as part of the regular process by which any business of the Trustee operated to produce income, but was incurred in order to provide a necessary component of the profit-making structure of the gaming business to be carried on by the Trustee.

The respondent's contentions

275 The essence of the respondent's submissions was as follows. The Trustee had, since its acquisition of the Royal Hotel in 2005, conducted a business which included making

available to its customers the ability to engage in gambling on machines. The Trustee's business also included the provision of accommodation, food and alcohol.

276 The characterisation of an outgoing as capital or revenue does not depend on a juristic classification of the legal rights but "on what the expenditure [was] calculated to effect from a practical and business point of view": *Hallstroms* at 648, cited in *Tyco Australia Pty Ltd v Federal Commissioner of Taxation* (2007) 67 ATR 63 at [36], per Allsop J (as his Honour then was). The respondent submitted that, from a practical and business point of view, the expenditure was calculated to enable the Trustee to continue to provide gaming activities to its customers in accordance with the relevant laws as they stood from time to time. The Trustee incurred the expenditure, the respondent submitted, "to continue to receive income from customers by providing the same goods and services, including gaming services, it had previously provided to them".

Consideration

277 The general principles relevant to whether expenditure is on capital or revenue account were recently set out by the majority (French CJ, Kiefel and Bell JJ) in ***Ausnet*** *Transmission Group Pty Ltd v Commissioner of Taxation* (2015) 255 CLR 439 at [14] to [30], where their Honours noted the question calls for an evaluative judgment: at [14]. The following principles are relevant:

(1) *First*, the distinction "may require a weighing of factors including the form, purpose and effect of the expenditure, the benefit derived from it and its relationship to the structure, as distinct from the conduct, of a business": at [15]. Some factors may point in one direction, others in a different direction.

(2) *Secondly*, a "once and for all payment" might tend to indicate the expenditure was a capital outlay, particularly when made with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade; a "recurrent payment" might tend to indicate the expenditure was of a revenue nature: at [15]. However, the fact that a payment is recurrent is not determinative. For example, a payment by instalments of a charge imposed as a condition upon the grant of a liquor licence reflecting its monopoly value has been held to be a capital outlay: at [16], referring to ***Henriksen*** *v Grafton Hotel Ltd* [1942] 2 KB 184.

(3) *Thirdly*, a payment which is part of the consideration for the purchase of a business is generally capital, even if paid in a manner which can be seen to be recurrent: at [17],

[18]. "The fact that a payment can be viewed as part of the consideration for the acquisition of a business or capital asset weighs heavily in favour of its character as a capital outlay"; however "the question must always be asked – was the payment made 'for' the acquisition?": at [18].

(4) *Fourthly*, the fact that the asset acquired is a "wasting asset" does not necessarily deprive the asset of its capital character: at [20]. In ***Sun Newspapers*** *Ltd v Federal Commissioner of Taxation* (1938) 61 CLR 337, the contested expenditure of Sun Newspapers secured, from its potential competitor, a non-compete covenant which was limited in duration and spatial coverage. The covenant secured, so far as possible, a monopoly and obtained a real advantage, namely the exclusion of what might have been serious competition. The covenant was held to have been acquired on capital account.

(5) *Fifthly*, referring to *Sun Newspapers* at 359 (per Dixon J), "the distinction between capital and revenue account expenditure corresponded with the distinction between the business entity, structure or organisation set up or established for the earning of profit and the process by which such an organisation operates to obtain regular returns by means of regular outlay": *Ausnet* at [21]. Thus, "an intangible asset might, according to its nature and function in the conduct of the business, be properly characterised as forming part of the structure of the business and the cost of its acquisition as a capital cost": *Ausnet* at [21]. It was noted, by reference to *Henriksen*, that a licence, essential to the conduct of the business, may fall within that description.

(6) *Sixthly*, their Honours in *Ausnet* at [22] noted that Dixon J in *Sun Newspapers* at 363 had referred to three factors and a fourth in *Hallstroms* at 648:

(i) the character of the advantage sought, and in this its lasting qualities may play a part;

(ii) 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;

(iii) 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; and

(iv) what the expenditure is calculated to effect from a practical and business point of view, rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process. Their Honours in *Ausnet* at [22], however, cautioned that "the emphasis placed by Dixon J on the 'practical and business point of view' does not mean that it is unnecessary to examine the legal rights (if any) obtained by the expenditure".

(7) *Seventhly*, their Honours emphasised the importance of the "advantage sought by the taxpayer by making the payments" and the "character of the advantage sought by the expenditure": at [23]. Their Honours referred to the decision of Fullagar J in ***Colonial Mutual*** *Life Assurance Society Ltd v Federal Commissioner of Taxation* (1953) 89 CLR 428 at 454 to the effect that payments forming part of the purchase price of an asset, which form part of the fixed capital of a business, are outgoings of capital. Their Honours referred to Fullagar J in *Colonial Mutual* at 454 who identified the questions commonly arising as:

> (1) What is the money really paid *for?* – and (2) Is what it is really paid for, in truth and in substance, a capital asset? [Emphasis in original]

278 In *Ausnet,* Gageler J stated at [73]-[74] (some footnotes omitted):

> 73. The distinction between expenditure that is an outgoing of a capital nature and expenditure that is an outgoing of a revenue nature is sufficiently stated for present purposes as "the distinction between the acquisition of the means of production and the use of them" [*Hallstroms* at 647]. The distinction "depends on what the expenditure is calculated to effect from a practical and business point of view" [*Hallstroms* at 648].
>
> 74. To characterise expenditure from a practical and business perspective is not to disregard the legal nature of any liability that is discharged by the making of that expenditure [*GP International Pipecoaters Pty Ltd v Commissioner of Taxation* (1990) 170 CLR 124 at 137]. It is not to inquire into whether the expenditure is similar or economically equivalent to expenditure that might have been incurred in some other transaction. It is to have regard to the "whole picture" of the commercial context within which the particular expenditure is made [*BP Australia Ltd v Federal Commissioner of Taxation* (1965) 112 CLR 386 at 399], including most importantly the commercial purpose of the taxpayer in having become subjected to any liability that is discharged by the making of that expenditure. It is, where necessary, to "make both a wide survey and an exact scrutiny of the taxpayer's activities" [*Western Gold Mines NL v Commissioner of Taxation (WA)* (1938) 59 CLR 729 at 740].

279 His Honour, referring to *Cliffs International Incorporated v Federal Commissioner of Taxation* (1979) 142 CLR 140 and *Commissioner of Taxation v Citylink Melbourne Ltd* (2006) 228 CLR 1, stated (at [77]-[78]):

> 77. Those cases can be taken to illustrate the negative proposition that the fact that a promise to make the expenditure formed part of the consideration for the acquisition of an asset does not foreclose the question of whether the expenditure when made is calculated to effect the acquisition of the asset. Other considerations – including the frequency of the expenditure, the circumstances in which it is to be paid and the method by which it is to be calculated – might yet lead to the conclusion that the expenditure when made is more appropriately to be characterised from a practical and business perspective as referable to the subsequent use of the asset or to some other circumstance.
>
> 78. Beyond that, I do not think that there is any general proposition to be taken from them. "The proper conclusion in each case in this particular area of the law", Barwick CJ observed as a member of the majority in *Cliffs*, "is peculiarly dependent upon the particular facts and circumstances of that case". Writing for the majority in *Citylink*, Crennan J made the same point when she endorsed the observation that there was "danger in arguing by analogy".

280 In the present case, the payments represented the purchase price of GMEs. That is what the payments were for: *Ausnet* at [23]. The GMEs were a capital asset. They were a species of property: *ICM Agriculture Pty Ltd v Commonwealth* (2009) 240 CLR 140 at [147] per Hayne, Kiefel and Bell JJ; at [197] per Heydon J. The GMEs would endure for a period of 10 years, extendable by two. The concept of "enduring" in this context does not mean permanent or perpetual: *Herring v Federal Commissioner of Taxation* (1946) 72 CLR 543 at 547, per Rich J; *Federal Commissioner of Taxation v Pine Creek Goldfields* (1999) 91 FCR 263 at [49], per Gyles J; see also the passage from *Henriksen* set out at paragraph [289] below.

281 The fact that the GMEs were paid for by instalments does not alter the fact that they were paid for the acquisition of a capital asset: *Ausnet* at [18]. The fact that the price was paid by instalments was a matter of the Trustee's choice. The payments were not in the nature of recurrent expenditure for fees incurred in the ordinary course of business operations, such as regular licence fees.

282 The GMEs were a "wasting asset" in the sense that they were limited in duration for a period of 10 years and the value of them might be expected to diminish over time. However, that does not prevent the asset being a capital asset: *Ausnet* at [20]. There are innumerable examples of "wasting" assets held on capital account. Where a "wasting asset" is structural – that is, a part of the structure or process of income derivation – it is ordinarily not deductible: Parsons RW, *Income Taxation in Australia* (The Law Book Company, 1985) at [7.9] and [7.10]

283 Although the GMEs are an intangible asset, they are properly characterised as forming a part of the structure of the business; they were essential to being able to conduct gambling on the premises: *Ausnet* at [21]. These activities would yield an income stream to the Trustee and give rise to an obligation to make regular deductible expenditure.

284 The GMEs were required as a "means of production" (*Ausnet* at [73]) in that they were necessary for the Trustee to acquire in order for the Trustee to be able to conduct gaming at its venue and thus continue to make gambling available to its customers. The "use" (*Ausnet* at [73]) of the GMEs gave rise to deductible expenditure in the form of the requirement to make various payments.

285 From a commercial and practical perspective, it was either desirable or necessary for the Trustee to acquire the GMEs. Without them, it would not be able to make gaming available to its customers. The various activities of accommodation, gaming and sales of meals and alcohol were complementary in the sense that each potentially or actually enhanced the profitability of the other. Customers coming for one activity might engage in another. Customers might not come at all in the absence of gaming being available; they might choose a competitor location. However, the fact that the acquisition of the GMEs was commercially desirable, and necessary if gaming was to continue to be provided to customers of the hotel, does not alter the fact that the GMEs were capital assets forming part of the business structure and that the payments were made for those capital assets.

286 As noted above, the respondent submitted that the outgoing was incurred "to continue to receive income from customers by providing the same goods and services, including gaming services, it had previously provided to them". In one sense this is correct; but its imprecision masks much. The Trustee did not "receive income from customers" from the conduct of gaming activities before 2012. Tattersalls received income and paid an amount of "commission" to the Trustee. The Trustee did not provide the same services before 2012 as it did thereafter. From 2012, the Trustee became the only person lawfully entitled to conduct gaming at its venue and came under the various obligations imposed on it by statute as a person conducting such activities. The new regime and the acquisition of GMEs resulted in a new business structure, including very different rights and obligations and consequent risk. An examination of what the expenditure was calculated to effect from a practical and business point of view does not mean that it is unnecessary to examine the legal rights obtained by the expenditure: *Ausnet* at [22]. In any event, from a practical and business point

of view, the expenditure was calculated to put the Trustee in a position where it owned the capital assets necessary for it to conduct gaming activities. It is not to the point that changes in the law were the reason why the Trustee formed a desire to acquire those assets, or formed the view that it was commercially necessary for those assets to be acquired.

287 The Deputy President reached the conclusion that the outgoings were revenue in nature. A key element of the reasoning was that the outgoing for the GMEs was "more like a fee paid for the regular conduct of a business than the acquisition of a permanent or enduring asset": at [13].

288 The Commissioner contended that this conclusion involved a mischaracterisation of the nature of what was acquired and the manner in which it was acquired. The authority conferred by the GMEs would endure for 10 years. The Trustee could not commence and thereafter carry on a gaming business without the authority conferred by the GMEs. They were enduring assets for the period of the authority they conferred. In addition, the GME expenditure which secured the GMEs was a one-off expense, albeit payable by instalments. The GME expenditure was accordingly incurred for the acquisition of an enduring asset in contrast to a fee paid for the regular conduct of a business. These submission should be accepted.

289 In reaching the conclusion that the outgoing was "more like a fee paid for the regular conduct of a business than the acquisition of a permanent or enduring asset", the Deputy President referred to the decision in *Henriksen* and set out the following passage from the judgment of Du Parcq LJ at 194-196 (footnotes omitted):

> The payment of the £570 was an expense which secured for them the right to open the Grafton Hotel as a licensed house: without that right they must either have ceased to trade there altogether, or carried on some different trade, but they could not have continued in business as licensed victuallers in those premises. In other words, when the licence dies, the trade dies, unless the grant of a new licence enables it to be carried on for a further period.
>
> Thus the question which we have to consider comes to be whether a payment of a lump sum made to obtain permission to trade for a term of years is of such a character that it "is proper and necessary" to deduct it "in order to ascertain the balance of profits and gains." (See the speech of Lord Parker in *Usher's Wiltshire Brewery, Ld. v. Bruce*.) It is conceded that if the payment was in the nature of a capital payment, it is not deductible. Unfortunately the expression "capital payment" does not appear to be capable of precise definition. At any rate I will not attempt to define it, but will confine myself to dealing with the facts of the present case. Here each sum in question was part of a total amount paid to acquire the right to trade for a period of years. At the date when that period began the possession of that right was essential before trading could be begun. In these circumstances, I am of opinion that

> each sum paid must be considered part of a capital outlay. This view is, I think, in accordance with the principle laid down by the Lord Chancellor in *British Insulated and Helsby Cables, Ltd. v. Atherton*, when he said: "But when 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 very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital. For this view there is already considerable authority."
>
> In two Scottish cases, Lord Clyde (Lord President) formulated the question for decision as follows: "Are the sums in question part of the trader's working expenses, are they expenditure laid out as part of the process of profit earning; or, on the other hand, are they capital outlays, are they expenditure necessary for the acquisition of property or rights of a permanent character the possession of which is a condition of carrying on the trade at all?": (see *Robert Addie & Sons Collieries, Ltd. v. Inland Revenue Commissioners*, and *Inland Revenue Commissioners v. Adam*).
>
> It is true that the period for which the right was acquired in this case was three years and no more, and a doubt may be raised whether such a right is of "enduring benefit" or "of a permanent character." These phrases, in my opinion, were introduced only for the purpose of making it clear that the "asset" or "right" acquired must have enough durability to justify its being treated as a capital asset. This is borne out, so far as Lord Clyde's judgments are concerned, by the fact that in Adam's case, the duration of the right acquired was eight years, and that his Lordship there spoke of its "relatively permanent character." "Permanent" is indeed a relative term, and is not synonymous with "everlasting." In my opinion the right to trade for three years as a licensed victualler must be regarded as attaining to the dignity of a capital asset, whereas the payment made for an excise licence is no doubt properly regarded as part of the working expenses for the year.

290 The Deputy President distinguished *Henriksen* by stating that, in this case, the outgoing "reflected the economic value of the income stream expected from putting other assets to use to derive income from gaming", rather than "the monopoly value of what was acquired". This was seen to be a basis for distinguishing the decision because the High Court in *Ausnet* at [16] had referred to *Henriksen* with the observation that "[t]he payment by instalments of a charge, imposed as a condition upon the grant of a liquor licence reflecting its monopoly value" was held to be a capital outlay.

291 The outgoing in the present case did not reflect "the economic value of the income stream expected from putting other assets to use to derive income from gaming". Further, even if it had, that would not have been a basis for concluding that the expenditure was on revenue account.

292 In *Ausnet* at [16], the majority identified what they saw as "an element of monopoly" by reference to ***BP Australia*** *Ltd v Federal Commissioner of Taxation* (1965) 112 CLR 386. It is desirable to set out paragraph [16] in full (footnotes omitted):

> The fact that a payment is recurrent is not determinative of its character. The

payment by instalments of a charge, imposed as a condition upon the grant of a liquor licence reflecting its monopoly value, was held by the Court of Appeal in *Henriksen v Grafton Hotel Ltd* to be a capital outlay. Du Parcq LJ, citing Viscount Cave LC, said:

> Here each sum in question was part of a total amount paid to acquire the right to trade for a period of years. At the date when that period began the possession of that right was essential before trading could be begun. In these circumstances, I am of opinion that each sum paid must be considered part of a capital outlay.

Referring to that decision, the Privy Council in *BP Australia Ltd v Federal Commissioner of Taxation* observed that: "Without the license the business could not be carried on. There was also an element of monopoly." The term "an element of monopoly" might today be understood in terms of enhanced market power where the requirement for a licence, not freely given to all comers, constitutes a barrier to entry for potential competitors into the relevant market.

293 The GMEs in the present case did provide a relevant "element of monopoly", within the sense that phrase was used in *Henriksen* and in *Ausnet*. The GMEs were a barrier to entry to the gaming market, because it was unlawful to conduct gaming without a GME. The evidence established that there was a bowling club 200 metres from the Royal Hotel which had acquired thirty-two GMEs. In the sense that a number of venue operators in the Hepburn Shire could hold GMEs, the GMEs did not provide the Trustee a (complete) monopoly, as the Trustee submitted. However, this is to misunderstand the sense in which "monopoly" is used in this context. The GMEs constituted a "barrier to entry" (*Ausnet* at [16]) and provided a shared monopoly to those who held them.

294 The Deputy President's conclusion that the outgoing "reflected the economic value of the income stream expected from putting other assets to use to derive income from gaming" may have been influenced by evidence given at trial that the directing mind of the Trustee, Mr Canny, engaged an analyst to provide advice about bidding strategy and the price which the Trustee should pay for GMEs. He was provided with a report which included a statement about the maximum price that a rational person would bid up to, based on a number of assumptions. Mr Canny understood the "maximum price" in this context to mean the maximum which could be paid in order to maintain a reasonable rate of return. Significantly less was paid ($33,350 per GME) than the upper limit so determined ($81,515 per GME). There is nothing surprising about that evidence. One would expect, for example, a purchaser of a hotel to assess what income stream might be anticipated from conducting the hotel's operations in order to determine the price which might be offered or paid. That obvious proposition does not have the consequence that the amount paid is on revenue account. The purchase of the hotel business would still be a capital outlay. In any event, the evidence did

not establish that the price paid "reflected the economic value of the [expected] income stream". The price offered by the Trustee and accepted by the State was not set by reference to expected income flows from the operation of gaming machines by the Trustee; it was a price determined through an auction process.

295 Other aspects of the Deputy President's reasoning refer to the connection between the price paid for the GMEs and the income stream. At [13], the Deputy President referred to the "close connection between the amounts paid for the gaming machine entitlements and the income stream expected". At [14], the Deputy President stated that "the amount of the bid reflected the expected income stream from the use of those other assets [presumably the other assets used in the hotel business] which the gaming machine entitlements permitted". As mentioned, the evidence established that Mr Canny took into account advice as to a maximum amount which should be paid in order to maintain a reasonable rate of return in order to determine, commercially, what maximum bid to place for acquisition of the GMEs. In the circumstances of this case, that does not indicate that the expenditure was on revenue account.

296 At [13], the Deputy President likened the amounts paid for the GMEs to those considered in *BP Australia* and referred specifically to the passage at 398 where the amounts were said to be ones "which had to come back penny by penny with every order during the period in order to reimburse and justify the particular outlay". BP sold petrol to service stations. Marketing in the petrol trade changed suddenly in 1951 with the consequence that BP needed, as a matter of commercial practicality, to secure tied retailers, namely retailers that would only sell BP-branded petrol. BP entered into numerous trade ties which varied in term between three and 15 years. The average was just under five years and the predominant number of agreements was for a five year term. The Privy Council noted at 399-400 that, had the length been for 20 years, that fact would have pointed to a non-recurring payment of a capital nature. The longer the duration, the greater the indication that a structural solution was being sought.

297 The advantage BP sought by making lump sum payments to various retailers was "to promote sales and obtain orders for petrol by up-to-date marketing methods": at 397-8. It had to obtain ties with numerous retailers so that it could obtain orders which would flow from those ties: at 398. Lord Pearce, delivering the judgment of the Privy Council stated:

> To obtain ties it had to satisfy the appetite of the retailers by paying out sums for a period of years, whose amount was dependent on the estimated value of the retailer as a customer and the length of the period. The payment of such sums became part of the regular conduct of the business. It became one of the current necessities of the trade.

298 This led to the conclusion that the sums were paid out of circulating capital, rather than fixed capital, and were, accordingly, on revenue account: at 398. Lord Pearce stated:

> Fixed capital is prima facie that on which you look to get a return by your trading operations. Circulating capital is that which comes back in your trading operations.

299 The GME expenditure is not comparable to the outgoings in *BP Australia*. The practical commercial requirement to acquire the GMEs was a one-off expenditure which would secure for the Trustee the ability to conduct gaming for a period of 10 years. This was a significant, one-off, structural change to the way the business operated. It was not expenditure which would need to be repeated over and again as a necessity of trade comparable to the need on the part of BP to secure trade ties with numerous petrol retailers.

300 The Deputy President also stated, at [13], that the GMEs "had no intrinsic value other than by reference to the income stream expected from its [sic] use with other assets to derive gaming income". The GMEs did have value otherwise than by reference to the income stream expected. They were in fact sold with the hotel business's other assets in late 2015. However, even if they did not, that does not lead to the conclusion that the expenditure was on revenue account. Even if the GMEs had "no intrinsic value", they were still required in order for the Trustee to be able to conduct the gaming activities it wished to conduct on its premises. It may have only wished to conduct those activities because of a change in legislative environment, but that does not alter the fact that it wanted to conduct those activities. Just as the licence in *Henriksen* was required to sell alcohol, so here the GMEs were required to conduct gaming activities. The licence in *Henriksen* was not something which could be traded. That fact did not have the consequence that the annual licence fees were on revenue account.

301 The GMEs in this case could be transferred in accordance with Division 5 of Chapter 3 of the *Gambling Act*. It is true that there were restrictions on a transfer and that transfers were regulated. For example, a GME could not be transferred except to another venue operator: s 3.4A.16(1). It is also correct that the evidence was to the effect that the cap of 112 GMEs in the Hepburn Shire was never reached. However, the GMEs were in fact transferred for

value when the Trustee sold the hotel business in November 2015 for $2,453,000 plus $40,000 for stock.

302 Finally, the Deputy President observed at [13] that the outgoings were unlike a lease premium "which secures, albeit for a diminishing period, a right to occupy and enjoy premises" because the rights attaching to the GMEs "had nothing comparable to the rights to occupy and enjoy real estate". It is not to the point that lease premiums are concerned with the rights to occupy and enjoy land and GMEs relate to the entitlement to conduct gaming activities. This was not a basis for concluding that the GME expenditure was revenue in nature. A lease premium secures an enduring advantage and, when that is the proper characterisation of the particular premium being considered, that fact weighs in favour of a conclusion that the outlay is an affair of capital. To the extent the treatment of lease premiums is relevant to the present question, that treatment supports a conclusion that the outgoings for the GMEs was on capital account. Like a lease premium, the GMEs secured an enduring advantage, albeit for a diminishing period.

ISSUE 2: SECTION 40-880

303 Before turning to s 40-880 in its current form, it is perhaps useful to refer briefly to the history of the provision and the meaning and treatment of goodwill.

Goodwill

304 Goodwill is not defined in the ITAA 1997. The meaning of goodwill was considered in *Federal Commissioner of Taxation v* ***Murry*** (1998) 193 CLR 605. The majority (Gaudron, McHugh, Gummow and Hayne JJ), in their joint judgment at [30], noted that "[c]are must be taken to distinguish the sources of the goodwill of a business from the goodwill itself". They dealt separately with the nature of goodwill (at [12] to [22]) and the sources of goodwill (at [24] ff). Goodwill is an item of property (an asset) in its own right which much be separated, for both legal and accounting purposes, from the assets of the business that can be individually identified. Goodwill cannot be transferred separately from the business to which it is attached but, nonetheless, it has a market value when transferred as part of the business: *Murry* at [23], [30], [48] and [49].

305 Goodwill, although not defined in the ITAA 1997, is itself a CGT asset: s 108-5(2)(b). The statute tells us that goodwill is not as well-known a CGT asset as some other CGT assets, such as a "weekender", which is apparently "reasonably well-known": s 100-25.

Section 40-880 when introduced in 2001

306 Section 40-880 was inserted by Act No 76 of 2001 and was applicable on or after 1 July 2001. The provision was amended in 2006, with effect from 1 July 2005, by the *Tax Laws Amendment (2006 Measures No 1) Act 2006* (Cth) (**2006 Amendment Act**). Prior to the 2006 Amendment Act, s 40-880 contemplated a deduction over five years for specific items of expenditure (commonly referred to as "black hole" expenditure because of the likelihood the expenditure would not otherwise have been deductible), which did not include expenditure in relation to goodwill.

307 As originally enacted, s 40-880(1) provided:

> You can deduct amounts for capital expenditure you incur that is one of these:
>
> (a) expenditure to establish a business;
>
> (b) expenditure to convert your business structure to a different business structure;
>
> (c) expenditure to raise equity for your business;
>
> (d) expenditure to defend your business against a takeover;
>
> (e) costs to your business of unsuccessfully attempting a takeover;
>
> (f) costs of liquidating a company that carried on a business and of which you are a shareholder;
>
> (g) costs to stop carrying on a business;
>
> to the extent that the business is or was carried on for a taxable purpose.

308 Prior to the 2006 Amending Act, taxpayers could take into account expenditure in relation to goodwill in the fourth element of cost base under s 110-25(5). That section provided:

> The fourth element is capital expenditure you incurred to increase the asset's value. However, the expenditure must be reflected in the state or nature of the asset at the time of the CGT event.

309 In other words, before 1 July 2005, provided the expenditure in relation to goodwill fell within s 110-25, capital expenditure in relation to goodwill could be taken into account when a relevant CGT event occurred, such as when the asset was sold. There was no deduction for expenditure in relation to goodwill over five years under s 40-880. Obviously, the fourth element of cost base cannot apply to expenditure being an acquisition of goodwill, because goodwill is itself a CGT asset. Expenditure to acquire goodwill falls in the first element of cost base.

Section 40-880 from 1 July 2005

310 Section 40-880, which in this form was introduced with effect from 1 July 2005, and which is applicable in the present case, provides:

> (2) You can deduct, in equal proportions over a period of 5 income years starting in the year in which you incur it, capital expenditure you incur:
>
> (a) in relation to your business; or
>
> (b) in relation to a business that used to be carried on; or
>
> (c) in relation to a business proposed to be carried on; or
>
> (d) to liquidate or deregister a company of which you were a member, to wind up a partnership of which you were a partner or to wind up a trust of which you were a beneficiary, that carried on a business.
>
> ...
>
> (5) You cannot deduct anything under this section for an amount of expenditure you incur to the extent that:
>
> (a) it forms part of the cost of a depreciating asset that you hold, used to hold or will hold; or
>
> (b) you can deduct an amount for it under a provision of this Act other than this section; or
>
> (c) it forms part of the cost of land; or
>
> (d) it is in relation to a lease or other legal or equitable right; or
>
> (e) it would, apart from this section, be taken into account in working out:
>
> (i) a profit that is included in your assessable income (for example, under section 6-5 or 15-15); or
>
> (ii) a loss that you can deduct (for example, under section 8-1 or 25-40); or
>
> (f) it could, apart from this section, be taken into account in working out the amount of a capital gain or capital loss from a CGT event; or
>
> (g) a provision of this Act other than this section would expressly make the expenditure non-deductible if it were not of a capital nature; or
>
> (h) a provision of this Act other than this section expressly prevents the expenditure being taken into account as described in paragraphs (a) to (f) for a reason other than the expenditure being of a capital nature; or
>
> (i) it is expenditure of a private or domestic nature; or
>
> (j) it is incurred in relation to gaining or producing exempt income or non-assessable non-exempt income.
>
> (6) The exceptions in paragraphs (5)(d) and (f) do not apply to expenditure you

> incur to preserve (but not enhance) the value of goodwill if the expenditure you incur is in relation to a legal or equitable right and the value to you of the right is solely attributable to the effect that the right has on goodwill.

311 The 2006 Amendment Act which introduced this more general business "black hole" deduction by amending s 40-880 also replaced s 110-25(5) (as set out above) with new ss 110-25(5) and 110-25(5A). The new provisions were:

> (5) The fourth element is capital expenditure you incurred:
>
> (a) the purpose or the expected effect of which is to increase or preserve the asset's value; or
>
> (b) that relates to installing or moving the asset.
>
> The expenditure can include giving property: see section 103-5.
>
> Note: There are 3 situations involving leases in which this element is modified: see section 112-80.
>
> (5A) Subsection (5) does not apply to capital expenditure incurred in relation to goodwill.

312 The effect of those changes was to remove capital expenditure in relation to goodwill from the fourth element of cost base but to allow it to be claimed in the circumstances envisaged by the new s 40-880.

313 A consequence of the removal of expenditure in relation to goodwill from the fourth element of cost base was that, if the new s 40-880(2) applied to the expenditure such that it was deducible over five years, the expenditure would not receive less generous treatment than it would have under the previous regime (as part of the fourth element of cost base). This was explained in the following way at [2.144] of the Explanatory Memorandum to the Tax Laws Amendment (2006 Measures No 1) Bill 2006 (Cth):

> The fourth change is that the element does not apply to capital expenditure incurred in relation to goodwill. A consequence of this exclusion is that expenditure in relation to goodwill already attracting deductibility over five years does not receive less generous CGT treatment by reason of the enlargement of the fourth element.

Application of s 40-880(6)

314 The parties agreed that s 40-880(5)(f) applied unless s 40-880(6) prevented it applying. This is because there is no question that the GMEs were a "CGT asset" within the meaning of Part 3-1 of the ITAA 1997: ss 100-25, 108-5.

315 The construction of s 40-880(6) must begin and end with a consideration of the statutory text. The statutory text must be considered in its context, which includes legislative history and

extrinsic materials: *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue* (2009) 239 CLR 27 at [47]; *Federal Commissioner of Taxation v Consolidated Media Holdings Ltd* (2012) 250 CLR 503 at [39]; *Federal Commissioner of Taxation v Unit Trend Services Pty Ltd* (2013) 250 CLR 523 at [47].

316 In *Certain* ***Lloyd's Underwriters*** *Subscribing to Contract No IH00AAQS v Cross* (2012) 248 CLR 378, at [24], French CJ and Hayne J said (emphasis of French CJ and Hayne J, emphasis in original):

> The context and purpose of a provision are important to its proper construction because, as the plurality said in *Project Blue Sky Inc v Australian Broadcasting Authority*, '[t]he primary object of statutory construction is to construe the relevant provision so that it is consistent with the language and purpose of *all* the provisions of the statute' ... That is, statutory construction requires deciding what is the legal meaning of the relevant provision 'by reference to the language of the instrument viewed as a whole', and 'the context, the general purpose and policy of a provision and its consistency and fairness are surer guides to its meaning than the logic with which it is constructed'.

317 The purpose of a statute resides in its text and structure, not outside of the statute. The Court is to give the words of the statute the meaning the legislature is taken to have intended them to mean. The task of construction will properly involve the identification of a statutory purpose, which may appear from an express statement in the relevant statute, by inference from its terms and by appropriate reference to extrinsic materials: *Lacey v Attorney-General (Qld)* (2011) 242 CLR 573 at [43]-[44]; *Lloyd's Underwriters* at [25].

318 The text of the relevant subsections of s 40-880 is set out above. The deduction provided by s 40-880(2) is one of last resort in the sense that, subject to specific exceptions, it operates only in circumstances where other provisions of "this Act" (defined in s 995-1(1)) do not operate to provide for the relevant expenditure to be taken into account: s 40-880(5). The expenditure in relation to the GMEs is taken into account under the capital gains tax regime as the first element of cost base in the acquisition of a CGT asset and is, accordingly but subject to s 40-880(6), caught by s 40-880(5)(f).

319 Section 40-880(6) operates to allow a deduction in respect of capital expenditure incurred "to preserve (but not enhance) the value of goodwill if the expenditure you incur is in relation to a legal or equitable right and the value to you of the right is solely attributable to the effect that the right has on goodwill".

320 Subsection 40-880(6) must be read as a whole and in the context of the whole statutory regime. Whilst recognising that the components of s 40-880(6) must be read together, it is useful to note that the subsection directs attention to three principal matters:

(1) the expenditure was incurred "to preserve (but not enhance) the value of goodwill"; and

(2) the expenditure was incurred "in relation to a legal or equitable right"; and

(3) "the value to you of the [legal or equitable] right is solely attributable to the effect that the right has on goodwill".

321 The inquiry in (1) above is into whether the expenditure was incurred to "preserve (but not enhance) the *value* of goodwill", as opposed to goodwill. The inquiry in (3) is directed to the value *to you* of the right and whether it is solely attributable to the effect the right has on goodwill.

Whether expenditure incurred to "preserve (but not enhance) the value of goodwill"

322 As the Commissioner submitted to the Tribunal, an example of expenditure which would clearly meet the description of expenditure "incurred to preserve (but not enhance) the value of goodwill", is expenditure to secure a restrictive covenant, such as a payment to a departing business partner in return for an agreement not to operate a similar business in competition – see Tribunal reasons at [22]. The evident purpose of such expenditure is to protect the existing goodwill from damage, that is, to preserve the value of the existing goodwill. That purpose is evident from the effect of the expenditure: preventing competition from a new source (the exiting business partner). The value of such expenditure lies in the effect the existence of the asset has on the value of existing goodwill. The value does not lie in the asset acquired in the sense that, for example, the restrictive covenant does not ordinarily have any value to a third party purchaser of the covenant. The real purpose behind the expenditure was to ensure that the goodwill was preserved, not to own a restrictive covenant.

Purpose of expenditure and effect of expenditure

323 The inquiry into whether the expenditure was "incurred to preserve (but not enhance) the value of goodwill" is an inquiry into the purpose of the expenditure, not the effect of it. For example, if there was expenditure incurred for the purpose of preserving the value of goodwill but, in the events which ultimately transpired, the value of goodwill was not

preserved, the provision would still respond notwithstanding that the expenditure, in the events which in fact transpired, had no effect on the value of goodwill.

324 However, the effect of the expenditure may, and generally will, be at least probative and often determinative of the purpose of the expenditure because the effect of expenditure is an objectively ascertainable fact which is likely to illuminate the purpose of the expenditure. The inquiry is into the actual purpose of the entity incurring the expenditure. That purpose is to be assessed having regard to the objective circumstances and to the person's evidence of purpose. A person's evidence of purpose may need to be closely scrutinised, but the weight to be attributed to such evidence depends on the particular case, including the cogency of the evidence when assessed against the objective circumstances and the fact of, or consequences of, cross-examination – see: *Pascoe v Federal Commissioner of Taxation* (1956) 30 ALJR 402 at 403, per Fullagar J; *Visy Packaging Holdings Pty Ltd v Federal Commissioner of Taxation* (2012) 91 ATR 810 at [191], per Middleton J. One of the objective circumstances from which a conclusion as to the purpose of incurring the expenditure can be drawn is the effect the expenditure in fact had, or the likely effect the expenditure might be considered to have, viewed as at the time the expenditure was incurred.

325 The respondent submitted that the purpose of the expenditure was to preserve (but not enhance) the value of goodwill as, it submitted, the Tribunal had found. The Tribunal stated, at [26]:

> ... The expenditure on the gaming machine entitlements was to enable the trustee to derive directly the income from gaming activities which the trustee had previously derived indirectly as commissions by the gaming activities carried on by Tattersalls. That purpose of the expenditure (on the assumption that it was of capital) was, from a practical and business point of view, to preserve the value of goodwill and was also reflected in the trustee's goodwill.

326 The Tribunal, at [27], went on to conclude that the expenditure enhanced goodwill, because the expenditure "increased the trustee's rights by 10 years longer than it had previously".

327 The respondent submitted that the finding at [26] of a purpose of preserving goodwill was a finding as to *purpose*, but the finding at [27] of enhancement was one as to the *effect* of the expenditure. That may be accepted. However, as noted above, the effect expenditure has is relevant to the objective ascertainment of the purpose of expenditure. Reading the Tribunal's reasons as a whole, it is tolerably clear that it considered, having regard to the objective effect of the expenditure, that the purpose of the expenditure was not "to preserve (but not enhance)

the value of goodwill", but something more than that. That finding was open on the material before the Tribunal.

Subjective purpose

328 The respondent stated that the evidence of subjective purpose was to be found in (and only in) the following evidence of the directing mind of the Trustee, Mr Canny (at [80] of the affidavit of David John Canny affirmed on 28 April 2017):

> My wife and I agreed that she would bid up to the same limit as the maximum price indicated in the Red Lion report. I was not able to actually bid for GMEs for the Royal at the auction of the GMEs as I was bidding for GMEs for the Red Lion and not permitted to move between bidding booths during the auction. As a result, I agreed with my wife and an administrative manager, Kimberley Roberts, to bid for exactly 18 GMEs to continue to enable DRHT [the Trustee] to operate its existing business as it had under the then existing regime.

329 This evidence demonstrates that the decision was to purchase the GMEs for the lowest possible price so that the Trustee could continue to provide access to gaming services as it had in the past; but that decision necessarily involved acquiring GMEs which would enable the Trustee to conduct the gaming activities and to do so until 2022. If it had not acquired them, the customers would only have had access to gaming until 2012. The profitability of the Trustee taking over the conduct of the gaming activity would depend in part on the amount it paid for the GMEs. This evidence does not demonstrate that the purpose of the expenditure was "to preserve (but not enhance) the value of goodwill". It demonstrates that the purpose of the expenditure was to acquire GMEs at the lowest possible price.

Effect of expenditure

330 There was no evidence adduced which quantified the effect on the value of goodwill of the acquisition of the GMEs. It would have been necessary, at a minimum, to identify and value the assets of the business and the likely income stream from the various operations with and without the GMEs and then to determine the value of goodwill in each scenario in order to reach a conclusion as to the actual effect of the expenditure on the value of goodwill. That is not to say that, in an appropriate case, a conclusion might be drawn about the effect of expenditure on the value of goodwill in the absence of quantification or expert evidence on the issue more generally.

331 In the present case, however, there was no evidence directed specifically to the effect of the expenditure to acquire the GMEs on the value of goodwill of the Trustee's business. No

doubt that was a forensic decision, perhaps informed by the respondent's view that the *effect* of the expenditure was not relevant to an analysis of the *purpose* of the expenditure.

332 On appeal, the only evidence relied upon by the respondent in respect of the value of goodwill was the following evidence of an accountant, Mr Paul Foley, who had provided accounting and general business advisory services to a number of hotels and hospitality businesses, including the Trustee. In his affidavit affirmed on 28 April 2017, Mr Foley stated:

> 10. In my experience the change to the new regime from the old regime has not affected the value of hotel businesses when taking into account the cashflow impact of the payment for the gaming entitlements together with the limited tenure for the gaming entitlements expiring in 2022 and as, in substance, the new regime simply substituted the charges previously earned by Tatts with a combination of fees from other third party service providers such as PVS Australia Pty Ltd, Itralot Gaming Pty Ltd and the State government's gaming tax.
>
> 11. However, since the introduction of the new regime there has been greater uncertainty about the potential revenues from gaming machines into the future. This has affected the values of hotels because purchasers cannot be assured of revenues from gaming after 2022 and banks have, as a consequence, been reluctant to lend without that certainty of revenues. The downward pressure on value caused by the 10 year term of the gaming machine entitlements is consistent with the effect a shorter term lease on the price of a hotel, where anything less than 20 years is considered to be too short a term to be considered worthwhile purchasing.

333 Three observations can be made of this evidence. First, this evidence was general in nature and not directed to the business conducted by the Trustee. Secondly, the general evidence in paragraph [10] does not address the specific evidence as to the expected profitability in the Trustee conducting gaming activities. A cash flow analysis comparing the profit from receiving commissions from Tattersalls (up until August 2012) with the profit from the Trustee conducting gaming activities (from August 2012) was in evidence. Whilst this showed that the profit from gaming was broadly similar for the years 2012 to 2015 to what it had been when the gaming was conducted by Tattersalls, that result was only achieved because of the instalments of purchase price paid by the Trustee to acquire the GMEs. After 2016, when the instalments were no longer payable, the profit was likely to be substantially higher. Thirdly, the general evidence in paragraph [11] is not only not directed to the Trustee's particular business, but is not directed to the value of goodwill as opposed to the values of hotels.

334 This evidence did not provide a sound basis for inferring, in respect of the Trustee's expenditure, that the expenditure had the effect of preserving, but not enhancing, the value of goodwill.

Conclusion on purpose of expenditure

335 The expenditure here was incurred to acquire the GMEs. The GMEs were purchased so that the Trustee could commence lawfully conducting gaming activities at the Royal Hotel in August 2012 and to continue to do so for a period of 10 years, deriving roughly equivalent profit to that which it had derived from Tattersalls' gaming activities until 2016 after which (absent a sale of the business) it would derive substantially more profit.

336 The Trustee considered the purchase of the GMEs desirable (and commercially necessary) so that customers of the Royal Hotel would still be able to access gaming activities at the venue once Tattersalls was no longer able lawfully to conduct such activities. The value of the Royal Hotel business might be anticipated to be adversely affected if the Trustee did not acquire GMEs with the necessary consequence that no gaming activities could have been carried on once the new regime commenced in 2012.

337 It may be accepted that a motivation for acquiring the GMEs was the positive effect that was perceived as likely to have on the value of the Trustee's business as a whole. It may also be accepted that the Trustee's business as a whole included goodwill as an asset. It may be accepted that the Trustee, if it had not acquired the GMEs, would have ceased to obtain revenue from any gaming operations being conducted at its venue. Given the complementary nature of the activities, an absence of gaming activities being able to be conducted on the premises from August 2012 would likely also have adversely affected the non-gambling revenue centres of the business, namely accommodation, food and alcohol.

338 In these circumstances, it is appropriate to conclude that a motivation of the Trustee in acquiring the GMEs was its perceived effect on the value of the business as a whole and probably on goodwill. The perceived effect was one of increasing the value of the business as a whole and probably goodwill. If the GMEs had not been acquired, the value of the hotels and the goodwill would have reflected the fact that no gaming activities could lawfully be undertaken on the premises from August 2012. The acquisition of the GMEs meant that gaming activities would be able to be conducted, with a substantially higher profit to the Trustee from those activities after the last instalment for the acquisition was paid in 2016.

339 Section 40-880(6) contemplates a conclusion that the expenditure was incurred "to" preserve (but not enhance) the value of goodwill. It does not expressly state whether that purpose must be a sole purpose or a dominant purpose or one of which no more can be said than that it was one of the purposes behind the expenditure. The use of the word "to", when read with the second and third matters to which s 40-880(6) directs attention (dealt with below), and with the history of the provision (outlined above), suggests that the subsection does not cover a situation where all that can be said is that the purposes for which a CGT asset was acquired included a purpose of preserving (but not enhancing) the value of goodwill. Here, the real purpose of the expenditure was "to" acquire the GMEs as part of the profit making structure of the business, not "to" preserve (but not enhance) the value of goodwill.

340 If it is sufficient to engage the operation of s 40-880(6) that *a* purpose or motivation of incurring the relevant expenditure (acquiring the relevant asset) is one of preserving but not enhancing the value of goodwill, then no such purpose existed because the purpose was not "to preserve (but not enhance) the value of goodwill".

341 In the present case, the rights (the GMEs) were acquired to enable the Trustee lawfully to commence conducting gaming activities and derive income (greater over the full term than had previously been derived) through the exercise of the rights and to be able to do so for 10 years absent a sale of the rights to an incoming purchaser; the rights were not acquired "to preserve (but not enhance) the value of goodwill".

Whether expenditure incurred "in relation to a legal or equitable right"

342 There was no dispute that the expenditure was incurred in relation to a legal or equitable right.

Whether the value to you of the right is solely attributable to the effect that the right has on goodwill

343 The value to the Trustee of the GMEs was not solely attributable to the effect that the right had on goodwill. The GMEs provided an entitlement for the Trustee lawfully to conduct gaming at its venue and to generate substantial income from those activities. The GMEs had a value distinct from any effect the GMEs had on goodwill. The GMEs resulted in a taxable income stream. This income stream was different to that which had previously been earned and it was likely to be significantly more profitable after the last instalment was paid in 2016. Further, the GMEs were a valuable asset capable of transfer.

CONCLUSION

344 The appeal should be allowed and the decision of the Tribunal should be set aside.

I certify that the preceding eighty-eight (88) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justice Thawley.

Associate: 

Dated: 27 September 2018