Privy Council Appeal No. 51 *of* 1964

B.P. Australia Limited – – – – – – – – *Appellant*

v.

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

FROM

THE HIGH COURT OF AUSTRALIA

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

Present at the Hearing

LORD REID
LORD MORRIS OF BORTH-Y-GEST
LORD PEARCE
LORD UPJOHN
LORD WILBERFORCE

(*Delivered by* LORD PEARCE)

This appeal is concerned with the question whether certain sums expended by B.P. Australia Limited (referred to as B.P.) in its business of marketing petrol during the year ending 30th June 1952, are revenue expenses which may be deducted in calculating its assessable income or are capital expenses in respect of which no deduction can be made. B.P. were assessed to income tax on the basis that the expenses were not deductible. Taylor J. confirmed that assessment. He heard evidence and came to various conclusions of fact and inference. The final result however depends not on fact so much as on the weight and emphasis that one gives to indisputable facts and the overall inference which one draws from the situation as a whole. The Full Court of the High Court affirmed his judgment by a majority (McTiernan J., Windeyer J. and Owen J.; Dixon C.J. and Kitto J. dissenting). Their Lordships are indebted to counsel on both sides for their careful, fair and vigorous arguments.

The sales of petrol by B.P. to service stations represent a substantial part of B.P.'s total sales. Before the war in Australia (as in England) various brands of petrol were sold in competition with each other at each service station. The different producers would own their particular tanks and pumps at the service stations, letting them to the retailer at a nominal figure, and each supplying its particular brand to fill its particular tank. This necessitated frequent small replenishments. A different system is now in force in both countries. Under the " Solo Site Service Station System " in Australia (and " the exclusivity system " in England) service stations stock only one brand so that deliveries by the individual producers are bigger and less frequent with a consequent saving in expenses. This also reduces the number of staff necessary to work the service stations and obviates certain undesirable practices that had arisen under the former system.

The change in Australia came about in this way. During the war all imports of petrol were pooled and the spirit ceased to be sold under the various brands. Pool petrol was put into all the existing pumps in disregard of their labels. In 1947 the pool system ended, and in 1949 rationing came to an end. There was a return to the pre-war system. In August 1951 however the Shell Company suddenly announced to the trade its intention of securing economy of distribution by introducing the " solo site service station plan " whereby

it would supply petrol to service stations on the basis that those stations would deal exclusively with Shell. B.P. at that time had pumps at the service stations of some 4,000 retailers. Immediately after the Shell Company's announcement 437 of these asked B.P. to remove their pumps. By December 1951 this number had risen to 1,012. It was clear that steps must be taken by B.P. and other wholesalers to deal with this alarming situation and make provision for the future. B.P. were in a difficulty in adopting the solo site plan on their own since they did not market any brand of lubricating oil. There was also a financial difficulty. B.P. therefore co-operated with three other companies for the purpose of persuading retailers at service stations to establish "Independent Service Stations" where only the respective brands of the co-operating companies would be sold. The co-operating companies at first attempted to induce the retailers to deal solely with their companies by undertaking to paint the retailers' service stations with distinctive colours. Their efforts were not wholly unsuccessful and at the end of December 1951 B.P. had gained 326 sites to set against the 1,012 it had lost. But it soon became clear that rival companies were offering direct financial inducement to retailers to join in their solo site plan and that the co-operating companies must follow suit. In February 1952 therefore they too decided to offer financial assistance. A lump sum payment was to be offered to retailers who would tie themselves to the co-operating companies for not less than three years. The State Committee of the co-operating companies were authorised to pay on the basis of £100 for every thousand gallons per month (estimated) with a maximum of £1,000 for a three years tie. If the basis of payment was " unacceptable " in any case the sum might be increased to £150 for every thousand gallons per month provided a tie for a period of not less than five years could be arranged. The Head Office Committee could authorise special arrangements and did so on many occasions.

By the end of the financial year in question, namely by June 1952, B.P. had been told to remove its pumps from 1,964 sites but it had obtained trade ties at 791 sites. The exhibits show that in the ensuing years they made progress in surmounting their difficulties.

The intricacies of the expenses and the obligations of the co-operating companies as between themselves are irrelevant for the present purpose. During the year in question B.P. spent a total sum of £270,569 either in payment direct to the retailers under written agreements, or by way of adjustments with the other co-operating companies in respect of such payments made by them. If this total sum is allowable as a deduction against income, this appeal succeeds. One may deal with the case for the sake of simplicity as if the agreements and payments were made by B.P. alone. The small sum of £671 expended in making structural alterations for some retailers who entered into agreements must stand or fall with the larger sum as it has done in the other Courts. Substantial sums spent in decorating service stations in accordance with the written agreements were admitted as deductions and were not in issue before Taylor J.

The written agreement was as follows:—

> " This letter confirms the verbal agreement reached between yourself and a representative of this company regarding payment to you of an allowance to be used for the improvement of your business and hereinafter referred to as ' The Development Allowance '.
>
> The Company undertakes to—
>
> 1. Contribute a Development Allowance of £ to be used by you to defray the cost of advertising and other merchandising expenses, alterations and/or improvements.
>
> 2. Supply your requirements of the products marketed by the company.
>
> 3. Assist you to develop your business by providing you with a comprehensive Merchandising Plan as described in a brochure already in your hands.

In consideration of the above you, on your part, agree to:

1. Increase the sale of C.O.R. Products to the best of your ability.

2. Refrain from reaching any agreement, either verbal or in writing, with any other wholesale distributor of petroleum products.

3. Resell from your premises only the brands of motor spirit approved by this company from time to time.

Accordingly, until further notice we approve the resale of C.O.R. or a combination of C.O.R. with any or all of the brands Ampol and Golden Fleece, as may be available on your station.

4. Permit this company, or its contractors, to paint such parts of your premises, which we consider as being ancillary to the sale of our products, to our standard colours.

5. Make no alteration to those arrangements for a period of 00 years.

6. Should your business be sold or otherwise transferred during the period mentioned in the preceding clause, a condition of such sale or transfer will be that this arrangement will continue for the unexpired portion of the period.

Will you please signify your agreement to the above arrangements by signing in the space provided at the foot of the duplicate of this letter."

Taylor J. after a careful examination of the facts and the authorities came to the conclusion that the amounts paid were lumps sums for the purpose of securing a trade tie over a period of years and that they were capital outgoings for the purpose of obtaining the resultant advantage.

In reaching this conclusion he distinguished *Bolam v. Regent Oil Company* 37 T.C. 56 where lump sums were paid in advance as a rebate pursuant to agreed trade ties for various relatively short term periods, some of which however were as much as six years. These sums were calculated by reference to the estimated gallonage and were *pro tanto* repayable if the estimate was not reached. In the present case Taylor J. relied strongly on the fact that the payments had no real relation to gallonage and could not be assimilated to a trade rebate or discount. He found however that the—

". . . gallonage factor was first of all a matter for consideration in determining what particular sums should *prima facie* be regarded as the maximum amount which in any particular case might be laid out by the State Committees without reference to the Head Office Committee. No doubt, also, it was a material factor in ultimately determining whether any particular proposal should be entertained by the Head Office Committee. But the ' gallonage ' factor played no greater part than this and I am satisfied on the evidence that the lump sums paid to service station operators by the appellant and its co-operating companies were not paid either in form or substance as the equivalent of trade rebates or discounts."

His Honour found that the service stations on strategic sites afforded advantages of considerable value and that the amounts which were paid were determined by the intensity of the competition for securing a site and obtaining re-selling outlets. He relied on the fact that B.P. had by June 1952 spent £600,000 in buying sites for service stations and making loans to retailers who had secured ties (£144,000 was spent in loans during the relevant year) as giving some indication that the introduction of solo site trading required a substantial reorganisation of marketing and distribution methods in this section of the trade. In his opinion B.P. obtained an asset and an enduring benefit by securing substantial freedom from competition on each selected site for periods extending from three to ten years.

On appeal McTiernan J. supported His Honour's judgment in toto. Windeyer J. affirmed it expressing the view that B.P. obtained for a substantial period and with a prospect of renewal thereafter something that was to become a part of the structure, organisation, or framework within which and by means of which it carried on its business.

Owen J. affirmed the judgment because there was in this case no material distinction from the case of the *Vacuum Oil Co. Ltd.* in which he gave a careful and reasoned judgment with regard to somewhat similar payments. That appeal was heard immediately after the present case both in the High Court and before their Lordships. His Honour there came to the conclusion that although the making of payments had the feature of a recurrent expenditure the character or nature of the advantage gained by the tax payer tilted the balance in favour of the view that the outgoings were of a capital nature. In his opinion the advantage gained was the operators' undertaking to deal exclusively in the tax payer's products and give it exclusive advertising rights on the station site for a substantial period of time. " The advantages thus obtained," he said, " were of a continuing and not of a transient nature. The purpose or effect of the expenditure seems to me to have been to add valuable even if intangible assets of a lasting character to the appellant's profit earning organisation ".

The competing view of the transactions in question was put broadly by the learned Chief Justice and in greater detail by Kitto J.

Dixon C. J. said—" 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."

Kitto J. said,—" But a promise by a service station operator not to deal with oil companies other than the appellant 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 the appellant or its allies for the agreed period; and what the appellant 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 of the money was analagous to expenditure in sending a commercial traveller on his rounds to secure orders; it was part and parcel of the business of effecting sales . . . The change in the organisation of the wholesale trade in motor spirit from the old system of multiple pump service stations to the new ' solo ' system meant inevitably that every oil company, if it wanted to sell motor spirit to service stations in the future, had to accept the necessity of spending money, not at the beginning once and for all, but at the beginning and from time to time, to ensure that it would receive from as many service stations as possible the whole of their orders for limited periods."

Again:—" . . . 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 the appellant's could be carried on."

He concluded " . . . that it would be an odd piece of accounting that would work out the appellant's profit from supplying motor spirit to service stations without bringing in, as an item of marketing cost, every sum spent to make sure of securing orders in the new way in which the trade was going about the securing of orders, namely by inducing individual resellers to put themselves in the position of having to give the whole of their orders for a period to a single oil company."

There was considerable argument as to the findings of Taylor J. concerning the relation of the sums paid to gallonage and how far they were affected by competition, but these do not conclude the matter one way or the other.

B.P.'s ultimate object was to sell petrol and to maintain or increase its turnover. There can be no doubt that the only ultimate reason for any lump sum payment was to maintain or increase gallonage. If B.P. paid a higher lump sum to A than B it was because (1) A then was selling at a higher rate than B or (2) A was likely to sell at a higher rate in the future than B either since he was a better salesman or had a better strategic site or (3) A was a better bargainer and therefore obtained from B.P. the highest price which it was prepared to pay instead of the lower price which it had induced B to accept or (4) A had a particularly good site which must not go by default because that would allow rivals to encroach and so decrease B.P.'s overall gallonage. All these reasons are founded on gallonage whether immediate or ultimate. The fourth reason which is founded on the Company's overall gallonage as opposed to A's personal gallonage was no doubt infrequent; and it does not alter the general relation of the sums paid to the estimated efficacy of the recipient retailer in selling B.P.'s petrol, and to the impact of his efforts on the overall gallonage. The fact that the amounts of the lump sums were influenced or even decided by competition does not greatly affect the matter. Every price or rebate is influenced and largely decided by competition. The trader offers the rebate that competition renders necessary or desirable. So too with lump sums paid to retailers. The more they were based on the particular retailer's gallonage the more closely they were tied to the immediate costs of selling to an individual customer. But even where the overall gallonage rather than the immediate gallonage influenced the sum paid it could still be one of the revenue expenses of marketing.

Considerable emphasis has been put on the fact that B.P.'s whole existence was threatened by the new situation which had occurred. But this is not a decisive factor. Whenever a business finds that its trade rivals are getting ahead of it, its existence is threatened. The seriousness of the situation has, however, this much relevance, that it provided ample justification for capital expenditure in the reorganisation of its business structure if that should be necessary or desirable. It demolishes any argument that the occasion was too trivial or too ordinary to enable counter-measures in the means of marketing to assume the structural quality of capital expenditure. But it still leaves unanswered the question whether the steps which were taken to meet the crisis were in fact of a capital or of a revenue nature.

A valuable guide to the traveller in these regions is to be found in the well-known judgment of Dixon J. (as he then was) in the case of *Sun Newspapers Ltd. and another v. Federal Commissioner of Taxation* 61 C.L.R. 337 where he discussed the nature of certain sums spent in buying up the competition of a rival and concluded that they were capital. "There are, I think " he said at p.363 " 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." And at p.362 he said " 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."

To this one may add the general observation of Viscount Radcliffe in *Nchanga's* case [1964] A.C. 948 at 959—" Nevertheless, it has to be remembered that all these phrases, as, for instance, ' enduring benefit ' or ' capital structure ' are essentially descriptive rather than definitive, and, as each new case arises for adjudication and it is sought to reason by analogy from its facts to those of one previously decided, a court's primary duty is to inquire how far a description that was both relevant and significant in

one set of circumstances is either significant or relevant in those which are presently before it." And at page 960 " Again, courts have stressed the importance of observing a demarcation between the cost of creating, acquiring or enlarging the permanent (which does not mean perpetual) structure of which the income is to be the produce or fruit and the cost of earning that income itself or performing the income-earning operations. Probably this is as illuminating a line of distinction as the law by itself is likely to achieve, but the reality of the distinction, it must be admitted, does not become the easier to maintain as tax systems in different countries allow more and more kinds of capital expenditure to be charged against profits by way of allowances for depreciation, and by so doing recognise that at any rate the exhaustion of fixed capital is an operating cost. Even so, the functions of business are capable of great complexity and the line of demarcation is sometimes difficult indeed to draw and leads to distinctions of some subtlety between profit that is made " out of " assets and profit that is made " upon " assets or " with " assets."

Many cases have been cited to their Lordships and careful arguments have been based on the decisions either by analogy or on the actual language used in illuminating those decisions.

Some of the cases on which the revenue rely deal with the buying off of competition. Instances of these are the *Sun Newspaper Case* (supra), *United Steel v. Cullington* 23 T.C. 71, and *Collins v. Joseph Adamson* [1938] 1 K.B. 477. The *Associated Portland Cement* case 27 T.C. 103 also comes in this category. And *Van den Berghs'* case ([1935] A.C. 431) has an element of this although it comes into another category.

Where a trader buys out a rival in order to secure his goodwill or to suppress it and so provide or maintain a clear field for his own enterprise over a substantial period, there is a definite *prima facie* pointer towards a capital payment. But in the present case B.P. was not achieving a monopoly nor buying off competition nor obtaining any substantial area for its own domain. Although one retailer was tied to B.P., the retailer next door could still buy some other brand and the passing motorist could do likewise. When a shop agrees to deal only in the goods of a certain manufacturer, it may be said loosely that the manufacturer has a monopoly in that shop. But the word is misleading when all the other shops in the row are available to competitors. It may be that a particular shop is in a site so superior to the others, that securing its trade is a matter of great local importance. But looked at over a broad front, as one should look at dealings which are so widely spread as those in the present case and are common to the whole of a vast and universal trade, the particularly good site should be balanced against the particularly bad site. It is the acquisition of the sole trade of a retailer sited at an average service station which should be regarded. The wholesaler would in practice achieve the same result by entering into a forward instalment contract for the supply to a particular retailer of an amount of goods which equalled his anticipated capacity to sell. As to the advantage to the wholesaler of being able to paint the service station in his own colours, or advertise in any other way, it is a misuse of the word to describe it as an advertising monopoly. In practice a retailer welcomes (or demands) advertising matter from his wholesaler, and the advertising advantage is no more than a natural by-product of the wholesaler having tied a dealer to take his goods.

For those reasons the cases where competition had been stifled for a substantial period or a monopoly has been acquired have little direct bearing.

Some of the cases on which B.P. relies deal with the removal of unsatisfactory personnel. An instance of these is *Mitchell v. Noble* [1927] 1 K.B. 719 in which a lump sum paid to get rid of a bad director was held to be a revenue payment. In that case Hanworth M. R. (at 737) said that the payment was made " not in order to secure an actual asset to the Company but to enable the company to continue to carry on as it had in the past unimperilled by the presence " of one who . . . might have caused difficulty." Again in *Nevill's* case (56 C.L.R. 290) a lump sum paid to get rid of an unnecessary director was held to be a revenue payment since " the purpose was transient and

although not itself recurrent, it was connected with the ever-recurring question of personnel " (per Dixon J. at 306). A gratuity of £1,500 paid to a reporter on his retirement (*Smith v. Incorporated Council of Law Reporting* [1914] 3 K.B. 674) and £4,994 spent in buying an annuity for an actuary who had retired (*Hancock v. General Reversionary and Investment Co.* [1919] 1 K.B. 25) were held to be revenue payments. But the facts of these cases which deal with the recurrent problems of personnel do not provide an analogy to the present case. Nor on the other hand can any useful comparison be made with *British Insulated* and *Helsby Cables v. Atherton* [1926] A.C. 205. There a company's contribution of over £30,000 to form the nucleus of a fund and provide the amount then necessary to provide pensions for its staff was held to be a capital payment on the ground that " when an expenditure is made, not only once and for all but with a view to bringing into existence an asset or advantage for the enduring benefit of a trade . . . 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." Those words are useful as an expression of general principle on *prima facie* indications, but the benefit in the particular case was the foundation of a fund that would endure for the whole life of the company and provides no analogy to the present case.

The solution to the problem is not to be found by any rigid test or description. It has to be derived from many aspects of the whole set of circumstances some of which may point in one direction, some in the other. One consideration may point so clearly that it dominates other and vaguer indications in the contrary direction. It is a commonsense appreciation of all the guiding features which must provide the ultimate answer. Although the categories of capital and income expenditure are distinct and easily ascertainable in obvious cases that lie far from the boundary, the line of distinction is often hard to draw in border line cases; and conflicting considerations may produce a situation where the answer turns on questions of emphasis and degree. That answer " 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." (per Dixon J. in *Hallstrom's* case 72 C.L.R. 634 at 648). As each new case comes to be argued felicitous phrases from earlier judgments are used in argument by one side and the other. But those phrases are not the deciding factor, nor are they of unlimited application. They merely crystallise particular factors which may incline the scale in a particular case after a balance of all the considerations has been taken.

One may approach the problem by considering the first of the matters mentioned by Dixon J. above, namely the character of the advantage sought, and in this both its lasting qualities and the fact of recurrence may play their parts. Under this head one might also take account of the nature of the need or occasion which calls for the expenditure (Dixon J. in *Hallstrom's* case (supra)).

The need or the occasion came from the fact that marketing in the petrol trade in 1951 changed its nature suddenly but for sound commercial reasons. This change was in accord with modern tendencies in commerce. Instead of being a short term trade it became a long term trade. The producers' output no longer flowed unimpeded, intermingled, and haphazard over the whole area of consumption. It was diverted into separate specialised and individual channels. Henceforth the customer gave his whole loyalty or none at all. The producer in accordance with the new market fashion needed to have his own tied retailers, fewer in number but individually better customers, if he was to compete with his rivals. The advantage which B.P. sought was to promote sales and obtain orders for petrol by up-to-date marketing methods, the only methods which could now prevail. Since orders were now and would in future be only obtainable from tied retailers, it must obtain ties with retailers. Its real object however was not the tie but the orders which would flow from the tie. 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.

The test of whether these sums were payable out of fixed or circulating capital, referred to for example in *John Smith & Son v. Moore* [1921] 2 A.C. 13 at 19 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. If one imagines a B.P. agent justifying the price of petrol to a retailer or discussing whether price reduction was possible, it is hard to imagine him omitting the lump sum so paid (divided by the estimated gallonage) as an item in the cost per gallon. It is doubtful if he would even relegate it to overheads since it was in the forefront of the wholesaler's selling costs. Nor can one imagine the retailer demurring at such a calculation. *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. This however is merely one indication and by no means concludes the matter.

Mr. Menhennit forcibly contends that these were payments of a " once and for all " nature producing assets or advantages which are an enduring benefit and which should therefore go into capital account. (See per Lord Cave in *British Insulated and Helsby Cables Ltd. v. Atherton* (supra)). Further he argues that the benefit was to the structure of B.P. within which its profits were earned and not to the process of earning them. These are admittedly valid tests to apply and he contends that each points in favour of a capital expenditure.

The first point involves the question of recurrence. The Lord President in the *Vallambrosa Rubber* case (5 T.C. 529) said, as a rough criterion, " capital expenditure is a thing that is going to be spent once for all, and income expenditure is a thing that is going to recur every year." But as Rowlatt J. pointed out in *Ounsworth v. Vickers* [1915] 3 K.B. 267 the words " every year " are not to be taken literally but mean pursuant to a continuous demand.

It is argued that here there is nothing to show that the retailers would or could insist on fresh payments for a renewal at the end of the periods. But the reasonable inference is that they would and could do so. Unless the demand for petrol exceeds the supply (which on a balance of probabilities seems quite unlikely) the retailers would at the end of the period be in a position as good as or better than their original position. The fact that B.P. did not regard the lump sum payments as a permanent solution but considered that some other method should be found does not prevent their being of a recurrent nature. A temporary *ad hoc* solution is none the less of a recurrent nature because it is recognised that when the problem recurs it may have to be met in some other or more permanent fashion. Nor does the fact that in some cases B.P. dealt with the problem by an admittedly capital solution (e.g. by buying the service station itself and letting it to a customer) affect the question whether the method here in issue was a capital or income solution. Moreover there were fresh sums being paid each year to fresh retailers, a fact which cannot be wholly disregarded in considering whether there is a recurrent demand.

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. *Prima facie* matters connected with the ever recurring question of marketing and customers, though not themselves recurrent in an identical form, share the same quality of recurrence possessed by matters " connected with the ever-recurring question of personnel".

What additional indication is given by the actual length of the agreements? That must be a question of degree. Had the agreements been only for two or three year periods that fact would have pointed to recurrent revenue expenditure. Had they been for twenty years, that fact would have pointed to a non-recurring payment of a capital nature. Length of time, though theoretically not a deciding factor, does in practice shed a light on the nature of the advantage sought. The longer the duration of the agreements, the greater the indication that a structural solution was being sought. In this case the periods varied between 3 and 15 years, but the average appears to be something just under 5 years and the predominant number of agreements was for a five-year period. The case was argued before their Lordships as in the Courts below on the footing that 5 years was the length of the tie and neither side sought to make any differentiation because a few of the ties were very much longer. That length of time appears to be neutral, and in itself indicates neither capital expenditure nor revenue by its mere length. It therefore does not add effectively to the argument either way. The question must be decided by other weights in the balance.

In support of his argument that this was an enduring benefit Mr. Menhennit stresses the fact that B.P. secured a valuable chose in action namely the contractual obligation of the retailer to order from B.P. and to allow them to advertise at his station. Once an asset outlives its year of acquisition, its proper place, he contends, must be in the balance sheet as a capital asset. He relies *inter alia* on the observations of Lord Reid in *Hinton v. Maden and Ireland* 38 T.C. 391, where expenditure on knives which were used in machinery and had on the average a life of three years (but sometimes a life of only one year) was held to be capital expenditure. But the observations were directed to tangible tools and such assets do not form a safe analogy when dealing with choses in action. The plant and machinery and tools of a factory and other tangible assets are *prima facie* durable objects and part of the structure within which the profit yielding process is carried out. By convention and practice they are placed in the balance sheet and their diminution in value is acknowledged and accommodated by a system of capital depreciation for revenue purposes. No such clear practice or convention exists with respect to choses in action and their Lordships cannot accept the contention that a chose in action must be a capital benefit if its value outlives the year of accounting.

Much reliance is placed on *John Smith & Co. v. Moore* (supra), as showing that the contractual right to buy goods is a capital expense which must be distinguished from the actual purchase which is a revenue expense. Therefore, it is said, in the present case one cannot (as did Kitto J.) equate the tie to obtaining the mere " practical assurance of receiving bundles of orders " but one must treat it as a separate asset of enduring capital benefit. But that case dealt with special facts. The son had bought the father's business of a coal exporter for an overall sum on a valuation. An item in the valuation consisted of forward contracts with collieries for the delivery of coal at a very low price. The father had paid nothing for the contracts but owing to the rise in the price of coal, the forward contracts were valued at £30,000. The son made a large profit on the coal, and sought to set against them £30,000 as expenditure in the profit and loss account for the purposes of Excess Profits Duty. The expenditure was disallowed. Lord Cave held that the change of ownership must be disregarded since the duty was a tax on a continuous business, which was the chief point there urged on behalf of the Crown. His opinion therefore has no relevance to the present case. Lord Haldane held that as the son had acquired the contracts among other assets of the business as part of the capital of the business they became his fixed capital. " It was not by selling these contracts . . . but by retaining them, that he was able to employ his circulating capital by buying under them." Lord Sumner held that the case was covered by *City of London Contract Corporation v. Styles* 2 T.C. 239 where the purchaser of a business of contractors which had some construction contracts uncompleted, sought to set against the profits of the contracts when completed such part of the purchase price for the business as was attributable to their value. The Court had there held that that sum was paid with the rest of the aggregate price to acquire

the business, and not as an outlay in a business already acquired. Neither of their Lordships indicated that, had there been no change of ownership and purchase of the business assets, and had the son himself paid £30,000 to the collieries for the benefit of the contracts, the sum so paid would have been a capital expenditure. Lord Finlay however, who dissented, did deal with " the distinction " between " goods " and " choses in action ", such as contracts for coal. " This distinction ", he said (at p.28), " seems to me to be for this purpose quite untenable. The contracts gave the means of getting coal, and there is no difference for this purpose between having coal stored in your yard and having a contract which enables you to get it from time to time as you want it. This indeed was admitted by the Lord Advocate in argument when he was asked the question specifically by Lord Haldane."

It is clear that this Board found difficulty with that case in *Nchanga's* case [1964] A.C. 948 at 964. Lord Radcliffe observed that it decided nothing that could govern *Nchanga's* case and pointed out that Lord Haldane's and Lord Sumner's opinions had been determined by a combination of two elements namely that no sum of £30,000 had ever been paid and that in paying something in respect of the benefit of the contracts the son had not acquired stock in trade or anything like stock. In the present case likewise their Lordships do not derive help from *John Smith & Son v. Moore*. One certainly cannot deduce that the result would have been the same if the son had paid £30,000 to the collieries for the contracts.

Nor do their Lordships obtain help from the case of *Kauri Timber Co. Ltd.* [1913] A.C. 771. There the company in order to carry on its business of cutting and selling timber had bought twenty years previously (and in some instances thereafter) land with timber on it, or had bought timber with the right to cut and remove it during a stated time which in most instances was 99 years. It subsequently claimed to set off the value of the timber against revenue but this claim was rejected. The case was decided on the wording of the New Zealand Act and the references to the general principles of mining law with regard to capital and income do not help in the present case.

Their Lordships do not find *Stow Bardolph v. Poole* 35 T.C. 459, or *Rorke v. Commissioner of Inland Revenue* 39 T.C. 194, helpful. In the former case Jenkins L. J. expressly mentioned that the distinction on which the Court decided that the right to get gravel differed from the getting of gravel and was a capital expenditure might not be satisfying to some minds. Both are within the difficult area of mining cases; and principles governing extraction industries have little relation to the present case.

It is of commercial importance that profits should not be inflated for tax purposes by the artificial withdrawal from the profit and loss account of expenditure directly incurred in earning them unless it is of a truly capital nature. There is force in the observation of the Lord President in the *Vallambrosa* case (supra at 535) " The Crown will not really be prejudiced by this because when the tree comes to bear, the whole produce will go to the credit side . . . the only deduction will be the amount which has been spent on the tree in that year; they will not be allowed to deduct what has been deducted before."

In the present case one is dealing with payments made to particular customers to secure their particular custom. The only case cited which deals with that problem is *Bolam's* case (37 T.C. 56) which in their Lordships' view was rightly decided. But that case (as Taylor J. found) does not necessarily decide this case. For in that case the payments were simply calculated as an advance rebate which was repayable *pro tanto* if the actual gallonage fell below the estimated gallonage. *Usher's* case ([1915] A.C. 433) decided that where a landlord brewer pays or allows moneys to the tenant of a tied house as a necessary incident of the profitable working of a brewery business, the landlord brewer may deduct those moneys in the balance of profit and loss for the purpose of income tax, in spite of the fact that they enure also for the benefit of the tenant's separate trade in the tied house.

But the question whether the outgoings were of a capital or revenue nature was not raised and it was assumed that they were revenue payments.

One of the matters to be considered is how the sum in question should be treated on the ordinary principles of commercial accounting (see *Whimster's* case 12 T.C. 813). The sums paid to the retailers in the present case were put by B.P.'s accountants in the profit and loss acount. Had they been put in the balance sheet together with the choses in action for which they had been paid, the latter would have been inappropriate capital assets. They would necessarily have to be written down in the first and every succeeding year by one third or one fifth, (or whatever was the figure appropriate to the length of the tie) if the balance sheet was to be honest. And they would have to be written down out of money which had borne tax although the depreciation had gone directly to earn the taxable profits during the period. On the other hand it may be fairly said that to put the whole sum into one year's expenses is also misleading. But at least it evens out fairly over a period of years as do major repairs or renewals (e.g. the *Rhodesia Railways* case [1933] A.C. 368) or other intermittently recurring revenue expenditures.

The most apt way of dealing with these sums might seem to be to debit the profit and loss account with the whole payments and credit it with their unexpired value, thus treating them as a revenue item; but this is not the practice of accountants. If therefore one must allocate these payments either wholly to one year's revenue or to capital it would seem that either course presents difficulties but that an allocation to revenue is slightly preferable.

Finally were these sums expended on the structure within which the profits were to be earned or were they part of the money earning process? In *Hallstrom's* case (supra) where by a majority the Court held that the cost of fighting a patent was a revenue expenditure, Dixon J. (at 647) described the difference between capital and income expenditure as lying " between the acquisition of the means of production and the use of them; between establishing or extending a business organisation and carrying on the business; between the implements employed on the work and the regular performance of the work . . .; between an enterprise itself and the sustained effort of those engaged on it."

On this aspect of the matter two cases point the contrast. In *Van den Berghs Ltd. v. Clark* [1935] A.C. 431, £450,000 was received by one company from another as damages on the rescission of a twenty year agreement with thirteen years unexpired by which the companies agreed to share profits of trading in margarine instead of competing with one another. The case therefore had certain similarities to the cases of buying off competition, and to that extent the argument in favour of a capital payment was strengthened. It was held that this sum was a capital receipt, since " the agreements formed the fixed framework within which their circulating capital operated; they were not incidental to the working of their profit making machine but were essential parts of the mechanism itself. They provided the means of making profits, but they themselves did not yield profits."

A contrary conclusions was reached in *Anglo-Persian Oil Co. Ltd. v. Dale* [1932] 1 K.B. 124. The oil company employed an agent company to manage its business in Persia and the East, and to carry out the oil company's sales there for ten years, renewable for a further period of ten years. Eight years later it decided that it would be cheaper to dispense with its agent and to employ the agent's staff and organisation direct. It paid the agent company £300,000 cash in consideration of the agency agreement being terminated. It was held by Rowlatt J. that this was a revenue payment since there was no purchase of goodwill or start of a business, but simply the putting to an end of an expensive method of carrying on the business which remained the same, whether the distributive side was in the hands of the oil company itself or its agents. The Court of Appeal affirmed this decision. Lawrence L. J. concluded that " The contract to employ an agent to manage the company's business in Persia, however, in no sense forms part of the fixed capital of the company but is a contract relating entirely to the working of the

company's business, the method of managing which may be changed from time to time. Neither the contract itself nor a payment to cancel it would, in my opinion, find any place in the capital accounts of the company."

That case goes some way in support of B.P.'s contentions. Although it does not provide any compelling analogy, it is nearer to the present case than is *Van den Berghs Ltd. v. Clark*. It justifies the argument that expenditure incurred in making a radical change in the marketing arrangements of a company's organisation need not be a capital payment. It refutes any argument that the bigness of the amounts and the widespread area involved and the finality and extent of the change point automatically to a capital outlay.

Henriksen v. Grafton Hotel 24 T.C. 453 was a special case dealing with the payment for a license. Without the license the business could not be carried on. There was also an element of monopoly. On those grounds it was held to be a capital payment. In *Adam's* case (14 T.C. 34) the sums in question were spent on a dumping ground which the company had to have in order to carry on its business. These cases do not provide any safe analogy with sums paid to customers to secure their custom.

Thus a consideration of the nature of the benefit sought and obtained by B.P. would on the various tests suggested by the authorities seem to point to the expenditure being revenue rather than capital.

The second of the considerations suggested by Sir Owen Dixon above, namely the manner in which the benefit was to be used, relied on and enjoyed by B.P., points in a similar direction. The benefit was to be used in the continuous and recurrent struggle to get orders and sell petrol. The agreements were not strictly " bundles of orders " but they were the basis of them and made orders inevitable. The retailer was bound to sell none but B.P.'s petrol and to increase the sale of its products to the best of his ability. This means that in practice he was bound to give orders for petrol which B.P. was bound to supply. Although the price and time of delivery were not specified these would be implied by law as reasonable. No fresh consensus between the parties was necessary. All that was needed was that the retailer should specify from time to time what quantity he required. Thus the agreements merged in and became part of the ordinary process of selling. These facts point to the expenditure being a revenue item.

The third consideration suggested by Sir Owen Dixon, namely the method of payment, does not point very clearly in either direction. An advance payment for a period is not unusual in many revenue matters (e.g. purchase of stock). These payments were not current payments made annually over the period of benefit but on the other hand it was clear that they would have to be made again at intervals of a few years. In a durable company of this nature recurrent five yearly payments certainly cannot be said to have a " once for all " quality. Had the payments been for one or two years they would point towards revenue; had they been for twenty years they would point towards capital. But the actual period of time for which these particular payments were made, as in the consideration of the nature of the advantage (above), gives no indication which could outweigh the indications given by other considerations.

The case is not easy to decide. But on a balance of all the relevant considerations the scales appear to incline in favour of the expenditure being revenue and not capital outgoings.

Mr. Menhennit raised an alternative argument that this expenditure could not come within the words of section 51(1) of the Act since it was not incurred in gaining the assessable income. B.P. made the payments, he argues, to put itself into a position from which to make income; it simply entered into arrangements favourable to the making of income and the payments are too indirect to fall within section 51(1). He relies on the observations of Menzies J. in *Fairfax's* case (101 C.L.R. 30 at 48).

Their Lordships do not feel able to accept this narrow view of the matter in the light of their conclusions on the broader issue. The alternative argument stands or falls with the main argument. For the reasons given they hold that the expenditure was incurred in gaining the assessable income.

Their Lordships will therefore humbly advise Her Majesty that the appeal should be allowed, the orders of the Full Court and of Taylor J. set aside with costs and the amended assessment for income tax and social services contribution for the year ending 30th June 1952 remitted to the respondent for him to allow the appellant's objections thereto. The respondent must pay the costs of the appeal.

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In the Privy Council

B.P. AUSTRALIA LIMITED

v.

THE COMMISSIONER OF TAXATION OF THE COMMONWEALTH OF AUSTRALIA

DELIVERED BY

LORD PEARCE

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