HIGH COURT OF AUSTRALIA

Herring

Vs.

Federal Commissioner of Taxation

(Rich J.)

20 June 1946

Rich J

These are three appeals from assessments for income tax upon a timber company in the hands of a receiver. The company's accounting period ends on 13th September and the assessments are for the three financial years beginning on 1st July 1936 and ending on 30th June 1939 and are made in respect of the years of income extending from 14th September 1935 to 13th September 1938. The greater part of the assessable income for this period consists in royalty paid to the taxpayer company in respect of timber obtained from land belonging to the company. The appeals raise the question whether any deduction should be made from the assessable income on account of some part of the expenditure incurred by the company in connection with the construction of a road made, as the taxpayer company claims, so that the timber could be won and royalties obtained. The Commissioner refused to allow any such deduction in assessing the taxable income, on the ground that the expenditure is of a capital nature. The taxpayer company carried in an objection to the assessments to the effect that there ought to have been allowed "the deductible cost of getting the timber carried upon the land of the taxpayer, that is to say the cost of making certain roads made by the taxpayer necessarily and solely for the purpose of getting such timber from the said land and for obtaining the royalty charged thereon and of certain survey and other fees and other expenditure incidental thereto."

The appeals are from the disallowance by the Commissioner of this objection. The material facts can be briefly stated. But in order to understand the matter it is necessary to go back as far as 1921. On 20th January of that year a company called Laheys Ltd. sold to the War Service Homes Commissioner a large area of timber country subject to an option of re-purchase exercisable at a date when apparently it was considered the timber on the land would have been worked out and removed. I gather that the date was 1st July 1937. On 11th February 1924 the War Service Homes Commissioner entered into a contract with the taxpayer company to sell to it upon terms the lands comprised in the sale by Laheys Ltd. to him but subject to the option of re-purchase reserved by Laheys Ltd. In 1927 the taxpayer company decided to sell to another company, called Standply Timber Co. Ltd., the right to cut timber from an area of 1,231 acres of the lands comprised in the before-mentioned agreement. This area seems to have been upon a not very accessible plateau of some elevation. An agreement dated 27th April 1927 was entered into between the two companies. The consideration for the sale was a royalty or, rather, royalties, varying with the nature of the timber, calculated on the quantity in superficial feet of the timber got or removed from the area by Standply Timber Co. Ltd., the purchaser. But the purchaser was also to pay down a sum of £5,000. The agreement was to operate until 31st October 1936 and during any extension the taxpayer could obtain from, I imagine, Laheys Ltd. of its right to the land. In the event, on or about 1st July 1937, the taxpayer company in fact bought in the option or interest of Laheys Ltd. The agreement between

the taxpayer company and Standply Timber Co. Ltd. contained a stipulation that the taxpayer company would on the payment of the £5,000 already mentioned carry on with all due diligence the construction of a road from a named point on a public road to one of the boundaries of the area over which the cutting rights of the Standply Timber Co. Ltd. extended. The road was to be made according to certain specifications and was to be suitable for lorry traffic. Endeavours were to be made to complete it within two years. The purchaser company was to be entitled to use the road for the removal of timber not only from the contract area but also from any other areas it might acquire and the taxpayer company was also to be entitled to use it but not to grant rights to others for its commercial use without the consent of the purchaser, Standply Timber Co. Ltd. Apparently, as to one block of the contract area, a block of 160 acres, the taxpayer company was to cut the timber and deliver it at a price to the purchaser company, but it is not clear that the road would serve this block. The latter company was to advance to the taxpayer company against royalties such further sum not exceeding £28,000 as might be found necessary for meeting the cost of constructing the road. The amount advanced was to be repaid by a refund of half the royalties payable to the taxpayer company by Standply Timber Co. Ltd. The construction of the road in fact occupied ten years and it cost in all £39,479 7s. 5d. It was completed about September 1938. But in the meantime the lengths from time to time completed were used for hauling timber. On 27th May 1940 the taxpayer company sold its right in the road to the Commissioner of Main Roads for £10,290. The taxpayer company claims to deduct an apportioned part of the expenditure upon the road from the assessable income of each of the three income years in question as part of the losses or outgoings in gaining or producing the assessable income or necessarily incurred in carrying on a business for the purpose of gaining or producing such income (s. 51 (1) of the *Income Tax Assessment Act 1936-1938*). The apportionment proposed is by taking the same rateable proportion of the total expenditure as the royalties of the given year bear to the total royalties. The actual expenditure in connection with the road in the income years in question was as follows:—Year ended 13th September 1936£2,373 3s. 11d.Year ended 13th September 1937£1,206 1s. 1d.Year ended 13th September 1938£125 0s. 0d.

Even if the contention of the taxpayer company that a deduction should be made on account of expenditure on the road were otherwise sustainable, I do not think that the proposed mode of calculating the deduction could possibly be adopted. What s. 51 authorizes as allowable deductions are losses and outgoings incurred in gaining or producing the assessable income or necessarily incurred in carrying on a business for the purpose of gaining or producing such income. In some sense at least the expenditure claimed by a taxpayer as a deduction must be "incurred" in the year of income. What that sense is and what it covers have been the subject of discussion in this Court more than once: See, for instance, *Amalgamated Zinc (De Bavay's) Ltd. v. Federal Commissioner of Taxation*[1], and the cases there cited. But how in any sense could it be said that a proportionate part of the aggregate cost of such a work as the road was so incurred? There are special provisions dealing with the cost to a timber business of land carrying standing timber and of rights to fell timber: See ss. 69 and 70. These provisions give a deduction from assessable income of an aliquot part of that cost ascertained by reference to the timber felled in the year of income. Possibly the provisions are the source of the idea upon which the taxpayer company's claim to proportion the cost of the road is founded. But they do not cover such a case as this, and the fact that it was necessary to make such a special enactment shows how little justification can be found for the process in the general rule laid down by s. 51.

But in any case I have come to the conclusion that no deduction on account of the expenditure upon the road can be allowed at all. Section 51 expressly excepts from its operation losses and outgoings of capital or of a capital nature. In my opinion the expenditure by the taxpayer company is an outgoing of a capital nature. I do not found this opinion in any way on the suggestion that the

company constructed the road for a dual or secondary purpose and not simply to enable the timber to be obtained. I accept the position that the road was constructed in pursuance of the agreement and because it was necessary for the purpose of removing the timber. But even so it amounted, as I think, to an outlay of a capital nature. It is not to the point that the outlay was made in connection with the creation of an asset of which the value for the purpose of profitably working the timber or obtaining royalties therefrom would progressively diminish. That happens when capital is spent in acquiring patents, mining leases or concessions limited in point of time. Income tax law may not always be just in the provisions it makes for writing off against assessable income the cost of such wasting or terminating assets. But that does not make their acquisition or creation any the less an affair of capital. The expenditure on the road formed a necessary outlay to obtain the "enduring benefit" of the expected royalties. Lord *Cave* L.C., in using the phrase "enduring benefit" in *British Insulated and Helsby Cables Ltd. v. Atherton*[2], was not thinking of advantages that are permanent. There is a difference between the lasting and the everlasting. The time over which the thing "endures" is a matter of degree and one element only to be considered. Horses in the old days and motor trucks in these are plant and their acquisition for the purpose of transport in business usually involves a capital expenditure. But the horses were not immortal any more than the trucks have proved to be. Another test is that of Lord *Dunedin*, when Lord President, a test almost as frequently employed as Lord *Cave's* was, expenditure made "once and for all" (*Vallambrosa Rubber Co. Ltd. v. Farmer*[3]). That test I think can give only one answer if applied to the case of the road. To deepen a shaft in a mine so that in the future the mine may be further worked involves an expenditure of a capital nature (*Bonner v. Basset Mines Ltd.*[4].). So is a lump sum payment by a colliery towards drainage works to allow a coal seam to be worked (*Bean v. Doncaster Amalgamated Collieries Ltd.*[5]). Further examples are to be seen in *United Collieries Ltd. v. Inland Revenue Commissioners*[6]; *Boyce v. Whitwick Colliery Co. Ltd.*[7]; *Taupo Totara Timber Co. Ltd. v. Commissioner of Taxes*[8]; and *Minister of National Revenue v. Kellogg Co. of Canada Ltd.*[9].

These are but illustrations but they support my conclusion that the cost of the road is altogether an affair of capital.

I think that the appeals should be dismissed.

Appeal dismissed with costs.

Solicitors for the appellant, Morris, Fletcher & Cross.

Solicitor for the respondent, H. F. E. Whitlam, Crown Solicitor for the Commonwealth.

[1] [1935] HCA 81; (1935) 54 C.L.R. 295.

[2] (1926) A.C. 205, at p. 213.

[3] (1910) 5 Tax Cas. 529, at p. 536.

[4] (1912) 108 L.T. 764; 6 Tax Cas. 146.

[5] (1944) 171 L.T. 214.

[6] (1929) 12 Tax. Cas. 1248.

[7] (1934) 18 Tax Cas. 655; 151 L.T. 464.

[8] (1912) 31 N.Z.L.R. 617; (1913) A.C. 771, at p. 777.

[9] (1943) S.C.R. (Can.) 58, at p. 60.

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