IN THE SUPREME COURT OF NEW ZEALAND SC 74/2015

[2016] NZSC Trans 4

BETWEEN **TRUSTPOWER LIMITED**
Appellant

AND **COMMISSIONER OF INLAND REVENUE**
Respondent

Hearing:	8 - 10 March 2016
Coram:	Elias CJ William Young J Glazebrook J Arnold J O'Regan J
Appearances:	G J Harley, S A Armstrong, F M Ward and V V Kumar for the Appellant D H McLellan QC, R L Roff, C M Kern and R N Park for the Respondent

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CIVIL APPEAL

MR HARLEY:

Good morning, Your Honours. I appear with my colleague Sarah Armstrong, Frederick Ward and Varoon Kumar for the appellant and taxpayer.

ELIAS CJ:

Thank you, Mr Harley. We don't normally have four counsel appearing. It does not really matter but for future reference.

MR HARLEY:

Thank you, Ma'am.

ELIAS CJ:

Thank you. Oh, another four. Well, at least it's even.

MR McLELLAN QC:

I was going to tell one to sit down. May it please the Court, I appear with Rachel Roff, Carolyn Kern and Roslyn Park for the respondent.

ELIAS CJ:

Thank you, Mr McLellan. Yes, Mr Harley.

MR HARLEY:

There's one housekeeping and small matter, Your Honours. Both Courts below have been careful and circumspect on their judgments about the use of confidential commercial material. It mostly relates to the Kaiwera Downs indicative offer that was made in 2010 but my friends have been entirely co-operative about managing that and so I'd invite you to leave that issue to us and if and when it becomes important we'll raise it with you directly rather than jump up and down at various times.

ELIAS CJ:

All right.

MR HARLEY:

I've prepared a careful road map which I'll hand in. I'm going to address myself the first three questions before the Court. Ms Armstrong will deal with question 4. It's as well, Your Honours, if you would turn to the Court's questions. You'll find the leave terms in the pink volume, 23. I think it's tab 160. It should be the last volume. I think Your Honour Justice Young will be reasonably familiar with the leave terms because, as I read them, you had a hand in writing them. Whether or not that is so, the approved questions –

WILLIAM YOUNG J:
Too long ago.

ELIAS CJ:
It's the style.

MR HARLEY:
The four questions are set out in Part B and then the Court offers two comments. So as I deal with the questions A, B and C it's also important to address directly the Court's observations in the comments. There are two particular aspects to that which are really set out in comment 2. It raises two different matters. So I'll make sure with your guidance that I deal with those fully.

If we could hand in these roadmaps, Madam Registrar.

I propose to deal with what's question A very briefly. The question poses whether the Court of Appeal was correct to determine that section DA 1 [Income Tax Act 2007] which is the general permission was or wasn't satisfied. In order to answer that question, if Your Honours have had regard to the legislation materials which is before you in volume 1, you'll see the two sections that are in issue in this case. The first section that we're referring to – this is general permission DA 1 – this is the general provision that allows for the deductibility of expenses that are incurred by a taxpayer either in deriving assessable income or in the course of carrying on business in order to derive assessable income and it's referred to generally as the general permission.

The section poses, as the subheading has, the nexus with income. All the cases refer to what is called the statutory nexus test. The statutory nexus test simply poses the question as to whether or not the amount of expenditure is incurred by the taxpayer in deriving assessable income or in the carrying on of the business.

The second section that's in issue and we say is clearly an issue in this case is DA 2 [Income Tax Act 2007], which is the capital limitation. That is, it denies a deduction for an amount of expenditure if it's of a capital nature. It's clear law that there are large classes of expenditure that fall within the general permission and which do not satisfy the capital limitation, therefore DA 2 overrides DA 1. It's common ground in

this case and remains common ground with the Commissioner that DA 1 was always satisfied in respect of Trustpower and the nature of its business and the Court of Appeal was plainly wrong in respect of holding that that was not so. The proposition here is that the relevant expenditure, if it is properly characterised as feasibility expenditure, is deductible for an existing business, which Trustpower is. And so the Commissioner was right in the adjudication report's first section, holding that all these costs in issue were part of Trustpower's general feasibility costs and were deductable for the purposes of DA 1.

The alternative proposition then and the only proposition remaining before the Court is whether the resource management consents were themselves separate and tangible capital assets and for that reason the costs were not deductable.

GLAZEBROOK J:
Is that really the issue or is the issue whether they are capital expenditure? Are you saying they're limited to whether they were separate capital assets or is there a more general indication in terms of deductibility or whether it's on capital account?

MR HARLEY:
My answer to your question, Your Honour, is unless it's possible to characterise these resource consents as being separate, identifiable, intangible assets then they can't be subject to the capital limitation. Obviously the Court of Appeal came to a different view about that and for the reasons that we've submitted the Court of Appeal was wrong in law.

WILLIAM YOUNG J:
There are two questions. There are two stages to it. Is it within the general limitation? That's the primary question. And then you say that should be answered by reference to whether the resource consents are intangible, discrete assets.

MR HARLEY:
That's the second question.

ELIAS CJ:
Is the second question a matter of necessary implication from the terms of the statute or are you relying simply on the assessment?

MR HARLEY:

No, I'm relying on the case law dealing with what is capital and adopting the case law conception of that by reference to what is called the identifiable capital asset test. Going back to Justice Glazebrook's question, the proposition being argued for the taxpayer here is that unless the expenditure relates to and is part of an identifiable capital asset it's not capital. It's revenue. And so we part company fundamentally with the Court of Appeal on that matter, as we do with the Commissioner, who seeks to support the judgment on the basis that the Court of Appeal's approach to that interpretation matter was correct in law.

GLAZEBROOK J:

Could I just check with you again, question 1 was directed both to the DA 1 question but also to the question of jurisdiction which was raised by the taxpayer. Is there any question of jurisdiction that you want to raise in respect of your identifiable capital asset test or is it merely a submission that we assess in general with the case law?

MR HARLEY:

It's the latter, Your Honour.

GLAZEBROOK J:

So there's no jurisdictional issue?

MR HARLEY:

Well, in respect of DA 1 it's common ground between us that DA 1 was satisfied and therefore the Court of Appeal can't be right in respect of holding that it wasn't. The pleadings themselves are closed on that point as well and so we can just move directly to DA 2 and there's no jurisdiction issue there, unfortunately or fortunately, depending on where we get to.

There's a good deal of common ground nevertheless between us. First it's now common ground that the depreciable and tangible property regime that the Commissioner initially relied on is no longer before the Court. Both parties accept at the depreciable and tangible property regime is not applicable to these circumstances.

WILLIAM YOUNG J:

What, for the reasons given by the Court of Appeal?

MR HARLEY:

Yes and primarily, Your Honour, that is that in the depreciable and tangible property regime there is a carve-out in respect of expenditure incurred that is otherwise deductable. If it's otherwise deductable under general principles then it can't be depreciable and tangible property, therefore the depreciable and tangible property regime can't apply.

GLAZEBROOK J:

But if it isn't otherwise deductable?

MR HARLEY:

Then it's capital.

GLAZEBROOK J:

But why doesn't the regime apply then?

MR HARLEY:

It may apply to some of the consents but not to all of them and that's another question that was left open by the Court of Appeal.

WILLIAM YOUNG J:

Is that the land use consents it might not apply to?

MR HARLEY:

Correct.

WILLIAM YOUNG J:

Because they're not time limited.

MR HARLEY:

Correct.

WILLIAM YOUNG J:

So you would never depreciate the value of the land use? You would never depreciate the value of the land use consent?

MR HARLEY:

Yes, Your Honour. If I could take you back into the past into access management Ben Nevis, that was the issue in respect of the premium paid on the grant of the licence fee. Because the licence was fixed life, the issue was whether it could depreciate. For land use consents which are perpetual, they are the land themselves and in concept you can't depreciate land.

WILLIAM YOUNG J:

So it would be necessary to apportion – if you were to treat it all as capital assets it would be necessary to apportion the value of the project as a whole between land and land use consents and water discharge consents?

MR HARLEY:

Yes and if that were possible because it –

WILLIAM YOUNG J:

But it must be done in some respects. It must be electric-generating plant or systems where that sort of exercise is carried out.

MR HARLEY:

Definitely and that is in respect of what Trustpower refers to as its type 1 consents, existing plant where there are renewals of consents. Those renewals are always for fixed terms and where the apportionment process is directly applicable to the types and nature of the renewed consents in respect of operating that kind of plant and equipment.

The fundamental question that needs to be addressed in this proceeding is what is actually meant by the expression "identifiable capital asset". Capital is one part. The other is the meaning of "asset" itself. I say that if you go back to the basic concepts of what is capital and what is not the answer emerges from the cases in respect of what is fixed capital. That provides operating structure so as to enable the firm to earn its profits. In one of his speeches Lord Morris refers to the word "picture" to explain what is capital and what is not. We're all familiar, of course, with these as basic ideas in respect of, for example, the manufacturer's factory or the farmer's farm or the mine. Each of those types of asset inherently define fixed capital, meaning that for the mine, for example, and we're using a lot of the mining cases here, the taxpayer purchases the land or the mine or leases the property that is the subject of

the mine. It's that very cost that creates the structure of the business and then as the land is the subject of extraction or the factories used, that is the fixed capital in operation.

Everyone agrees that the starting place is Sir Owen Dixon's judgment in *Hallstroms Pty Ltd v Federal Commissioner of Taxation* (1946) 72 CLR 634. A curious aspect about that judgment is that he was in the dissent and the view he expressed in result has never been accepted in the law in any jurisdiction except in Australia itself when Sir Owen was able subsequently to command a majority of his own Court. But putting that to one side, the authority of Dixon is recognised in the House of Lords and Privy Council where they refer to the classic guide to the traveller. Sir Owen in *Hallstroms* had two particular passages that are, we say, of basic importance here in terms of approach.

WILLIAM YOUNG J:
Where do we find *Hallstroms*?

MR HARLEY:
I think it's 4 and it's number 41. I'm going to take you through these judgments quite carefully later but the particular paragraphs that are always referred to in practically every judgment in this area of law is on page 648 and it's the last section of the judgment where he starts – well, I should just explain a little. The issue in the case involving *Hallstroms* was an attack on the renewal of a competitor's patent being extended. The argument for the Federal Commissioner was that the expenditure was capital because it had the character of providing to Hallstroms an extension or expansion of its business structure and was therefore referable to business structure and was not deductable. So the Dixon view starts with once there is a clear appreciation of the actual place in the business of the company which the existence, expected termination, and threatened extension of the patent took, then I think the difference between on the one hand gaining or preserving a freedom to use the invention as a common right and on the other hand acquiring the exclusive right to use which the extended patent would have conferred ceases to be significant when deciding whether the expenditure belonged to capital or revenue.

The most famous passage, then, is the next part. What is an outgoing of capital and what is an outgoing on revenue account depends on what the expenditure is calculated to effect from a practical and business point of view rather than upon a

juristic classification of the legal rights, if any, secured, employed or exhausted in the process.

Just pausing there, two observations. We say that the whole focus here of the Commissioner and Court of Appeal on the RMA [Resource Management Act 1991] consents themselves is the juristic classification and treats the consents as being ends in themselves when we say properly understood on the evidence having regard to a clear appreciation of the actual place in the business of the company and what these consents provided and were used for. They're not ends in themselves at all and the approach taken is misconceived.

ARNOLD J:
So do you say the approach is a subjective one? Because the Judge refers to expenditure being calculated to effect. Should we be looking at it subjectively or objectively, in your submission?

MR HARLEY:
The correct way to look at it, Your Honour, is to have regard to the trial Judge's findings of fact where she accepted plainly the evidence that was before her and its credibility. Credibility in the trial was fundamentally an issue. These witnesses were cross-examined from one end of the Court to the other over many days. The answer to your question, then, is that it is the taxpayer's evidence as to the nature of the business which, if accepted as credible, is determinative. Of course, the Court takes a view as to whether or not that evidence is credible and truthful. Of course it does. But the trial Judge –

ARNOLD J:
You are saying, then, that it is a subjective approach.

MR HARLEY:
Yes.

ARNOLD J:
Because the credibility is simply an issue. Do I believe it or not?

MR HARLEY:

Do you believe and in addition to that, Your Honour, I would say apart from accepting the believability is it rational, does it make sense having regard to the background and nature of this business, this is how these consents are used and the Judge obviously accepted it was.

ELIAS CJ:

Are you contending for a sort of business judgment deference to the decision of the taxpayer?

MR HARLEY:

Not entirely. But the fact that a taxpayer conducts its business in a strange or idiosyncratic way from the perspective of the Commissioner or Judges doesn't change the way in which the taxpayer has actually conducted the business and spent the money and for what it's spent the money.

ELIAS CJ:

What I'm sort of trying to understand is whether you're arguing for a correctness approach or a supervisory approach, one that allows some margin to the taxpayer. When you talk about a reasonable – if it was reasonable for this subjective view to be held, I think that's what you said.

MR HARLEY:

Rational.

ELIAS CJ:

Rational, just not sure what you're seeking to convey by that.

MR HARLEY:

I'm drawing on Lord Radcliffe's speech in *Edwards (Inspector of Taxes) v Bairstow* [1956] AC 14 where the proposition there – and it's familiar law – is that if the conclusion reached by the trial Judge on the basis of the evidence before her just does not make sense then a supervisory Court will hold that that is not rational and there must be some explanation that's different. But my submission to you is, we're not within a million miles of that here, that the Judge was quite entitled.

ELIAS CJ:

So it's the Judge's determination that has to be cut some slack in this.

MR HARLEY:

Yes.

ELIAS CJ:

Can you just – because I'm less familiar with this dreadful statute than colleagues – can you just tell me what the appellate provisions are in the Act and I'll have a look at them.

MR HARLEY:

This is the Supreme Court Act?

ELIAS CJ:

No, I'm talking about appeal to the Court of Appeal.

WILLIAM YOUNG J:

The appeal to the High Court, which is an appeal authority, and then it's an appeal by way of rehearing to the Court of Appeal.

ELIAS CJ:

Yes.

WILLIAM YOUNG J:

So you want to go to the hearing authority provisions.

ELIAS CJ:

Just tell me them. Don't take the time of the Court on those.

MR HARLEY:

But you'll enjoy this, Your Honour. I'll be brief. Under 138 whichever letter it is of the Tax Administration Act, the Court sits as what's called a hearing authority.

ELIAS CJ:

Yes.

MR HARLEY:

The hearing authority is the super-Commissioner. It is the Commissioner with the Judge wearing her hat deciding properly instructed as to the law and applying the law to the facts that are in the record. And so this is the ultimate form of what is right for the Commissioner. The Court's decision as the super-Commissioner reflects the perfect answer. That's quite an unusual Court power. In fact, I know of no other jurisdiction that matches that explanation. We don't need to get into it.

ELIAS CJ:

Does that mean the Commissioner can never challenge the Judge?

MR HARLEY:

The Judge is the Commissioner so she's talking to herself.

ELIAS CJ:

So there's no appeal by the Commissioner?

MR HARLEY:

No.

WILLIAM YOUNG J:

But the Commissioner can appeal against the decision of the High Court, can't they?

MR HARLEY:

Yes but the next Judge, in this case Justice Francis, the presiding Judge, is the super-Commissioner and here, Chief Justice, it's you.

ELIAS CJ:

Oh, here it's us, good. Now, I still don't see why that suggests that the Court of Appeal and therefore we have to defer so much to the assessment of the Judge.

MR HARLEY:

I think we may be playing with words here with "defer so much". The proposition is –

ELIAS CJ:

Well, you're saying we can't intervene if it was a decision which on the evidence applying *Edwards v Bairstow* [1956] AC 14 (HL) was reasonably open to her. Where do you get that from?

MR HARLEY:

Was reasonably open to her and on the evidence cannot be shown to be wrong. Where do I get that from, Lord Nolan's judgment in *Rangatira Ltd v Commissioner of Inland Revenue* [1997] 1 NZLR 129 (PC) is the classic application of that proposition.

ELIAS CJ:

Okay, I'll have a look at that. You carry on.

MR HARLEY:

Your Honour will find that in your footnote in the *Austin Nichols & Co Ltd v Stichting Lodestar* [2007] NZSC 103, [2008] 2 NZLR 141.

ELIAS CJ:

Right, I do remember that.

MR HARLEY:

And it's not special, in my submission, to tax cases.

ELIAS CJ:

No, that's why I was asking you about it.

MR HARLEY:

I'm not intending here to be controversial. The law is as stated in your judgment in *Austin Nichols* and it happens that that footnote picks up the passage that Lord Nolan used when he reversed the Court of Appeal in *Rangatira*. But Your Honour will be familiar with this across a broad range.

ELIAS CJ:

Well, yes, I am. But I was wondering whether you were contending for something peculiar to tax law. That's all right. You carry on.

GLAZEBROOK J:

But wrong can be just take a different view, can't it? Because you're actually going further, suggesting that the rehearing authority, which would be contrary to *Austin Nichols*, can't take a different view. Obviously the Court has to be persuaded that it should take a different view.

MR HARLEY:

The Court must take a different view if it is satisfied that the Judge was wrong and my submission to you, which I'll come on to in terms of all the evidence is the Court of Appeal could not properly have come to that view at all.

ELIAS CJ:

Can't we cut to the chase, though, and just ask whether the Court of Appeal was right or whether the Court of Appeal to have been wrong in deciding that the High Court Judge was not right?

MR HARLEY:

And we will, Your Honour, but in order to come to that view my submission to you is that you need to understand the legal framework in respect of what is the identifiable capital asset test and why that is the law.

ELIAS CJ:

Yes, of course we do.

ARNOLD J:

Can I just go back to the subjective question? When you look at this language of Justice Dixon what the expenditure is calculated to effect from a practical and business point of view, as I understood your answer, the approach to that is a subjective one, subject only to a sort of rationality requirement. Is that right?

MR HARLEY:

Yes.

ARNOLD J:

Does that mean – you're presumably going to develop this but for example in the area of repair and maintenance, whether something's revenue or capital account, if

you look at the *Commissioner of Inland Revenue v Auckland Gas Co Ltd* [1999] 2 NZLR 418 (CA), for example.

MR HARLEY:
Yes.

ARNOLD J:
It wasn't the taxpayer's view of what it was doing that ultimately prevailed. I mean, there were all sorts of arguments from the taxpayer that what it was doing was repairing the network but the Court looked at it from a practical and business point of view and said, "No, what's happening here is a new network is being developed." Do you say, well, that's just an example of the rationality overlay at work? That's a very objective approach, it seems to me.

MR HARLEY:
Your Honour, I can't remember the exact sequence but I think it's the case in *Auckland Gas* that the High Court found for the Commissioner against the taxpayer.

ARNOLD J:
No. In the High Court the High Court found for the taxpayer. That was overturned in the Court of Appeal and upheld in the Privy Council.

MR HARLEY:
Thank you. In the Court of Appeal the main judgment for the plurality was given by Judge Blanchard and the essence of the judgment was to reflect the legal concept of the difference between a repair and what was a fundamental enhancement of the capital asset itself which was, as you've said, the network. The Privy Council said absolutely right, that is the correct legal question and the Court of Appeal was right in responding to it on the basis of the taxpayer's own evidence. So it is an interpretation approach in the Court of Appeal as to what the evidence properly meant when responding to the legal question.

Your Honour will have a far deeper command of what was argued in that case than I do but that is the approach that was taken in the Court of Appeal, I believe at your urging.

ARNOLD J:

Yes, that sounds right. That's helpful, thank you.

ELIAS CJ:

Just on that point, this suggestion calculated to effect from a practical et cetera, calculated to effect is language Courts often employ when they are referring to objective effect rather than subjective intention, so when you come on to look at the authorities you're going to take us to authorities which suggest that this is intended in the subjective sense that you've explained that you're arguing?

MR HARLEY:

Yes but Lord Nolan himself reflects this by referring to, in that case the question was whether or not the taxpayer's business involved dealing in shares and he said the only way you can answer that question is by looking at the evidence from the taxpayer itself explaining what its business was and how it was conducted.

Now, in that case the trial Judge accepted on the basis of the evidence that was before him that the business was one of investing in shares, not in dealing with them. And the Court of Appeal reversed that judgment on the basis of its view of what the business of *Rangatira* was. The Privy Council reversed the Court of Appeal on that basis, saying no, the evidence in the trial Court was probably open to either interpretation but that there was no proper basis for the Court of Appeal to say that the Judge was wrong and that he had the benefit of the trial and therefore unless it could be shown that the Judge got the wrong conclusions, his findings had to stand.

ELIAS CJ:

But in that case the fact was actually the intention of the taxpayer, so you can see that if it was open to both interpretations one might think that the trier of fact was, had an advantage in assessing what the intention was. But that's not the sort of fact we're concerned with here because there's no question about the business of your client, for example.

MR HARLEY:

Well, Your Honour, I would agree that there's no question about the business of Trustpower but the Court of Appeal itself reversed the Judge in respect of what that business was. I say it was not entitled to do that.

ELIAS CJ:

All right. Well, you better carry on with it but I see where it's heading. Thanks.

MR HARLEY:

The second point that arises in terms of the Court of Appeal's judgment was that transportation from DA 1's general limitation provision to the capital limitation, the so-called sufficient connection test. The submission for Trustpower here is that these are very different concepts and ideas, but it's DA 1 that poses the statutory nexus sufficient connect aspect, not the capital limitation. The capital limitation simply poses the question for what was the expenditure incurred. Was it capital in law or not. And as the cases show, which we'll get to, what is capital, is it a business conception or idea? The sufficient connection language is well explained in the judgments in the materials, primarily judgments of Justice Richardson in the *Commissioner of Inland Revenue v Banks* [1978] 2 NZLR 472 (CA) and *Buckley & Young v Commissioner of Inland Revenue* [1978] 2 NZLR 485 (CA) cases and I don't particularly need to take you through them in detail, save to make the point that the Judge emphasises the importance of focusing on the character of expenditure, not on its purpose.

There is, in our submission, no case law support whatsoever when it comes to considering the capital limitation for using the sufficient connect approach. Indeed we say that it fundamentally contradicts the correct approach which is the identifiable capital asset test. So there's a head on conflict between us and the Commissioner in respect of this matter where the Commissioner at paragraph 43 of the written submission asserts that the sufficient connection approach is drawn from and relies on the judgments of *Hallstroms* and the Privy Council in *Commissioner of Taxes v Nchanga Consolidated Copper Mines Ltd* [1964] AC 948 (PC) and when I get to go through those cases my submission will be that neither comes close to using anything like that language or approach. Both reflect the identifiable capital asset test.

An important dimension to this case is the difficulty in dealing with intangibles. The Court reflect that intangibles pose questions that are usually more difficult to deal with than tangibles. We can all see easily the idea of fixed capital in respect of the factory or the farm but when it comes to intangibles, particularly contractual rights or legal permissions, the nature of them becomes far harder to reflect in terms of

whether or not they provide fixed capital, as in structure, or whether they are truly simply part of the current operations of the business on revenue account.

So the cases are best approached in chronological order, and if I could introduce now, first, *Hallstroms* case. As I have explained already, in *Hallstroms* the issue was Hallstroms' expenditure to attack the extension of the patent held by Electrolux. The question in issue was whether or not that was on capital account. The Court divided, the Chief Justice Latham holding that the expenditure provided no new asset. It simply enabled Hallstroms to continue to conduct its business as a manufacturer of refrigerators. The essence of the Chief Justice's judgment is from page 641 to page 642 where in the second whole paragraph, about a third of the way down, he holds explicitly, "In my opinion the expenditure by the company was not made for the purpose of acquiring an asset or of adding to the profit-yielding subject." He then refers to the *Mitchell (Inspector of Taxes) v B W Noble Ltd* [1927] 1 KB 719 (CA) case, and you'll see this case referred to repeatedly. *Mitchell v B W Noble Ltd* is a case that involves expenditure to get rid of an unsatisfactory employee. Or a director, I can't remember which. In that case the English Court of Appeal held that the payment to get rid of that person did not affect fixed capital, it was an operating expense, and so for the reasons that are then expanded on by the Chief Justice, and this gets to the heart of where the Court divides, the majority of the High Court of Australia adopts the identifiable asset approach and applies the English Court of Appeal decision in *Southern v Borax Consolidated Ltd* [1941] 1 KB 111 (CA) that what is called maintenance expenditure is deductible.

The second Judge concurring is Justice Starke. For the same reasons he comes to the same conclusion so he forms part of the majority but there is a passage of that Judge's judgment that I draw attention to and rely on at page 645. When you read carefully what he says in the conclusion my submission to you is that properly understood the Judge is contradicting any conception of sufficient connection in this passage and for reasons that we'll come to I draw that from particularly the use of the words "apart from the indefiniteness of this test and the practical difficulty of its application, I am unable to follow how the manufacture of a new model of refrigerator altered the structure of the taxpayer's business which was to manufacture refrigerators."

Justice Dixon takes a different view, fundamentally. Firstly, in drawing on what was his classic judgment in *Sun Newspapers Ltd v Federal Commissioner of Taxation*

(1938) 61 CLR 337 at the bottom of 646, the Judge holds that the identifiable asset approach is not the law and he makes this clear by saying that he regards the *Southern v Borax Consolidated* case as being wrongly decided at page 649. The crucial passage where he rejects the identifiable asset test is at page 650, about two-thirds of the way down, having discussed the judgment of Justice Lawrence in the *Borax* case he says, with reference to that, "If no alteration is made in the capital asset by the payment it is a revenue expenditure, appears to me to have no foundation in principle or authority." As we'll see, all of the English cases, and all the New Zealand cases are to the opposite effect, and they treat *Borax* as correct.

The next Judge is Justice McTiernan who simply agrees with Justice Dixon and Justice Williams goes on in his judgment for the reasons that he gives to adopt the same approach as the Chief Justice. This is maintenance expenditure. There is no new asset. He holds that *Borax* is very much in point and applies it mutatis mutandis.

That then brings me to the judgment of Lord Radcliffe in *Nchanga*, which is in volume 5 of the materials, I think the last tab, 57. An easy way into the facts of the case is to adopt the Court of Appeal's description of it here at 56. *Nchanga* concerned a payment of compensation by two copper mining companies to a third copper mining company in return for the third in return for the third abandoning its production for the year following a steep fall in the world market price of copper. The issue in the case, then, involves understanding that as a result of entering into that agreement to put the third company out of business for the year Nchanga was actually able to increase its own production for that year by a few thousand tonnes. So the Commissioner argued that the nature of that payment was capital because it expanded production and it extended over the period of a year. The Privy Council responds to that in very strong terms making two points. First, the fact that a payment may have a beneficial effect running over more than a year is neither here nor there in respect of whether it's revenue or capital and that, if you think about it, is a pretty basic and simple idea. If you repaint the factory roof and the repainting lasts 15 years, on that basis you wouldn't be allowed a deduction for what is a repair.

Lord Radcliffe goes through the approach to the issue by reference to what is called the identifiable asset test and he's the first of the Lords to use that expression. There are important passages in this judgment which come through on a number of occasions in subsequent judgments. The first is at page 958. The argument at 958

being put for the Commissioner is that the payment provided an enduring advantage and this was drawn from Lord Caves' judgement in the *British Insulated & Helsby Cables Ltd v Atherton* [1926] AC 205 (HL). In that case, the company paid a lump sum into a pension fund and the argument for the company was that the payment was deductable providing for the future benefit of its employees. The House of Lords would have none of that and said that the effect of the payment was in the nature of a defeasance capital contribution and so the payment operated as an asset, an identifiable capital asset of the company.

So the first part of Lord Radcliffe's judgment here is leaving aside the undesirability of determining the nature of a payment by the motive or object of the payer. Their Lordships can't find in the evidence any idea that the preservation of Nchanga's business was, in fact, the purpose of the arrangement or that the benefit obtained by the payment was to endure in any sense other than it was to condition the year's production.

And so he then moves on to the top of –

GLAZEBROOK J:
That does seem to go against your subjective submission that you were making earlier.

MR HARLEY:
Your Honour, the nature of the payment, the character of the payment in the business can only be identified from what the evidence is in respect of what that business is and how it's conducted. And I'll come more directly to the relevance of taxpayer evidence and its credibility shortly but I maintain the proposition that it is the facts in respect of the business itself and how it's conducted that reflects the answer to the question for what was the payment made. It's not the same thing as why the payment was made, as we'll see.

At the top of 960, after referring to what is a difficult case, Lord Radcliffe observes that so long as the expenditure in question can clearly be referred to the acquisition of an asset which satisfies one or other of the accepted categories – by which he means capital or revenue – as in the ordinary framework of manufacturing or merchant business the test is a critical one. And then he refers to the extraction industry cases which regularly convert part of their fixed capital for which they've paid

him as part of their stock and trade which they sell and that's the mining cases that I've already referred to.

So for the reasons that he then goes on to give, he holds that there is no identifiable asset in respect of the payment and for that reason it was held to be on revenue account.

Now, the point about both those cases at this point is there is no language here in respect of what are intangibles both holding revenue that reflect any conception of what is sufficiently connected or not. In fact, both focus on what is or is not an identifiable, intangible capital asset.

GLAZEBROOK J:
What about attempting to get an identifiable capital asset, maybe unsuccessfully, so you spend a lot of money trying to get some land for a head office and somebody outbids you?

MR HARLEY:
And you're already in business?

GLAZEBROOK J:
Yes, it's a change of head office. It's absolutely clearly related to business.

MR HARLEY:
Revenue.

WILLIAM YOUNG J:
But if you buy a new head office, that's capital?

MR HARLEY:
Correct.

GLAZEBROOK J:
So it depends on the success or failure of your enterprise, whether it's a capital asset or not?

MR HARLEY:

No, it doesn't depend on the success or otherwise.

GLAZEBROOK J:

The failure of the particular acquisition?

MR HARLEY:

No. It depends on whether or not you have committed to the purchase, for instance, your judgment in the *Opua Ferries Ltd v Fullers Bay of Islands* [2003] UKPC 19, [2003] 3 NZLR 740. All the expenditure incurred by Fullers in respect of the legal battle was to obtain the new ferry contract capital. The fact that it failed was irrelevant.

GLAZEBROOK J:

Well, I don't quite see why my example – it's not capital, then I really want that building for my new office. I tried my absolute hardest to get it. At the last minute, I'm pretty sure, I'm just about positive I will. I've done all my homework and at the last minute somebody comes in and just trumps me.

MR HARLEY:

And steals it.

WILLIAM YOUNG J:

Or your specific performance finally fails in the Supreme Court. You've been absolutely committed to the purchase throughout but you miss out on it.

MR HARLEY:

Absolutely. That is capital. You are absolutely committed to the purchase and that is the relevance.

WILLIAM YOUNG J:

Say you can't raise the money. Say you've signed a conditional agreement but subject to finance and the finance doesn't come through. You say revenue?

MR HARLEY:

You've made the commitment to purchase subject to conditions, capital.

ELIAS CJ:

So it's wholly subjective then if it's a commitment.

MR HARLEY:

Well, the answer is yes and we say the commitment test in respect of the Commissioner's interpretation statement and as partly expressed in various parts of the written submission for the Commissioner is right.

O'REGAN J:

Does that mean that different taxpayers applying for a resource consent could have different tax treatment depending on whether their Board says, "We're not going to apply for resource consents unless we know we're going to go ahead with the project," as opposed to the other one which says, "Let's apply for the resource consent to decide whether we go into the project."

MR HARLEY:

That's exactly right. Yes.

O'REGAN J:

Doesn't that mean to some extent you determine your own tax liability rather than the Act?

MR HARLEY:

Well, you determine your own tax liability in respect of a large number of aspects of how you conduct business. If you hold shares in a company and you choose to be in the business of dealing in shares then the tax consequence follows.

O'REGAN J:

Yes, but that's an assessment made by the Court as to whether your conduct has illustrated that you are trading, not investing and that's often just a numbers game, isn't it, of how much trading you did. But in this case in effect Trustpower could, by deferring the application for resource consents until after a committed project, you know, the Board had resolved to go ahead with the project, change the tax treatment on your test, couldn't it? I mean, basically the Board could say, "Let's not resolve now. We'll resolve in a year's time," and that would change the tax treatment.

MR HARLEY:

Well, Your Honour, it's as if behind that question was the proposition that this taxpayer was making choices in terms of –

O'REGAN J:

No, no, I'm talking about a hypothetical taxpayer but I'm just really trying to get the bottom of this subjective/objective analysis. I mean, if it's entirely based on what the enterprise does and obviously usually will be a well-advised enterprise doesn't that mean it essentially chooses the tax treatment?

MR HARLEY:

Yes, it does and that applies across all manner of things in respect of the tax system. It's simple a reflex of how the company carries on its business.

It's important to identify what is further common ground with the Commissioner in respect of the identifiable capital asset test. The Commissioner's case here is to treat the RMA consents as being separate identifiable capital assets separate from the underlying projects.

WILLIAM YOUNG J:

Can't it just be, to use the language of Lord Radcliffe at page 960 of *Nchanga*, a cost of creating, acquiring or enlarging the permanent, not necessarily perpetual, structure?

MR HARLEY:

Which is the asset?

WILLIAM YOUNG J:

You're using a different – there's a different flavour to the way you put it.

MR HARLEY:

I'm using exactly his language where he says where you are within the accepted categories and you can identify the asset in respect of that, it is a critical test.

WILLIAM YOUNG J:

Well, he's talking about structure, not asset.

MR HARLEY:

He's talking about asset as in what is the nature of this contract.

GLAZEBROOK J:

We're perhaps looking at a different passage.

WILLIAM YOUNG J:

I'm looking at page 960.

GLAZEBROOK J:

I see this – there it's talking about the structure of the business as against identifiable particular assets because, of course, trading stocks in asset and when you acquire a widget you're not acquiring – assuming you're in the business of buying and selling widgets and it's not …

MR HARLEY:

Yes and Your Honour that makes an important point here about the language we're using. When we talk about an identifiable asset and the identifiable asset test, we mean capital asset as in fixed capital. We are not talking about a revenue account item which is what Nchanga's contract was held to be.

GLAZEBROOK J:

Although that begs the question slightly, of course, because you say creating an identifiable asset is the test but then you accept, as you must and as anyone must and the Commissioner must, that because it's an asset it can actually be an asset of revenue account and capital account so isn't that rather circular as a test?

MR HARLEY:

I didn't say this was easy, Your Honour. It's not. Fortunately here we don't have to get into dealing with negative assets and the nature of them. The language is important simply because, as we'll see shortly, the identifiable capital asset test becomes very firmly entrenched in New Zealand law and we need to understand what it means and I simply say again an identifiable capital asset means as a matter of definition that you are coming to the conclusion or you have decided that what you are dealing with is not on revenue account.

WILLIAM YOUNG J:

It can't be as simple as that. It can't be whatever subjective – whatever level of subjectivity is appropriate. It can't be a matter for the business judgement of the directors or the taxpayer to say, "Well, we think this is on capital account. We think this is on revenue account," and the Commissioner is controlled by that.

MR HARLEY:

I wouldn't disagree with a word of that. Of course that's right. The question is whether properly applied as a matter of law the nature of the expenditure has the legal result into one category or the other.

ELIAS CJ:

But it's the proper application we're probing.

MR HARLEY:

Yes.

GLAZEBROOK J:

And the result as well because as the passage that Justice Young was referring to was talking about business structure, not particular assets at 960 so where do you get identifiable – sorry, really the question was are we looking at the same passage and do you get identifiable asset out of that or somewhere else?

MR HARLEY:

The answer to you, Your Honour, is the business structure reflects identifiable capital assets. It can't be anything else. Going back to the simple examples of the farm or the manufacturer's factory which are tangibles, we don't have any difficulty with that at all, do we? Plainly identifiable capital assets and the building that's on the farm or the machine that's in the factory are plainly part of the permanent structure of the business, identifiable capital assets and they may be separate capital assets within the factory. It becomes more difficult when we're dealing with intangibles and particularly with legal permissions and contractual rights. For reasons we'll come to shortly, this is exemplified by the difference between *BP Australia Ltd v Commissioner of Taxation of the Commonwealth of Australia* [1966] AC 224 (PC) and *Regent Oil Co Ltd v Strick (Inspector of Taxes)* [1966] AC 295 (HL).

ELIAS CJ:

So in terms – if you were starting with the statute which I understand that is probably impossible given the overlay of cases but is the argument that of a capital nature necessarily imports a business structure test which necessarily imports an identifiable capital asset approach?

MR HARLEY:

The reason I'm pausing is because of the first part of that question where you –

ELIAS CJ:

If you start with the statute –

MR HARLEY:

No, no, I was happy with that. You used the expression "with the business" and I'm just thinking whether or not it's necessary –

ELIAS CJ:

I thought you said the business structure or the capital structure, I suppose, of the business.

MR HARLEY:

I don't want to split hairs with you. Can we just concentrate on businesses? Forget about other taxpayers who are not in business because they can have capital, of course they can. So for taxpayers who are in business, my answer to your question is yes, the business structure of the business reflects capital. What is the reflected capital is the body of identifiable capital assets that make part – make up that structure and I'd go further and say that the cases emphasise again and again the idea of what is fixed capital, that is what is it that functions and operates to provide the source of income, the business income to the business. Well that's the difference between fixed and circulating capital; I prefer the words "revenue" because using circulating capital gets into the problems that Glazebrook J is explaining although the Courts are pretty clear about it.

WILLIAM YOUNG J:

Look, down at the bottom of 960 and top of 961 Lord Radcliffe accepts the, that a payment is shutdown a competitor for good would be on capital account.

MR HARLEY:
Yes.

WILLIAM YOUNG J:
What's the asset?

MR HARLEY:
Goodwill.

WILLIAM YOUNG J:
But it's not, that's not really true is it?

MR HARLEY:
Well the cases are clear about it Your Honour, *Sun Newspapers* is all about doing exactly that, it's a goodwill payment and goodwill is inherently capital.

WILLIAM YOUNG J:
But the shut, the company that's shutting down isn't necessarily transferring its goodwill in any meaningful sense of the other company?

MR HARLEY:
You're taking out a competitor –

WILLIAM YOUNG J:
Yes that's right.

MR HARLEY:
– and enhancing your goodwill in respect of that. The cases are very clear about that.

WILLIAM YOUNG J:
So is that what *Sun* turns on?

MR HARLEY:
Yes, and so does *Buckley*. And that is probably, I'm going to get into trouble here with Mr Ward but I'll say it anyway. That is probably the clearest example of an

intangible asset that is capital, in any business and the exception is unless you happen to be dealing in buying and selling businesses which is different.

WILLIAM YOUNG J:

Yes well I don't know we'll worry about that. Okay so you'll take us to cases that say that, *Buckley & Young* is one I take it?

MR HARLEY:

And we'll get to *BP Australia* where the same argument is made. But to be direct with Your Honour a payment made to shut down a competitor is to obtain or enhance the goodwill of your own business not deductible, that is *Sun Newspapers* and *Buckley & Young*.

WILLIAM YOUNG J:

And that's irrespective of the absence of the usual indicia of the transfer of goodwill like words of transfer and covenants and restraint of trade?

MR HARLEY:

There's even more direct authority on this which, now that I think about it, that's the *Commissioner of Inland Revenue v LD Nathan & Co Ltd* [1972] NZLR 209 (CA) case. And in *Buckley & Young* there were elaborate covenants, in *Sun Newspapers* I don't remember now the detail of the contract but there's no question about the nature of the payment affecting goodwill and being held to be capital. And *L D Nathan* is the same.

GLAZEBROOK J:

I think your argument seems to be if it's not an identifiable capital asset it's clearly on revenue account. The Commissioners might well be the other way round to say if it's not something that you can identify with what would be normally seen as circulating capital such as labour, raw materials, stock in trade, just to take what's said at the bottom of 960, then it's effectively on capital account if it is effectively trying to create, enhance, acquire or enlarge the business structure?

MR HARLEY:

That is exactly the difference between us Your Honour, I agree with you.

GLAZEBROOK J:

Well then what's your answer to that because cases which are looking at whether a particular capital asset or a particular payment has created an asset on revenue account or an asset on – because if you're looking at the very short term restraint of trade payments for example, then they, they are probably on revenue account in the sense that they're only doing something for a short period, as against enhancing the capital structure. So the cases you're looking at are looking at identifiable cases of capital assets effectively in many cases in the classification of those, they're not looking at whether trying to do something actually gets you within capital or revenue?

MR HARLEY:

And I say that there is no case that the Commissioner can point to where a future possible capital asset could be the result means it's capital, except the Court of Appeal's judgment here.

GLAZEBROOK J:

Well there have been cases on feasibility expenditure that go either way, I can't – I haven't look them up again but –

MR HARLEY:

We'll come to them, they're in the materials, they're the Australian cases. But they're not that helpful Your Honour because, except for *Commissioner of Taxation v Ampol Exploration Limited* (1986) 13 FCR 545 (FCA), they're all what are called preliminary expenditure cases and so they self-answer the question because the taxpayer is held not to be in the relevant business and so the expenditure's not deductible under the general permission to start with. But just to go back to the opening proposition in terms of the difference between us, yes I'm saying that unless it is possible to explain this expenditure as being an identifiable and tangible capital asset, reference to the RMA consents themselves, then it's on revenue account, that is the submission.

GLAZEBROOK J:

And you're going to say why those aren't identifiable assets?

MR HARLEY:

Yes I am.

ELIAS CJ:

So there – is it the case that there are really two planks to your argument, first the one we've just been discussing whether it's on capital account or whether it's to be treated as on revenue account, but also the test of commitment which you say is subjective and you will come back to tell us how you derived that test because it does occur to me that commitment is really perhaps viewed as a connector, as a proximity test and I had understood you to say we're past all that, we've established a connection, so I'm not sure why you're reintroducing a further connection test?

MR HARLEY:

I say commitment was fundamental and is not proximate, it's absolute. Once on the facts you have committed to spending money to acquire or modify a capital asset, it is inherent in that expenditure that it is of itself on capital account related to that asset, that is the capital asset test.

ELIAS CJ:

Well whether it's absolute or not it seems to me that that is a further requirement of connection and I'm still not sure where you get it from. Presumably you're going to take us to other cases in which that is?

MR HARLEY:

Yes I will, yes. And also to the accounting standards where exactly that concept is reflected and very firmly in the idea as I've tried to short form express it.

ELIAS CJ:

Right, thank you. But those are the two, two points, legal points around which this revolves?

MR HARLEY:

Yes, yes.

ELIAS CJ:

Yes. Thank you.

GLAZEBROOK J:

And so any money spent thinking about and assessing whether or not to acquire a capital asset is not on capital account, that's the corollary of that?

MR HARLEY:

In respect of an existing business yes.

GLAZEBROOK J:

However close you are to acquiring the capital asset, you're looking at two projects, two head offices, two possible head offices, you're doing so because you know someone may gazump you at a bid on one so you have a backup plan and I'm using head office –

MR HARLEY:

No, and the example is a good one because the example reflects an idea which ought to identify or establish a principle and whatever else is the case Your Honour I think we'd all agree that buying a head office is about as far into capital account as you get. And so my answer to your question in terms of, for an existing business that is in the process of exploring the options in respect of which office it might buy, all that is on revenue account unless and until it enters into the contract to purchase whichever it chooses, and everything flows as capital from that point, whether or not you succeed in buying the office or not.

GLAZEBROOK J:

So, sorry, once you've done what?

O'REGAN J:

Until you've entered into a contract to buy or until you've committed to enter into a contract to buy?

MR HARLEY:

I think that's a better way of putting it.

GLAZEBROOK J:

But you may only do that at the final option on your second side, having been gazumped on the first one.

MR HARLEY:

You may well do Your Honour.

GLAZEBROOK J:

So you have, the only expenditure you'll have at that stage is the actual purchase.

MR HARLEY:

Yes.

GLAZEBROOK J:

Everything else is –

MR HARLEY:

Yes.

GLAZEBROOK J:

We probably do need authority on that. Has that particular issue ever come up in the cases? Or would people just not even think that it was on capital account or revenue account so nobody's bothered to bring it to Court? Because the answer doesn't seem to me to be as obvious as you say from the existing cases, just to be clear.

MR HARLEY:

Very clear. The example that comes closest, but involves the actual decision, is reflected in your judgment in *Fullers Bay of Islands Ltd v Commissioner of Inland Revenue* (2006) 22 NZTC 19,716 (CA).

GLAZEBROOK J:

And have we got that somewhere?

MR HARLEY:

No, it's not, well High Court judgments are in the material but for a completely different reason that doesn't add anything, but we'll get that for you. From memory –

GLAZEBROOK J:

You're presumably suggesting it was my decision, I have absolutely no recollection of it so…

MR HARLEY:

I'm sure it was your decision in the Court of Appeal.

GLAZEBROOK J:

I'm not saying it wouldn't have been, I'm just saying I have no particular recollection of it.

MR HARLEY:

Well we'll get a copy of it and, Your Honour, as I think about the question in a slightly broader context this gets to the Australian cases of feasibility expenditure. There are two, particularly, which we'll come to –

ELIAS CJ:

Are those Federal Court cases?

MR HARLEY:

Yes.

MR HARLEY:

Ampol is one. The other is the *Goodman Fielder Wattie Ltd v Federal Taxation of Taxation* (1991) 29 FCR 376 (FCA) case. The *Ampol* case, which I'll go through in quite a lot of detail, but the essence of it is Ampol enters into agreements with an agency of the Chinese Government to spend large sums of money on seismic surveys which give it a preferred status so as to be an invited bidder in the next round with the Chinese Government agency if invited. And by majority the Federal Court there held that expenditure was revenue. The *Goodman Fielder* case, I'll just pause there for a minute and just go back to you Chief Justice for a moment. For obvious reasons there is a factual commitment in that case by virtue of the contract to spend the money on the seismic surveys, and so once committed the question still remains as to the nature of what was purchased by that money and the Federal Court held it was on revenue account. I'm trying to keep away from the word "asset" here to avoid constantly begging the question, which is whether it's an identifiable capital asset because obviously the contractual rights in respect of those arrangements are, in the broader sense, assets as a question of what the nature of them is.

In *Goodman Fielder* there were two problems in the case. The scientist in that case, Dr Watson, was a specialist and an enthusiast for a particular type of scientific research in respect of the possible production of pharmaceutical-type drugs. The first part of the case involves Goodman Fielder making payments to a research

institute to establish a research organisation and the Federal Court, Justice Hill, held that was preliminary expenditure because that was not part of – that particular type of activity was not part of Goodman Fielder's existing types of business.

The second part of the case which is the more direct case – sorry, circumstance here is where the company had actually started the process of manufacture of certain types of these pharmaceuticals and the question was whether the costs of the ongoing research in respect of the process of developing those products for manufacture was or wasn't on revenue account or capital account and he held it was on revenue account for the reasons he explains.

I'm going to draw on those cases quite heavily because I rely on them, particularly the *Ampol* case as illustrative of the idea that unless you can identify the intangible capital asset to which the expenditure relates then it's on revenue account.

That really brings me directly to trying to explain what the word "asset" means in respect of intangibles and the cases that I'm particularly drawing on and relying on are *Anglo-Persian Oil Co Ltd v Dale (Inspector of Taxes)* [1932] 1 KB 124 (CA), *Hallstrom*, *BP Australia* contrasted with *Regent Oil*, *Ampol*, and *Goodman Fielder*.

I've mentioned *Birkdale Service Station Ltd v Commissioner of Inland Revenue* [2001] 1 NZLR 293 (CA) for completeness but it's not particularly helpful because it involves both BP-type expenditure and Regent Oil-type expenditure, the difference turning on the lease, sublease structure in these cases embodying the trade tie.

The submission – and this directly answers Your Honour Justice Glazebrook's question – is this. There is no decided case of which I am aware that holds that expenditure that might possibly acquire a capital asset in the future is in itself capital expenditure from the time that that possibility is recognised and the money is spent.

There's a delightful sentence in the judgment in *Ampol* which I'll take you to where he refers to the poet's dream and he refers there in that context to the man's reach which should exceed his grasp and he uses that idea to anchor his reasoning as to why the expenditure in that case was on revenue account. I'll get to it.

I think at this point just to reset the scene, if I may, can I take Your Honours to the Court of Appeal's judgment in this case and the fundamental objection that I take to some of the reasoning that is expressed in it?

ELIAS CJ:

I see it's morning adjournment. We'll take the adjournment now, thank you.

COURT ADJOURNS 11.30 AM

COURT RESUMES: 11.49 AM

MR HARLEY:

This is kind of going backwards. Justice Young you were questioning the authority for the proposition about goodwill.

WILLIAM YOUNG J:

I had a look at some and I agree that they talk about goodwill, but it's a very amorphous concept. It's not an acquisition of goodwill in the sense of we're going to buy the goodwill of your proposed newspaper business and we want covenant and restraint of trade. It's simply we're going to take you out of play and we can continue to sell our rag at a penny ha'penny a pop every evening because that was what the deal was, wasn't it?

MR HARLEY:

Yes, and isn't it an amazing commentary on yesteryear in terms of competition in law.

WILLIAM YOUNG J:

But I mean we may say it improves the goodwill of the company. All they mean is the company is going to be more profitable.

MR HARLEY:

Yes.

WILLIAM YOUNG J:

It's not really an asset in an orthodox sense.

MR HARLEY:

Well I can go one better, Your Honour, which is Justice Richardson in *Buckley & Young*.

WILLIAM YOUNG J:

But that was a – there was a restraint of trade there.

MR HARLEY:

Yes there was but as a matter of general principle he says, a payment made to a retiring director or employee, in consideration for a restrictive covenant not to compete with the company after retirement, which has the effect of buying off competition, of its very nature affects the value of the company's goodwill, and is referable to the income earning structure rather than to the income earning process and is of a capital nature.

WILLIAM YOUNG J:

Well I don't think we need to be troubled with that. It's just that I don't, I wouldn't really regard it as a payment for an asset. Because I don't think it's, I don't think in that sense goodwill is the sort of asset that, it's an asset only in the loosest of senses. It's not something which seems to me to correspond to the, you know, purchase of land or purchase of plant or purchase of something to be sold.

MR HARLEY:

I think Your Honour makes some valuable observations there. The –

WILLIAM YOUNG J:

But there's a fatal flaw, obviously.

MR HARLEY:

No, no. No, no, I'm hopefully not putting words into your mouth, but trying to articulate some principle in agreement. Intangibles are much more difficult to describe, in terms of what it is we're talking about, and the effect they have within the business. Goodwill is the clearest example that I can think of with an intangible and where, I just wanted to take you along with me if I can, is with the identifiable capital asset test, the languages, we'll see, that's used by Lord Wilberforce is a payment that acquires, modifies, enhances a capital asset, or an existing capital asset, has the same character as the asset itself. So just to take the idea that you've exchanged

there, the business goodwill of the purchaser is already the inherent intangible asset of the business itself. It makes a payment to kill the competitor off. The effect of that payment is to enhance or to modify the goodwill that already exists within the payer's business.

WILLIAM YOUNG J:

I can see that, and I can see that the Sun Newspaper if they had sold the business to someone else, they can say what a great business it is, there's no one undercutting us in the Sydney evening paper market.

MR HARLEY:

Yes, I'm just trying to use the language of Lord Wilberforce to articulate the great care that you would expect of him in expounding the idea and as we'll come on in a few moments, Justice Richardson picks it up wholly in his judgment in *Commissioner of Inland Revenue v McKenzies New Zealand Ltd* [1988] 2 NZLR 736 (CA) and reflects all of it. I was taking the Court particularly to paragraph 97 of the Court of Appeal judgment to express why I fundamentally object to the Court asserting that by obtaining resource consents here Trustpower invested unequivocally in capacity.

WILLIAM YOUNG J:

Sorry, where's the most accessible version of the Court of Appeal judgment.

ELIAS CJ:

I just had my separate copy delivered.

O'REGAN J:

It's in the supplementary case on appeal.

MR HARLEY:

It's in the pink volume right at the end, number 23, and I confess that I have my own copy for the same reasons. That's at tab 152. It's worth spending a few moments just going through the critical passages of reasoning in this judgment to which we object almost entirely. They start from paragraph 85. The Court asserts at 84 that it accepts the factual findings made by the Judge and, for reasons I'll come on to, my submission is it did nothing of the sort. The Court then asserts that in the course of argument the findings of fact that I accepted in the course of argument that the

correct approach was an objective one. I didn't. I made the submission in that Court, that I've made in this Court, in respect of the factual basis for the reasons already argued. Notice first at the top of 87 the heading –

ARNOLD J:

Just pause there a second. So the next sentence, this is 85, "Determining on which side of the line the expenditure falls involves an objective analysis of the factual background relating to the nature and purpose or effect of the expenditure and not a subjective approach based on the views of the witnesses for Trustpower," you say that is wrong?

MR HARLEY:

Yes. And if you look at *Grieve v Commissioner of Inland Revenue* [1984] 1 NZLR 101 (CA) case, which is the judgment of Justice Richardson, Your Honour will remember this, this is the hobby farmer case, in the early 1980s. What the Judge says there is in order to determine whether this taxpayer is in business, it's fundamentally important to have regard to the evidence that he gave. Actions can speak louder than words. It's important to consider the actions as well as the words. But if the taxpayer has given evidence that's accepted, that his intention was to carry on business for profit, then it doesn't matter if he does that in an idiosyncratic or strange way, those are the facts. He's in business. So the passage that's referred to in the Court of Appeal in *Grieve* does not stand for what they claim. It's the reverse when you understand it properly.

GLAZEBROOK J:

Well that's right because you actually, when you're looking at business and looking at intention, just the same way in *Rangatira* you're looking at intention, but that doesn't mean that the test for capital or revenue is intention necessarily.

MR HARLEY:

I agree with you.

GLAZEBROOK J:

So it's a wrong citation but it doesn't necessarily mean that last statement is wrong. So *Grieve* doesn't stand for that proposition but understandably because the test of being in business does relate to intention to a large degree.

MR HARLEY:

And the question here is, what is the nature of this taxpayer's business, and for all the reasons we've gone through this morning, that primarily is a function of the evidence before the Court and its credibility.

So the next part of the –

ELIAS CJ:

Well I – the taxpayer's business here is supplying and obtaining electricity, isn't it?

MR HARLEY:

Yes, and it's part of that business, it is fundamental that it costs competing sources of supply. In order to cost competing sources of supply, it mirrors in the market offerings from wholesalers, and compares them with its own operating costs of generating that exist, and potential costs of generation that it may be able to build, and it has that reflex every day in respect of the purchases that it is making on the day, but electricity being a very long term industry, that mirror reflects the future and the future anticipated costs of supply and that is what its pipeline optionality conception is all about.

ELIAS CJ:

Well I don't, not necessarily disagreeing with that approach, but why is the evidence and the, why is the evidence of subject of intention so important in this?

MR HARLEY:

Well Your Honour to be frank I find the dichotomy between what's objective and subjective –

ELIAS CJ:

Yes well you're probably right, yes.

MR HARLEY:

– it doesn't help in terms of explaining the process of the Court in determining what are the facts and you've have fair more practice at that than I have but that process involves an assessment of what the witnesses have said measured against what they have done and contemporaneous documents and that's all it is.

ELIAS CJ:

What is the, what are the – perhaps if you, don't take time now to interrupt but I'm really trying to feel for what was said that hasn't, apart from intention, subject of intention, what was said that hasn't fed into the conclusion as to the nature of the business?

MR HARLEY:

Pipeline optionality in respect of the entire –

ELIAS CJ:

Well that's just a label really, I mean it may be a useful metaphor to use but really does it go further than saying that the business is as you described it, that the taxpayer has to keep assessing the options in terms of purchasing and electricity and generating it?

MR HARLEY:

At the risk of failing to respond Your Honour, the conception of pipeline optionality as it is used by this company in its business is fundamental to what this case is about.

ELIAS CJ:

Well it, to me seems a statement of the obvious that you keep having to look at how long it will take you to get to various positions when you're assessing what course to follow. I'm not disparaging, I'm not disparaging –

MR HARLEY:

I'm not going to hold you –

ELIAS CJ:

– the usefulness of using an analogy like that but I'm not sure how far it takes us and what I'm feeling for is why you say the findings of fact and credibility of witnesses were so essential in this case?

MR HARLEY:

Yes. Can I just through the Court of Appeal –

ELIAS CJ:

Yes.

MR HARLEY:

– and I will tell you the objection to every one of the passages that it's used. Under the heading, "expenditure on potential capital projects in the development pipeline", no objection to the heading. First the expenditure was incurred for the purpose of enabling Trustpower to extend or expand its electricity generation business. As a matter of fact that is not correct. There was no such purpose.

GLAZEBROOK J:

Well is your point, because they go on to say the fact that the decision may not have been made doesn't make any difference, what you're really saying is that the facts are, and to be honest I don't think there's any difficulty with that and I don't think it relates to subjective intentions, it just is the fact that they may not, what they were actually doing was assessing what the costs of generation would be of particular capital projects to compare them to the costs of buying in the market and that they hadn't made any definitive decision to commit to any of these projects, is that the point?

MR HARLEY:

Correct. Correct.

GLAZEBROOK J:

And the real issue is whether that makes a difference?

MR HARLEY:

Correct. So calling or saying that the company had the purpose of extending or expanding its electricity generation business is on the fact wrong. It had no such purpose. In fact the evidence was to the contrary, and I'll take you to it.

WILLIAM YOUNG J:

Because you mean because there was never a decision that the generating capacity had to be expanded?

MR HARLEY:

More than that Your Honour, the company was completely indifferent.

WILLIAM YOUNG J:

Yes because all it wants is electricity to sell, which it can either generate or buy.

MR HARLEY:

And as the evidence showed its alternative was to reduce its retail offering. It reduced its retail offering by about a quarter in the relevant period. So doing nothing was as much of a choice as buying from competitors or seeing whether or not it was possible to obtain alternative supplies from its own existing capacity or from building new capacity.

ARNOLD J:

Do all generators now, do all the large generators have retail operations?

MR HARLEY:

I don't know the answer to that. I know there was the split between lines companies, retail companies and generators and you couldn't be all three. I think some are generators and retailers, some are loans companies and maybe retailers, I'm just not sure which is which, but I know you can't be all three.

ARNOLD J:

I guess the point is if all the generators have retail operations, you'd be putting yourself in a pretty vulnerable position if you relied on a buy decision for everything.

MR HARLEY:

Well Your Honour the evidence is that the Trustpower perspective is that some generators did not have good capital discipline in respect of whether or not they added additional capacity and when they added it and for that reason ended up in positions themselves of oversupply and then effectively having to, I was going to say undersell, that's – provide offerings to competitors that were cheaper than the competitors could themselves develop, I think is the better way of putting it.

ARNOLD J:

Right.

ELIAS CJ:

So you're saying that really all of this evaluation could equally be looked at as assisting the company to determine the price at which it was willing to buy in the future and/or to reduce its retail offerings or to set up generating capacity, that's about its, the conduct of its business going forward?

MR HARLEY:

Yes, that is the evidence.

ELIAS CJ:

I just, I suppose I, I just find it hard to see it's, well maybe it is evidence. I wouldn't have thought that the fact that it was evidence was or that the underlying evidence was there was the critical issue in the case, I would have thought it was the inference and to be taken from the evidence that you're really concerned about?

MR HARLEY:

I don't push back on that at all Your Honour. I'm a simple person, I just put the proposition, it's just the facts. What are the facts here and the Court of Appeal ignores the facts and it had no business to do so. So the other passages in here about the purpose of acquiring assets, the company had no purpose of acquiring assets.

GLAZEBROOK J:

Well what you're really saying is that they were looking at these in the way that my head office example, no sorry even less than the head office example, somebody looking at four particular sites to develop factories, having decided they're going to, they're just not sure when and the expenditure on them were, would, I think you accept, be capital expenditure because the fact they're not sure when they might develop those sites is actually irrelevant if they have decided they're going to develop them at some time and the mistake was saying the development pipeline as being five capital projects that they were going to do sometime, is that?

MR HARLEY:

Yes, I followed up the example of the building as a, as a thought piece, if I could put it back to you and with acknowledgement to Justice O'Regan for his correction, the Board of the company says, "We need to find a new head office. Management, go out and find out what there are in terms of suitable new head office premises for us, come back and tell us." The Board says, "There could be five. We've had a preliminary sort through them and these look like the best that are available." More work is done. They come back and say, "Three of these look like real prospects. We've spent a whole lot of money on engineering quality, geotechnical strength, building standards, the land ownership, whether it's lease or fee simple, carpark availability, equipment standards, the present maintenance levels and we're telling

you, the Board, there are two that look really, really good for us." The Board sits down and says, "Got all that. Stop there." I say all that expenditure is deductible at that point. The Board then says, "We need to buy one of these. Go out and negotiate the best terms you can for whichever of them meets the criteria in your judgement and we'll buy one of them if we can."

Lawyers, property specialists, what-have-you, go through the process – you'll all be familiar with it – of trying to negotiate to buy the building. I say all that at that point is committed. It is to acquire a capital asset, the new head office.

WILLIAM YOUNG J:
But it's only committed in the sense that they will go ahead with it if the price is right.

MR HARLEY:
But the Board has decided that it is going to buy one of those buildings on the best terms it can get.

ELIAS CJ:
But I don't know why you need to go so far because you're setting up quite a – you're setting up something that perhaps the Court might recoil against in circumstances where you may not need to. Isn't the point in terms of the head office is that what will happen is that the company will end up – either end up with a capital asset or not after doing its evaluation? So it may be that that is properly treated from the beginning as against capital account but what you're arguing for here is an evaluation which may not end up in that, in the acquisition of or the development of a capital asset or not at all but has these other options which, if they wouldn't be a capital asset, push you towards revenue account? Sorry, I put that very badly because this is not my area.

MR HARLEY:
No you didn't because underneath everything you've said is the difference between using examples and what the actual facts are and until you know what the actual facts are you can't make an informed, in principle and reliable decision of the outcome because you don't know what the facts are and that is always the problem with these kinds of example but at a high level of principle and in response to the questions of Justice Glazebrook and Justice O'Regan on the line of the continuum to decision-making by the Board in that company I would be in the same camp as the

Commissioner in terms of recognising the time at which the Board has committed to purchase one or other of the property and that would be a pretty good indication in my submission of when the capital expenditure – to beg the question – is required to be capitalised and the Commissioner states those propositions somewhat more broadly at 38 and 40 of the submission before the Court.

So having attempted to excoriate the Court of Appeal's judgment about the purpose, can I now –

ARNOLD J:
Just in fairness to the Court of Appeal they do say at 88, you know, they do recognise that these are possible future capital developments.

MR HARLEY:
How is it that we have an unequivocal investment and capacity when actually it's possible that you may have in future the contradictory propositions?

ARNOLD J:
Well, I think they're propositions that have to be read together. I mean, what they say in 88 is that they well understand that Transpower may not go ahead. They are possible future capital projects. They say they don't think it makes a difference because of this sufficient connection argument and that's the process of that reasoning.

MR HARLEY:
Yes and I am saying to you that the reasoning is faulty because the sufficient connection idea is not the correct approach and that there is no authority for the proposition that spending money on possible future capital projects is capital and I'm saying further in respect of this company and the way it conducts business that's actually not what it was spending the money for in the first place and that is factual.

ARNOLD J:
It seems to me that's your real point about this paragraph, about this section of the judgment rather than the point you were making about whether they were right in talking about purpose because when you read the paragraphs together it's this idea that they're getting at sufficient connection and you just say, well, that's wrong.

MR HARLEY:
Correct, yes, I do.

Can I take the Court, please, to Justice Richardson's judgment and you'll find this as a body of authority that covers pretty much the spectrum here. Volume 2 at 13.

This judgment received a serious accolade before the Privy Council when we were arguing the *Wattie* case on appeal. Lord Nolan, who was the presiding Lord in that case, came to it with a high level of experience and authority for the simple reason that he had been junior counsel for the Federal Commissioner in the *BP* and *Mobil Oil* cases in the trio of BP, Mobil and Regent and he said in the course of argument when looking at this judgment, "This is just masterly," and so it is.

The case is about a payment made to terminate a lease that had 38 years to run and whether that payment was capital or income. Justice Richardson starts the discussion by reference to the judgment of the trial Judge Justice Tompkins – this is at page 739 – the first part refers to the argument as to whether or not the payment was deductible under section 104. That's the general permission. There was no argument from the Commissioner finally as to whether or not that was so. So the Judge then moves on to whether the capital limitation is applicable.

The Judge then goes on to explain the reasons of Justice Tompkins in *Commissioner of Inland Revenue v McKenzies New Zealand Ltd* [1988] 2 NZLR 736 (CA) who found it a difficult case and he could see competing answers on both sides of the capital income boundary, which are explained. The first part is that the Judge could see that the lease was an identifiable capital asset in the business of McKenzies and on the other hand the Judge could see that the payment was made to eliminate future revenue liability to get rid of the lease and to get rid of the onerous payments of rent. He explains that what tipped the balance in favour of the Judge's thinking was the treatment of lease premiums as prescribed in the income tax at the time. If I just pause there, Your Honours, there was a provision which still remains for what was called key money where the tenant paid the landlord key money on the grant of the tenant's lease. There's a special provision that enables the tenant to write off the key money over the period of the lease term. This payment goes the other way. It's the tenant paying to get rid of the obligation under the lease and for the reasons that are given by Justice Richardson he, for the Court of Appeal, holds that you can't have regard to one set of provisions dealing with a payment one way, to answer a

question in respect of a different conception in payment going the other way. Justice Andrews correctly identified this passage in her judgment as a reason for why the depreciable and tangible property regime couldn't help.

The Judge then explains by reference to *BP Australia*. You've got the whole passage there. It gets cited time and again and it refers to Justice Dixon's *Hallstroms* formulation of the practical and business point of view.

Justice Richardson then goes on to list the various factors that were taken into account by the Privy Council in *BP Australia*. There are five of them.

He then explains the difference between BP, Mobil and Regent Oil. *Regent Oil* is the case where the – these three cases are all heard in the House of Lords and the Privy Council in successive hearings. *BP Australia* is the case that has the trade tie that is the contract. *Regent Oil* has the trade tie embodied in the lease, sublease mechanism and for that reason there are different results in the case.

Curiously, neither of the judgments of the Privy Council with the same panel or the House of Lords refers to the other and explains the difference in outcome.

Moving on, then, the Judge says that it's appropriate to start by looking at first principles. The starting place on 741 is to look at the character of the asset involved. The Judge has found that the lease itself was a capital asset and explains the difference between leases between capital assets on business account, revenue account when they're trading stock, and then articulates the proposition in an uncomplicated case the characterisation of the asset acquired or disposed of will determine the character or quality to be attributed to the costs of acquisition or deposal –

GLAZEBROOK J:
What line is that at?

O'REGAN J:
45.

MR HARLEY:
Yes.

And as we can see, that passage is drawn from Lord Wilberforce's speech in the *Tucker (Inspector of Taxes) v Granada Motorway Services* [1979] 1 WLR 683 (HL) case.

He then moves on to discuss whether there were any special considerations. This is about whether or not the payment made to terminate the lease was actually properly described as a commutation payment, which could be on revenue account, decides that it's not, and then he moves on to the authorities. He says in *Mallett (Inspector of Taxes) v Staveley Coal and Iron Co Ltd* [1928] 2 KB 405 (CA) to start with there's a clear line of authority in England dealing with leases and the lease that he starts with happens to be a mining case and it reflects and entrenches the idea of what is fixed capital and what is an identifiable capital asset. I'm going to take you through this passage carefully.

The leading case is *Tucker*. It holds that a payment to effect the surrender of a lease is a capital expenditure. The mining leases were held to be fixed capital assets of the company. A corollary company acquires the lease. The expenditure on doing so is expenditure on acquiring a capital asset. That's capital expenditure. When they sell the lease that they've acquired at an advantage that is receipt on account of capital. When they pay to rid themselves of a disadvantageous lease, that's capital. The judgments on appeal in the Court of Appeal all proceeded on the footing that the leases were capital. They emphasised the distinction between fixed and circulating capital of the business and they conclude the expenses in question were outlays in respect of fixed capital.

Richardson J then goes on by reference to the authorities, he refers to the difference between payments made to get rid of an unsatisfactory director or employee saying they don't affect fixed capital, they are on revenue account. He then goes to the mother ship as it were, in terms of Lord Wilberforce's speech in *Tucker* and in there having referred to *Nchanga* Lord Wilberforce says, "The key to the present case is to be found on those cases which had been, which have sought to identify an asset. In them it seems reasonably logical to start with the assumption that money spent on the acquisition of the asset should be regarded as capital expenditure. Extensions from this are first to regard the money spent on getting rid of a disadvantageous asset as capital expenditure, secondly to regard money spent on improving the asset or making it more advantageous as capital." Richardson J then goes back to the

earlier formulation of what is called “the enduring benefit test” that was stated by Viscount Cave in the *Helsby Cables* case, that’s the pension fund case which was subsequently explained in *Anglo-Persian Oil*. The payment in *Anglo-Persian* involved a 20 year agency and Anglo-Persian made a payment part way through the agency to get rid of it because it was found to be a too expensive way of conducting the business. Two points of the decision should be noticed, this is in respect of *Anglo-Persian.* The first is that the distinction between fixed and circulating capital reflected in *Staveley Coal* was expressly recognised. The agency agreement was held not to be fixed capital asset of the company and where Justice Rollett then explains in the famous passage about what enduring benefit of a trade actually means in terms of the fixed capital enduring. It goes on to refer to the Court of Appeal judgment upholding Justice Rollett and then gets back to Lord Wilberforce in terms of *Granada Motorway Services* where in that case the payment was made, what I mean here is in *Granada Motorway Services,* the payment was made by the garage owner to modify the terms of the lease. The lease terms provided for rent to be paid on a turnover basis. The Government changed the law in respect of putting up tobacco taxes and so the rent went up as a function of the increase in the tobacco tax basically killing the service station. It made a payment to extinguish that term of the lease. Lord Wilberforce then treats this as the lease as an identifiable capital asset and he explains why *Anglo-Persian* with the 20 year agency is different. He recognises there’s not much commercial difference between a payment of this kind and a payment to get rid of an onerous lease. But since the Courts have accepted and worked the identifiable asset test, the decision is no doubt right in law. The test is maybe somewhat arbitrary but it’s a method by which the Courts can work.

And when he refers to the identifiable capital asset and the Courts working it, basically he’s referring to himself as one of the leading exponents of how it works taken from his speech in *Regent Oil*.

My colleague Mr Cloose had the bold task of submitting to Richardson J that *Granada Motorway Services* was wrongly decided. That was not effective as a submission to Richardson J and he went on to explain why *Granada Motorway Services* would be followed and applied in the Court of Appeal. He does make the point at the bottom of 745 that not every case can be resolved by reference to fixed and circulating capital and that’s undoubtedly so.

WILLIAM YOUNG J:

I actually find the fixed and circulating capital distinction a bit awkward in this context.

MR HARLEY:

And it can be.

WILLIAM YOUNG J:

I mean it's one thing to say well it's circulating capital because it's stock in trade and it's being turned over all the time and that's obvious –

MR HARLEY:

Yes.

WILLIAM YOUNG J:

– but how do you apply that to, what does it actually mean in the context of this case?

MR HARLEY:

Your Honour ordinarily I'd answer you immediately –

WILLIAM YOUNG J:

Well if you come to it later, I know you –

MR HARLEY:

When I get to *BP* I will explain that using exactly the language of Lord Pearce as to why the payment made in *BP* to the garage owner for the tie was circulating capital. Without dealing with the passage particularly, Your Honour will probably recall the Privy Council there reflects the true conception of the payment as being marketing support to enable *BP* to obtain tied orders of petrol from the secured garage site.

WILLIAM YOUNG J:

Okay well we've leave it until you get it.

MR HARLEY:

But I will come back to it. And then Richardson J attributes to Lord Radcliffe the very great weight to the ready identification and classification of an item in respect of the asset itself.

WILLIAM YOUNG J:
Sorry I've lost the line reference now.

MR HARLEY:
746. Line 10.

WILLIAM YOUNG J:
Okay. Thank you.

MR HARLEY:
I want to make six points about *McKenzies* case and its authority. The first I've already referred to, why the Judge in this case was right to put aside the depreciable and tangible property regime that's reflected in Richardson J discussion of the lease premium rules. Second to emphasise that what's fixed and circulating capital can be a very powerful idea and have overwhelming effect in some cases. Third, there's not one word in this judgment about the source of the funds that was used by McKenzies to make the payment, the Court of Appeal and the High Court are wrong to deal with the source of the funds as being referenced to fixed or circulating capital. In our written submission I've given the obvious example of where Trustpower's monthly billings to customers come into its bank account and it takes that cash and goes out and buys a whole lot of windmills. The fact that the money came out of the bank account from the revenue earned by the monthly billings is just irrelevant to the nature or character of the expenditure, it's not about source of funds.

GLAZEBROOK J:
The point being that it's what the asset is rather than the source of funds to buy the asset, is that the point?

MR HARLEY:
Yes. And additionally Your Honour to go back to the question that Young J has just been exchanging with me, it's about how funds are used, how they flow within the business and for the reasons I'll come to. I am submitting that the funds used here for Trustpower flow within the business in terms of identifying and costing alternative sources of supply. That's the primary character of the expenditure. My fourth point is that here in respect of the identifiable capital asset or not, it's not an inquiry about purpose at all. The lease here is a capital asset because we can see it providing the

structure of the business, so it's a blunt factual inquiry, did the money acquire, modify, enhance or dispose of a thing or property that is an identifiable and tangible asset in this business? And we answer that question, in my submission, primarily by looking at the idea of what's fixed or circulating capital. That is not responsive to the question as a possible thing or piece of property that might arise in the future, that is not the correct test.

The Court of Appeal at 87 footnotes its authority for purpose by reference it says to Justice Richardson's judgment in *McKenzies* at page 741. He said nothing of the sort. They're not his words. The only time he refers to purpose actually is by reference to the general permission earlier in the judgment, at page 739, and it was common ground that the general permission was satisfied. My last point in respect of *McKenzies* is, there's nothing here about sufficient connection. It's about the actual fact of the expenditure modifying or extinguishing the lease obligation. It's not sufficient, it's an absolute and direct factual connection as to how the money was used.

I've taken Your Honours through *Hallstroms* and *Nchanga* in order to confront the Commissioner's written submission at 44 and say that it is not authority, neither *Hallstroms* or *Nchanga* are authority from which one can draw the sufficient connection language. That language was taken from DA 1 and the statutory nexus. I've gone through the judgments of the judgments in *Hallstroms* and *Nchanga* to show you that and so I move on then to deal particularly with why purpose is a very slippery slope. The purpose of the expenditure. Some of the explanation for that is given by Justice Richardson in respect of his judgments in the *Banks* and *Buckley & Young* cases.

ELIAS CJ:

This is *Fullers*, by the way, in case you may want to refer to it.

MR HARLEY:

Thank you. I'm just hoping I'm right in terms of who the author is.

GLAZEBROOK J:

It looks like it.

MR HARLEY:

This is in the *New Zealand Tax Case Reports*, I'll give you the citation to it later. For reasons I'll come on to shortly in relation to *Regent Oil* and *BP Australia Ltd* but also *Inland Revenue Commissioners v Carron Co* (1968) 45 TC 18 (HL), Lord Morris and Lord Wilberforce and in *Tucker.* Lord Fraser and Lord Edmund-Davies, keep emphasising you ask the question for what was the expenditure incurred and I think it's Lord Edmund-Davies or Fraser says, it's different, no, Lord Morris it is in *Regent*, it's different from why. So taking *Tucker* in the materials first, Lord Edmund-Davies.

GLAZEBROOK J:

Are we going to go to that?

MR HARLEY:

Yes.

GLAZEBROOK J:

It probably is a good idea but we need to work out where it is.

MR HARLEY:

That will be in volume 4 at 54.

GLAZEBROOK J:

Volume 5 at 54.

MR HARLEY:

We've already dealt with Lord Wilberforce's speech and the essential elements of it by drawing from Justice Richardson but then if we go to the judgment of Lord Edmund-Davies, he's highly critical of the special Commissioner's reference and use of the word "purpose". You'll find this at page 691 of the speech. It starts somewhat unpromisingly with, "For this purpose I want to consider shortly the findings of the special commissioners," which he sets out. He itemises and underlines them all. So in (A) and (B) he talks about purpose and effect and then over to (F) resulted, not made with a view.

ELIAS CJ:

Sorry, is that 691?

GLAZEBROOK J:

About half way down I think

ELIAS CJ:

I see, yes.

MR HARLEY:

And then having referred to *Edwards v Bairstow* he moves on at D, in considering how the question that's been answered – asked by the special Commissioner should be answered the starting place is surely that throughout it's been undisputed the three leases represent capital assets of the appellant's trade. And then he continues on by referring to the speech of Lord Wilberforce and says that it's going to be superfluous to go over that, but he confines himself to commenting on the great weight the special Commissioners manifestly attached to the purpose. Indeed this purpose element features no less than three times, as we've seen, and then he refers to the judgment of Lord Justice Stamp in terms of the Court of Appeal. He then adopts Lord Radcliffe's caution about the undesirability of motive or object and proposes that's why the principal test is unsatisfactory. The purpose of any payment will generally be to improve a company's trading profits, even if the purchase is obviously a capital asset.

GLAZEBROOK J:

Sorry, I've lost you now.

O'REGAN J:

Top of 693.

GLAZEBROOK J:

693, thank you.

MR HARLEY:

And so the reason I'm referring to it is this is probably the strongest judgment that I'm aware of, on why purpose is not the appropriate reflex. Lord Fraser makes the same point in a slightly different way at the foot of 694. After referring to Lord Morris in *Regent Oil* and *Nchanga*, and drawing on Lord Radcliffe, he says at B, "A more relevant test in the present case is to see for what the payment was made. It was made for commuting part of the liability for additional rent payable under the lease.

That fact goes a long way to stamp it with the character of a capital payment, because the lease is, in my opinion, a capital asset of the appellants." That is a classic illustration of the approach of the identifiable asset test as capital. For what was the payment made. And then he explains in agreement with Lord Wilberforce why it can only be to modify the lease. The lease is a capital asset.

I'll come to *Regent Oil* and *BP* shortly, but this is a convenient place to deal with the Commissioner's reliance on the use by Justice Thomas in the *Birkdale* case of the expression "closely associated." That language is taken by the Commissioner in this submission out of context as the Judge makes absolutely clear he's cross-referencing the use of that expression back to Justice Blanchard's plurality at 46 to 52 and where the plurality use no such expression. *Birkdale* is a trade tie case. And at 91 Justice Thomas himself refers to the identifiable capital asset test. What he's really trying to make clear at 94, if you understand the context, is that he dissented in *Wattie*, arguing that the identifiable capital asset test, as expounded in *Regent Oil*, should be re-interpreted, and the majority of the Court of Appeal wouldn't have that and in the Privy Council they said it was wrong. So he's really trying to disinter that dissent by some of this.

The next case that's important here is the Commissioner's reference at 46 of the written submission to the *Waste Management New Zealand Ltd v Commissioner of Inland Revenue* (1995) 17 NZTC 12,147 (CA) case and I'd like to take you to it. That's at volume 2 number 19. This is another judgment of Richardson for the Court of Appeal. The case does not directly confirm, concern the capital limitation but what he says in respect of the capital limitation is undoubtedly right, so that's volume 2 at tab 19. The starting place is to understand the facts. As he explains this case is about Waste Management Redvale waste site in the northern part of Auckland, I think it's at Albany. And as Your Honours will know, Waste Management is a very large waste management company. The company had purchased the 80 hectare site. It exercised the option to purchase in February 1998. It then commenced investigation and design work to develop the landfill and it commenced in October 1989 the detailed design and proposal and sought consent from the Council in 1990. The site development work had already commenced in respect of the landfill during that period. Two points. It's the owner of the land that has classically, in a reverse kind of a way, commenced minor. So it is in the extraction class of cases and for that reason this expenditure is clearly on capital account from the time the company owns the land. The Judge comes to that conclusion having

explained what the expenditure is at page 12150 of the report. The Commissioner's argument, and this is on 12150 left-hand side, gosh it would have been a good idea if they had paragraph numbers in those days; under the deductibility test in the case it's common ground that Waste Management is in the waste management business and so he dismisses out of hand the Commissioner's contention that this could be preliminary expenditure in the nature of start up, it's already in the business and the landfill is part of the business. He then goes on and says that the expenditures in the present case are capital and then considers the real issue in the case which is the provision 124. The point of referring to the case here is simply this. While the proposition that the Judge has asserted here is that the expenses and capital, is in a technical sense obiter. It is so plainly right that the Court should just adopt it as being correct. This is a mining case, just like *Mallet* case which we'll come to, all of the cases in the context of the extraction and mining industries treat this kind of "development expenditure" for the taxpayer when it owns the property as being inherently capital and so it is.

The *Milburn New Zealand Ltd v Commissioner of Inland Revenue* (2001) 20 NZTC 17,017 (HC) which the Court of Appeal also refers to and that's Andrews J is exactly the same. The taxpayer owned the mines, as in the quarries or it had leased them. The expenditure is of the exactly the same character and quality as was incurred here in *Waste Management* and the *ECC Quarries Ltd v Watkis (Inspector of Taxes)* [1977] 1 WLR 1386 (Ch) in Chancellor and a judgment of Lord Brightman is to the same effect on the basis of the same authorities.

I now want to move onto the submission to advance why the Court should pay proper regard to the relevance of the applicable accounting standards in this case. I did not make the submission in the High Court or Court of Appeal that the accounting standards were determinative or controlling. I did make the submission that they were significant and should have had proper regard paid to them as the trial Judge did. To introduce this, first the Court of Appeal at 124 of its judgment was plainly wrong to assert that the accounting opinion evidence was neutral. It was anything but. Second at 121 and 123 of the Court of Appeal's judgment as I've already introduced, I did not say that the standards were determinative. What I do say and did say in the Court of Appeal is that here we're dealing with a legal question, that legal question is what is meant by the term "asset" in the context of the identifiable capital asset test concerning intangibles. The meaning of what is an asset is in part introduced and well explained by one of the witnesses John Hagen, in his evidence.

If I could take Your Honours to his first brief, paragraph 4.2, you'll find that at volume 7 of tab 50. Mr Hagen was called as an expert and at paragraph 4.1 he introduces what is a very basic idea. At the basic level the firm's financial statements record, was in the statements of assets and liabilities or the balance sheet as some of us refer to it, and its profit and loss statement. "The accountant's role is to itemise the transactions in the year, record the firm's earnings on the income statement and the adjustments to its assets or liabilities. In these very simple terms if the firm's built a new factory during the year the factory would be a balance sheet item, an item of fixed capital, a capital asset. On the other hand if the firm was exploring the possibility of whether it could build a new factory, those costs would be part of the current operations of the business, a revenue expense in the nature of research and development. The costs would be reflected in the income statement as a deductible expense. No capital asset could or would be recognised." Now that's the principle for commercial accounting purposes. It goes on later after going through –

O'REGAN J:
When he says it's a deductible expense, he means tax deductible does he?

MR HARLEY:
Both.

O'REGAN J:
But does the account, do your accounts determine that?

MR HARLEY:
No, no. For financial –

GLAZEBROOK J:
I'm not sure where you are sorry, what paragraph are you on?

MR HARLEY:
4.1.

GLAZEBROOK J:
I thought that's where I was.

MR HARLEY:

Tab 50.

GLAZEBROOK J:

Okay.

MR HARLEY:

Okay so it's an expense.

WILLIAM YOUNG J:

It's a deductible expense in terms of profit to profit and loss account not in terms of tax.

MR HARLEY:

Correct. Thank you yes. He then goes on a little later, having spent quite a lot of time talking about the standards, to set out diagrammatically at 4.21 where in his opinion for the purposes of financial reporting this expense would lie. And as we'll see in a couple of paragraphs further on, he asserts that the expense is at the extreme end of A.

WILLIAM YOUNG J:

So what paragraph are we now at?

MR HARLEY:

The diagram's at 421.

ELIAS CJ:

So while it's improbable it's to revenue.

MR HARLEY:

Yes.

ELIAS CJ:

Yes, so it's an improbability/probability test.

MR HARLEY:

It goes further, Your Honour. He says, "There can be no asset."

GLAZEBROOK J:

One can understand why you do that from an accounting perspective, can't you? I'm not saying it doesn't translate over but you would be misrepresenting the financial position of the company if you're saying that you have an asset that is part of the business structure when, in fact, all you've got is expenditure that may possibly result in an asset in the future and it's really asking whether that is the test because what you're trying to do with accounting standards is not to – is to present a snapshot, and I mean some people would say of course not a proper snapshot because they don't take into account economic assets et cetera but a proper accounting snapshot of the business and the way it is.

MR HARLEY:

Well, Your Honour, I agree and having seen PricewaterhouseCoopers Mr Freeman dealing with the labyrinth of the standards he too would offer you a job in PricewaterhouseCoopers audit department having recognised what he said was a very simple concept once you get through that labyrinth and you're right, that is the position that's adopted by the company in respect of the evidence that the chairman gave about its financial accounts and the reasons why the Board would never contemplate capitalising these expenses.

Rather than take Your Honours through what was that labyrinth, the short form of the accounting standards is well explained by Justice Andrews and she reflects the careful opinion advice that was given to the company by PricewaterhouseCoopers which you'll find in volume 23 of the case. That's the pink volume.

ELIAS CJ:

If Justice Andrews' judgement is the short form, can we just look at that or do you really want to take us to the evidence on this? I'm happy for you to do so but can you at least give us a paragraph number to this short form statement?

MR HARLEY:

I'm very grateful to you, Your Honour. This labyrinth can be made very short.

ELIAS CJ:

Well, I need a short form.

MR HARLEY:

The Judge deals with this in 126 on the case of appeal. It's the green volume, 2, at 26. Before you start reading it, just as explanation to following the logic, there are two accounting standards that are being considered here. NZIAS 16 is the first. It deals with what is called plant property and equipment. The proposition in respect of NZIAS 16 and what is an asset is a reflection against the underlying project providing the plant property and equipment, that is, the wind farm. And so the question the standard is posing is what is the asset and how do you recognise it? As Your Honours will understand, plant property and equipment is tangible. NZIAS 38 deals with intangible property. It asks an identical question, albeit somewhat differently worded, but it's the same, but in both cases the question is, in respect of what does an asset mean here? It means a resource that is controlled by the company and which the company can use and is committed to using.

So the argument in respect of the two standards starts off with which is the correct standard to be used? Our submission to the Judge was NZIAS 16 and that was the opinion of both Mr Hagan and Mr Freeman. In the alternative, the submission through the experts was that if it's NZIAS 38 and here we're focusing on the RMA consents themselves as intangible items, you get the same answer. With that introduction, Your Honours, I'll be quiet and if you would just read through.

ELIAS CJ:

If you want us to read through we'll do that at lunchtime. What paragraphs do you want us to read?

MR HARLEY:

126 to 134. Could I just also note to you that the Judge has made a mis-expression in terms of what she meant at 132? When you read the whole passage, the sentence should read in the last line under 57, "Then they would be treated as revenue." She says "capital" but she means "revenue" and it'll become clear when you read the rest of what she says that's what she means.

ELIAS CJ:

All right. Thank you, we'll take the adjournment now.

COURT ADJOURNS 1.03 PM

COURT RESUMES 2.19 PM

ELIAS CJ:
Before we get underway, Mr McLellan, I wonder whether I could just ask you whether you'd confirm that you think that that is an error in the judgment of Justice Andrews.

MR McLELLAN:
I didn't look at it over the luncheon adjournment. I'll do that. I think it is but I will confirm it.

ELIAS CJ:
Yes, thank you. Thank you, Mr Harley.

MR HARLEY:
To be fair to Her Honour, she did give us the judgment to check and correct and that was one that went past me.

ELIAS CJ:
Right.

MR HARLEY:
For those of you who have an appetite to get into the accounting evidence, you'll find the PricewaterhouseCoopers opinions in the core bundle volume 1 at tabs 8 and 9 and the short form explanation in Hagan second brief which is in volume 7 at tab 51 section 5. But the Judge got it right in respect of the analysis.

My submission to you in respect of these standards is that where, as is clearly the case here, the accounting standards are identically focused on what is meant by the meaning of an intangible capital asset and what is meant by a taxpayer committing making the difference between what's research on revenue account on the one hand and into development, which is the exploitation and enhancement of the asset itself on the other, then those are exactly the questions that are before the Court.

This next part doesn't come easily to me in terms of acknowledging the accounting standards and their authority but they are an internationally prescribed code and they are made part of New Zealand law for financial reporting purposes. They are an

elaborate and highly-detailed body of doctrine which are intellectually articulate, closely-reasoned and logical, leading to fact-based conclusions.

For that reason, my submission is that the Court should pay careful regard to that body of professional doctrine. While the question is ultimately one of law, this is highly fact-specific and these standards help us understand how the facts should be marshalled and analysed.

For those reasons, I say the Judge at 129 through 133 reached the right conclusions and that she was right to conclude that there was no relevant asset under the identifiable intangible asset test.

That then leads me to go back into the case law and particularly into the intangibles.

GLAZEBROOK J:
And you are going to get to why the consents themselves aren't assets?

MR HARLEY:
Yes.

GLAZEBROOK J:
Right. It's fine, I don't need it now. I'm just checking we are getting there.

MR HARLEY:
Yes. But to deal with it as introduction, they're property because the Act tells us that. They're legal permissions. They are highly conditional and they are inchoate. They have absolutely no functional capacity whatsoever in themselves unless and until stapled to complete land access with grid and transmission connection.

I'll come to why all that's important and what all that means as we go through the evidence.

GLAZEBROOK J:
Do you accept that they would be saleable and have a value and, if so, why is that not relevant? I know you'll be coming to this, presumably. But if you're doing a brief overview it will be helpful to have that, as well.

MR HARLEY:

The answer is in respect of the consents themselves it was accepted that they are saleable.

ELIAS CJ:

Is that under the RMA?

MR HARLEY:

The answer to that question has to be yes. I say that because what else could prescribe that outcome?

ELIAS CJ:

Well, it just strikes me as slightly odd in circumstances where the land isn't owned but I'm probably wrong on that.

MR HARLEY:

You're right. My understanding is that the consents actually go with the land so that if the land is sold the consents relating to the land use go with the land. The other consents don't, is my understanding.

ELIAS CJ:

Yes. Well, that is of some significance, I would have thought, to your argument.

MR HARLEY:

Yes, it is. It's for that reason that I used the expression "stapled to land access grid transmission connection". Your Honour Justice Glazebrook, if you could just refresh my memory. I think the question you asked me was whether they had value.

GLAZEBROOK J:

Which is tied in with the – whether they're able to be sold. I thought the Courts below and the witnesses had assumed they could be sold, even if not tied to land access but I might be wrong on that.

MR HARLEY:

You're correct. In theory the consents themselves could be transferred. No Trustpower witness accepted the consents alone had value beyond zero. Their

evidence is there's no circumstance in the New Zealand market where that's ever occurred.

WILLIAM YOUNG J:
What, where consents have been sold?

MR HARLEY:
On their own?

GLAZEBROOK J:
Well, one can certainly accept it's not a ready market because there would be, for a start, very few players who would be in the market, for a start.

MR HARLEY:
But there is evidence that consents with land access and the other package of rights could be purchased or sold and in fact Trustpower itself purchased two sets of consents, land access, and what went with that, and we'll come to that briefly in respect of the evidence of Mr Campbell when he discussed what's called Esk Valley wind farm. So the proposition and sharp difference between the Commissioner and the company is whether consents on their own have a monetary value above zero. No Trustpower witness accepted they did.

WILLIAM YOUNG J:
I haven't really got my head around this. How much land did Trustpower own that was referable to the consents?

MR HARLEY:
Starting with the Wairau scheme, there were 60 affected landowners. Trustpower had what were options to obtain licence agreements for access in respect of approximately 30. It also owned some of the land at what I would call the headwater, the upper stream where the canal intake would have started. It's obvious that without complete land access you can't build a canal down the Wairau Valley without irritating some of the landowners. And some of them will not deal at all.

WILLIAM YOUNG J:
So is there an ability to compulsorily acquire land or easements?

MR HARLEY:

There is a theoretical legal power which could be possibly obtained by Trustpower as what is called an acquiring authority. It isn't. And the evidence is that's not how it thinks about the world to do that.

WILLIAM YOUNG J:

Well, it spent quite a lot of money on the consent so it must have an idea it's going to get a completed project. In other words, it won't have said, okay, well, there are 30 people who won't agree so we're never going to get this done but let's just get the consent anyway. They must have an idea of a way through all this.

MR HARLEY:

I think Justice Burchett would refer to this as the poet's dream. They had a belief that they would be able to negotiate their way through to completion. It's simply not happened. In respect of the Arnold hydro scheme Trustpower owned land in respect of that scheme and had options to obtain licence agreements in respect of some of it. But there are fundamental land access problems caused in relation to that scheme by Kiwi Rail. The canal happens, from an engineering perspective, to go clean through the middle of the main trunk line tunnel. And so it would be necessary for Trustpower to negotiate an agreement with Kiwi Rail to enable it to put the canal literally through the middle of the tunnel. There's no agreement to that effect and there never will be, unless and until Trustpower can demonstrate to Kiwi Rail what the engineering is to achieve that in a way that does not destroy Kiwi Rail's main source of income in respect of the West Coast coal.

The wind farms are slightly less complicated. In relation to Kaiwera Downs there were nine of 10 access agreements by way of licence which were completed after the consents had been obtained and for the Mahinerangi wind farm Trustpower had succeeded in negotiating the licence agreements in respect of all the land by the end of 2008.

WILLIAM YOUNG J:

So did Trustpower have landholdings or licence agreements before the consents were obtained?

MR HARLEY:

Yes.

WILLIAM YOUNG J:

Why can't the consents just be treated as augmenting the value of the existing assets held by Trustpower?

MR HARLEY:

Well the question is whether the licence agreements themselves, and that's what we're mostly talking about, are such assets because all they authorise is the ability to Trustpower to access the land to conduct its feasibility studies. Until they're converted into interests in land, then there is no interest in land.

WILLIAM YOUNG J:

Is there a convenient analysis somewhere of the full project and –

MR HARLEY:

Of the land?

WILLIAM YOUNG J:

– a convenient analysis of the current state of play with respect to the four projects?

MR HARLEY:

Yes.

WILLIAM YOUNG J:

Well where's that?

MR HARLEY:

In the evidence of Mr Campbell.

WILLIAM YOUNG J:

Mr Campbell, thank you.

GLAZEBROOK J:

Well would they ever have more than licences to access though even if they're building something –

MR HARLEY:

Yes Your Honour.

GLAZEBROOK J:

They do because –

MR HARLEY:

They would exercise options for the grant of an easement and register the grant in order to secure the permanent land access. Without over-burdening you Justice Young with detail, there is a summary of the status of the land in the evidence in the case on appeal.

ARNOLD J:

Can we work off the amended chronology?

MR HARLEY:

This is a one-pager Your Honour.

ARNOLD J:

No, no, this – this is the one that you're talking about?

MR HARLEY:

I'm talking about a one-pager.

ARNOLD J:

Right.

MR HARLEY:

You'll find that in what is called "the core bundle volume 1" in this Court, a summary is at tab 11. And the detail on this document is confidential to the parties.

WILLIAM YOUNG J:

But these rights, the – in relation to the wind farm option agreements they, under them Trustpower does have a right to acquire an easement if it chooses?

MR HARLEY:

Subject to conditions.

WILLIAM YOUNG J:

If it gets that far.

GLAZEBROOK J:

Just the confidentiality issue, if you've got a list of things that are confidential?

ELIAS CJ:

There's a protocol is there?

MR HARLEY:

Yes there is.

ELIAS CJ:

Is that in the, is there, is that in the bundle? It's just so that we don't make an error.

MR HARLEY:

The answer to Your Honour's question is yes there is a protocol and yes there is schedule of what are confidential documents. So if I could take you to the index –

ELIAS CJ:

Of what?

GLAZEBROOK J:

The next one I suppose is it.

MR HARLEY:

And index to volume 2 of the case on appeal. And there's a list within it of what I've marked as confidential documents. And this happens to be one.

GLAZEBROOK J:

And where is the list sorry?

MR HARLEY:

I'll have to find it Your Honour, I can't remember. But I will find it.

GLAZEBROOK J:

Well it's really just, if you let us know at some stage so that we...

MR HARLEY:

It's just, the issue here is just the amounts and the names of the people and this is, as we'll see in the evidence, highly valuable information to Trustpower because its terms it believes are far superior to any of its competitors. My friend's pointed out that the confidentiality is marked in the index to each volume of the material.

GLAZEBROOK J:

I see.

MR HARLEY:

I'll tidy that up.

WILLIAM YOUNG J:

Just looking and I'm looking through the attachments to the Crown submissions to the Arnold River project and note in November 2005 which refers to the decision, the proposal to go ahead with the resource consent, comment is also made, "If Trustpower chooses not to proceed with the full development there appears to be little downside if the land resource consents have been secured as the project at either of its stages should be very saleable as is"?

MR HARLEY:

Yes. That proposition does not correctly reflect the document that has been relied on. And the document that's been relied on is a Trustpower board paper that considered whether or not Trustpower would or would not purchase some land and the terms upon which it might agree to buy the land. It has nothing whatsoever to do with whether or not the consent would be exercised so that the scheme could be developed or that the scheme with the land would be sold. The document is only about the purchase of the land and its sale value.

WILLIAM YOUNG J:

But this bit I'm looking at all got underlining, what does that mean, that you challenge it?

MR HARLEY:

We don't agree with it –

WILLIAM YOUNG J:

Yes.

MR HARLEY:

– and nor do the witnesses.

WILLIAM YOUNG J:

And sooner or later we'll be taken to the document I guess?

MR HARLEY:

You'd not want to be. It is a math –

WILLIAM YOUNG J:

Well I mean on the face of it, I mean it's –

MR HARLEY:

It's a mathematical model.

WILLIAM YOUNG J:

Yes but if that's an accurate summary then the Commissioner's kick off date which sort of, which is around that time would look a pretty reasonable one?

MR HARLEY:

Well I disagree with that Your Honour.

WILLIAM YOUNG J:

If it's an accurate summary would you agree that that would …

MR HARLEY:

No I wouldn't because it depends on what state the underlying project could have been at that time. And as I've just explained to you, at that time the choke point in respect of the canal was well known and unsolved and that remains the case today and that's not the only problem. There are other issues affecting Arnold relating to the road, the riverbed, riparian rights in respect of the riverbed, none of which are

resolved and none of them can be resolved unless and until Trustpower knows how it could engineer the canal and we'll come on to that. Trustpower has ceased its second-step feasibility process because those problems cannot be solved.

WILLIAM YOUNG J:
So nothing's happened since April 2012?

MR HARLEY:
I'd have to check that nothing's happened since April 2012 but it's certainly the case from Mr Campbell's evidence that the Board agreed that the second step feasibility process should stop.

GLAZEBROOK J:
So there is land owned there?

MR HARLEY:
Yes, at the headwaters.

GLAZEBROOK J:
Do you accept that that's on capital account?

MR HARLEY:
The land itself, yes. It's got a dam on it.

GLAZEBROOK J:
And there are consents relating to that land that can be sold with the land?

MR HARLEY:
Relating to the operation of that dam, not this, which is a different scheme.

WILLIAM YOUNG J:
But these consents could be sold as part of the land?

MR HARLEY:
With that land, that's my understanding, yes. Which begs the question as to why anyone would buy them if they can't be used.

GLAZEBROOK J:
Well, that's what I was going to say. Presumably you would say, well, they can be but their value would be zero if you can't use them because of these engineering and other problems.

MR HARLEY:
And there is some evidence to the effect that it's negative, the value is negative. I'll take you through some of this evidence because these engineers are far better able to explain it than me and I'll be reasonably efficient about how I do that.

What I now want to move on to are the intangibles cases and take you further into how intangibles are dealt with and why they're treated differently and more circumspectly by the Courts. The first case that I would like to take you through is *BP Australia* and in that context I'll deal with Justice Young's question earlier about circulating capital and how the idea works in that case.

BP Australia is in volume 4 of the materials at 43. At least some of us are old enough to remember that in the 1950s petrol stations had multi oil company outlets. You could get Mobil. You could get BP. You could get Shell products from the same station.

WILLIAM YOUNG J:
I can't.

ELIAS CJ:
Neither can I.

O'REGAN J:
You're so young.

WILLIAM YOUNG J:
Let's ask Justice Arnold if he can remember.

ARNOLD J:
Not at all, not in the slightest.

MR HARLEY:

A war broke out, started by Shell, which was to entice the garages to become sole outlets. The other oil companies joined the war to protect their outlets and so a bidding war started between the oil companies and the various garage owners as to which of the oil companies would pay the highest price to effect the tie. Depending on one's view of which petrol station happened to be in the best location, the amount of money went up and so did the length of the tie. The case was argued by the High Court of Australia and the Privy Council on the basis that the average tie was five years but some were as long as 20 and some were as short as three. For obvious reasons, a tie of that nature which is contractual is an intangible item of property and it's valuable.

WILLIAM YOUNG J:

Well, it's a chosen action.

MR HARLEY:

Yes and the oil company wouldn't be paying for it, for whatever the price was, unless it was valuable to it, any more than the garage owner would have sold the tie to the oil company if it weren't valuable to it. In some cases, they were transferable, that is, the ties.

WILLIAM YOUNG J:

What, to another oil company?

MR HARLEY:

Yes. The difficulty with transferring the tie in those circumstances was that the oil company usually owned or controlled the ownership of the tanks in the ground and so unless the garage owner was prepared to have the forecourt ripped up and go out of business for the period that was a pretty effective contractual –

WILLIAM YOUNG J:

Well, they still do, don't they? Don't the oil companies by and large own the tanks, the underground tanks?

MR HARLEY:
I haven't dealt with oil companies in some time, Your Honour, but that was certainly the circumstance that was in *Birkdale* and I have no idea whether that market's changed or not but I'd be surprised if it had.

The High Court of Australia split 3/2. Sir Owen Dixon and Justice Kirau dissenting that the expenditure from the oil companies' perspective did not obtain an identifiable asset. The true nature of the expenditure from the practical business point of view was to offer marketing support so that they were able – that is, the oil companies – contractually to secure lengthy periods of orders from the garage station for BP's products and the other companies did the same thing.

When the case came before the Privy Council, as I've already noted, it was being argued at the same time as *Regent Oil* was being argued and also the other Australian companion case of *Mobil* so the Lords were dealing with all three at the same time and the fundamental difference between them, as it turns out, is the existence of the contractual framework providing for the tie. In *Regent*, that framework was embodied in a lease and sublease where the garage owner granted a lease to Regent and then Regent paid a premium on the grant of the sublease back to the garage owner. The sublease contained the tie and by virtue of the sublease Regent obtained an interest in land and so the fundamental difference between the cases is the effect in law of the interest in land, although some of Their Lordships in *Regent* gave that different emphasis but that's where it ended up. So in the context of *BP* Lord Pearce, one of the Lords, starts the discussion with the valuable guide to the traveller, this is at page 261 of the judgment, introducing Sir Owen Dixon's judgment in some newspapers. And it's worth Your Honours if you will, just read carefully the passage because it comes up again and again in respect of the other cases.

ELIAS CJ:
261?

MR HARLEY:
Yes. And the next passage if you would please, is at the judgment of Lord Radcliffe in *Nchanga*, the passage I want to draw particularly to your attention is the second one on page 262, just the first few lines.

ELIAS CJ:
Where's that again?

GLAZEBROOK J:
Over the page.

ELIAS CJ:
In the same...

MR HARLEY:
The reason for drawing your attention to that in particular is you'll see in the fourth line Lord Radcliffe referring to permanent structure of which the income is to be the produce or fruit in the cost of earning that income itself. That is the classic idea of fixed capital and revenue account. The fruit and the tree and that derives from the Supreme Court of the United States very early judgment in tax cases called *Eisner v Macomber* 252 US 189 (1920) And the fruit and the tree is a classic starting place for reflecting the ideas of what is fixed capital and revenue, whether it's –

ELIAS CJ:
Well it maybe one of those rare cases where metaphors help but –

MR HARLEY:
Don't answer the question. This is what Lord Morris refers to as "the word picture", it gives a concept and then the question is how do you apply it.

So in the next part, and this really picks up some of the exchange with Young J earlier about goodwill, Lord Pearce refers to where a trader buys out a rival to secure goodwill or suppress it, that's prima facie capital and that's *Sun Newspapers*, but in the present case *BP* wasn't obtaining a monopoly or buying off competition. Although one retailer was tied to BP, the retailer next door could still buy some other brand and then he goes onto explain some of the differences in quality between who had the best site. I draw attention to this particular passage because if it important when Your Honours come to understand the criticism that I make of the Court of Appeal's judgment here about paragraph 94 in terms of the so-called first mover advantage said to approve of Trustpower by having a consented site. I'll just make sure that I gave you the right paragraph. 94. And I'll come back to say why that's just wrong. But the Privy Council here is making the point that security over a

particular site isn't securing, in this context, a monopoly in respect of the business overall.

The next point that's made by Lord Pearce then is to start drawing into the cases, the differences between cases such as *Mitchell & Noble* and *W Nevill and Co Ltd v Commissioner of Taxation* (1937) 56 CLR 290 case, these are the cases about payments to get rid of unsatisfactory people and why those payments don't affect fixed capital. He then refers to *Atherton*'s case which is the pension fund and he says the pension fund is so different from this, it's just not useful.

Then he refers to Sir Owen Dixon in *Hallstroms*, the practical and business point of view and then goes onto talk about what the ties did here and this is the crucial paragraph that explains the outcome in the case on page 265 starting at E, "The advantage which BP sought was to promote sales and obtain orders for petrol by-up-to date marketing methods, the only methods which could now prevail, since the orders were now and would be 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 the sums." It became one of the necessities, of the current necessitates of trade. And then this is the crucial paragraph where His Lordship now starts to deal with why these payments are circulating capital. "Having referred to the John Smith case fixed and circulating capital, fixed capital was prima facie that which looked to get a return from your trading operations." And if Your Honours, if you could just read carefully on page 266 through (a) through (c), he explains why these payments are truly to market the sale of petrol to the retailers. I make two points. This has got nothing to do with the source of the money. It is about how BP is marketing and affecting the sales of its petrol trading stock. It is the trading stock that is in circulation, the marketing payment, the lump sum marketing payment, the supporting the orders of petrol from the garage owner. Recognise –

WILLIAM YOUNG J:
I still confess to find it a pretty elusive test –

GLAZEBROOK J:
Yes.

MR HARLEY:

Recognising that language like this doesn't have statutory force and that you can't necessarily lift language like this from one to the other, let me try and reflect the idea in the context of Trustpower.

WILLIAM YOUNG J:

Okay.

MR HARLEY:

If one imagines Trustpower justifying the price of electricity to its retail customers, it's hard to imagine Trustpower omitting its pipeline optionality costs as an item in each electricity unit purchase from wholesalers or produced by itself and sold to retail customers. It is doubtful that Trustpower would relegate those costs to overheads since they are in the forefront of Trustpower's every day cost of supply decisions and its purchases from other wholesalers made daily. Nor can one imagine the retail customer being able to argue about that as a cost base. Prima facie therefore, those pipeline optionality costs are circulating capital which is turned over and in the process it's been turned over yields either a profit or loss from trading in electricity. The trading in electricity is inherently –

WILLIAM YOUNG J:

Couldn't that –

MR HARLEY:

– on revenue account.

WILLIAM YOUNG J:

Couldn't that have been applied in the *Regent* case?

MR HARLEY:

And they tried and the Lords rejected it in terms because of the existence of the tie being embodied as an interest in land. They wouldn't have it because of that.

WILLIAM YOUNG J:

It seems a funny thing to worry about, really, doesn't it? When economically the transactions are identical.

MR HARLEY:

Your Honour, Lord Wilberforce who I will draw on shortly will tell you that that is bad language in a tax case. It's not about the economics.

WILLIAM YOUNG J:

That's not quite the way we think about it now, though.

MR HARLEY:

Yes, it is. This is about the form of the agreement and how the agreement is embodied as an interest in land. It uses exactly that language that you just put to me and says that is wrong.

WILLIAM YOUNG J:

Well, I suppose I'm really talking about avoidance cases but we're not so perturbed about taxing by reference to substance rather than form now.

MR HARLEY:

This is not an avoidance case. We simply apply the law in terms of what is the nature of the agreement here. I'll come to it in a minute.

GLAZEBROOK J:

Well, isn't the point that land is just in a different category and as soon as it's related to a lease it's a capital asset unless it's rent and even capitalised rent isn't seen as rent but there's no particular logic to that, is there?

MR HARLEY:

It's just a rule and as *Tucker* says some of this was arbitrary but you're right, unless you're dealing with a land dealer land is about as far into capital territory as you can get as the mining cases show.

WILLIAM YOUNG J:

Unless you're a dealer in land.

MR HARLEY:

That's what I said, yes.

ARNOLD J:

You were saying that this, the costs of the feasibility optionality would be incorporated in the, as I understood it, the pricing decision in exactly the way that was talked about in *BP Australia*.

MR HARLEY:

Correct.

ARNOLD J:

But doesn't – don't you have to distinguish between the short term and the long term? I mean, in the short term Trustpower's buying power, presumably some of it on the spot market and some with longer-term contracts and it will price that in, I'm sure, into its retail price but then it's generating power and it will seek to recover the costs of that through weighted average cost of capital or whatever and do all of that and so I can understand that on the short-term sort of pricing basis when you're operating on the spot market or through longer-term contracts but does that necessarily carry over when you're making much longer-term decisions because the run-in to build a capital item like a power station is so long aren't you going to be using a longer-term time horizon and will it necessarily follow that all of that will be priced in the sort of way that you're talking about in these sort of everyday prices?

MR HARLEY:

The answer to the question is yes as we'll see when we get to consider some of the evidence, but of course Your Honour is right in respect of the daily spot price, if I can put it that way. But what this company is doing is apart from making decisions about what it'll buy today, it's also making decisions today about securing long-term supplies of electricity either today or next month or whenever the contract rolls over, and it's doing that by reference to its view of the supply path, that is, what its competitors are doing taking supplies out and bringing new supplies on stream and what the cost of those supplies is likely to be and on the other side, the demand path, trying to measure its expectation of what its market might be, reflecting that supply path. What everywhere else is clear, this is a pretty complex decision-making process and as the witnesses themselves say, they make decisions that turn out to be wrong frequently. Trustpower happens to be the most profitable of New Zealand's generation companies and when you understand how they go about conducting their business it's understandable as to why it has achieved that standout performance.

WILLIAM YOUNG J:

Mr Harley, if I'm buying power from Trustpower as a consumer it's a matter of indifference to me where Trustpower sources the power from, whether it generates it or buys it.

MR HARLEY:

As a consumer, that's right.

WILLIAM YOUNG J:

So I'm not really thinking in the way of the petrol retailer postulated by Lord Pearce because that's a sort of a bipartite situation, that BP gives the petrol retailer effectively a discount in advance closely referable to the estimated gallonage that the retailer's going to be selling which in a sense comes off what the retailer's got to pay for the petrol that is acquired.

MR HARLEY:

But the passage is reflected to BP as the payer. It's circulating capital. It's an issue.

WILLIAM YOUNG J:

But would Trustpower, if it's got – wouldn't the value of its generating capacity effectively be a sunk cost, that the price it's charging me is the market price and if it's made a good investment in the past or not in relation to generating capacity that's irrelevant? What I'm suggesting is that this passage of thinking that Lord Pearce postulates slightly – which I don't find entirely convincing in the particular context he proposed it for but I find it very unconvincing in relation to a power company.

MR HARLEY:

Well, I don't understand why you would take a different view of a power company from a petrol supply company.

WILLIAM YOUNG J:

If I'm selling you petrol and I'm a wholesaler and I'm selling you petrol I intend to sell you five million gallons over a five year period. I give you an advance, a payment that's referable to those sales.

MR HARLEY:

Yes.

WILLIAM YOUNG J:

The way of thinking that that might engender is that it's effectively a discount on the cost of the petrol that I'm charging you and that's the point that Lord Pearce is making.

MR HARLEY:

And as was argued, it is in the nature economically of being a rebate.

WILLIAM YOUNG J:

Yes, and that's got nothing to do with a power company and its retailers and its retail customers.

MR HARLEY:

But on the Trustpower side we're looking at its generation capacity and what it's purchasing from its competitor wholesalers and what it's paying in respect of how it costs those supplies. Now, I agree with you they're not the same things as in they're not identical. It is a way of thinking about how the business, Trustpower, sources its supply. The case concerning BP is not about how BP sources its supply. It's how it secures outlets for its products. But the businesses and the issues affecting the businesses in terms of the cost base are the same.

WILLIAM YOUNG J:

But if Trustpower built a hydro dam wouldn't you say the costs associated with the hydro dam would be subject to this sort of analysis? Why wouldn't that be treated as circulating capital? Because you as Trustpower would be factoring it into your pricing decisions unit by unit, cent by cent what you want to get back for building a dam.

MR HARLEY:

And as we'll see in a few moments, Lord Wilberforce would say, along with Lord Denning in *Regent Oil* that's exactly right and it's irrelevant. They are an interest in land you have paid for and identifiable capital asset. That is the end of it and that's Justice Glazebrook's point in terms of there is a rule about interests in land capital. But *BP* is about a contractual trade tie in tangible property. Different. And all I was trying to do in respect of the passage was illustrate using it. The concept of what is circulating capital and how it works to make two points. It's not about source. It's about how the trading stock is used and relevantly in this case how it's priced. The

discussion goes on and I won't take you through all of it, through to really the method that the Lords used to distinguish between capital and income and this becomes clear at the foot of 271 to 272. They take the case of *Van Den Berghs Ltd v Clark (Inspector of Taxes)* [1935] AC 431 (HL) on the one side, I'm pretty sure Van Den Berghs is Unilever these days, this is the margarine case, the joint venture to produce margarine where one cancelled the contract with the other and made a lump sum payment. The House of Lords treated that payment as capital reflecting the structure of the business. It is an illustration of the identifiable capital asset test at work in respect of the nature of the contract in issue, and on the other side is *Anglo-Persian* which we've already discussed, that's the 20 year agency agreement and we've already seen the passages from the judgments of Justice Rollett and Lord Justice Lawrence and Lord Pearce concludes for the board that *Anglo-Persian* is the nearer than *Van Den Berghs.*

He then goes on to discuss Sir Owen Dixon's second framework from *Sun* on page 273 about the bundle of orders and treats them as part of the ordinary process of selling revenue and concludes for those reasons the case is not easy to decide, on balance it's revenue. There is one passage I've missed which I should have referred to where he articulates by reference to *Hinton (Inspector of Taxes) v Maden & Ireland Ltd* [1959] 1 WLR 875 (HL) case, this is on page 268. The fundamental difference and difficulties caused by tangible assets which is *Hintons* case and intangibles where the treatment is different in respect of accounting. So in *Hintons* case we've got cutting knives that had an average life of three years, capital treated by Lord Reid, the observations directed to tangible tools don't provide a safe analogy when dealing with chosen inaction and he explains why.

On outcome to *Regent Oil* on the other side, 51.

ELIAS CJ:
51 tab.

MR HARLEY:
Of tab, sorry of volume 5.

ELIAS CJ:
What's on the spine of this one?

MR HARLEY:

Tab 5, volume 5, tab – UK cases. Lord Reid's speech commences at page 310, I'm not going to take you through all these speeches, they're lengthy and I'm going to deliberately, selectively highlight them for particular purposes in terms of the argument. Lord Reid explains the same marketing problem as was present in *BP* and then goes on at page 313 to refer to the importance of the essential nature of the question, the income tax that requires the balance of profits and gains to be found and he says that, "Ordinary principles of commercial accounting so far as applicable, are relevant and helpful and that there's no one test or principle or rule that's paramount. It's a question of law for the Court, the reasonable circumstances to take into account at page 313. The purpose of any commercial account must be to give a fair and accurate picture as possible of the trader's financial position." Then he discusses the *Kauri Timber Co Ltd v Commissioner of Taxes* [1913] AC 771 (PC) case, *Hintons* case over the page. It goes with an extensive discussion of some of the cases and lump sums paid in advance. On page 317 he says, with reference to what is taken as the identifiable asset test at (b), "If the asset which is acquired is in its intrinsic nature a capital asset, the sum paid to a client must surely be capital." Then he explains why that is, refers to the fruit and the tree –

GLAZEBROOK J:

What page are you on, sorry?

MR HARLEY:

317. And then a little later he refers to the structure arising from *Van Den Berghs* and the treatment by Lord McMillan of the *Sun* and then contrasts *Van Den Berghs*, now on page 318 to *Anglo-Persian* and we've been through those passages and comes to the same conclusion.

He then discusses what actually happened as the market war developed and explains that in conclusion that the length of the tie and the fact that money flows over different periods doesn't make it capital and why that's so. He then further goes onto the lease and sublease form and this at page 325 of the speech. At (e) he explains why the nature of the tie reflected in the lease/sublease is fundamentally different and he regards it as a highly relevant factor.

WILLIAM YOUNG J:

Sorry, what page is it, I'm sorry?

MR HARLEY:

325. At (e). I'm trying to be as economical with time as I can be but I don't want to rush past your ability to digest this. So I'm in your hands in terms of speed.

ELIAS CJ:

Carry on.

MR HARLEY:

Lord Reid regards the lease/sublease structure as highly relevant and makes the observation that a premium paid on the ground of release is capital and that's sufficient to turn the case in his view.

Lord Morris is in agreement, at the top of the page he gives his first reason for why the lease/sublease method means capital. He then explains a second reason –

WILLIAM YOUNG J:

Can I just pause there. At Lord Reid page (c) says that, at letter (c) says that, "The lease and sublease arrangements is irrelevant in relation to the transactions that are for 10 and 21 years," because –

MR HARLEY:

I'm sorry I've missed, I'm not with you.

WILLIAM YOUNG J:

Page 325 –

MR HARLEY:

Yes.

WILLIAM YOUNG J:

– he says, he deals with the two longest ties and then says, "I would have no doubt that the lump sum paid for the 21 year ties could not be treated as revenue outgoings even if there were no lease and sublease."

MR HARLEY:

Correct.

WILLIAM YOUNG J:

"These ties were not a," so there it's just the length of the tie, it's got nothing to do with the fact that an interest in land is acquired?

MR HARLEY:

In his view.

WILLIAM YOUNG J:

Right, okay.

MR HARLEY:

And we'll see a little later Your Honour that other Lords took a different view but nothing turns on it because they all agree the lease/sublease is capital.

WILLIAM YOUNG J:

Yes.

MR HARLEY:

Lord Morris is to the same effect with his first reason. I won't take you to the second reason which is at the foot because as he says, "That's not the view that commends itself to the rest of the Lords." Lord Morris refers particularly to the *Sun Newspapers* and *Hallstroms* approach of Sir Ron Dixon on page 329, he then goes through quite a few of the cases and as I observed earlier this morning at page –

WILLIAM YOUNG J:

Sorry, is it – I mean you're familiar with this and I'm not but Lord Morris seems to be saying that he doesn't seem to think the lease and sublease component is central.

MR HARLEY:

In the first part of his reason he said it was.

WILLIAM YOUNG J:

Right, well I'm looking, I'm sorry and I'm just reading very quickly, at the bottom of page 326, "I also arrived at the conclusion –

MR HARLEY:

No, no, no Your Honour, that's the second reason, that's the one that doesn't commend itself to the other Lords. His first reason is the lease/sublease interest in the land capital.

WILLIAM YOUNG J:

Okay so he seems to be at one with Lord Reid in relation, at least, to the longer-term transactions.

MR HARLEY:

Yes and several of them were. Lord Wilberforce is perhaps the most extreme in saying that he can't see how the length of the tie can make any difference. That view was subsequently corrected by Justice Blanchard in *Birkdale*.

So the next passage I was referring to was at page 332 which is the nature of the question the Court should be asking. Starting at B, it is important to consider not so much why the payments were made but for what they were made, then he talks about motive and being unhelpful. And then at the foot of the page, right at what should be H, what falls to be considered is the nature of that for which the payment has been made. This becomes familiar language.

At page 334, he expresses the conclusion at E that aided by the word, pictures or descriptions of a capital asset which the decided cases contain I consider the tie of the kind now being examined as a capital asset and he reflects the lease/sublease tie structure.

On page 335 at D through E, he starts talking about the fruit and the tree as well.

Lord Pearce is the third Judge in the panel and obviously because he's already taken the burden of expressing the Privy Council's view in *BP* he decided he could write a one-page judgment and it's about the lease/sublease being materially different in form and substance at C to D. The interest in land is capital dominates other considerations.

Lord Upjohn just dismisses the submission for the taxpayer. He sets out the argument that Your Honour Justice Young has raised with me about the form or the economics of the premium and the day-to-day gallonage at the top of – he starts the

discussion at the bottom of 339 over to page 340 and the cloak that must be pierced through the lease/sublease procedure. I am unable to accept these submissions. It was a real transaction representing the realities of the situation and it's anchored in the lease/sublease capital which he says on page 342 at C.

He then goes on to discuss some of the more difficult questions that arise by reference to the length of the tie and I won't take you through that.

Lord Wilberforce is the last Judge in the panel and he explains the position and this speech is probably the most often referred to and it certainly is the Privy Council's judgment in *Wattie* where Lord Nolan adopted substantial parts of it.

Lord Wilberforce starts his discussion really at page 348 at C. I begin by asking two questions which may be said to be generally relevant. What is the nature of the payment and for what was the payment made, together with a third question, namely, how that for which the payment was made was to be used as stated by Sir Owen Dixon in the *Sun Newspapers* case which we've seen and then he goes into Dixon's formulation in *Hallstroms* and then readdresses himself in terms of –

WILLIAM YOUNG J:
I think Lord Upjohn was in the same camp as Lord Reid. So by my count that's three of the Lords were of the view that there didn't have to be a lease and sublease for the transactions to be on capital account.

MR HARLEY:
I think that's right in terms of the headcount. The fact that there was a lease/sublease created capital, all the Lords agreed with that. The others –

WILLIAM YOUNG J:
But three of them didn't think it was necessary in the case of the long term.

MR HARLEY:
As we'll see, Lord Wilberforce is the most extreme in saying that that doesn't make any sense to him.

WILLIAM YOUNG J:

I hope it's not a carping criticism but you are taking us to what in the sense is a minority position. Perhaps it's been sustained in later judgments.

MR HARLEY:

Well, I'm not taking you to the minority position, Your Honour. I'm taking you to the unanimous decision of the House of Lords.

WILLIAM YOUNG J:

No, but unanimously it's enough for it to be on capital account if it's connected to a lease. By a majority, it doesn't have to be connected to a lease.

MR HARLEY:

Yes, that's where they get to.

GLAZEBROOK J:

Although then I suppose you'd say that's because they would see those longer-term things as part of the capital structure of the business. They're part of the capital structure of the business because they confer a long-term advantage on the business under just normal convention principles so that they are an asset of the business. Well, they are an asset, in a sense, I suppose.

MR HARLEY:

They're a capital asset.

GLAZEBROOK J:

A capital asset as against a revenue asset.

MR HARLEY:

For that reason because they prescribe capital assets and that's what *Van den Berghs* is about and that's why they contrast *Van den Berghs* on the one side with *Anglo-Persian* on the other. In *Anglo-Persian* the agency agreement was 20 years. So here with Lord Wilberforce addressing what was question C of Sir Owen Dixon's formulation in *Sun* being 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 provisional payment so as to secure future use or enjoyment. Now, this becomes critical in terms of Lord Wilberforce's view of the

lease/sublease. He explains at the bottom of this paragraph that the premium paid for a lease produces an asset for future use. The rent paid under the lease which is for current use, the first capital, the latter revenue, I find it helpful here. Then he explains the lump sums providing an asset secured and why that was a capital payment for an asset to him. Now, that's in the passage A through C.

Now, Justice Young, you'll find yourself in the camp of Mr Burn in making the submission in terms of the proposition you put to me, page 349 in the middle. The appellants bring forward two arguments at this stage. They say firstly truly enough that the sums or premium were calculated by reference to the gallonage. Correct. That's what Lord Denning said. It simply confuses the measure of the payment with the payment itself.

A more elaborate form of the argument was that the sums were circulating capital because Regent expected to get its money back out of the current profits as sale gallon by gallon, day by day is made. Of course they did. Then he explains that many traders, and this was your proposition pretty much word for word so I'm happy with all of it in terms of the concept and for reasons we'll come to he rejects it outright. The form of the agreement, the lease/sublease for him is controlling but he puts it in a very elegant way on the next page at page 350. The nature of the asset or advantage gained, there are possibly two ways of regarding it. The first is to treat the payment as made for a lease from five years to 21 for a legal estate and land. The second, which I prefer and which fits closely with what Sir Owen Dixon said in *Hallstroms*, is to treat it as made for the granting of the lease which was as part of a single bargain the subject of a sublease containing the exclusivity covenant. So regarded, the payment was for a solid recognisable asset, evidently to my mind, of a capital nature.

Then importantly – and this is probably the passage that most clearly explains the difference between *BP* and *Regent* – it was transferable in a limited market, no doubt, but in that market it was valuable. It was a source or foundation for the earning of profits through orders for petrol to be placed under it. It can fairly be described as a piece of fixed capital which is to be used in order to dispose of circulating capital.

WILLIAM YOUNG J:

Does he say that the lease and sublease arrangement was critical to the conclusion? I know he regards it as effectively enough to justify the conclusion of the transaction with capital but he does refer to the Scottish case at the bottom of 350 which doesn't seem to have been a lease or sublease case.

MR HARLEY:

That's the *Commissioner of the Inland Revenue v Coia* [1959] SC 89 (Scot IH (1 Div)) case?

WILLIAM YOUNG J:

Yes he does and he holds that that's right and to answer your question, Your Honour, he says a little later in the speech that he doesn't want to anchor his reasoning in the length of the tie or in the lease/sublease itself. It's the combination of, as he puts it in the passage at 350, but then when we come to Tucker's case he explains it as an identifiable asset case. So time has moved on. But, Your Honour, to deal with the transparent form of the lease/sublease and the commercial reality which is what you were putting to me he deals with that squarely at page 351 and rejects it outright. So it's in the passage from B through D.

GLAZEBROOK J:

How long would the ties in *BP* or did it depend?

MR HARLEY:

It was argued on the basis that the average of the ties was five years. Some were 21 and some were three.

GLAZEBROOK J:

It's relatively difficult to reconcile those cases, isn't it?

MR HARLEY:

Well, Lord Nolan explained to us that it was him that made the agreement to argue the case in *BP* on the basis of the average because it was too difficult to deal with the extremes. The reconciliation in principle can really only be justified by reference to the lease/sublease anchored in land and while some of the –

GLAZEBROOK J:

But that seem to be necessarily the reasoning.

MR HARLEY:

Well, it becomes the reasoning and the Court of Appeal adopted it subsequently in the *Birkdale* case where there were both types of agreement in issue. It's easy to understand, Your Honour.

GLAZEBROOK J:

Well, I think it's only – what your argument is that it can only be referable to the lease/sublease otherwise there really isn't any difference between the cases.

MR HARLEY:

Because the commercial effect of them in respect of the payments is identical. That's why the payments were made.

WILLIAM YOUNG J:

But it's odd, isn't it, that Lord Reid thinks a 21 year tie in *Regent* is plainly on capital account in respect of a structure. Nothing is said about that in the *BP* where it would appear that at least some of the ties were that long.

MR HARLEY:

Yes, they were that long.

WILLIAM YOUNG J:

Yes, so it is, as Justice Glazebrook indicates, a bit odd and you say you think it's because the case was argued on an assumption.

MR HARLEY:

Well, I know that's the case but I know that was the assumption in terms of the five years in *BP* but just going back to Lord Reid in respect of the 21 year tie and why that was inherently capital the reason for that is because he's putting into the *Van den Berghs* category and not putting it into the category of *Anglo-Persian* and the *W Nevill* kind of case.

GLAZEBROOK J:

One can sort of understand that if you're looking at one agreement but it becomes difficult in the *BP* case when you're talking about a whole pile of agreements to build up the business structure whether for five years or 21 years to say that's clearly on revenue account unless you look at it as a rebate on price. But in fact that's not because you will often have purchasers that will then allow you to buy cheap or more cheaply so in theory there's not much distinction between that. I mean, yes, if you were buying one of them because the one next door, their analogy of the row of shops I can understand but this wasn't. This was a whole business structure and presumably there was a limit to capacity so the fact that you weren't going to be monopolistic, well, one you mightn't have been able to be monopolistic, I don't know about the particular trade antitrust provision but you may not have been able to be monopolistic but in any event your capacity may not have enabled you to be monopolistic in any event, even had you wished to be and even were you allowed to be.

MR HARLEY:

Well, I think the history of oil companies is that if they could be monopolistic they would be.

GLAZEBROOK J:

I'm sure that's right.

MR HARLEY:

But to respond to that, I think that the way to understand the cases and this is both of them is that in the early 1950s because of Shell it starts a marketing war and the war fundamentally affects the way each of the oil companies is able to place their trading stock into the garages for sale and so there's a passage in Lord Pearce's judgment in *BP* where he says this is a fundamental change to the way they conduct business and because it's a fundamental way to the way they conduct business you can't treat this as trivial.

GLAZEBROOK J:

But that actually all smacks capital to me.

MR HARLEY:

He reflects exactly that as an initial response and then starts to explain it's just another way of selling petrol to the wholesalers. They had to change the way they did it. But it's the same business selling petrol to retailers.

I think the point about where we get to with these cases is, you know, they've been treated as definitive now for nearly 60 years. They've been applied repeatedly in New Zealand Courts in my submission slightly too late to go back and attempt to rewind the clock and the most recent reflection of it in New Zealand is the *Birkdale* judgment, as I've said.

GLAZEBROOK J:

Well, we're not dealing with trade ties so we're not trying to rewrite that. We're trying to extract principles from them that might be applicable in other cases. Nobody's really quibbling about the principles. It's the application of them to the particular facts and the issue about whether they're reconcilable.

MR HARLEY:

I agree with you and the basic difference between the two as they're explained is one treats the tie as an intangible and treats that as much more difficult through the hoops that we've gone through. The other treats the trade tie through the lease/sublease and interest in land clearly capital and whatever you think of the articulation of the reasoning at least we've got a rule that's been applied for years since.

WILLIAM YOUNG J:

Have we got *Birkdale*?

MR HARLEY:

Yes. That will be in volume 2 or 3 of the materials and I think it's right at the end. Volume 2 at tab 25. In addressing Your Honour Justice Young's curiosity, the starting place for the cases to understand that it's a receipts case not a payments case, the receipt is to the garage owner. The garage owner is arguing that this receipt is a capital receipt because it affects the trade tie and alters the structure of the business. The Court of Appeal said no it doesn't. The nature of the trade tie is an ordinary incident of the petroleum marketing framework in New Zealand from 1988. They then go on to consider a different set of transactions which are described

in the judgment as Kenlock 2. Kenlock 2 is the lease, sublease method and they hold the treatment as different and capital.

ELIAS CJ:
What other authorities are you going to want to take us to?

MR HARLEY:
I now need to move to Australia.

ELIAS CJ:
Can I have some sort of indication as to what sort of progress you think you're making?

MR HARLEY:
We should be finished by mid-morning tomorrow.

ELIAS CJ:
Excellent, thank you.

MR HARLEY:
I'm now going to Justice Burchett in the *Ampol* case in the poet's dream and *Ampol* and *Goodman Fielder*. *Ampol* is 45. This case is not easy to understand and requires a reasonably close reading of its facts but then you could say that about most of them.

Ampol Exploration Limited is the taxpayer and it is part of the Ampol Group. Ampol was, in the olden days, an Australian listed company selling petrol. So Ampol Exploration, as the headnote has it, was engaged in the exploration of hydrocarbons. It claimed to be deductible under section 51 of Australia's Act in respect of the expenses incurred in respect of the exploration off the China coast pursuant to the agreement with the Chinese Government.

I'm pausing, Your Honours, because I'm just thinking about where section 51 is actually quoted in one of these cases. I'll come to it but the essential point –

GLAZEBROOK J:

Can I just take you back? You said Ampol Exploration was part of the Ampol Group then you said something about a retailer. Which was the retailer?

MR HARLEY:

The parent.

GLAZEBROOK J:

Okay, thank you.

MR HARLEY:

So section 51 of Australia's Act has got three rules which, as we've rewritten our Act is the same three rules as we've got. Rule 1 is the general permission that says the statutory nexus in respect of expenditure is deductable to the extent it's incurred in production of assessable income. Rule 2 says that expenditure which is incurred in the carrying on of a business for the purpose of producing assessable income is deductible and rule 3 says the capital limitation and we've just split that out. But otherwise these sections, we've always used these cases as being pretty much interchangeable depending on whether you think they happen to be right or wrong in terms of decisions.

ELIAS CJ:

Well, the legislation doesn't provide any basis for distinguishing.

MR HARLEY:

No and New Zealand and Australia wrote their own Acts off the back of the English position in the late 1890s and so we've always had this statutory code for deductibility in the capital limitation.

Starting with Justice Lockhart, who's one of the two majority Judges, Justice Burchett with him, he explains in great detail the facts of this case and I will truncate that and try and keep it to a high level of principle. It's the taxpayer that's engaged in the business of exploration for petroleum in Australia and it's part – it's the exploration arm of the Ampol Group. It then talks about the various different exploration permits that it holds in Australia and elsewhere and then goes on the role of Mr Harris at page 547 who is the Chief Executive of the taxpayer, becomes interested in

developing a relationship with the People's Republic of China and takes the company into an extended and artful negotiation with an arm of the Chinese Government in order to seek to develop a relationship so that it can conduct exploration activity.

The Judge explains this in considerable detail but explains at the bottom of 547 that it becomes involved in a programme of seismic investigation of the petroleum prospects in South China and the Yellow Seas and he explains in detail what the nature of that seismic exploration process was through a large part of the judgment.

Crucially as to understand what the agreement was between Ampol and the Chinese Government which he captures in the middle of 548. The survey agreement provides for the operator to conduct a geophysical survey over a portion of the designated area. So that it may be offered by the Chinese Government for the next phase of exploration and development on a competitive bid basis which won't involve the transfer of ownership of oil or gas resources. So the case is about spending money in respect of seismic exploration so that you get to the next step of being invited to bid again in a competitive tender. The detail of all that is explained meticulously by Justice Lockhart through many pages and I fast-forward now to page 555 of his judgment to the essence of the arguments between the two parties. It starts in the whole first paragraph. To the Commissioner, the argument is that the expenditure is not deductable because it's not within either limb of section 51, that is, not incurred in the business of producing assessable income and then separately the capital nature prohibition.

First, it's said to be expenditure that merely is to obtain seismic data and a right to bid competitively. Second, it said that the expenditure was antecedent to the commencement of the business of the oil production preceded the commencement of the business to be operated by another company or entity. That second point is what is called the preliminary expenditure point and where preliminary expenditure is incurred to start up a new business, it's not deductible.

The submission for the taxpayer is then advanced at page 556 in terms of what the character of the expenditure was. The principal activity is the exploration of petroleum. This activity is part of that exploration for the Ampol Group. It was the appropriate member of the group to enter into the participation agreement. The participation involved no more than the possibility of a right to bid to undertake for the seismic work as I've explained. There was no transfer of oil or gas resources

obtained, or could be obtained by this expenditure. The Judge then goes on at the bottom of 556 to explain what is the initial question as to whether or not the expenditure is deductible under the statutory nexus propositions in section 51 and he deals with this starting at the foot of page 558 and expresses his conclusion at the top of page 560. Rather than me read that to you it's just the whole of that paragraph at the top of page 560 where he holds that this is deductible expenditure within section 51.

He then goes on to discuss a special provision and moving on then to the second part of the Federal Commissioner's argument, which is the capital limitation, that's at the foot of 561. And perhaps predictably, but without criticism, he starts off with *Sun Newspapers* and we move on then to the approach on page 562. He comes to the conclusion that, "The payments were in truth part of the outgoings of the taxpayer in the course of carrying on its ordinary business activities. It was not expenditure incurred for the purpose of creating or enlarging a business structure or profit-yielding or income-producing asset." So the Judge is applying the identifiable asset test here in respect of intangible rights and, for reasons that are explained, these are somewhat unusual tangible rights, which is a right to continue to negotiate.

It then explains the principle, next, about the mining cases at page 562 which I have covered, and which he deals with in very clear terms. He then discusses a number of the authorities that deal with the various different types of expense. On page 564 he discusses the *Carron* case, in which I am going to take you to carefully. He then goes on to the *Softwood Pulp & Paper Ltd v Federal Commissioner of Taxation* (1976) 7 ATR 101 (VSC) case, which is an Australian first instance decision of Justice Menhennitt, where the Judge treated the expenses in that case as being preliminary expenses for starting up a business. So he concludes at page 565 in the middle whether the expenditure is of a revenue nature turns on the particular facts of the case.

Justice Beaumont comes to the opposite conclusion for the reasons that he gives. I won't take you through all of his judgment but there's one passage at 571 that I would draw attention to. Right in the middle of 571 the heart of his reasoning is, "But the taxpayer's business is that of the exploration for petroleum with a view to the development of any commercial discovery." It's not merely an explorer. "It's also concerned to develop any find for its own commercial profit… The second phase,

that of exploitation of the discovery, is critical for present purposes." So that's where they differ.

Then we get to the concurring judgment of Justice Burchett –

GLAZEBROOK J:
It would be slightly odd if just because you're a developer as well as an explorer, it changes the character of the expenditure.

MR HARLEY:
At this point, yes. If you have obtained –

GLAZEBROOK J:
Well I suppose actually if you're just an explorer then you're going to sell the –

ELIAS CJ:
Yes.

GLAZEBROOK J:
– rights afterwards so it probably does make a difference.

MR HARLEY:
Sorry, Justice Burchett then states his own reasons for agreeing. He too starts with the *Hallstroms* formulation and then explains, on page 574, what that means to him, and makes the obvious point in the paragraph that, "These concepts are easily applied to (and naturally fit) expenses in connection with the setting up or operation of a factory, but the comparison they require seems less appropriate for a series of exploration activities which may go on for years without the establishment of any productive field at all." Then he goes on and explains if the test can be sensibly in the case here then he explains how it is that, "The activities of which directed to the finding and commercial exploitation of undiscovered oil. But once the matter is so regarded, there is no longer any question: the expenditure is a quite ordinary incident of the company's operations." This is where we get to the poet. He says on page 575, "An oil exploration company does not expend its moneys upon, for example, seismic surveys, with any expectation of obtaining thereby an enduring asset, but upon the basis that if it engages in efforts of that kind often enough, whilst exercising what judgment the nature of the pursuit permits, one of its outlays may

eventually yield a rich return. The whole operation is in marked contrast to such a case as the *Hallstrom* case where the expenditure, though the result might be seen as doubtful," well he has to say that because the High Court of Australia subsequently has taken up the Dixon view about maintenance expenditure, and then, "it is only in a sense akin to that intended by the poet when he wrote that a man's reach should exceed his grasp that the respondent reached for an interest in oil in the South China Sea, and only in heaven could the result be predicted."

We say this passage is helpful to understanding what Trustpower is doing in its business as it seeks out opportunities including seeking resource consents in relation to the particular projects. And I'll come back to make that submission more carefully later. He goes on to explain why, for his reasons, he sees the nature of Ampol's expenditure in respect of what it was seeking to do, was being akin to that in *BP Australia* that found favour with Justice Dixon and Justice Kitto in that case and also in what he refers to as the *Vacuum Oil Co Pty Ltd v Federal Commissioner of Taxation* (1964) 110 CLR 419 case, which is the Mobil case.

The conclusion that he comes to then is expressed on 577 about the discovery process. Part of the constant demand of the enterprise, which Justice Dixon spoke of in *Sun Newspapers* is, "Of the kind normally pursued by the company in or near Australia, with a view to the rewards that exploration might bring." I am not going to take you to the cases of *Re Griffin Coalmining Co Ltd v Commissioner of Taxation* [1990] FCA 343, [1990] 21 ATR 819 and *Esso Australia Resources Ltd v The Commissioner of Taxation of the Commonwealth of Australia* [1998] FCA 851, [1998] 164 ALR 293 for the simple reason that they are preliminary expenditure cases, they are not relevant here.

That leaves me with *Goodman Fielder*. If you'll indulge me Your Honour I'll be quick.

ELIAS CJ:
All right. Carry on.

WILLIAM YOUNG J:
What tab?

MR HARLEY:
Tab 47.

WILLIAM YOUNG J:

Is that just the first instance report or is it the other one?

MR HARLEY:

No, this is Justice Hill as trial Judge in the Federal Court.

WILLIAM YOUNG J:

Yes. Was there not an appeal? I thought you said there was an appeal.

MR HARLEY:

No, not in *Goodman Fielder*. This is one of those reports where the headnote is completely useless to understand a case. A word from my friend here in terms of the importance of headnotes to explain what cases are about, are properly written. At the beginning of his judgment at 377 Justice Hill introduces the facts concerning Dr Watson and his role in terms of providing the payments to set up the Research Institute in the Queensland Institute of Technology, which led to the formation by Goodman Fielder, ultimately, of what was called the Mabco Division and what the case is really about. If I could fast forward through the material where the Judge comes to the conclusion that in respect of the set up of the research facility with the Queensland Institute of Technology, outside of Goodman Fielder's existing business, that is preliminary expenditure and not deductible, treats it as capital.

GLAZEBROOK J:

Sorry, where are you? I missed the page.

MR HARLEY:

I'll get to it. The issues are explained on page 384, what the assessments under appeal were. The essential point, Your Honour, Justice Glazebrook, is a timing case in terms of when they commenced the business. And this is as good a place as any for Your Honours to see section 51 in its full glory at the foot of page 384. So in respect of the period up to November '83, this is at page 385, the Federal Commissioner submitted, "That the applicant had not commenced business or its income-producing activity until the setting up of the premises in Slacks Creek, so that its pre-business expenditure was not deductible." He upholds that submission. And the reason for it is a proper concession for Goodman Fielder, this is on page 386, "That if the business claimed to be carried on by it was to be characterised as one of manufacturing and selling monoclonal antibody products, then that business did not

commence until around November 1982 when the move to the Slacks Creek Premises took place," and started there.

The case then goes on to what happened after that date and for the reasons that the Judge gives he holds that all of the expenditure was revenue account and he explains that from 387 through to the end. Important though to note that he's using for his conclusion a specific and special provision relating to research expenditure, most of what he says in respect of section 51 and the general permission is therefore obiter.

He starts his reasoning at 388 at the bottom by starting with *Sun Newspapers*, and Your Honours will have seen this now about 19 times, and he explains *Sun Newspapers* by reference to current and recurrent expenditure, this is in the middle of 389, and then he postulates the hypothetical with the pharmaceutical company and why a pharmaceutical company is always in the process of exploring for new pharmaceutical products in its research phase, part of its working expenditure and deductible on ordinary principles. He refers to *Ampol* and explains at 390 why *Ampol* is slightly different and then explanation he gives in relation to *Ampol* being slightly different is the nature of the right, or lack of rights, that *Ampol* could have secured by the expenditure. But he goes on to conclude, at the foot of 390, that there's much to be said for the view that the whole of the expenditure is deductible as part of the current operations of the business, not on capital account. He explains why that is at the foot, and then goes on to consider the special provision and upholds the taxpayer's deductions on the basis of section 73A being applicable.

That's it, in terms of the cases, except for two Canadian ones which I'll deal with quickly tomorrow. One is *Bowater Power Company Limited v National Revenue* (1971) 71 DTC 5469 and one is *Wacky Wheatley's TV & Stereo Ltd v Minister of National Revenue* [1987] 2 CTC 2311 (TCC), believe it or not.

ELIAS CJ:
Thank you, we'll take the adjournment and we'll resume at 10.00 am tomorrow.

COURT ADJOURNS: 4.05 PM
COURT RESUMES ON WEDNESDAY 9 MARCH 2016 AT 10.03 AM

MR McLELLAN QC:

Your Honour, should I perhaps first deal with that point that you raised with me yesterday about paragraph 132 of Her Honour's judgment in the High Court?

ELIAS CJ:

Oh, yes.

MR McLELLAN QC:

Yes, we agree that that is an error.

ELIAS CJ:

Yes, good, thank you, Mr Harley.

MR HARLEY:

Without wanting to muddy the waters, Your Honour, there is an alternative way to read the sentence that you've just referred to, but it's still wrong. The word "not" could be removed from it and then the sentence would read correctly the other way.

ELIAS CJ:

Yes. That's right. But it's clearly not what's intended.

MR HARLEY:

Just in terms of an update of where we're going and how quickly we'll get there, I'm going to refer very briefly to the *Fullers* case. I forgot to mention and go through *Carron* yesterday. I'll go through very quickly the *Bowater* but not *Wacky Wheatley*. It adds the same idea.

Your Honour the Chief Justice asked me to deal with in particular the nature of resource consents under the Resource Management Act.

ELIAS CJ:

Well, you probably don't need to deal with it. It was just a question that perhaps doesn't connect to anything very much.

MR HARLEY:

Well, the Judge does a good job and so it's very useful just to pick up on what she says. I have no issue to take with her. She's got that right. Then I'll get into the

most important subject which is what was the evidence. Then I need to deal really with the direct question of Her Honour Justice Glazebrook, which is why aren't these resource consents assets and that largely is a reflection and adoption of the judgment of Justice Andrews. That then leaves the question in the Court's comment as to what happens when a project comes to fruition and that then gets me to the fourth question which Ms Armstrong will deal with.

GLAZEBROOK J:

On that question, you were indicating what you thought the tax treatment was in your submissions. Does the accounting treatment accord with that?

MR HARLEY:

Yes it does and the cutting point is the difference between research where you don't recognise and may not recognise an asset and development when you are in the process of creating the asset and then the standard prescribes in very rigid terms when you are able to capitalise to the balance sheet.

GLAZEBROOK J:

Yes. I just must admit I thought that had vague memories with oil and gas that they might capitalise that they might capitalise some of that expenditure on exploration and the same with the drug companies. So that must be presumably in accordance with an accounting standard but I'm not entirely sure – or else they might just market the value of the assets in which case it would be irrelevant.

MR HARLEY:

The petroleum mining regime in the Income Tax Act –

GLAZEBROOK J:

I was thinking of accounting standards rather than the actual regime.

MR HARLEY:

And I think Your Honour is right. I think there is a specific standard dealing with petroleum mining but I'm not sure. With the research and development for drugs, that is NZIAS 38 and the standards are written – I wouldn't say with that industry in mind but it's not hard to conceive that the author was certainly thinking about that industry at the time.

The comment I wanted to make to Your Honour Justice Glazebrook in terms of *Fullers* is that the Judge actually did refer to *Fullers* and the report at 105 to 107 with the judgment but it's not relevant here. The footnote picks up the correct citation at 61 and my comment in respect of the judgment itself is paragraph 61 of that judgment is what I would describe as home in one as a proposition. That is the clearest exposition of the identifiable capital asset test there could be in terms of that expenditure.

ELIAS CJ:
What are you referring to?

MR HARLEY:
Paragraph 61 of the *Fullers* Court of Appeal judgment.

WILLIAM YOUNG J:
One of the cases you took us to yesterday afternoon, one of the Australian cases, I can't recall whether it was the *Ampol* one or the *Goodman Fielder*, the Judge says, well, identifiable capital asset is a good thing but not always required if you want to argue something that's capital. What do you say about that?

MR HARLEY:
I think it's *Goodman Fielder* but I'm not sure. What it reflects –

WILLIAM YOUNG J:
It also referred to a South African case.

MR HARLEY:
It also reflects Sir Owen Dixon in *Hallstroms* where the Judge reserves in a polite way whether *Hallstroms* is actually correctly decided. The proposition that I put to you is –

WILLIAM YOUNG J:
You say it's got to be an identifiable capital asset.

MR HARLEY:
Yes, I do.

WILLIAM YOUNG J:

Now, I thought the Australian Judge said, well, yes, that's a really good thing if you're arguing its capital but it's not necessary.

MR HARLEY:

And that's because Sir Owen Dixon in *Hallstroms* said for the basis for his dissent it's not necessary and here we have Federal Court Judges sitting with their own deference to Dixon's commanding authority in Australian jurisprudence.

WILLIAM YOUNG J:

So you say they're just wrong, he was wrong on that?

MR HARLEY:

Yes, I do and I said yesterday –

WILLIAM YOUNG J:

I missed the case. He didn't cite many cases that showed where expenditure was held to be on capital account otherwise and by reference to identifiable assets.

MR HARLEY:

Yes and to be fair to Sir Owen Dixon, when he is propounding these ideas starting with *Sun Newspapers* in the early 1930s he's not getting very much help from the other mainly English cases.

WILLIAM YOUNG J:

Well, except that at the later case that we went to, the *Regent* case, three out of the five Judges didn't seem to see an identifiable tangible asset as a requirement for a capital allocation, allocation of capital.

MR HARLEY:

Well, we went through that yesterday, Your Honour, and for the reasons that we exchanged my submission in respect of the very long-term ties is that the identifiable asset emerges from the length of the tie because it affected the structure of the business and that's the *Van den Bergh* case but we don't need to go over that again.

GLAZEBROOK J:

You have identifiable assets and the question is whether it's identifiable capital, isn't it, and that's what you say the long-term nature of it could make it a capital asset.

WILLIAM YOUNG J:

It's a chose in action and because it's a long-term chose in action it's capital.

MR HARLEY:

Going to the structure of the business. If it doesn't go to the structure of the business then it gets into the *Anglo-Persian* side of the divide. Carron's case hopefully sheds some further light on this. We rely on this case strongly. The case is about –

ELIAS CJ:

I thought yesterday you said that the temporal element was not of such significance, that you put it all on the structure of the business.

MR HARLEY:

Three of the five Law Lords in *Regent* clearly said separately from the lease/sublease that the length of the tie fundamentally affected the structure of the business and for that reason they would have held it was capital, I say because it's an identifiable asset itself. So they're treating the 21 year chose in action as an identifiable capital asset because of its nature. It's Lord Wilberforce who says most clearly he can't see that that makes any sense but for the reasons we went through the other three were pretty clear about that and to be complete about it, in *Birkdale* the Court of Appeal clearly expressed the same view that is of the other three.

ELIAS CJ:

So what is the effect of length? Is the effect of length that it may affect the structure of the business?

MR HARLEY:

Yes.

GLAZEBROOK J:

Or it's part of the structure of the business because a long-term supply contract could well be part of the structure. In fact, it could be the only structure of the business in some businesses.

MR HARLEY:

Yes. In one of the cases – it's not in any of the materials but I think the Judge refers to the *Thomas Borthwick & Sons (Australasia) Ltd v South Otago Freezing Co Ltd* [1978] 1 NZLR 538 case in the Court of Appeal where there was a long-term supply contract affecting either Canterbury Frozen Meats or Borthwick. I can't remember which it was. The Court of Appeal held that because of the nature and the fundamental effect on the marketing structure of – I think it was Borthwicks the payment had to be treated as capital and they adopted *Van den Berghs* to support that proposition.

If I could move to *Carrons* case, *Carrons* is a Scottish case before the Lords. It's in volume 5 at tab 52. The case is about a charter company which had a charter of ancient standing going back to 1773 and the company formed the view, or the management of the company formed the view, that it was unable to carry on business because of the nature of the very restrictive terms including about borrowing, so it set about securing from shareholders, the modification to the charter and the new charter. There were dissenting shareholders who launched legal proceedings against it. So the nature of the case is the company coming to settlement terms with the dissentients to get rid of them and so as to enable itself to adopt the new charter. The argument for the Commissioner was put in two different ways but both of them assert that the nature of the expense to Carron was to acquire a perpetual legal right which was fundamentally capital because it prescribed the structure and the way in which the business could be carried on.

WILLIAM YOUNG J:

So they acquired some shares on the basis that he promises never to bother them again and never acquire shares in the company again.

MR HARLEY:

I believe that's the first payment. There's also the legal fees. So with that –

ELIAS CJ:

So was legal fees plus the payments made?

MR HARLEY:

Yes, they treated them as the same. Lord Reid starts his speech at page 65. It deals very quickly with whether or not the expenditure was incurred to carry on the business and he says it obviously was so we get, really, to the serious issue as to whether or not it's capital. That's right at the foot of 67.

At this point, Lord Reid says, "I adopt everything I said in *Regent Oil* and I approach the question in that way." It's all in the middle paragraph from C through F and rather than going through it myself if Your Honours will read it then you will pick up the other two of the five speeches.

As an observation in respect of this passage but it comes through on a number of the speeches of the Lords across this, they're using classes of cases as the dividing line and you keep seeing *Anglo-Persian* as being on one side of the line which is the 20 year agency agreement, the payment there to cancel the agreement is treated as revenue. The demarcation point then is on the other side which are what they call the identifiable asset cases.

Lord Guest then gets to the second question at page 70 of his speech.

GLAZEBROOK J:

Just incidentally, it's interesting it was a new charter because in fact that is the structure of the business so they're really saying that you, by getting a new one, you're actually just repairing the old one so they really are looking at it in substance rather than form terms.

MR HARLEY:

I know this is slightly playing with words. I prefer the way they put it themselves which is to disregard the charter itself as being the end in itself. They're treating the charter not as the end in itself but as creating the framework in which the business can operate currently. That is an important point here and the Judge adopted it in her judgment. These resource consents, when you understand what they did and what they were used for, are not ends in themselves. Their primary purpose – and we'll get to this in the evidence – for this company was to make a decision using them as to whether it could move to second step feasibility. But it also provided the cost base that we went over yesterday but I'll move on to that when we get to the evidence.

ELIAS CJ:

I'm just trying to get a handle on this rather slippery distinction. The charter was not an end in itself but a framework for action or something.

MR HARLEY:

The current operation of the business.

ELIAS CJ:

The framework for the current – I see. It's very odd.

GLAZEBROOK J:

They were just repairing, maintaining the old charter by getting a new one that didn't have the difficult bits in it.

ELIAS CJ:

I'll defer to your explanation.

GLAZEBROOK J:

No, that's a substance argument, of course, which is the point I was making and so they obviously didn't put it quite that way.

MR HARLEY:

And I recoil at the word for obvious –

GLAZEBROOK J:

Yes I know that's why I said it.

MR HARLEY:

– and I suspect you're teasing me. In the passage then in page 70 Lord Guest adopts Lord Reid's approach in *Regent Oil* and he explains that there's no acquisition of the capital asset in the sense that it's used in accounting practice, but there was an advantaged was undoubted, but was it of a capital revenue nature, and he explains why, in his opinion, it's plainly of a revenue nature, that is, there is no capital asset. He uses *Hallstroms* and *BP* to explain that and then on the next page, at 71, he goes over to the other side of the line, drawing on that in *Van den Berghs Ltd v Clark*. *Van den Berghs* is the structural contract case dealing with the margarine

business. And then he crosses back, the line with the *Mitchell* case, which is the getting rid of unsatisfactory director and forms the view that the removal of these disadvantages enable the company's business to be carried on more efficiently to do its day-to-day trading. Lord Upjohn says he finds it difficult, but he agrees with the other Judges. Lord Wilberforce's opinion is more elaborate and responsive to the whole argument for the Crown. At page 73, first of all he dismisses outright the Crown's contention that the expense wasn't incurred for the carrying on of the business, and then he gets on to the second and difficult question.

This passage in the speech needs to be read carefully. He addresses the Crown's two arguments, one of which he describes as being far too radical and general for it to be adopted.

ELIAS CJ:
Sorry, where are we?

MR HARLEY:
The bottom of 73. "The argument for the Crown was put in two ways." It refers to the Solicitor-General's argument and refers than to the basis of it, which is the *British Insulated* case and also *Van den Berghs.* Then the key sentence here is the submission of the Solicitor-General right at the foot. "It might be true that no new capital asset could be identified as having been brought into existence, but this was not essential in order to confer the character of capital expenditure." And as we'll see, he rejects that submission outright.

The second submission for the Crown is over the page at 74, arguing that the company's constitution and charter was itself a valuable thing, and in that sense a capital asset. "So general an argument as the latter I am unable to accept. A change in the constitution of a trading company is not and cannot be regarded as an end in itself." And I adopt those words, not because of their formulaic effect, but because it is the practical and business point of view perspective about what is a legal permission, and I say it's applicable here in respect of these resource consents.

So then he notes that the difference between capital and revenue is by nature a commercial distinction, and then goes on to the demarcation approach that you've already – which he picks up later in his speech in *Tucker*. So he's going to *Van den Berghs* on one side, and *Anglo-Persian* on the other, and forms the view that this is

closer to *Anglo-Persian* and it carries the day. The important part of his speech is really to explain in relation to *Atherton's* case, but *Atherton's* case is an identifiable capital asset case, and that's on page 75. So the conclusion is in really the last sentence of the speech.

I'll deal very briefly with *Bowater*, which is the Canadian decision in its, at tab 55. There were two issues in the case, and it's the second one that we're concerned with. If you look at the headnote, it's the deductibility of outlays made by the appellant for engineering studies undertaken to explore means –

GLAZEBROOK J:
Where do we find that?

MR HARLEY:
Tab 55.

ELIAS CJ:
Sorry is this –

GLAZEBROOK J:
Oh this one, okay.

ELIAS CJ:
Sorry, before you pass on that, is that a test that you're urging on us, that a permanent and enduring thing?

MR HARLEY:
That is the identifiable asset test, Ma'am, yes.

ELIAS CJ:
Yes.

MR HARLEY:
That is fixed capital, the factory.

ELIAS CJ:
Even though not treated as capital in the company's accounts?

MR HARLEY:

Correct.

ELIAS CJ:

Yes.

MR HARLEY:

Yes, all the cases recognise, Your Honour –

ELIAS CJ:

Yes.

MR HARLEY:

There are circumstances where there are identifiable capital assets that are not in a company's account.

ELIAS CJ:

Yes.

MR HARLEY:

And leases are probably the –

ELIAS CJ:

Yes.

MR HARLEY:

– and goodwill can be standout examples –

ELIAS CJ:

Yes.

MR HARLEY:

– of both those. So if I just pick up briefly *Bowater*, the issue's explained in the headnote in that second headnote in terms of the feasibility –

ELIAS CJ:

Where's *Bowater*, sorry?

MR HARLEY:

It's 55, in the same volume. And then if we fast forward to page 833, the Judge deals with what has now become the third issue in the case at the bottom.

WILLIAM YOUNG J:

Sorry what page?

MR HARLEY:

Right at the foot of page 833.

WILLIAM YOUNG J:

It's a long case.

MR HARLEY:

From 833 he discusses the evidence that's before the Court. Authorities in Canada in respect of the capital income dichotomy and then on page 836 expresses the views as to the nature of the feasibility study costs, and then right at the bottom he adopts and starts to apply the approach taken in *BP Australia*, and then if you move over to the next page, at 837, you'll see also reference to *Hallstroms* and then in the middle he refers to the nature of the feasibility expenditure on a factual basis. A continuous evaluation and appraisal of not only power resources, but methods and operations. It seems to me, from a practical point of view, part of the current operations of the company. Then the key passage in his reasoning is at the foot of 837 over through 838. I simply make the submission with reference to that case that it is similar to, conceptually, what we're saying here in respect of this type of expenditure.

GLAZEBROOK J:

So it seems to me, picking up your development differs between research and development phases?

MR HARLEY:

Yes.

GLAZEBROOK J:

And it's capital once it gets to development rather than research?

MR HARLEY:

Yes.

GLAZEBROOK J:

It's rather a vast number of cases on that, it's not terribly helpful that he says at the bottom of 837 but it's – expenditure for the purposes of determining whether to bring into existence a capital asset should not always be considered a capital expenditure but without really saying exactly when it should or it shouldn't be. Not much authority either.

MR HARLEY:

Well, Your Honour has the opportunity to do both.

GLAZEBROOK J:

I'm really asking about other authority for that.

MR HARLEY:

I know of no other authorities.

GLAZEBROOK J:

Specifically on this point?

MR HARLEY:

Yes, other than the Australian cases that I referred to yesterday and which I'm deliberately not taking you to because they're all preliminary expenditure cases. They don't answer the question here. In order to introduce the next section, which is about the evidence, if I could just ask Your Honours to look at Justice Andrews' judgment where she correctly lays out the resource consent regime. While I'm content with all the paragraphs 57 through 61, it's paragraph 61 that's really the important one for present purposes. She says pursuant to section 134 – volume 3 tab 25 in the pleadings file – and also if you could just pick up the legislation volume 1, the purple one, go to tab 6, and Her Honour the Chief Justice will remind me that actually starting with the section is not a bad place to start. The Judge from 57 describes what Trustpower refers to its type 2 consents which are these and then explains the legal framework in respect of the Resource Management Act at 58 and

as she says a consent is permissive. It authorises a certain land use or activity that will otherwise not be lawful.

Then she refers to who is the holder of the consent and what the nature of rights are as between the holder and the landowner and it's 134 that she summarises in 61 in terms of the relationship between the landowner and the holder where the holder is different. The point about all that is that is this case. That then gets me to a detailed review of the evidence.

I thought carefully how to take the Court through this evidence and formed the view that the most efficient way of doing it was to follow the briefs rather than the roadmap in terms of the topics because they all draw on each of the different briefs. So the person to start with Dr Harker. He's in volume 4 of the case. That's the blue volume.

GLAZEBROOK J:
Can I just check you don't take any issues with the findings of the High Court Judge specifically?

MR HARLEY:
No, I rely on him.

GLAZEBROOK J:
Yes, that's what I'd assumed.

ELIAS CJ:
And we're going to this to demonstrate that she had evidence on which she was able to draw those conclusions?

MR HARLEY:
Yes and my submission will be to you that it's overwhelming. These are lengthy briefs and cross-examination and so I'm going to draw to the highlights only to understand the way these briefs have been structured, particularly Dr Harker and Mr Kedian. They'd originally provided draft briefs to deal with the Commissioner's position at the statement of position stage. At that point, the contention was for the Commissioner that Trustpower had actually committed to building each of these four projects and so those briefs in draft dealt to that proposition and then in the adjudication report it accepted that that was simply factually not correct and then

moved to the alternative, which is what we're now talking about. So these briefs now are amended to reflect what is being talked about in terms of the dispute before the Court.

Dr Harker had been a director and chairman on the Board of Trustpower since the beginning of 2000 and he represented through the period its majority shareholder which was Infratel. He explained the structure of his brief at 2.6 and if I could just draw your attention to it because it is the high level overview of what his evidence is.

Section 3 of the brief explains Infratel's investment in the company. Section 4 refers to the state of the New Zealand electricity market from the beginning of the 2000s period. Part 5 deals with Trustpower's place in the market and part 6 then gets to the heart of the matter which is the process for sourcing supply.

At 6.2 he notes that in terms of the matching of production to sourcing it's about 55% at that point between purchases from wholesalers and self-generation. The balance of the book then being matched from ASX options and long-term bilateral supply contracts with wholesalers.

At 6.3 he describes the build option and then at 6.4 he explains the reasons why having different options in Trustpower's pipeline is of strategic advantage to the company. In 6.4B makes the point that expanding the business is not Trustpower's purpose. All it wants to do is make more money, and it's a question of how to go about doing that from a shareholder perspective.

At 6.9 he starts – 6.8 sorry, he starts to explain what the buy option –

GLAZEBROOK J:
On your argument it wouldn't matter if they were looking at expanding the business because if it was just research you say it's not in the nature of a capital asset –

MR HARLEY:
Yes.

GLAZEBROOK J:
– until it's turned into development.

MR HARLEY:

At one point in his evidence he's just absolutely blunt. Trustpower will do anything in the electricity industry to make money. That's the business. So he explains in 6.8 the buy option in terms of bilateral contracts and ASX options. At 6.10 makes the point that it will postpone, and keep postponing, any development so long as it can get lower costs supplies from competitors. He explains why competitors will offer lower costs supplies and how Trustpower goes about evaluating them. That's at 6.12. Then at 6.14 he introduces the optionality that the development pipeline confers to the company. He explains in 6.15 that the development option is weighed up against other options such as the supply of contracts. It's got no predetermined bias as to which or which it will choose. It's simply a question of which will, in their judgement, provide the lowest cost base. He refers in 6.16 to options just being the ability to make good decisions. These options, he describes, is simply providing a chance. In section 7 he goes through the development pipeline and the economics that are adopted by the company. There are a whole lot of different factors that he refers to here in terms of market demand, competitor activity, the economy, newly identified projects and then in section 8 he gets to the decision-making process.

He explains the delegation by the Board to Mr Kedian generally, who was the general manager of the development process, the Board simply agreeing to budgets for the development expenditure and monitoring the process as it developed.

The important points about this section are that the feasibility process adopted by Trustpower proceeds in three broad steps, what they call first step feasibility, the third stage of which is whether or not to apply for consents. The second step of the feasibility is with the consents in hand to go through detailed engineering and technical and geotechnical analysis to see whether it's possible to build, and what the cost would be. The third phase is to develop what they call a business case, which would go to the Board, and where the Board would decide whether or not it would commit the money.

In section 9 Dr Harker refers to the difference for Trustpower between type 1 consents and type 2, and he adopts the type 2 conceptualisation of Mr Kedian, and he explains the strategic protection of holding consented options in 9.3. In 9.4 makes the observation the existence of consents simply pushes the project further along the continuum, which is to lead into the second step feasibility. 9.6, he explains carefully why the consent process is just one element in the feasibility process that Trustpower

follows, and that he can't understand the Commissioner's focus on the consents. He expresses his view that they're not separate from the other items of information that inform consideration of a project as a whole. That they maintain the pipeline because they want to acquire capital assets in the form of hydro wind farms in the right circumstances, but they simply don't know which ones. The consents are part of the assessment of each project. They're no more important or valuable than any other part of the feasibility analysis. He accepts, of course that a project can't proceed to construction without the consent but that doesn't mean that a consented project would proceed. 9.7 is where we get the evidence he looks at them as primarily defining the fuel. It's the fuel that he regards as the most important aspect in terms of what can be built, constructability and project economics.

ARNOLD J:
So in what sense is an RMA consent an item of information?

MR HARLEY:
In about 1200 pages of incredibly detailed material, the consenting authority will confer a prescription of the fuel that is available and when it can be used, and then secondarily will prescribe the basis on which those conditions can be exercised, construction may proceed, and then of course provides the operating consents once all that's done.

ELIAS CJ:
Is the answer that it's information?

MR HARLEY:
Yes, yes, it is. Every part of it is information and large parts of it are the company's own information. They are the ones that are developing the research data that underpin the entire consent terms.

In 9.9 Dr Harker explains who controls the spending of money, the Chief Executive is just using Trustpower's operating cashflows to fund the costs –

ELIAS CJ:
Sorry, can you just pause a moment? The fact that large parts of it are the company's own information is neither here nor there, is it?

MR HARLEY:

Well, it's simply a statement of fact as to the research data and how it is obtained and put into the consent.

ELIAS CJ:

Yes, I mean, there's still a cost in the company generating that information.

MR HARLEY:

And of course once it goes into the consent application it's public so it loses the intellectual property consent, if I can put that in a general sense, not trying to beg the question. The data becomes public and everything that embodies the AEE is public information. So he explains the Board process with the Chief Executive. The Chief Executive is the person who's authorised to spend the money and makes the decisions delegated, as in this case, primarily to Mr Kedian but as we'll see there's a whole team of the senior management that are at work here in making these decisions and he explains on the other side in 9.10 that the management spending money exploring and negotiating the renewal by extension of bilateral contracts and obtaining further bilateral contracts, these two are normal operating costs. In either circumstance, whether it's the first step feasibility or bilateral contract, Trustpower is simply spending money to appraise how it's able best to source wholesale electricity supplies. Each form of the option is just as attractive depending, of course, on securing the supplies for reliable periods at an acceptable price. It's just a continuous process of evaluation.

He explains in 9.12 that the cost of the process isn't what determines the value of the optionality and that the consents have no income earning potential separately from every other aspect of the options that are in the development pipeline.

In 10 he explains the structure of the balance sheet. The essential point about that is when they decide to spend all this money to build one of these projects they just borrow the amounts. Part 11, he explains the company's financial statements and why the Board considers that it's absolutely inappropriate to capitalise these expenses. Importantly in this section he says that at the time this was all being done in the years March 2006, 2007, 2008, in fact they gave no thought to what the accounting treatment should be. They thought it was obvious and they didn't get any advice about it from PricewaterhouseCoopers either so they expensed the lot just as a matter of course.

In section 13 of the brief, he deals specifically with the Wairau project which was a Board decision to proceed with obtaining the consent. That will become more relevant when Ms Armstrong deals with section 4.

He provided a second brief because at this point we had the benefit of Professor Evans' view as to whether or not consents could block competition in respect of either wind or hydro schemes and for the reasons that are set out in section 3 Dr Harker's view is, yes, a consent on a particular site can prevent competition in respect of that particular site. That's true. But it will not prevent competition on what became in Mr Campbell's evidence the next hill for a wind farm and there are a number of different examples of where there are competing wind farms in existence on different hills. The Tararua Ranges have got three different companies owning different wind farms all going at the same time.

WILLIAM YOUNG J:
It discourages – if there's a wind farm in existence doesn't that discourage not necessarily preclude but discourage a wind farm nearby because of the climatic conditions, the wind conditions are going to be the same meaning that generation is – they both generate at the same time?

MR HARLEY:
The word is "co-relation", yes, you're correct. He uses Tararua as highly co-related and shows that there are competitors to Trustpower. In fact, with one of them Trustpower worked together with the competitor so they could both get grid access at a lower cost.

WILLIAM YOUNG J:
I know but that's not quite the answer to the question. Doesn't it tend to discourage another wind farm nearby if there is an existing wind farm?

MR HARLEY:
Well, he says it doesn't.

WILLIAM YOUNG J:
He said it did.

MR HARLEY:

Well, he shows –

WILLIAM YOUNG J:

I know it can happen. I'm just saying I thought it did tend to discourage it.

MR HARLEY:

Well, his evidence is that from Trustpower's perspective they take the high co-relation of wind in the same geographic area into account when they're considering the prospectivity of a particular site and he refers to the Waverley prospect as being – as an example of why they do that.

ELIAS CJ:

It will, of course, depend on the circumstances because it may be that a consent in one location will effectively preclude a consent being given nearby on the basis that there are compromises in terms of the extent to which you want to compromise a landscape, for example.

MR HARLEY:

Yes, yes and Mr Campbell's evidence refers exactly that. We've got too many wind farms in this area and we don't want any more.

WILLIAM YOUNG J:

Just looking at 7.14 of his evidence, "As it is unlikely to be economic to build three wind farms in close proximity unless there is a significant change in demand. I venture that not all three could proceed." That's by reference to wind farms near Gore?

MR HARLEY:

I think he's there referring to Mahinerangi, Kairewa Downs and what was project Hayes, each of which is huge or was huge. The response to that is entirely a market capacity response. If the market is growing sufficiently, then there may be room for three, even though they are highly co-related, which is exactly what happened with the Tararua wind farms. So to answer Your Honour's question, the disincentive to a would-be competitor with the next wind farm in the same geographic area depends entirely on the circumstances of the market. If the market has grown enough or

someone has withdrawn production from elsewhere, there may be a very good opportunity for that person to enter, notwithstanding the co-relation and that is what happened in the Tararua Ranges.

With the hydro schemes, he accepts, of course, that in respect of a particular river the consent in relation to that particular river at that spot will, of course, preclude a competitor but there are examples which are given in the evidence of different competitors on the same river and rivers next door to each other each having consents and the obvious example for that was in the West Coast of the South Island with the Arnold scheme and Meridian Mahinerangi. But there were also coal schemes and the Buller Amethyst hydro scheme as well which he refers to in 3.3.

His view is that the fundamental effect on competition in terms of particular geographic areas is likely to be determined by transmission capacity more than anything else.

In Part 4 of the second brief – this is in response to an expert called for the Commissioner – Dr Harker just rejects outright the proposition that was argued by Mr Hucklesby that the company's accounts were materially misstated for financial reporting purposes. We don't need to deal with that. It's not an issue now.

In the cross-examination which is at tab 31, there's an exchange that starts and really continues over many pages with my friend as to whether or not a consent has values which starts in the middle – and I'm using the page references here at the bottom of the page, the case references 554, where Dr Harker's response is the value comes from the kilowatt areas to be produced by the farm. Then he discusses the optionality and how it works and the questions then focus on the Commissioner's view that with a consent the company has a benefit from being able to choose the time at which it might proceed or to defer and the substance of the exchange is Dr Harker saying repeatedly the value of deferral is nothing because Trustpower has no compulsion at any point to do anything, so it's simply an ability to choose, when it wants to, to proceed or to do nothing.

GLAZEBROOK J:
What is the timeframe? How long does it take to – presumably somebody sends this to construct once you have decided to construct.

MR HARLEY:
Yes, somebody does say that.

GLAZEBROOK J:
Right, and you'll come to that, will you?

MR HARLEY:
The answer to the question is for a wind farm in the order of a year to 18 months, obviously, depending on the size. For a hydro scheme of the substantial nature like Wairau, which is canals running 47 kilometres with six generators and for the Arnold scheme canal running for 12 going through the middle of the railway line and one or two generators between three and four years could be longer. In fact, the second step feasibility process for wind and for these hydros are also substantially different in terms of time.

So the summary of the position between my friend and Dr Harker is at page 560. The exchange next deals with the Board's deliberation relating to the Arnold scheme at page 566. The point about this which we'll come to a little later is those documents that Justice Young was referring to, but the essential point in this exchange is the Board's supervision, if I can put it that way, of the potential economics of the project and intervening in respect of what is called the Taramakau diversion, saying that it's not satisfied with the project economics being close to acceptable. The diversion was to reverse the flow of the river to increase the flow into the canal and the Board was saying hang on a minute, we are very uncomfortable with that as a proposition, let alone with the economics. So they intervened and said, "We want more work." The document you were referring to yesterday was in the middle of that. The Board is saying, "You can go ahead if you want to buy land because the value of the land won't change that much. We're not making any decision about whether or not the project would change. We're not satisfied with it." So it's saying to the development team, "You go away and do a lot more work on this before you go ahead with the consent process."

I was having an exchange with my friend about the importance or otherwise of complete land access at page 574. In the exchange, Dr Harker is saying his view is that land access is fundamentally important because you can't do anything without it. There's an exchange then that continues about how much of a risk the company was prepared to take in terms of proceeding with consent applications without complete

access which is, in fact, what they did. At 581 there's an exchange with Dr Harker about the fundamental importance of the consent terms. This is the section where he explains his view about the most important information coming from consents is the fuel and he explains the huge numbers that are involved in relation to Wairau with every cubic of water that was removed from the application. Each cubic of minimum flow is between 10 and 12 million on the present value.

Then we get into an exchange between Dr Harker and my friend as to competitive relationships at 582. There's a discussion about Meridian with its Project Hayes and Trustpower with Mahinerangi and the relative merits Trustpower saw with Mahinerangi relative to Project Hayes and whether there was benefit in having a first mover advantage in terms of completing the consenting process for Mahinerangi before Hayes was brought forward.

Then there's more about land access issues in 590 when they're discussing Wairau and the nature of the process that Trustpower adopts when formulating resource consent applications to spend the absolute minimum that's necessary for design. It's about 10% in order to get the broad framework. They talk about the shape of the envelope.

ARNOLD J:
So given that the Board intervened to stop the applications for resource consent in relation to that Arnold River thing that you talked about, before the resource consents are applied for the Board will be satisfied that the sort of economics stack up to some level?

MR HARLEY:
Yes. It's not that the Board said to management, "Don't you go ahead and make that application now." That's not what happened.

ARNOLD J:
I thought that's what you said.

MR HARLEY:
"We're not satisfied with project economics and with the Taramakau diversion. We think you need to go and do some more work," and Mr Kedian says in cross-

examination that it would have been a career-limiting move on his part to have gone ahead and made the application.

ARNOLD J:
Well, that must be right so in reality the Board did intervene and did prevent it.

MR HARLEY:
And supervises closely the whole process by which Trustpower is evaluating project economics, constructability, buildability, and they're also acutely concerned about what these projects look like to the community. There's evidence, for instance, in respect of the Marlborough market where there was a great deal of opposition in terms of the Wairau project. That is one of the largest customer bases for Trustpower and they were acutely careful not to alienate that customer base because it's fatal if you do that. So the Board and management are working together across the whole spectrum of managing a process reflective of a market.

ARNOLD J:
I guess the point is that there is a hurdle that has to be overcome before – and there may be a whole lot of elements going into the analysis before resource consents can be applied for.

MR HARLEY:
Yes. In 595 to 596 there's a discussion with Dr Harker about what he knew about the offer made by one of the competitors for the Kaiwera project and Dr Harker was aware of the existence of it and then not aware of anything more and, as we'll see from Mr Kedian's evidence, it's because he didn't take it seriously and didn't pursue it. So that exchange continues over 598 and then we get back to land access agreements and the exchange between Dr Harker and Mr McLellan about four key benefits that a purchaser would acquire in respect of Kaiwera, the land access, the resource consents, the intellectual property, and the future prospects of profit. Then he raises the question in the bottom of 599 over to 600 and the answer comes back to this is a package and the land access agreements are of fundamental importance and why that's so.

ELIAS CJ:
What is the point for which you're taking us to this?

MR HARLEY:

Because the Court of Appeal regarded the existence of this indicative offer which was for the package as supporting the proposition that the consents stand alone had value and we say that just can't be right on the evidence at all but it's also entirely in hindsight because this occurred in April 2010. We're talking about March '06, '07 and '08 and nothing of that nature could ever have been in contemplation.

ARNOLD J:

Can I just – "nothing of that nature could ever have been in contemplation", what do you mean by that? Do you mean that Trustpower would never think, well, we've done all this development in terms of this potential project. We're not going to develop it ourselves but if a competitor wants to buy us out we're perfectly happy for them to take the package. I mean, isn't that a sort of rational thing to have in the back of your mind when you're looking at possibilities, incurring expense, that if you don't develop it you might be able to sell the concept?

MR HARLEY:

In theory, yes, and the company certainly acknowledges that that was a theoretical possibility and Dr Harker says if the price was right he would have sold it. But the point in respect of the particular competitor here that was making the approach is that no one would have known then in '06, '07 and '08 that project Hayes would be in very serious trouble in 2010 and that's what prompted the overture.

ARNOLD J:

Yes, I certainly accept that but I guess all I am saying is that the general possibility is always on the table.

MR HARLEY:

This is a company that deliberately and constructively expands its options in the way it thinks about how to make money.

ARNOLD J:

Yes.

MR HARLEY:

I take your point that's exactly how they think across the spectrum.

He explains the royalty structure at page 601 and then moves on to the exchange at page 604 with my friend referring to research and ability referring to the first stage including the preparation of the resource consents.

They then exchange views about the consenting process in the context of consulting and the importance of consulting to make the points that I've already covered. That's on page 610, 611 and 612. Then there's an exchange about the purposes of some of the content of the AEE. I'll come to this in more detail with Mr Kedian but the example that's being discussed with Dr Harker is the road transport reports and then moving on from there there's the role of the consultants being instructed and the basis on which they're instructed to prepare the research material that ultimately finds its way into the AEE chapters. That's at page 624, 625.

At 632, there's a discussion about the Board itself making the decision to proceed with the Wairau consent and at page 644, 645, 646, 647 there's an extensive exchange with the witness about the package and its potential value and his view that the consents themselves are zero on their own. Somewhere in here Dr Harker makes it absolutely clear that his view is that consents, unless they're stapled to complete land access and those are his words, are not valuable and not useful to the company.

O'REGAN J:
They must be useful to the company. I mean, the value of knowing more about the project and being able to make a better decision about it. That certainly has value in a non-accounting sense, doesn't it?

MR HARLEY:
It's good knowledge, yes, and I agree with you.

WILLIAM YOUNG J:
So why do you say – does Trustpower never use compulsory powers of acquisition, never seek to use?

MR HARLEY:
Correct.

WILLIAM YOUNG J:

What about other generators?

MR HARLEY:

I don't know, Your Honour.

WILLIAM YOUNG J:

Do they discuss that in the evidence? I've seen it alluded to but only in general terms.

MR HARLEY:

Yes, there is. That is between my friend and Dr Harker and whether or not Trustpower was or would become an acquiring authority.

GLAZEBROOK J:

Is it 638?

MR HARLEY:

Thank you, and he says it's not an acquiring authority and it's not how the company views the world or thinks about the world.

WILLIAM YOUNG J:

Did he explain why?

MR HARLEY:

Not in evidence, no. But it's not very hard to think that a company as distinct from the Government taking someone's land compulsorily is a very serious step when you're in a market and people have their own views about people who exercise that kind of power.

WILLIAM YOUNG J:

Yes but if you've got 59 out of 60 required blocks of land you don't necessarily want to be held to ransom by the 60th owner.

MR HARLEY:

Well, it's a Mexican standoff, isn't it, in terms of just how far you're prepared to go to push that line.

GLAZEBROOK J:
He does say at that page I referred to it would be a last ditch approach so presumably in that situation they may do so.

MR HARLEY:
Well, this is a company that keeps its options open. So with that, if I could go now at about, hopefully, the same pace through Mr Kedian which is in volume 5. In the first parts of his –

O'REGAN J:
Is his evidence essentially the same effect as Dr Harker's or are there differences? I mean, is he really saying the same thing about the pipeline, the use of the consents, the fact they don't have value unless they're stapled to land and so on? Or does he add something to that?

MR HARLEY:
What he adds to it is how the feasibility process itself is undertaken. A large part of the evidence he gave became irrelevant because there was an argument about whether it was in three steps or 24 and he said he'd never heard of 24. It was three and as the Judge said, well, no one ever argued that it wasn't just three so we move on from there.

The point in terms of the evidence that he does give and he says it several times in his witness brief and then in cross-examination is fuel, the primary purpose of the consent is to enable the company to move to second step feasibility if the terms of the consent are satisfactory and it thinks that there is a prospect that something's constructible and buildable.

O'REGAN J:
But that's essentially Dr Harker's evidence too, isn't it?

MR HARLEY:
Yes so with that hurry-along the exchange between my friend and Mr Kedian is all along exactly the same lines as we've already seen.

ELIAS CJ:

And you've given us the page references in your roadmap?

MR HARLEY:

Yes, I have. That then gets to Mr Campbell. Mr Campbell succeeds Mr Kedian and the evidence primarily given by him affects three different matters. The first is he explains how Mahinerangi stage 1 came to be recognised by Trustpower as a prospect and then proceeded to be constructed. That's outside this period.

The effect of that evidence is to illustrate a range of different factors that come into existence that were unknown at the time these consents were sought and we'll get to answer the Court's questions as to what happens, what is the correct tax accounting treatment, when a project comes to fruition, which Mahinerangi stage 1 did outside this period.

He explains in detail the Arnold scheme which they did take into the first part of first step feasibility and gives quite a lot of detail about that and why the Board agreed to suspend that process after having spent several million. I think it was Justice Young yesterday asked me whether anything further had occurred with Arnold since then. The answer, I am told, is no but it is sitting there and they're watching it to see if there's anything that might turn up that's prospective.

The third part of his evidence is to explain two different projects or prospects in respect of the transfer of resource consents that Trustpower itself has been involved with. The first involves what is called Esk Valley. Esk Valley involves the purchase of a company which had land access rights and the suite of consents and he explains why the consents themselves were not of great value to Trustpower because it then had to go through its own feasibility process through the second stage in order to see whether or not it was buildable and through that they ultimately did build what is now the Esk Valley hydro scheme, all outside the period. With the other –

O'REGAN J:

That's not in the attachment we're dealing with?

MR HARLEY:

In the other – the point about the evidence is without the whole suite he wasn't interested. In relation to the Whetu wind farm prospect he explains how Trustpower

was able to step in and acquire the consents when the holder allowed them to lapse and it was the land access that was the most important. He regards the term of the consent as being highly problematic. So that's the effect of the evidence.

O'REGAN J:

So is his evidence basically that if you have the consent and you have the land access then you do have a valuable asset, an identifiable asset? It's only when you've got those two altogether all the land use consents you need, presumably water consents or whatever else you're doing and the access to all the land you need access to, to build it.

MR HARLEY:

His evidence was what you then have is the ability to move to stage 2 of the feasibility process. He's not expressing a view to answer the question that's before the Court in his evidence. He doesn't describe it as an asset in the sense that we're talking about. I mean, the consents as an asset on the sense that we're talking about.

O'REGAN J:

So that doesn't arise on the facts of this case a situation where, going into stage 2, they did in fact have not only the consents but also all the land access arrangements they needed?

MR HARLEY:

They did with Esk Valley.

O'REGAN J:

Right but that's not our concern in this case, is it?

MR HARLEY:

Correct and to go backwards they did ultimately with Mahinerangi stage 1 because they were able to complete grid access and they were able to complete a number of other aspects in order to make that part of that project embed into the Dunedin city network, all after the event.

O'REGAN J:

Right, but you're not contending for a position that says even if you do have the consents and all the land use arrangement you need you can deduct your expenses from then on as revenue expenses?

MR HARLEY:

If I needed to make that submission I would do so.

O'REGAN J:

But you don't need to?

MR HARLEY:

I don't need to.

ELIAS CJ:

Except that doesn't the argument you've advanced to us carry the implication that it wouldn't be to revenue account?

MR HARLEY:

Yes it does, Your Honour, and the reason to keep to the principle here and why I answered the question in the way that I did is if your process with the suite of consents in your hand and with complete land access is to then determine is it feasible for me to design, build and construct economically whatever the subject matter is. I say that is still feasibility research expenditure because you have not crossed into and are not capable of crossing into development.

ELIAS CJ:

Even though you have an identifiable asset?

MR HARLEY:

You don't. You may have. That is the future prospect.

GLAZEBROOK J:

Although you agree the land consents because of being land would usually be on capital account, in any event, or not? Because remember we discussed yesterday

about land being in a special category but I realise land access consents are perhaps slightly different.

MR HARLEY:

The way I'd answer the question, Your Honour, is in two steps. If you look at the facts in cases like *ECC Quarries*, *Milburn* and *Waste Management* in each the company owns the land and has made the commitment to develop the mines. Everything that it is doing, then, is in the process of development of the land, improving the land, to get to operate the business or capital. The second step backwards from that is if you have a complete suite of consents at the stage these consents are, which is about 10% of the design that's necessary, in order to be able to make the decision as to whether or not you're going to commit to improve the land, you have to complete all that work and everything that goes with constructability, engineering, and economics and at that point you may well be in a position where you can then commit to improve the land.

GLAZEBROOK J:

Well, if you flick the land consents, though, I would have thought that would normally be on capital account no matter what unless you're in the business of trading in land.

MR HARLEY:

When you say "flick the land" …

GLAZEBROOK J:

Flick them on, sell them.

MR HARLEY:

Yes. With the land?

GLAZEBROOK J:

Well, in some cases we're talking about land access options that may not be – you may not own the underlying land. You may just have an option to have an easement, as I understand.

MR HARLEY:

Can we take it in two pieces, then?

GLAZEBROOK J:

We probably do need to take it in two pieces. Selling the land – if you own the land then that probably is on capital account, in any event, so there's no issue.

MR HARLEY:

It's the mine, isn't it?

GLAZEBROOK J:

That's right. Well, it mightn't even be the mine. It might just be a bit of land but it was certainly not on revenue account in the sense of being trading stock.

MR HARLEY:

Now to get to the second point, you're not the landowner and you don't have complete land access and the proposition is you sell the land use consents themselves. In order to answer the question, there is absolutely no market evidence in New Zealand that that has ever occurred and these witnesses say there is no value that they can perceive in respect of that transaction. So it's not a complete answer to you, Your Honour, but the hypothetical doesn't exist.

GLAZEBROOK J:

Well, I suppose that's really just coming back to say that's not a complete asset at that stage on any basis.

MR HARLEY:

Yes. So the Trustpower witnesses would say actually you've got nothing to sell.

O'REGAN J:

But your point is that in any event until you've committed to developing it it's not on capital account. That's the position you're asking us to accept.

MR HARLEY:

Yes, that is the position.

I'm now in a position where I can trot through very quickly the propositions in the fact base.

ELIAS CJ:

So the possible outcomes are we might accept that but if we don't accept that your fallback is that it doesn't cross the line because of the facts. Is that right?

MR HARLEY:

Yes, particularly incomplete land access or ownership, no grid transmission access and not possible to obtain it, and because of the state of the consents themselves in terms of the level of engineering design at about 10%. So to answer better the proposition that you've put to me, Your Honour, I'm asking the Court to accept the proposition that these consents are all about from Trustpower's perspective defining fuel to provide the platform for second step feasibility studies and it's because of that conception I'm saying, going back to cases like *Carron*, they're not ends in themselves. That is the practical and business point of view that I assert should be taken.

ELIAS CJ:

Yes, thank you. We'll take the adjournment now.

MR HARLEY:

If I could ask you, if you would, to read Justice Andrews' judgment that's what I'm going to use as my platform to answer the question that's been put to me by Justice Glazebrook.

ELIAS CJ:

I think we'll take the adjournment and we'll come back and if you want us to look at Justice Andrews' judgment at that stage you can take us through it, thank you.

COURT ADJOURNS 11.33 AM

COURT RESUMES: 11.51 AM

MR HARLEY:

Justice Andrew's judgment, just one point of clarification before I adopt her reasoning really in respect of the question we're arguing. This is at paragraph 74, having discussed the resource consents and the nature of them. She says with reference to the depreciable intangible property aspects of the consents, those consents don't

include the land use consents, and it's the land use consents which are significant in each of the four projects referred to in this case.

The Court of Appeal criticised that, and indeed went so far at 23 of its judgment to say that the parties accept that the suggestion that it was the land use consents that are significant, was not correct. I don't accept that at all, and it's not what I said in the Court of Appeal. In my submission the criticism that's implicit in the Court of Appeal's 23 is just unwarranted. She's reflected that view because of the evidence in respect of the stapled land access, and that's what she means by most significant. I did say in the Court of Appeal –

ELIAS CJ:
Sorry, that's what she means by most significant?

MR HARLEY:
She means they're more significant than the other consents.

ELIAS CJ:
Oh, I see.

MR HARLEY:
And I would adopt that and agree with it. I don't accept that I said they were, as the Court of Appeal says at 23, that I didn't support that part of her judgment. I do. There are two points. Obviously in respect of the whole suite of consents, you can't cherry pick one part, or other parts, and say they're more important, because without the whole suite you've got nothing. That's clear. But the point about the land use consents is, without them you haven't got the fuel defined, and you haven't got the ability to execute the project in respect of that land, and that's why they're significant. That's all she means, and I agree with it, and that's what the witness has said.

From that point, and really responding now, Your Honour Justice Glazebrook, to the submission as to why the consents themselves are not intangible assets on a standalone basis, but actually they're part of the whole underlying suite of the optionality, I start with the Judge's explanation of what was submitted to her from paragraph 87 and if Your Honours just look at from 87 through to 90, those are the submissions that were made to her by the parties. And I support the conclusion she comes to reflecting the submission that I made and rejecting my friend's. And the

evidence that she accepted in responding to my friend's submission at 91 is that she preferred the evidence of Trustpower and concluded that Professor Evans, in terms of the views he expressed, was wrong.

In the next part of her judgment, from 92 through 93, in my submission she rightly distinguished *Milburn* and *ECC Quarries*, to which I add *Waste Management*, for the reasons that I've already submitted in going through the cases, and it's why the submission is made that the consents in this case can't be seen as being separate or standalone. Now just in relation to that aspect, and taking up Your Honour Justice Young's question to me yesterday about that passage in the Arnold document, when you understand the context of that, it is an author –

WILLIAM YOUNG J:
Are you going to take us to that document?

MR HARLEY:
I can do, yes Sir.

WILLIAM YOUNG J:
Yes, I mean I sort of prefer the steak to the sizzle.

MR HARLEY:
I beg your pardon?

WILLIAM YOUNG J:
I prefer the steak to the sizzle.

ELIAS CJ:
We'll be here a long time.

WILLIAM YOUNG J:
That's one we haven't seen.

ELIAS CJ:
No we haven't seen it.

WILLIAM YOUNG J:

I'd rather see what the document is than what people say about it.

MR HARLEY:

Volume 1, tab 15, that's the core bundle, the white one.

WILLIAM YOUNG J:

So it starts in the middle?

MR HARLEY:

Yes and it's an extract. So this is a management paper to the Board, and when you work your way through the entire paper, you'll see that it is heavily infected with mathematical modelling. The substance of the paper is whether or not from a mathematical modelling perspective the purchase of land was or wasn't a sensible course for the company to adopt at this time. And the passage that you took me to yesterday, Sir, is at page 2845. That's the second paragraph. There are two points. The first, the author is expressly recognising the Taramakau diversion and the problems with it that the Board is itself focusing on. And then the author is expressing his or her opinion that there would be little downside in terms of the land as at the project at either of its stages would be very saleable as is. That's in November 2005 and we know that the Board never accepted that proposition for the simple reason that land access was not then secure and isn't now and the Board was very concerned about the prospects then of the Taramakau diversion being included or not included in the scheme. So it's simply a reflection of what the author thought, not what the Board thought. Dr Harker's evidence in cross-examination was very clear. The only issue before the Board in respect of this paper at that time was, would it authorise the purchase of some land? Yes, it did.

So I move on to adopt further the Judge at 93 and 4 as to the nature of the consents within the pipeline optionality and what they did and didn't provide for and I rely on all her reasoning through 95 through 97 as being correct. In particularly in focusing on 96 where she rejects the proposition that the Kaiwea Downs offer was relevant, she says it's not, the Court of Appeal said she was wrong about that at paragraphs 87 and 88 and then through 93 of its judgment. My submission to you is that it's completely misplaced what the Judge was saying and indeed what the argument was before it. The Kaiwera conditional offer was made long after the event in circumstances that no one could possibly have known about in 2006, 7 and 8. I

made that point earlier. But the essential point is that the approach made reflected the whole package, not the consents themselves, and the Judge was right for the reasons she gave.

I then adopt her conclusion at 97 where she says that the expenditure, when you look at the consents themselves as the Commissioner had argued are no different in respect of the overall feasibility process and why the first part of the adjudication report actually provided logically the same answer.

I agree also and adopt the Judge's approach at 102. This is primarily a factual issue and she correctly instructed herself in that respect in order to answer what is the legal question.

At 106 through 110, the Judge expresses the view that, "I was not correct in terms of my approach to the application of fixed and circulating capital." She uses the same language, I believe, that you did yesterday, Your Honour Justice Young, that it actually becomes a circular test. I disagree with that. I maintain the submissions that I made yesterday in terms of why that approach is correct and I'll come to why the Judge actually came to the right conclusion, reflecting that very idea later in her judgment.

I rely on and adopt what the Judge says completely at 115, 116, and 117. It's implicit in what I've already argued to you yesterday and through the morning that I repeat the submissions maintained by the Judge at 120 and 121. For the reasons submitted, she's correct.

I rely on the Judge at 123 where she refers to the consents, in this case, this conferring a chance. That's what the witnesses described. She accepted that. We've seen that language drawn from *Ampol*.

I rely on what the Judge says at 140 as reflecting why this expenditure is revenue as in circulating capital. Can I now take the Court back to the questions on which leave was granted? I've now covered the first, second and third questions, leaving question 4, and I'm now at the Court's second comment. Rather than take you to it, I'll just tell you what it is and I'll deal with it. This is the fruition point. Whether the feasibility expenditure is deductible will have to be the subject of argument in the appeal. The next point – and this is the fruition point – Trustpower should also clarify

what it submits the taxation treatment of expenditure relating to the consents would be should one or more of the projects come to fruition and as we know one of them has in respect of Mahinerangi stage 1. The position is this. It came to fruition in May 2011 when the Board adopted the business case to approve committing to the capital expenditure and the date for that was April 2010. So the project Mahinerangi stage 1 became operable in 2011.

The treatment is that all the costs incurred prior to April 2010, the Board commitment date, were deducted and are deductible. So when Trustpower filed the tax returns in March 26, 27 and 28, it treated the expenses that are in dispute here as deductable and as we know it's clear law that deductibility isn't determined by future events. It's not hindsight.

At that point, by which I mean March '06, '07 and '08 the expenditure does not create any fixed capital and couldn't.

WILLIAM YOUNG J:
Well, it could if the project proceeded.

MR HARLEY:
If the Board had determined it was proceeding as in *Milburn*, *ECC*, *Waste Management*, yes. But that's not this case.

WILLIAM YOUNG J:
What's your best case for the proposition that feasibility expenditure on what would be a capital project if it proceeded is automatically revenue, is revenue, that pre-commitment feasibility expenditure on a capital project.

MR HARLEY:
Ampol, *Goodman Fielder*, and *Bowater* and *Wacky Wheatley*. It's a matter for you but normally we would prefer in the first instance to go to Australian authority ahead of Canadian authority because of the similarity between the section 51 and the mantra that's dominated this entire framework from Sir Owen Dixon.

The final point in respect of that fruition is if Your Honours refer to the PricewaterhouseCoopers opinion which is in the materials at volume 1 at tab 8 paragraph 40.

Mr Freeman opines, “The treatment of expenses relating to a specific project that have previously been expensed as feasibility costs is not specifically addressed by NZIAS 16” which he said was the preferred standard. “However, in our view once the cost has been classified as an expense, it cannot be reclassified to an asset at a later date. Therefore, even though a commitment may have been made on a specific project such that costs in relation to that project are now to be capitalised, the feasibility costs which are attributable to that specific project but have been previously expensed are not able to be capitalised subsequently. This is consistent with the requirement of NZIAS 38 paragraph 71 which states that ‘expenditure on an intangible item that was initially recognised as an expense should not be recognised as part of the cost of an intangible asset at a later date’.” And it’s for that reason as a matter of law that I say this case is different in nature from the facts as reflected in *ESS Quarries*, *Milburn* and *Waste Management*, all of which I accept are correctly decided.

So those are the submissions in respect of the first three questions, which gets to the fourth question, which is the commitment point and which Ms Armstrong will direct you on.

ELIAS CJ:
Yes, thank you, Mr Harley.

MS ARMSTRONG:
May it please Your Honours. The fourth question is framed in these terms and I think it’s probably useful if I repeat the full question to orientate us here. Was the Commissioner correct or at least not in error to select a date by which Trustpower had decided to apply for a resource consent as the point at which its expenditure was sufficiently connected to the capital purpose of obtaining a resource consent to be on capital account? This was Trustpower’s alternative secondary argument before the trial Court and is addressed in the High Court judgment at paragraphs 148 to 156.

To orientate Your Honours by reference to the roadmap, page 8 and 9 are the key points that I would like to step Your Honours through in relation to this particular question.

The question is really in two parts. The first is the use of the Commissioner's commitment test to identify when a sufficient connection arises. On the Commissioner's submissions, both the Commissioner and Trustpower are on common ground in relation to that matter. In terms of where that issue which has already been addressed by Dr Harley is dealt with in Trustpower's submissions, if I could direct Your Honours to paragraph 9.4 which starts at the bottom of page 17 of Trustpower's submission where we set out there why based on the case law and authorities we consider that the element of commitment is an important criterion to apply in order to determine the boundary where expenditure will cross to become expenditure towards identifiable capital assets and those references are at paragraph 25 of the road map on page 8.

There is just one point I would like to make in that connection in relation to an observation Justice Glazebrook made in relation to the accounting standards and the recognition for internally generated capital assets. Paragraph 57 of the relevant standards sets out the six criteria on an accounting basis that an accountant would look to, to recognise an intangible capital asset. The key one that was the subject of the evidence, and there's just two references I would like to offer the Court there. I'm not going to take you to the accounting evidence but if I could provide two references, the first is to Mr Hagen's second brief, which is volume 7 tab 51 page 1097 starting at paragraph 5.18 which is at the very bottom of that page where he discusses one of the key requirements in paragraph 57 which is the company's intention to complete the intangible assets and use or sell it. That's just one of the six criteria but that was the one that was of significance in that passage of the evidence and then Mr Hucklesby, who was the expert accountant who gave evidence for the Commissioner and the evidence that he gave under cross-examination in relation to that very point can be found in volume 8 tab 64 page 1375 to 6 where the proposition that there was no intention on the part of Trustpower to complete and use or sell these resource consents was discussed and accepted by Mr Hucklesby. The whole concept that the accounting standards drive off is the distinction between research and development and the idea of the point at which it is legitimate for a company to commercialise the research that they are doing as the tipping point for when they recognise a capital expense, and at 9.5 and 6 of Trustpower's submissions we draw together why it is we say that that is a useful framework within which commitment features there as an important criteria.

The second part of the question is what date Trustpower decided to apply for the resource consents and that's where we depart company with the Commissioner, but as I observe at paragraph 24 of the road map there are no jurisdiction issues that arise on the Commissioner's submissions in relation to that.

The summary, Your Honour, of the competing contentions is set out by Justice Andrews in her judgment but before I go to that I've endeavoured to describe those in the diagram on page 8 so that we have a visual representation of the three categories over which the Commissioner and Trustpower are on common ground in relation to this alternative argument. You can see when you look at that diagram that the green area around the edges is the deductible feasibility costs that were allowed by the Commissioner. They total approximately 2.6 million across all three of those green boxes.

The blue area for the purposes of this alternative secondary argument was accepted also, and that's the non-deductible consenting costs. There's a breakdown by project in that box that shows that particularly in relation to the two hydro projects, the expenditure on that phase was significant. Just under three million for Arnold and over six for Wairau and then the figures for Mahinerangi at 1.79 and Kaiwera Downs at .32. On my version of this diagram the types of costs has been slightly obscured by the placement of that breakdown but for completeness the types of costs involved legal planning, peer review and consultation type of costs in that agreed category.

The yellow area on that diagram highlights the area of contention between the parties. As the Court of Appeal's judgment observed, there's 6.5 million approximately, just over a third of the disputed expenditure that falls within that category. The issue that's raised by this fourth question is what we call the date issue and the difference in views between the parties based on the quantum in dispute is represented by the two red lines there, with the Commissioner's date being described as the Commissioner's commitment test and then Trustpower's date, that the High Court upheld being at or around the date of lodgement.

There is a small dotted blue line at the very bottom of the column between those two dates that just indicates that in relation to the allocation issue, which I discuss at paragraph 26 of the roadmap, that's not an issue that need concern this Court. Both parties agreed and the Court of Appeal ordered by consent that that matter be

referred back to the High Court, and the dotted blue line is simply an indication that that's where some costs will lie in relation to that allocation dispute.

Moving then to paragraph 27 of the roadmap, in order to address Your Honours on this section of Trustpower's argument, there are two volumes that I would like to take you to. The first is volume 3 of the green pleadings file. If I can ask you to please get that out. And the second is volume 5 of the blue files, which is Mr Kedian's evidence.

WILLIAM YOUNG J:
So volume 3 and volume 5?

MS ARMSTRONG:
Green 3 and blue 5, yes Your Honour. There are also references in the roadmap to Mr Harker's evidence which I'm not going to take you to because Dr Harley has done that. Now in volume 3, tab 14 is the first tab, and in the trial, and in preparation for the trial, extensive agreed statements of fact were prepared between both the Commissioner and Trustpower in relation to each of the four projects. At tab 14 is just one example of those in relation to the Wairau project, and you'll see if you open the first page that the level of information reflected in that document records when briefs of work were sent out to those consultants, when those briefs were accepted, when they were engaged and what it is that those consultants were doing in respect of each of the projects. It's arranged by consultant rather than event date, and the purpose of that exercise was really to show the level of work and activity that was going on throughout the relevant timeframe within which the decision on the part of Trustpower to apply for the consent was being considered. And if Your Honours turn to tab 21 in that same volume, the intervening tabs are the summaries of the resource consents for each of the four projects.

So tab 21 is the first tab – sorry, tab 19 is the first project tab. This is the timeline of events that is a summary of those agreed statements of fact at a high level. It's been done as an Excel document and even when I blow it up in an A3 size I'm afraid that the typeset is just as small as it appears on this. You do have an electronic version of these timelines, however, and you can zoom in and see the language more specifically. The key point, and I'll go to each of these in relation to the projects, is this is the most helpful representation and summary of the various reports and levels of activities that Mr Kedian in particular explains was ongoing and the information

that he says in his evidence Trustpower required before deciding to apply for the consent. So I'm going to use those timeline summaries rather than the agreed statements of fact, but underpinning those summaries are, of course, very detailed descriptions of the specific reports referred to there.

Now the third category of documents Your Honours are aware of are the chronologies that are attached to both parties' submissions, and Justice Young you referred to a mark up version of one of the chronologies in the Commissioner's submissions yesterday in relation to an entry. Dr Harley confirmed that those mark ups aren't accepted. They do accurately record the words used in those documents, but Trustpower's arguments are you can't stop at the documents. The context in which these issues were being considered by management, by him and at the Board are very relevant to that. The chronology attached to Trustpower's submissions that have been marked up by the Commissioner is essentially based on the detailed project chronologies that Her Honour included in her judgment. If you stick with volume 3, the judgment is at tab 5 of that, and attached as an appendix is a project by project summary, and the events in the chronologies are –

WILLIAM YOUNG J:
Sorry, what tab?

MS ARMSTRONG:
Tab 25, so it's Justice Andrews, and at the very end of that document, Your Honour, is a project by project chronology that the Judge put together based on the evidence in the case.

WILLIAM YOUNG J:
All right.

MS ARMSTRONG:
And in our submission the mark up by reference to the specific documents is the only basis upon which the Commissioner says the Judge got the facts wrong. The summary in the Commissioner's submissions at tab 1 is all document based. There's no reference to the evidence given by the witness in their briefs, or the cross-examination or re-examination which we've taken you to. So turning back to my roadmap –

ELIAS CJ:

Sorry, so the appendix omits the evidence you've taken us to, is that the difference? Sorry, I might have misunderstood what you were saying there.

MS ARMSTRONG:

Tab 1 of the attachment to the Commissioner's submissions –

ELIAS CJ:

Oh yes.

MS ARMSTRONG:

– is a summary of what they say are the facts they rely on to support the Commissioner's selected dates and that doesn't have a reference to the evidence that we say the High Court properly had regard to in reaching the conclusion that those dates were wrong and that Trustpower's dates of commitment were correct.

Moving to paragraph 27 of the roadmap, we say that the Commissioner applied the right test but selected the wrong dates because the indicators of commitment relied on didn't reflect the Court's considered evaluation of the process Trustpower went through to decide to apply for consents in each of these three cases. As you've heard from Dr Harker's evidence, the position in relation to Wairau was different. It was one of the earlier projects but for all of the others Mr Kedian's brief of evidence describes that process. He also sets out what information Trustpower needed to make that decision and when it was that on his evidence he had all the information required so that that decision could be taken, and if I could just take you into that part of Mr Kedian's brief of evidence, so turning to volume 5 tab 33 at page 700, which is paragraph 3.4 of his brief of evidence.

In this paragraph, Mr Kedian really emphasises clearly the iterative process that Trustpower goes through in relation to consenting activities for these major scale generation projects. All aspects heavily interrelate and by using a wind farm as an example, if I could just ask Your Honours to read paragraph 3.46 through to the other page, and 3.47. That draws out the specific point very clearly, in my submission.

Trustpower's case was that it needed all of that relevant information before it could be in a position to weigh whether or not it should decide to apply for a consent and the best place to find that is in Mr Kedian's re-examination. That's under tab 36 of

the same bundle starting at page 859 line 27. It's the question in line 32, his answer begins. The question is put, effectively, "Can you explain what documents that you would have seen would inform your decision at the time to make a decision to either apply or not apply for a resource consent?" He answers starting at 32. "Once we've done all of the work, because until this research is done we don't really know what we're building. We don't know what its effects are going to be and we have no way of estimating what its costs are going to be so I would need to get all those reports back and then effectively have a roundtable discussion," and he goes on to just explain that.

So in relation to the types of information Mr Kedian is saying Trustpower needed to make the decision, it was technical feasibility, economic viability, and an understanding of how all the consultants' reports interrelated as a whole and without having a proper understanding of the prospects of success of the resource consent application, Trustpower was unable to properly assess what the additional costs of an appeal might be and what the conditions are that were being sought.

It's not the case that Mr Kedian accepted that even after the decision is taken and the consent applications are lodged that Trustpower is unequivocally committed to obtaining these resource consents because it's not, of course, until that application is lodged that the opposition, if any, comes out. These are highly public projects. They often attract a lot of submission evidence and certainly some opposition and as can be seen by the non-consenting agreed costs they can certainly be significant if that procedure is protracted. But Trustpower accepts on this alternative argument that those contingencies don't detract from the fact that at the time the decision is made to apply for these consents when the applications are lodged they are committed in the sense that the Commissioner's test requires them to be.

If I could turn now to Justice Andrews' argument where she pulls all this together, that's tab 25 of the same volume starting at paragraph 154 on page 487, the proposition that Justice Andrews accepted in this paragraph was that in Trustpower's business setting you can't equate the work done on writing an AEE report with the decision to apply for a consent and in the final sentence of that paragraph she says, "I accept on the basis of Trustpower's evidence supported by the matters recorded in the chronologies that Trustpower was not committed to lodging applications for resource consents until such time as it has received and considered all of the relevant information. In our submission, that's right, and for the further reason she

goes on to explain in paragraph 155 which she also adopts on Trustpower's facts and in Trustpower's business settings when that information received was also at or about the time Trustpower made, exercised its business judgment and made a decision to apply for those consents. In Trustpower's submission, there's nothing wrong with the Judge's reasoning on these points. The Court of Appeal could not find anything wrong, necessarily, with that reasoning and at paragraph 131 of the Court of Appeal's judgment subparagraph (B), if I could take you to that briefly, that's in the very final volume, the pink one, 23. We've essentially adopted the Court of Appeal bundle so this is the only new one that captures the Court of Appeal's decision, tab 152, paragraph 131 which starts on page 4331 of that bundle, and then from 132 the Court of Appeal considers at the end there this commitment point. But for my purposes, if I could just invite you to read the last sentence of 131 paragraph B. It's there that the Court of Appeal concludes when considering the Commissioner's challenge to the High Court factual findings which it didn't need to determine based on its, the findings it made on the primary submissions that it would have done so. However, not because Trustpower had met the Commissioner's commitment test but because the evidence put it beyond doubt that there was a sufficient connection and in my submission the Commissioner's case does not sufficiently identify where Justice Andrews went wrong in upholding Trustpower's objection and Trustpower's dates in relation to each of the four projects. In relation to each of the four projects which are treated differently, I think the most efficient way to understand the competing factual contentions for each of the parties is to look at 153 of Justice Andrews' judgment. Her Honour there deals with each of the projects by summarising some of the evidence she also sets out in her appendix. She deals with Arnold first, then Kaiwera, Mahinerangi and Wairau.

At paragraph 29 of my road map, I set out there some of the evidence from the transcript that overwhelming supports those factual conclusions by the Judge. Her summary at 153 doesn't cite any of those references so I've set them out there in paragraph 29. They specifically respond to the commitment dates in the points raised by the Commissioner.

In light of time I thought I would go briefly to each of the projects but if Your Honours want me to take you to any of the specific evidence on that point I'm happy to do so.

For the Arnold case, perhaps it's easiest if Your Honours could, at the same time as having open page 485 also hold open in the same volume tab 19. That's the timeline that relates to the Arnold project.

GLAZEBROOK J:
I don't think any of us can read it.

MS ARMSTRONG:
So without reference to the specific words you can see two red lines that demonstrate the gap between the time of the two dates and the evidence.

GLAZEBROOK J:
I lie. I can read it but I'm not sure about my colleagues.

ELIAS CJ:
Well, I've got super glasses.

MS ARMSTRONG:
So the point that Her Honour was making in relation to the Arnold project based on the evidence and this is something that Dr Harley's already taken you to was the concerns that the Board had about the economic viability of the project in light of the Taramakau diversion and the technical concerns in continuing discussions with the recreational groups and when you have a look at where those lines are drawn you can see the line for Trustpower coincides with the delivery of a number of reports from some of the key consultants. So to take an example in line 1, that's *Tucker v Granada*. They were doing civil engineering work. There was visual and landscape work done within that as well. Mr Kedian talks a lot about the importance of the aquatic assessment and the impacts on the hydrology report and again those entries show that Trustpower's date is aligned with the delivery of those final reports consistent with his evidence in relation to that.

The best reference and summary of his evidence in relation to that is at part 6 of his brief of evidence which steps through in relation to each of the three projects what all of those reports in evidence meant, and in my submission Her Honour accurately described that evidence in her summing up of what Trustpower's contentions were and her findings in 154.

In relation to the Arnold project and the document that you've been taken to in volume 1 of the supplementary core bundle which was the entry and the generation development report in November 2005 which is the date that the Commissioner selected for the date of commitment, the tab before that document contains the Board minutes of the previous month's meeting where some of the concerns around this project were articulated. The report you looked at was management's report back on some of those issues. The next tab after that is the Board minutes and they're the references I've given you in my roadmap which is where these concerns about the economic viability are best described. The Board's serious reservations are captured in some of the comments there and Mr Kedian at part 6 of his brief of evidence says that it was made and in re-examination, very clear that the Board weren't very happy to go ahead at that point.

In relation to the Kaiwera Downs project, the point of commitment selected by the Commissioner doesn't coincide with the commissioning of consultants to prepare the AEE reports. The point selected by the Commissioner there, and it's summarised in relation to Kaiwera Downs at paragraph 153B of Her Honour's judgment, and that refers to a document that was prepared in May of 2007 in relation to the Kaiwera Downs project. I'm just going to take you very briefly to that document. The reference is to the core bundle, volume 2 and it's tab 32. This is an internal memorandum to Mr Kedian and Mr Dion Campbell, both of whom gave evidence. It's to do with the Kaiwera Downs wind farm. If you turn to page 4232 of that document, there's a description there at that paragraph 5.1 of the summary of potential environment effects and fatal flaws, and Mr Kedian gave evidence at the time and this again is reflected in the summary of Her Honour at paragraph 153B that this issue required a whole lot more work, which was then done after the Commissioner's chosen commitment date that informed his decision as to whether to apply for consent.

He said in his evidence-in-chief that it was very clear to him that not only was he not committed at that time but neither was his team working on the project. The visual issue that arose in relation to this wind farm or the significance of the visual issue was the potential for far fewer wind turbines than originally anticipated to be located on the site and Mr Kedian in his re-examination explained the very significant environment effect that has on a wind farm project where many of the costs are fixed.

I've given Your Honours the reference for Mr Kedian's direct evidence on that point in paragraph 29B of the roadmap. The re-examination reference is volume 5 tab 36 page 837.

Turning now to Mahinerangi, which is dealt with at paragraph C of Her Honour's judgment, the selection of a commitment date here has shifted and Your Honours will see in the timeline for this project which is at tab 21 that there are a number of different red lines. These were prepared before the trial. The Commissioner's commitment date at trial was sometime after August 2005. It was a date in November 2005. The Mahinerangi wind farm project complicated, of course, because there was one resource consent that was withdrawn when the Dunedin City Council land was no longer available and a second resource consent lodged and those lines are explained at the back of that timeline.

The key point here to note, really, is that the Commissioner's selected date for Mahinerangi is different from the other projects because if you put your finger on the November 2005 date at the top of that timeline and go down you can see it's very much coinciding with the initial engagement of those experts rather than the production of any work product that Mr Kedian says was important for him to evaluate. That was the subject of extensive cross-examination and again adopting the same proposition about the need for substantive information in order to make the decision to apply for the resource consent, that is best captured by Her Honour's summary at 153C and the rework that needed to be done after the Dunedin City Council land was removed from the possible wind farm envelope and further rework was done on where those turbines would be placed.

The Commissioner's position in support of that date is summarised by Her Honour under that and coincides with what I've just demonstrated in terms of it being a date that aligns with the briefs of work being issued, not necessarily even accepted by the consultants.

Turning now to Wairau which is the final project, this is discussed briefly in Mr Kedian's brief but the main evidence is from Dr Harker. Again the competing contentions are summarised in paragraph D of Her Honour's judgment. This was a case that – a project, rather, that differed in terms of Trustpower's processes than the other ones in that the Board, due to the complexities of the project, and in particular the land access difficulties reserved for itself the decision-making in relation to the

lodgement of the consent. The timeline again for this project is instructive. That's at tab 22. There's only two red lines on this one, the earlier ones being the Commissioner's date. That's anchored to a September 2004 management generation report and you can see that that red line is going right through a number of areas of important activity by all of those consultants, the detail of which is explained in the evidence of Mr Kedian and summarised there in Her Honour's conclusion that Trustpower's submission that the decision was taken at the 30 June Board meeting once a full evaluation report of the Wairau project in its entirety was presented to the Board and it was able to have the benefit of that information and make that decision.

At a substantive level, it was the residual flow issue in the case of the Wairau project that was also the subject of further work on the part of the consultants after the Commissioner's selected date of commitment and that was ongoing. It wasn't until March 2005 that it was, it decided that because of the complexities of the land access issues that Trustpower needed 50 of the 57 landowners to have signed up to the project before it had a sufficient level of comfort about making the decision to apply for the resource consent.

So to conclude, it's my submission that Her Honour Justice Andrews had overwhelming evidence from the witness in support of Trustpower's commitment dates and to show that the dates selected by the Commissioner across all four projects were inconsistent in relation to the evidence and did not reflect the actual deliberations and decision-making processes that Trustpower needed to form that view.

At 155 of Her Honour's judgment, she deals with the arguments raised by the Commissioner largely based on the documents and came to the right conclusion, in our submission, that the fact that Trustpower was mindful of the possibility or even anticipated that an application would be lodged and wished to have the reports ready to go was not a reliable indicator of a decision to apply being made and from a business and practical point of view that wasn't made until at or about the time of lodgement.

Those are my submissions on those four projects, Your Honour, unless you have any questions.

ELIAS CJ:

Thank you, Ms Armstrong. Thank you, counsel, we'll take the lunch adjournment and resume at 2.15.

COURT ADJOURNS 12.55 PM

COURT RESUMES: 2.16 PM

ELIAS CJ:

Yes Mr McLellan.

MR McLELLAN QC:

I have a couple of materials to hand up. The first of these is a short roadmap and the second is some extracts from some of the key authorities which I had extracted largely for convenience rather than to use in my submissions. They may be helpful as snapshots from some of the cases if you can't remember where one of these very many statements come from. I don't want to be criticised for plucking the eyes out of the authorities because the context is all important and for that reason as an antidote to that suggestion, the very last one is the statement of Lord Reid's in *Strick* where he cautions against taking a legislative approach to the reading of the common law principles.

The second, the other document is my roadmap, and I'm going to, I intend anyway, to start with that sequence, which is to start with the issue on question C, the correct approach to the capital income distinction, and then I'll deal with the facts, and then I will come back to the remainder of question C, which is the application of the principles to the facts of this case, and then I'll deal with question D. I haven't included the first question, the jurisdictional point, because I apprehend that that is no longer strongly advanced.

ELIAS CJ:

That does not seem to be live.

MR McLELLAN QC:

No, for good reason.

ELIAS CJ:

Yes.

MR McLELLAN QC:

In that even if there was anything in it, no causative result could come of that. So I will start with question C which effectively responds to my friend's challenge to the approach which the Court of Appeal took, and in particular the sufficient connection test, which is in particular criticised as novel and without support in the authorities. So can I ask Your Honours to go to the Court of Appeal's judgment, which is in the supplementary bundle, 152 I think, and at paragraph 51 Justice White for the Court started by setting out, "The correct approach to the distinction between income and capital," and the Court said, " Was well established by appellate authority in New Zealand, Australia and England." He went through the key authorities in *Hallstroms*, *Nchanga*, *BP Australia*. He included another decision at 57 of the High Court of Australia *Foley Bros Ltd v Federal Commissioner of Taxation* (1965) 13 ATD 562, (1965) 9 AITR 635 (HCA), which is another means of production decision. At 59 His Honour went through, and over the page, *BP Australia*, and then came to *McKenzies* at 62 to 64. Dealt with *Sun Newspapers* and *Anglo-Persian* between 68 and 71 and then came to the New Zealand, the other New Zealand authorities *Milburn*, *Birkdale* and then returning to *Sun Newspaper*. Now the point I'm making to start with is that there isn't anything unorthodox, novel or unsupported in the authorities by the approach which the Court of Appeal took.

The suggestion that the sufficient connection test, or approach, that the Court of Appeal took is unorthodox seems to lie in the submission that that's all there is to the test, whereas in my respectful submission, the sufficient connection approach embodies all of the principles in these leading authorities which clearly the Court of Appeal adopted and analysed carefully before doing so.

WILLIAM YOUNG J:

If you look at para 98 of the Court of Appeal's decision, it effectively says that expenditure that is associated with possible capital investment is itself capital in the ordinary course of events.

MR McLELLAN QC:

In the third line, "All of the?"

WILLIAM YOUNG J:

Yes, they say, "All of the 'feasibility expenditure' related to possible future capital projects." And a little bit further down, "As Lockhart J recognised in *Ampol*, preliminary expenses incurred in the establishment, development or extension of a capital item… will ordinarily be in the nature of capital expenditure." And then further down, "As Richardson J indicated in *Waste Management New Zealand Ltd*, feasibility expenditure in relation to a capital asset will be on capital account." So this is sort of sidesteps the commitment issue. It just says, well because it's expenditure associated with a capital item which may or may not materialise is still capital.

MR McLELLAN QC:

Correct. That does, that is the Court of Appeal's decision and you can find that again in…

WILLIAM YOUNG J:

Perhaps don't worry too much about it. When I asked Mr Harley this question he said that the best authority for the idea that feasibility expenditure prior to commitment was revenue, was the Canadian case *Bowater* and he also referred to *Ampol*.

MR McLELLAN QC:

Yes.

WILLIAM YOUNG J:

So what do you say on that point?

MR McLELLAN QC:

Well there are clearer authorities where the line has come down on the capital side for preliminary expenditure for possible projects, for example, the *Softwood Pulp* case which is referred to in our submissions. *Waste Management* is itself authority for that proposition because the expenditure there was feasibility expenditure to look at a future landfill so –

WILLIAM YOUNG J:

Is it your position that we don't have to look for a commitment?

MR McLELLAN QC:

No the Commissioner supports the commitment test and if I can take you to the –

WILLIAM YOUNG J:

Well, based on what?

MR McLELLAN QC:

At paragraph 135 of the Court of Appeal's decision the Court said that, "In our view the fact that Trustpower's Board may not have made a final decision to apply for the particular resource consent did not meant that when the disputed expenditure was incurred it was not sufficient connected to a capital purpose. For tax purposes that question may be appropriately determined in hindsight because taxpayers invariably file their returns after the event. In this context, 'commitment' in relation to any given payment simply means that the payment is sufficiently connected to the capital purpose of obtaining a resource consent." So I support that reasoning and say that there does appear to be a significant degree of similarity between the Commissioner's commitment –

WILLIAM YOUNG J:

So where does the commitment test come from? Where does the idea of expenditure in relation to a capital project only goes to capital account once there's a commitment. Where does that test come from? I can see the practicality of it because otherwise that expenditure might fall between two stalls. It might be neither revenue and if the project never proceeds not appreciable or recognised capital.

MR McLELLAN QC:

Precisely.

WILLIAM YOUNG J:

So I can understand the logic of it, but what I'm interested in is what case law there is in –

MR McLELLAN QC:

From the Commissioner's perspective it comes from an examination of the key authorities and as are wrapped up in the interpretation statement. Cases such as *Milburn*, which of course refers to commitment, and it may well be that it has its genesis in the cases that deal with the general permission, because there are many

authorities. My learned friend referred to cases such as *Esso* and others where the issue of whether the taxpayer had commenced or was intending to commence business was based in part on whether the taxpayer had made a commitment to the new business.

WILLIAM YOUNG J:

It just seems to me that a lot of the cases we've been taken to are not very helpful on this because they're cases that provide guidance, or don't provide guidance depending on how pessimistic you are, as to whether particular completed projects are capital, or items of expenditure relate to capital or revenue, but here it's clear beyond doubt that a new hydro scheme in Wairau or a new wind farm in Central Otago would be on capital account. So the real question is at what point, if any, is there a necessity to say, well yes this is preliminary, we'll expense it, this is sufficiently connected to the final project to be capitalised even though perhaps that project still won't proceed.

MR McLELLAN QC:

Well this case effectively exemplifies the Commissioner's approach which is to treat the expenditure as on capital account once there is a commitment, and I'll come back to what I think that means in a moment, to the acquisition of the asset. Here, for the moment anyway, I'm talking about the resource consents as assets.

GLAZEBROOK J:

Well –

WILLIAM YOUNG J:

Sorry, this sort of reflects in a way the case is being shaped through the –

MR McLELLAN QC:

Through the disputes process.

WILLIAM YOUNG J:

– assessment, adjudication process and dispute process.

MR McLELLAN QC:

Yes, it does, because the Commissioner's original position was that there was a commitment to the end capital projects and that's apparent from the disputes

documents that are before the Court and the adjudication unit took a different view and it said that there wasn't sufficient evidence of a commitment to the end project but that the resource consents were themselves were identifiable assets.

WILLIAM YOUNG J:
Well the grant of leave did say whether its feasibility expenditure is deductible will have to be the subject of argument. We haven't, sort of, it's really just a matter of acceptance.

MR McLELLAN QC:
Acceptance that it's –

WILLIAM YOUNG J:
That pre-commitment feasibility expenditure is deductible is the sort of starting point for your submission.

MR McLELLAN QC:
Because that, because the issue of pre-commitment expenditure hasn't been before the Courts. So we are dealing with a line that was drawn at the point where the Commissioner decided, on the basis of the evidence, that the company had committed towards the process of acquiring resource consents.

ELIAS CJ:
So what is the position the Commissioner takes though? In other cases this may have been shaped by the history of the matter and the view that there was a commitment to the completed project, but what generally is the position, if you're in a, able to say?

MR McLELLAN QC:
Well, I can really only talk about what is in the interpretation statement. That those are the Commissioner's guidelines.

ELIAS CJ:
Can we, we haven't been taken to that?

MR McLELLAN QC:
No you haven't. They're in the supplementary bundle –

GLAZEBROOK J:

Can I just say that one of the reasons that we said we wanted to hear about feasibility expenditure generally is that this Court can't be constrained in a legal vacuum, or a factual vacuum, in terms of the test it said should be applied. So we can't pretend something is deducible or not deductible if we take a different view of that. So we can't say, well assuming that anything pre-commitment is deductible, we find that the commitment happened at this stage. It's just not what the function of this Court is.

MR McLELLAN QC:

The application for leave sought to introduce the specific issue of, for the Commissioner's approach to feasibility generally and that was rejected because the Court didn't want to be constrained by that issue. The problem with describing it as feasibility expenditure and hoping that an answer emerges is, of course, that's reasoning by labels and when you go to the interpretation statement –

ELIAS CJ:

So is commitment a label?

GLAZEBROOK J:

It is just a label to say that, is to see whether a project is going to go ahead, rather than working on a project you have decided to engage in. Because everybody agrees, even your friend agrees, that once you've decided, like *Waste Management*, that you are going to do a project, then it's on capital account, especially if associated with land and works on that land.

MR McLELLAN QC:

Yes and similarly I say here in relation to the consents themselves.

GLAZEBROOK J:

Well, yes, but we have to get to the consents themselves, so there's no point constraining ourselves to that.

MR McLELLAN QC:

No and it would seem to be apparent, well it is apparent from the Court of Appeal's decision, that the line may well have been able to be drawn a good deal further back into revenue territory because the Court said that all of the expenditure, this

expenditure, like all of the expenditure in the pipeline, is on capital account. So – but that is a difficult issue to deal with as a matter of fact, because that issue has not gone through the Courts.

GLAZEBROOK J:
Well it might have to go back, if that's the case, but we can't be dealing with this in a vacuum and pretending something is the case when it's not. Which is why the, it was quite clear that we wanted to deal with feasibility expenditure generally.

ELIAS CJ:
But you say that the Commissioner has followed the interpretation statement so is it so much a question of, I mean the facts perhaps haven't been looked at, as you say, but your starting point has been that, has it?

MR McLELLAN QC:
Has been?

ELIAS CJ:
Has been the statement?

MR McLELLAN QC:
The Commissioner would take the view that the decisions that have been made in relation to the assessments are consistent with the interpretation statement. The – yes.

WILLIAM YOUNG J:
It seems pretty generally. I'm only just looking –

ELIAS CJ:
Where is it, sorry?

MR McLELLAN QC:
I was just about to say, Your Honours, this is the pink bundle, 157.

ELIAS CJ:
Which bundle?

MR McLELLAN QC:
The supplementary bundle.

GLAZEBROOK J:
Well it is fair to say that the Commissioner has not in that statement taken a sufficient connection test as meaning that any time you were thinking about a possible capital asset, everything that you do is put onto capital account.

MR McLELLAN QC:
No.

ELIAS CJ:
Where do I find that?

MR McLELLAN QC:
If you have a look at paragraph 6, which is the summary, "In many situations it is likely that feasibility expenditure will be non-deductible on the basis that it is either incurred preliminary to or preparatory to the commencement of a business or income-earning activity or it is capital in nature." And then over the page –

ELIAS CJ:
That's a bit odd.

WILLIAM YOUNG J:
It's really 16, 17 and 18.

MR McLELLAN QC:
I was just moving, the next section is about the general permission and then over the page you'll see the heading, "Capital limitation," and then 15, as Your Honour Justice Young says, "Where particular feasibility expenditure is capital or revenue in nature must be determined on the fact of any particular case." Which is not terribly illuminating. 18, "Feasibility expenditure incurred principally for the purpose of placing a taxpayer," I'll just let you read that. Then the next paragraph, "The same principle applies.. If the feasibility expenditure is incurred principally for evaluating one or more proposals," it is unlikely that it will be capital. "However, when the feasibility expenditure goes beyond simply placing a taxpayer in a position to make

an informed decision, it is necessary to consider whether the expenditure relates to the profit-making structure or profit-making process."

ELIAS CJ:
So from 18, it is a statement of commitment being – well it seems to me that that's commitment, isn't it? A decision to proceed.

MR McLELLAN QC:
If you have a look at 20 it seems that commitment is used as a synonym for a decision to proceed.

ELIAS CJ:
Yes.

MR McLELLAN QC:
Commitment cannot, in this context, mean an irrevocable commitment.

WILLIAM YOUNG J:
Well it makes it clear it doesn't.

MR McLELLAN QC:
No.

ELIAS CJ:
No.

MR McLELLAN QC:
Because that can't happen commercially anyway. There can always be things that –

ELIAS CJ:
Go wrong.

MR McLELLAN QC:
– turn you back.

ELIAS CJ:
"A firm decision to proceed."

MR McLELLAN QC:

And one of the reasons why the Commissioner sought to include question D, was to seek clarity since we are, the Commissioner is in this Court on whether the approach it took was correct or at least not in error, which was the approach which the Court of Appeal took. So effectively the commitment test was seen by the Court of Appeal as a proxy for the sufficient connection test and that the Commissioner was not in error to take, what was described in the Court of Appeal's decision as a pragmatic approach to commitment, and I would support the approach that's being taken because it is evidence based. Two minds might disagree on exactly where it should be drawn but of course the line was drawn here at the point where the taxpayer had sent out briefs to its consultants specifically engaging them to prepare AEEs for –

WILLIAM YOUNG J:

What does that abbreviation mean?

MR McLELLAN QC:

Sorry, assessments of environmental effects.

WILLIAM YOUNG J:

Right.

MR McLELLAN QC:

Which is the vast document that is effectively the application for a consent. And at the same time engages its lawyers to do what needs to be done to get consent. So in terms of drawing a line the Commissioner would say that that is, there may be some pragmatism involved in it, but it is a, it is evidence based and it is principled –

ELIAS CJ:

So you agree with Mr Harley that it's purely a question of fact?

MR McLELLAN QC:

The commitment? Where the line is drawn is entirely a question of fact.

ELIAS CJ:

Yes.

MR McLELLAN QC:

Whereas the test, of course, is a question of law.

ELIAS CJ:

Well it doesn't really seem much of a test.

MR McLELLAN QC:

Well certainly if we come back to the ultimate issue, which is whether the capital limitation is engaged, that would seem to me to be a question of law, without too much difficulty, but underpinning, underlying that are the facts that, from which the inference is to be drawn as to whether this was expenditure on capital or revenue account. But certainly where the line is drawn is inherently factual, as you've already seen from my friend Ms Armstrong's submissions it's –

GLAZEBROOK J:

Can I just check, the Commissioner is now hanging her hat, if that's the correct expression, especially now nobody wears hats, on the resource consent as being the asset.

MR McLELLAN QC:

That has been the Commissioner's position since the adjudication report.

GLAZEBROOK J:

Well is it still the position is what I'm asking sorry?

MR McLELLAN QC:

Yes, that's the pleaded position.

GLAZEBROOK J:

Right.

ELIAS CJ:

Since the adjudication report.

GLAZEBROOK J:

Is it still the position, is what I'm asking.

MR McLELLAN QC:

Yes, that's the pleaded position.

ELIAS CJ:

Since the adjudication and the finding that Transpower wasn't committed from the outset, is that right?

MR McLELLAN QC:

The Commissioner's initial position was that Trustpower was –

ELIAS CJ:

Trustpower, sorry, Trustpower.

MR McLELLAN QC:

Committed to constructing the end capital project, the hydro and wind farms, at the time that the expenditure commenced. Just the expenditure that we're talking about here.

ELIAS CJ:

Yes, I see, all right.

MR McLELLAN QC:

There was an amendment, so the assessment is effectively the same but the grounds are that there was a decision made to proceed with applications for resource consent.

ELIAS CJ:

Right, same expenditure but based on a commitment.

MR McLELLAN QC:

A different commitment.

ELIAS CJ:

A more limited commitment?

MR McLELLAN QC:
Correct.

ELIAS CJ:
To get the resource consent?

MR McLELLAN QC:
Yes, but of course not in the abstract. It's still in the context of these consents being the permissions by which Trustpower can ultimately construct the projects.

ELIAS CJ:
I'm probably the only one who needs this explained but interpretation statements, not legal effect?

MR McLELLAN QC:
No, guidelines.

ELIAS CJ:
Subject to, yes.

MR McLELLAN QC:
Ultimately not binding.

GLAZEBROOK J:
But not an issue in this case because it's really an issue of where the line is drawn in terms of the agreed principles, really?

MR McLELLAN QC:
Correct. My friend says a commitment test is a principled approach. The Court of Appeal would also seem to agree with that, although –

ELIAS CJ:
And you do too?

MR McLELLAN QC:
Yes.

Just coming back to the sufficient connection test as stated by the Court of Appeal, one of the criticisms from Trustpower is that it is too broad, that it incorporates language such as purpose and the like. If you go back to the authorities that are cited in the judgment and in particular in *Nchanga* which the Court cited at 55, that case involves the expression – well, the question in *Nchanga*, is it a cost in enlarging the permanent structure or is it a cost of earning the income? Now, that is a factual question directed at understanding the purpose of the expenditure. Similarly in *Birkdale*, this is Justice Thomas at paragraph 91 of the *Birkdale* decision, His Honour used the language, the key issue, "Is the expenditure closely associated with the underlying structure of the business?" which seems to be to be fairly close to the sufficient connection test but again as with sufficient connection one needs firstly to understand what the first principles are set down by cases such as *Hallstroms*.

My friend criticises the use of the word "purpose" in the decision but if you have a look at – I don't need to take you there at the moment but in *Hallstroms* Justice Dixon himself at page 648 refers to whether the expenditure is directed to the acquisition of a particular thing and whether it goes to the structure of the business. Sir Owen expressly used the word at 649, "What is the purpose of the expenditure?" So this is really a bit of a linguistics game and it's not a particularly helpful approach because it doesn't identify – because Trustpower's approach doesn't identify any error in the underlying principles that the Court has clearly adopted.

GLAZEBROOK J:

Isn't the real issue, and it really does come back to feasibility expenditure generally, because if the only purpose of any of the expenditure that Trustpower is undertaking here relates to the acquisition of a possible capital asset that is undoubtedly a capital asset? So sufficiently connected, any expenditure related to that has to be sufficiently connected if the acquisition of the possible capital asset or the possible acquisition of a possible capital asset is the connection. So it has to be something more, as I think you've said, than sufficient connection and what is that? Is that the commitment? Is that the Commissioner's submission?

MR McLELLAN QC:

The point of commitment is when the expenditure comes on capital account and as I said the Court of Appeal saw that as being effectively, to use my words, not the Court's, a proxy for the sufficient connection test. The Court of Appeal has certainly seen, in my reading of the judgment, a sufficient connection with the development

pipeline and therefore with the end projects because one of the reasons for the decision is that the applying for and obtaining resource consents pushes these four best projects further along the pipeline towards the end result of possibly being built.

GLAZEBROOK J:

So you're really actually accepting what Mr Harley said in terms of an identifiable capital asset, aren't you? You just put the timeframe a bit earlier than Mr Harley's contending for in projects of this nature? Because sufficient connect doesn't tell you anything unless you tie it to commitment and then it seems to me the test you're proposing is exactly the same as Mr Harley's, it's just that you put commitment earlier than Mr Harley. It would be useful to know where the differences are.

MR McLELLAN QC:

The Commissioner's position on this expenditure is that the expenditure was incurred for a capital purpose, namely the acquisition of the resource consents because the –

GLAZEBROOK J:

Say we disagree with that as the resource consents being that because I think that's a red herring because in terms of getting the principles right.

MR McLELLAN QC:

Well, we suppose the sufficient connection test.

GLAZEBROOK J:

What do you say it means?

MR McLELLAN QC:

Firstly that there is a sufficient connection to a capital purpose.

GLAZEBROOK J:

Well, that can be easily done if the only reason you're doing it is for capital purposes, isn't it?

MR McLELLAN QC:

If we go back to 50.

GLAZEBROOK J:

Because there's no suggestion that this is looking at trading stock or anything of that kind, is it? It's capital structure. So that's easy enough.

MR McLELLAN QC:

Ultimately capital structure but Trustpower's position is that there isn't – that the resource consents have no functional asset status until they are combined with other assets such as complete land access and a commitment by the Board to build the projects and at least as far as this expenditure is concerned the Commissioner disagrees with that position primarily for two reasons, the first of which is that the expenditure is directed to effect or is calculated to effect a structural or it is calculated to effect an alteration in the profit-making structure of the company.

WILLIAM YOUNG J:

This is all – would building a dam be on capital account or revenue account, and obviously on capital account, now, the Commissioner's approach and I think Mr Harley's approach will accept that there will be money that gets capitalised even though the project is never completed and you seem to accept that there will be money that will be spent associated with a capital project that can be expensed, so somewhere in the middle there's a line on this idea.

MR McLELLAN QC:

It's a little bit more, it's a little different to that, because it's not just about where the commitment line is drawn. Trustpower's position would be that there is no expenditure on capital account until there is a commitment to build. So even though, for example –

WILLIAM YOUNG J:

Yes, I understand that, but they would accept that from that point on it's all capital, even though no asset is ever created because, for instance, the proposal falls over unexpectedly.

MR McLELLAN QC:

Correct.

WILLIAM YOUNG J:

So at one end they accept that some expenditure will be capitalised even though an asset isn't created and at the other end you accept that some expenditure can be expensed even though it's referable to what would be a capital asset if the project is completed.

MR McLELLAN QC:

Yes and that is the question of degree. That is the factual question of degree.

WILLIAM YOUNG J:

But I mean there might be other ways of looking at it. One might be, is this expenditure part of the general looking around at situational awareness one can expect of any firm, or is it specifically and unequivocally directed to a particular project, and that would be an approach, and there might be others.

MR McLELLAN QC:

Well the Commissioner's commitment test would be similar to what Your Honour has just suggested.

WILLIAM YOUNG J:

Yes.

GLAZEBROOK J:

No it wouldn't, I don't think, because I think Justice Young was suggesting as soon as you are looking at a particular capital project, whether committed to it or not –

WILLIAM YOUNG J:

Yes.

GLAZEBROOK J:

– it could be, it would be on capital account because instead of just a general sniff around to see what there might be, you're actually investigating one or more, which would be contrary to what's said at paragraph 19 of the interpretation statement –

WILLIAM YOUNG J:

Yes, it's not the Commissioner's position I think.

ELIAS CJ:

It's not the?

WILLIAM YOUNG J:

It's not the –

GLAZEBROOK J:

That's not the Commissioner's –

WILLIAM YOUNG J:

It's not as stated in the interpretation document.

MR McLELLAN QC:

You're looking at the words, Justice Glazebrook, "However, when the feasibility expenditure goes beyond"?

GLAZEBROOK J:

No, no, no, it's incurred principally for evaluating one or more proposals, it is unlikely that it will relate to the business structure.

MR McLELLAN QC:

Yes.

GLAZEBROOK J:

So the Commissioner does not take the view that's just been put forward by –

WILLIAM YOUNG J:

Well, maybe. I mean if you're looking at it in a preliminary way, we've got four possible projects. Here are back of the envelope calculations as to A, how much power they'll produce, B, what it'll cost. That sort of exercise wouldn't necessarily be referable in a practical business sense to any one project, but once you've gone, okay, the back of the envelope calculations look pretty good, let's spend a million dollars on it, then that sort of project might, that sort of commitment might be sufficiently referable to a capital project to be treated as being on capital account.

MR McLELLAN QC:

Correct, and the interpretation statement makes it clear that –

WILLIAM YOUNG J:

It's not inconsistent with it. It's not slightly inconsistent with the interpretation statement, it's not completely inconsistent.

MR McLELLAN QC:

It's not completely inconsistent particularly when –

GLAZEBROOK J:

Well, probably inconsistent with the way they've treated Trustpower here because there was quite a lot of expenditure before the resource consents that is accepted as deductible so.

MR McLELLAN QC:

Well one of the, some of the evidence that we'll come to in due course in question D, just since we have the recent context from my learned friend, is that the line, as I say, was drawn by the Commissioner when briefs went out to consultants to specifically prepare resource consent applications. But contrasting that with some months before the very, well many of the same consultants were engaged to do scoping studies and to, with an eye to lodging resource consent applications at some specific point in future, so it is a pragmatic exercise by the Commissioner to say, well here it's not very contestable that it's on capital account albeit it that it is possible that it may, and certainly the Court of Appeal seem to have taken the view, that it could have been pushed back further into what the Commissioner has regarded as revenue territory.

GLAZEBROOK J:

I guess what we're seeking your help with is where do you say the line is drawn and that's why I wanted you to get away from the particular resource consents because if you just look at the particular resource consents I can quite understand a view that if that's an asset then when you ask for the reports to be done in order to put in the application, I can understand that. Of course from Trustpower's point of view they say that's not the asset, you're looking at the later asset, therefore you have to bring it much closer to the creation of the resource consent. But that's beside the point, and that's getting down the track from where the, I'm interested in, in any event, as to where the Commissioner says that line goes. And what the test actually is.

MR McLELLAN QC:

Do you mean in relation to the ultimate –

GLAZEBROOK J:

Well to get away from the actual facts of this case and the Commissioner's contentions, because I think they're getting in the way of us understanding what the Commissioner says the test is.

MR McLELLAN QC:

The test is that set out in the leading authorities. I know that's not particularly helpful but –

GLAZEBROOK J:

Well it isn't because none of them actually deal with possible capital assets and feasibility expenditure. So they're supremely unhelpful because what they're looking at is whether actual expenditure is on capital or revenue account or actual assets are revenue or capital.

MR McLELLAN QC:

Well the best indication of that is in the interpretation statement.

GLAZEBROOK J:

So this is what you say the law is? The Commissioner says the law is?

MR McLELLAN QC:

That is the position that –

GLAZEBROOK J:

Which is possibly slightly different from the Court of Appeal's position then?

MR McLELLAN QC:

I agree with that. It's –

GLAZEBROOK J:

So you're not supporting the Court of Appeal position, you're reinterpreting the Court of Appeal statements in accordance with the interpretation statement?

MR McLELLAN QC:

I support the Court of Appeal's decision on the test, and I also support the Court of Appeal's decision on the approach of the Commissioner to commitment, which was that it is a matter for the Commissioner to decide, as a matter of pragmatism –

GLAZEBROOK J:

Well that can't be right because if the Courts come to look at it, they've got to decide the actual facts. They can't say, oh well, the Commissioner can do what she likes, can they? On a pragmatic basis?

MR McLELLAN QC:

No, this has been the approach taken to date based on the guidelines. Undoubtedly once there is a judgment from this Court there will be a high level decision on the authorities that are referred to in the guidelines and –

ELIAS CJ:

Well we don't want to blunder into giving indications which might cause changes if we don't understand what the position is on the law. So you're really only putting to us what's in the, well you're relying on the interpretation statement.

WILLIAM YOUNG J:

What's the best outcome? I mean in a way the best outcome might be that the firms are encouraged to innovate, to look for different and new ways to carry on their business. Some of these, in the nature of things, are never going to come off, they're going to be more incentivised to do that if they can expense the costs than if they can't. So that's one extremely simplistically expressed view. What, if any, is the policy in favour of capitalising this expenditure?

MR McLELLAN QC:

Capitalising expenditure on the resource consents?

WILLIAM YOUNG J:

Yes, yes, I mean why is it a good thing, or, I know capital and revenue is a distinction we've got to adhere to, and it's always going to be a bit arbitrary, the margin, but what would be a good reason for treating this as capital?

MR McLELLAN QC:

Because in simplistic terms it strikes a balance between deductibility and non-deductibility. So deductions do provide an incentive to businesses to spend money on new projects.

GLAZEBROOK J:

You mean, sorry, just to be clear, you mean deductibility up to a certain point?

MR McLELLAN QC:

Up to a certain point, correct.

GLAZEBROOK J:

Yes, thank you.

MR McLELLAN QC:

And legislative incentives such as those under, I don't know if you've got on top of the ITA provisions, the relief provisions in section DB 13 –

WILLIAM YOUNG J:

Is that for failed resource consent applications?

MR McLELLAN QC:

So now under the 2007 Act that was enlarged to cover withdrawn applications and declined applications and, indeed, consents which were allowed to lapse or were surrendered by the taxpayer. That expenditure can now be treated as deductible.

WILLIAM YOUNG J:

So in this case, so if Trustpower abandoned these consents, would it be able to then deduce the costs of obtaining them?

MR McLELLAN QC:

I don't want to give my own assessment on that at this point but –

WILLIAM YOUNG J:

Quite a significant one.

MR McLELLAN QC:

It, in 10 years from the grant of the consent, which is when they will lapse, the section DB 19(1B) allows a deduction, as a specific override to the capital limitation. So one of our submissions is that that is a quite strong pointer to it being capital up to the point that it lapses and that the override was necessary to grant that relief otherwise it would have been capital and potentially black hole.

ELIAS CJ:

Did –

GLAZEBROOK J:

Well, I have trouble, I'm not sure about that, because a failed resource consent is never going to generate income, is it? So the point is you might – so that there could be issues of deductibility in any event at that stage.

MR McLELLAN QC:

Well, no, not if you apply cases, a decision such as *Fullers* which say that it has to be a prospective view from a tax – from the point of view of tax treatment. So at the time that the expenditure is incurred it doesn't matter that the outcome may not be successful. So –

GLAZEBROOK J:

No, that wasn't the point I was making, sorry.

MR McLELLAN QC:

I'm sorry.

GLAZEBROOK J:

At the time that they've lapsed they're never going to grant income, have an income.

MR McLELLAN QC:

But they don't, the expenses don't become deductible then unless there is a legislative provision –

GLAZEBROOK J:

Unless there is a specific provision, that's right.

MR McLELLAN QC:

Correct, because it allows the deduction to be claimed in the tax year in which it lapses as opposed to the usual rule, of course, which is that it has to be treated in the year in which it's incurred.

ELIAS CJ:

Are you going to take us to these other provisions, the specific ones relating to resource consents?

MR McLELLAN QC:

Yes, I am.

ELIAS CJ:

Yes.

MR McLELLAN QC:

They are in my written submissions.

ELIAS CJ:

Yes, yes, I know that they are referred to but I – yes.

MR McLELLAN QC:

Yes, just briefly now but –

ELIAS CJ:

But your point on those is that those are specific provisions and they are a pointer to this expenditure being on capital account.

MR McLELLAN QC:

Otherwise they wouldn't have been required.

ELIAS CJ:

Otherwise they would have been –

GLAZEBROOK J:

Well, a lot of consents are going to be on capital account undutably, aren't they?

MR McLELLAN QC:

Well, this is my point. There were – while –

GLAZEBROOK J:

So it doesn't mean that all of them are on capital account. It just means that those that are get a deduction.

MR McLELLAN QC:

There are enough of them to justify Parliament enacting the relief provisions. There wouldn't be too many situations where they wouldn't be on capital account. In my submission, that would be where someone is trading in resource consents or the Court of Appeal gave an example in paragraph 99 of the judgment where someone is getting up projects for sale they may be on revenue account.

WILLIAM YOUNG J:

I suppose it doesn't entirely eliminate because of the time value of money problem but it mitigates the black hole problem.

GLAZEBROOK J:

But only in relation to resource consents. It wouldn't eliminate it –

WILLIAM YOUNG J:

Yes, sure, yes.

GLAZEBROOK J:

– to do with other feasibility expenditure or research and development -

MR McLELLAN QC:

No, and there are other –

GLAZEBROOK J:

– if you require capitalisation of that.

MR McLELLAN QC:

And there are other deductible, deductibility rules for those areas but here is a specific one and indeed it wouldn't necessarily be always be black hole expenditure because if the consents were available for use then many of them are depreciable

intangible property. So if a value can be ascribed to them then depreciation could be claimed for them.

ELIAS CJ:

I'm sorry, I'm just not sure that I'm following the point that you made. You said that since the adjudication you've focused on the resource consents rather than the ultimate end. Do you mean the adjudication in the High Court?

MR McLELLAN QC:

No, in the – the adjudication unit which –

ELIAS CJ:

Yes.

MR McLELLAN QC:

– expressed a view that the original assessment was incorrect because the Commissioner's original view was that there was a commitment evidenced to build the end projects.

ELIAS CJ:

And so can you just give me, don't take the time to take us there, the reference in the materials to that decision?

MR McLELLAN QC:

That is the previous tab to the interpretation statement, 156.

ELIAS CJ:

Thank you.

MR McLELLAN QC:

Your Honour. That's all I want to say about the sufficient connection test which I say is a perfectly orthodox one and the Commission supports it provided it is understood in terms of the principles that the Court of Appeal's judgment set out. There is no change intended by the Court of Appeal to those principles, particularly in relation to *Nchanga* and *Hallstroms* which the Court of Appeal expressly said were the best guideline.

GLAZEBROOK J:

Although the trouble is their judgment isn't in accordance with the interpretation statement or with the Commissioner's position in this Court. So you support a test that actually gives a wider capitalisation than the Commissioner is contending for. So it seems to me you're not supporting the Court of Appeal judgment in that regard.

MR McLELLAN QC:

The Commissioner is supporting the test in that it appears to be intended to be consistent with the commitment test, and I took you to that paragraph, I think 135, of the judgment where the Court said that all the Commissioner has done by applying a commitment date is to apply the sufficient connection test and it's a matter for the Commissioner whether it draws the line there. He's not in error.

WILLIAM YOUNG J:

Well, the most you could possibly –

GLAZEBROOK J:

Well, it can't be right.

WILLIAM YOUNG J:

You could possibly say that although the word "commitment" implies a binary decision going ahead with inevitably or not going ahead at all there are signs that it's a shades of grey component in the interpretation, say, but the Court of Appeal's approach seems to make it more a shades of grey assessment than the interpretation statement suggests.

MR McLELLAN QC:

That may be right. On the other hand, the Court of Appeal has come down quite firmly in ruling that those dates which the Commissioner has adopted –

WILLIAM YOUNG J:

Were conservative.

MR McLELLAN QC:

– were conservative, "pragmatic" was the word, and the appeal was allowed on that express basis as opposed to Trustpower's alternative, more revenue friendly dates. As the Court said at the last sentence in 135, "Regardless of whether there was a

Board or management decision, the commissioning of AEEs was sufficiently connected to a capital purpose."

And perhaps just while we're on that subject, the Court of Appeal has taken, in my submission, both a broad approach and a narrow approach so where the Court says that all of the expenditure in the pipeline may be, in my respectful submission that must be an overstatement because that issue was not before the Court, but the Court has also held, and this is in the middle of 135, "In this context, 'commitment' in relation to any given payment simply means that the payment is sufficiently connected to the capital purpose of obtaining a resource consent," and so both on general principles – well, on general principles including the identifiable asset test in relation to resource consents there was a capital purpose, and that's apparent from the section of the judgment dealing with valuable resource, resource consents as valuable assets. So whether on a narrow or broad view, the expenditure was all on capital account.

Turning to the factual or the challenge to the factual findings as being unsupported by the evidence, the first issue that I'd like to deal with is the objective versus subjective approach. The Commissioner obviously supports an objective approach and supports, therefore, the Court of Appeal's approach in particular at, I think, paragraph 85 of the judgment. That there must be an objective approach seems to be accepted by my learned friends in written submissions because at 9.22 this evidence, the evidence can only come from current and former officers of Trustpower in the sense that it is subjective. However, that does not mean those facts are not capable of being assessed objectively by reference to Trustpower's actions and the observed commercial and economic realities.

Now, I took my learned friend to be moving slightly from that proposition yesterday to be suggesting a subjective but a subjective analysis may be appropriate which I submit is incorrect. The *Rangatira* decision was cited in support of Trustpower's position. That was a case involving the issue of whether assets have been acquired for the purpose of resale and on those facts, on that test, there was clearly a need for a subjective element in the question of whether the taxpayer had a purpose of resale.

Here, however, we have a very different test which, if we start with the capital limitation, the simple question is whether the expenditure was of a capital nature. That in itself involves an objective assessment and the authorities such as *Hallstroms*

which refer to tests such as what is the expenditure calculated to achieve from a practical and business point of view itself requires an objective test.

If it were otherwise, then a taxpayer would simply be able to say, well, I have a slightly eccentric approach to the use of these particular assets and I don't treat them as a capital asset at all because they have no functional status to me until they're put in combination with other assets. There must – to preclude the Commissioner and the Court from examining objectively what the true purpose or what the expenditure was calculated to effect is quite wrong in my view and would allow a misuse of the tax system.

There are also the statements of – you will recall my friend taking you to a statement in *Nchanga* yesterday which refers to the undesirability of motive or object of the payer, which is a fairly clear statement against a subjective approach. And also the dicta of Lord Morris, which I've set out at 2B of the roadmap, what falls to be considered is the nature of that for which the payments were made, not why the payments were made.

I'm now going to deal with the evidential section in my submissions which are set out in paragraph 26 of the written submissions and I'm not going to take you to every one of these statements but I do need to take you to a number of them and to some of the evidence itself.

Can I just preface this section by reminding you that Justice Andrews in the High Court did not find that there was a capital asset. Her Honour found that there was a – that the resource consents were revenue assets but they did provide enduring benefits to Trustpower which I –

WILLIAM YOUNG J:
Did she say they were revenue assets or did she just say they were nothing?

MR HARLEY:
She says assets.

MR McLELLAN QC:

No, she says revenue assets. This is at 119. 119 is where Her Honour ruled that the – 119 to 124 that the consents, the expenditure produced something that had an enduring benefit. That's at 124.

WILLIAM YOUNG J:

I've forgotten where her judgment is.

MR McLELLAN QC:

That's at volume 3 of the pleadings, tab 25.

ELIAS CJ:

It is very convenient if the – I think it is in the rules that the first volume includes the judgment in the lower Courts so that you have them all together.

GLAZEBROOK J:

I think Ms Armstrong explained that they're using the Court of Appeal bundle.

ELIAS CJ:

Oh, yes. One volume would have been nice. Next time.

MR McLELLAN QC:

The first section I took you to, Your Honour, is 119 to 124 where the Court ruled that the expenditure produced something of an enduring benefit applying the British insulated asset or advantage with an enduring benefit, so the Commissioner succeeded on that point but oddly, in my submission, the Court came back at 135 to 138 to conclude that they were merely, at least on this *BP Australia*, that the resource consent should be found to be revenue assets.

WILLIAM YOUNG J:

So where does she say it's revenue – they're revenue assets?

GLAZEBROOK J:

What she's doing is going through the indicia saying this one looks this way, this one looks this way, this one looks the other way and I've got to make a decision at the end, isn't she?

MR McLELLAN QC:

Yes and *BP Australia* indicia are just that, as the Court of Appeal said, but it is perhaps, instinctively, at least, a surprising conclusion to form the view that these are assets or advantages that provide enduring benefits to Trustpower yet they are not identifiable assets that are capital.

So coming back to 26.1, there was no argument from Mr Hagen, Trustpower's expert, that –

GLAZEBROOK J:

This is off your submissions?

MR McLELLAN QC:

This is off my submissions, page 10, Your Honour. There's no argument it's an intangible asset. He also said at – this isn't in the written submissions. It may be in a footnote at 675 line 6 he said that consents are intangible transferable property. Only a very small proportion of the project …

GLAZEBROOK J:

We're not entirely sure about that, are we, unless they're attached to land?

MR McLELLAN QC:

Even if they are attached to land the holder can transfer the land and thereby the consents.

GLAZEBROOK J:

Sorry, I thought –

MR McLELLAN QC:

So it's the –

WILLIAM YOUNG J:

You can't practically transfer a land use consent without the land.

MR McLELLAN QC:

Well, for obvious reasons because the consent has been granted for that particular parcel of land.

WILLIAM YOUNG J:
But subject to practicalities other consents can be transferred?

MR McLELLAN QC:
Yes, so the section 12 to 15 consents are transferable with some limitations. Section 13 consents, which are land use consents but they relate to work and riverbeds, they are transferable again with some limitations, so if you look at the Kaiwera Downs project that Trustpower received an offer to purchase from a third party, that included the resource consents which would be an obvious commercial imperative for the purchaser.

The chairman of Trustpower agreed that the 10-year window that the lapse period under the consents provides is important. The default period under resource – under the RMA is a five-year lapse period and Trustpower invariably source a 10-year lapse period, and there was a lot of evidence and some of it's in this section of the submissions about why Trustpower did that and the benefits that accrued to it as a result. The more obvious statement in 26.5 that the resource consents gave Trustpower the ability to build immediately if it wished. There were long lead times for development and so getting projects sufficiently advanced at the consent stage meant that the company could move quickly.

Dr Harker's brief of evidence refers to the strategic protection of holding consented options in order to provide a meaningful chance for new generation and, of course, if we can just come back to that paragraph that my friend took you to in his brief, which I think was 6.1, that before they started these projects, well, indeed, perhaps to this day, Trustpower's generation produced a total of 30% of its capacity for sale, in other words demand, and so the shortfall either had to be made up by building new projects or by buying on the market, and that points to a, as Lord Pearce put it in *BP*, a structural solution by adding capacity by getting new sites consented for construction when it suited Trustpower –

ARNOLD J:
So you would say, I think Mr Harley referred to the possibility of shrinking the customer base, you'd say, well, that's really not a runner.

MR McLELLAN QC:
It's –

ARNOLD J:

As an alternative to meeting extra demand you can just shrink your customer base, reduce, effectively reduce the demand.

MR McLELLAN QC:

I'm not sure that there was evidence on that but that may be an economic alternative but I – as you heard my friend say earlier today that Trustpower would do anything to make money so rationally that would suggest that if that was a viable alternative then the company would do that, but that's not what Dr Harker's brief was suggesting and, indeed, it's contrary to the purpose of getting these sites consented.

I will take you to, if I may, some cross-examination of Mr Hagen which is in volume 7, tab 54, and I've got the notes of evidence numbers. Page 683 is the page I'd like to take you to. There was quite a lot of evidence about the options that resource consents get for Trustpower. That is the options to build now, the options to defer, and Mr Hagen said –

ELIAS CJ:

Sorry, what page?

MR McLELLAN QC:

I'm sorry, Your Honour. 683, line 7.

GLAZEBROOK J:

Top of the page numbers, the – that's the evidence number.

ELIAS CJ:

I see, those ones, yes, thank you.

MR McLELLAN QC:

1131, down the bottom, and I was putting to him that if Trustpower, "Believe that they're going to get their stars into alignment, then being able to get your consent now, bully the Government and then build, then that window is a thing of real value, it's a real option?" And John Hagen said, "It's a thing of value to have options in the pipeline. Some of them come into the money," like the Australian Snowtown project, and then in the next paragraph, turning his focus back to New Zealand, "But if you look at an HVDC problem, what happens in three years' time if the smelter says,

right, we're out of here and 14% of New Zealand's power supply comes back on the market and everybody who has their things in the pipeline will say, 'Well, they're out of the money for a while more.' So, these risks, that's why they need them in the pipeline. Any sensible company will have opportunities in the pipeline because you do not know what market conditions are going to do and you have to be ready to react quicker than your competitors to take advantage of market changes," and he said quite a few things like that. I've recorded the statement that he made in evidence in 26.8 that the consents provided Trustpower with a competitive advantage in that it was able to, he used the word "press the button", able to react quicker to changing circumstances and press the button.

And perhaps at some point, I don't think it's here and I don't need to take you to it, when I was cross-examining him more about the optionality and the economics of doing it he gave me a similar response and said, "Well, it's really just business theory 101."

Perhaps the proposition at 26.9 is also a fairly straightforward one but came through Dr Harker's evidence quite clearly that he accepted that resource consents have value to Trustpower in that once they are granted they take away the uncertainty or delay associated with the consenting process. And, of course, that's a very straightforward idea but commercially, in my submission, very important to Trustpower because being able to make a decision within 10 years was valuable rather than making a decision to build in conditions that were unfavourable.

Professor Evans described a resource consent as a defining element of generation projects in Trustpower's pipeline, provides rights to essential resources, the ability to choose the timing of investments.

Hagen at 26.13 again saw an economic benefit in having an option to defer the development/construction of a project and agreed that having the freedom to decide when or if at all to spend money on a building project was an economic benefit.

Can I just interpolate here with a proposition that was put to my friend today and this is in Dr Harker's evidence. This was about the acquiring authority point, and at Dr Harker's cross-examination, volume 4, tab 13 – tab 31, and page 637.

ARNOLD J:

Sorry, page number?

MR McLELLAN QC:

637, down the bottom.

ARNOLD J:

At the bottom, yes, thanks.

MR McLELLAN QC:

Now this is in the context of the Wairau project which you will recall from the discussion yesterday with my friend about the progress that Trustpower made with land acquisition rights. Trustpower – Wairau was the more difficult of the four projects in that regard. At line 19 I put to Dr Harker that, "Becoming an acquiring authority would give you rights of compulsory land acquisition?" He said he understood so. "But what this paragraph indicates is that if you were granted a consent, and not until then, the company would be in a stronger position to push the Government for an acquiring authority over the relevant land or to reach settlement with the landowners?" "Yes." Then over the page and just down the bottom, "The reason it was considered to preferable to wait until the resource consent was granted was that you would have stronger leverage than to reach a settlement with the remaining landowners." I got an answer from Dr Harker which I moved on from and asked him to answer the question. "There are two alternatives here, both premised on the company getting a resource consent. What I put to you is that the company considered that it would be in a stronger position to achieve full ownership by either of those means once it had the resource consent. That was the view of the Chief Executive." He said, "Because having the resource consent would give the company greater leverage to achieve that end. I think it's more that the resource consent means the project is more real and the discussions are less than the abstract domain." Over the page at 639 line 7 to line 13, "And that stronger position with landowners arises from having the resource consent as opposed to not having it." So there is another advantage in getting the consent, getting the sites consented which, as we can see from the summary of land acquisition and some of the documents that you've already been taken to, that the company would typically be accumulating land rights at the same time that it was consenting, again, an unsurprising commercial proposition.

Over the page back at my submissions, 26.14, Professor Evans said, "The right to choose the timing of an action is very valuable. The more so the more uncertain the payoff from the action." Mahinerangi stage 1 being developed in stages was an example of the resource consent providing Trustpower with the optionality to build part now and defer part until later.

It was accepted that the resource consents were transferable, could be traded for consideration, though there was obviously a value question as to what that would be.

At paragraph – this isn't in the section but at paragraph 6.7 of Dr Harker's brief of evidence he said that he had an open mind about whether to sell consented projects as a bundle and there's evidence cited at 26.19 that Trustpower's Board considered selling consented sites as part of its strategic planning.

I don't think you've seen the –

WILLIAM YOUNG J:
So if a consented site was sold, what would the tax treatment be on the different interpretations, on the Trustpower interpretation, the cost of consenting would be on revenue account, would the sale be on capital account, presumably?

MR McLELLAN QC:
This is perhaps one of the paradoxes of the case. If a third party purchased a consented site from Trustpower, then that would be on capital account to the purchaser and including in respect of the resource consenting costs. The purchaser couldn't take the view, surely, that it was entitled to –

GLAZEBROOK J:
I think you were being asked what the tax treatment for Trustpower was.

WILLIAM YOUNG J:
Yes. Rather simplistically I assume that Trustpower would be in that happy situation of having being able to expense the cost but not having to account for the profit.

MR McLELLAN QC:
Well, that would be a capital item, naturally.

WILLIAM YOUNG J:
Yes so it's expensed the cost of acquiring the resource consents but then sells them on capital account.

MR McLELLAN QC:
It's an illogical position.

GLAZEBROOK J:
Actually it probably wouldn't be the case because if you had expensed it, it probably becomes a revenue asset and you would have to at least account for that portion of the price that was associated with the consent.

MR McLELLAN QC:
Looking at it from the purchaser's point of view it would be even odder, wouldn't it, that –

GLAZEBROOK J:
Well, no, the purchaser doesn't get a deduction and that's quite often the case that if somebody who trades in land sells me land I don't get a deduction for it because it's on revenue account for them, do I?

MR McLELLAN QC:
But Trustpower isn't in the business of –

WILLIAM YOUNG J:
I'm more interested, really, in whether Trustpower would have to account for the portion of the sale price attributable to the resource consent or whether that just gets lost in the mix.

MR McLELLAN QC:
I don't think I can answer that. Logically one would expect it just to be on capital account, it being the sale of a capital asset. That's one issue that we don't have to grapple with.

Over the page at 26.21, Mr Hagen again agreed that there was a future economic benefit in Trustpower having consented sites with land access rights that are

available to be sold. He also accepted that a prudent purchaser would pay more for a consented package in the context of the offer for Kaiwera Downs.

O'REGAN J:
But all of these are the so-called stapled consent with the overall project, aren't they? This is a different thing from saying you just sell the consent to someone who doesn't have any interest in the land.

MR McLELLAN QC:
Well, whether you can sell them individually – theoretically you can but that may be commercially unlikely, but certainly as part of a package of rights and assets.

O'REGAN J:
Yes but I don't think Trustpower is disputing you can sell it as part of the package when you've stapled it to the rest of the rights you need for the project. So I'm not sure it takes your argument anywhere.

MR McLELLAN QC:
Well, there is value in the consents whether as part of a package of rights and assets or individually. But I don't think that the Commissioner needs to go further than to point to value in the consents as part of a package.

O'REGAN J:
The case you've got to answer is until you've got the rest of the package you don't have the value.

MR McLELLAN QC:
Well, they have increasing value as they go through the consenting process so at the –

O'REGAN J:
Let's say you've got the consent. You've gone right through the consenting process but you haven't got any rights in the land yet.

MR McLELLAN QC:
Well, you have accumulating rights so you have, for example, an interest in the land through the land use consents.

O'REGAN J:

Yes but you're asking us to accept the resource consent as an asset in itself so let's assume they haven't got anything else, they've just got the consent. Why does the fact that if subsequently they commit to the project, buy a whole load of sections of land, get access rights and so on, that becomes valuable? Why does that help you get back to having the analysis at the point where they've only got the consent and nothing else?

MR McLELLAN QC:

The cost of the consent starts at the time that the company starts consenting. So that is value and indeed Mr Hagen's evidence was that the value of a consent in the context of a project will be the amount that it's cost to get it to that stage. So there is value in it that –

WILLIAM YOUNG J:

It's like a work in progress. It's like treating it as a work in progress.

MR McLELLAN QC:

Work in progress is a good expression. That will increase in value as the resource consenting process continues towards the point where there is a grant.

Along the way, in tandem with the consenting progress, the company was continuing to acquire land access rights. So there is an accumulation of value to Trustpower through the complementarily of consents, the consenting process, and land acquisition. It has to be the case that a consented incomplete project is worth more than an unconsented project.

O'REGAN J:

Yes but your case is a consent absent everything else to do with the project is a valuable asset, so I mean you're saying the consent becomes valuable because you've got a whole lot of the things that Mr Harley talks about stapling to the consent. But what if you haven't got those and you've just got the consent? You haven't even spoken to a landowner yet.

MR McLELLAN QC:

Well, we know that the company was doing that, that it was accumulating land access in tandem with the resource consenting process.

O'REGAN J:

Is your case that they have to be doing that to make it capital or are you saying even if they haven't done that it's capital?

MR McLELLAN QC:

No, my –

O'REGAN J:

I thought you were saying just merely paying for a consent was enough to make this a committed, a commitment to purchase an asset and a consent –

MR McLELLAN QC:

In terms of it –

O'REGAN J:

– and that is a capital asset and therefore it's capital expenditure. Isn't that your case?

MR McLELLAN QC:

Yes, but it doesn't matter because the company was accumulating land access at the same time as the consenting process. So in terms of the suite of rights, it was accumulating a suite of rights, but the consent is an identifiable asset not as a standalone asset, as you might have seen that expression used quite widely in the High Court judgment, that's not been the Commissioner's position through the litigation. It's that the resource consents are identifiable assets that provide enduring benefits to Trustpower.

And on that point, Professor Evans's evidence at 26.26 said that resource consents are independent of the land to which they relate, and there was no reason why they couldn't be traded without land access rights, but the price of consents will be affected by the probability and expected cost of obtaining land access.

So if you look at the land use consents which run with the land, once the company obtains ownership or at least rights to use that land then the resource consent must become more valuable. It can be transferred to the owner or occupier. So if there is a sale of the land, for example, to a competitor, the consent goes with the land.

Perhaps I'll just take you to Dr Harker's evidence again if you've still got that volume open, which was…

ELIAS CJ:
Which one was it again?

MR McLELLAN QC:
4, tab 31, and at page 647.

O'REGAN J:
647, did you say?

MR McLELLAN QC:
I did, but could you go to 646 instead, please?

GLAZEBROOK J:
Is this the cross-examination, so am I on the wrong – no, I'm on the wrong…

MR McLELLAN QC:
You should be in volume 4.

GLAZEBROOK J:
Page 647 at the bottom?

MR McLELLAN QC:
Down the bottom, yes. Can I take you back just a little bit further, 646? 645, when I was talking to Dr Harker about options I put to him at line 30, or rather he put to me at line 30, "But it's just an option. It's nothing more." I said, "It's not a compulsion?" "I agree." "So the company has the ability within that – the company with a consent has the right to defer within that 10-year window the decision to build the project, you accept that, don't you?" "It never had the obligation to build. It purely had the option." "It has the option, it has the right, not the compulsion, to defer making a

decision to spend money building the project? And Professor Evans would say that's a real option, that it has economic value which arises when there is uncertainty and irreversible investment; you'd accept that proposition?" "I agree with Professor Evans that options are choices and they have a value somewhere between zero and positive numbers in the absence of any compulsion to spend." "When Trustpower has a consent, it's under no compulsion to spend, it has the freedom to decide when, or if not at all, to spend, within a 10-year window?" "Yes." "Being a bit real world about it, in the context of the electricity industry that you live in, that's of value to Trustpower because you can make the decision to build if the market conditions or the regulatory environment improve?" So in other words the consents don't just provide options to build. They provide important options to defer decisions during that 10-year development window, as they've called it.

Some evidence on competition over the page, 26.27. It was agreed by Trustpower's witnesses that the consents could have a blocking effect against competitors for a specific piece of land if there was a shortage of this type of land. A consented project in an area could block a generation competitor from impacting the value of Trustpower's other consented projects.

At – perhaps if you…

O'REGAN J:
Sorry, what page is that on?

MR McLELLAN QC:
That's on page 14 of my submissions, sorry, Your Honour.

O'REGAN J:
Sorry, I was looking at the cross-examination.

MR McLELLAN QC:
And if you've still got that volume open, if you could go to page 603, line 1. I've just asked him about a blocking effect. "That has a blocking effect?" "Yes." "And it has a potential, I won't put it more than that, a potential blocking effect on a competitor coming into the same geographical area?" "Absent any expansion of transmission, yes." So the Court of Appeal didn't, of course, say that there is some absolute blocking effect that will keep all competitors away from Trustpower's South Island

projects but the evidence shows a clear acceptance by Trustpower's witnesses that there is a blocking effect and, perhaps very importantly, there's first mover advantage to Trustpower in that to use, perhaps if I can just skip back a couple of pages in my submissions to page 9 where Trustpower's witness, Mr Campbell, said in cross-examination, that "The 3 year window here is, of course, about securing the consents, not building them, building the projects". That means that's the time period it would take to get the consents. "Of course, if you are the only one in New Zealand with projects in your pipeline that are far enough advanced through the feasibility process that they have a consent, then you'll be first up, best dressed, in the race for new generation." And that's all about effecting structural change, spending this money to position the company to change the profit-making structure when the time is right.

As you're still in that volume, I'll take you to a point that's referred to at 26.32 of my submissions and this is at the same tab, 31, Dr Harker, page 582, and Dr Harker and I were talking here about Mahinerangi and a document related to that. At line 6, "So in simple commercial terms it was of advantage to Trustpower to get an early decision on Mahinerangi which was looking positive, in advance of Meridian progressing its more opposed consenting process?" "Yes. Meridian were seeking 600 megawatt consent for Project Hayes. It stimulated a great deal of local opposition and concern led by a particular society, I think it was called that. I don't know with respect to timing of this report but there was also a Save Mahinerangi Protection Society and some other body. Yes, the general concern for landscape values was emerging as a potential fatal flaw for wind farms in that area." "Mahinerangi was on track, Project Hayes wasn't?" "Yes." "And it provided Trustpower with a competitive advantage in that little part of the market?" "I think the words here say it would be nice to be done and finished before opposition continued to mount." So again, some first mover advantage in the slightly nuanced aspects of competition which was that the first mover was more likely to get a site consented than the second mover because of increasing public opposition.

If I can just take you to a document by way of example of the type of analysis which the company went into, and this is at supplementary bundle volume 1, which is the core bundle, tab 15, page 2838, this is an Arnold River hydro scheme development update report dated November 2005, the analysis which you can see in the remainder of the document is summarised in the second paragraph. The analysis suggests that Trustpower should proceed to acquire land access by way of future

acquisition options or where necessary outright purchase and to secure resource consent. So just coming back to Justice O'Regan's point about land acquisition, this is typical of Trustpower's approach which was to authorise to commence the resource consenting process at the same time as approximately and to continue consenting in conjunction with the acquisition of land rights.

I won't take you to it but there's between there and the end of the document but I will take you to 2845. In the conclusions and recommendations section analysis suggests that there's potentially significant long-term value in the Arnold/Taramakau scheme and that the acquisition of land and resource consents are critical to any future developments. If Trustpower chooses not to proceed with the full development, there appears to be little downside if the land and resource consent had been secured as the project at either of its stages should be very saleable as it is.

As the preliminary investigation suggests, development of the Taramakau River diversion and Lake Brunner, control options will add significant value to the base Arnold scheme. However, a clear window of opportunity exists, possibly for less than two to three years, to secure resource consents as the risk of electricity supply shortages is publically and politically high on the agenda. Should a resource consent be secured, the likelihood of achieving a consent on the Taramakau scheme will be significantly enhanced because it will put some of the water back into the Arnold River. So the recommendation was expenditure of up to $5.6 million to acquire the necessary land purchases and option agreements, lodging a resource consent.

ARNOLD J:
Now, the Board didn't accept this and what you say follows from that.

MR McLELLAN QC:
The consenting process nevertheless commenced and as Dr Harker has said in his evidence, and I'll find the reference to it, the decision on consenting or decisions on consenting was left to the management. In the passage that I'll find and show you tomorrow, he said that, left those matters to management but we could intervene, of course, if the Board chose to. But what we know is that the Board didn't. The company carried on with consenting all the way through and I'll also take you to some passages tomorrow of Dr Harker's evidence where he talks about the fact that they had great faith in the management, that they expended these relatively

significant sums in the expectation of obtaining resource consents on favourable terms. Again, as you would expect a prudent company to act, but while there may have been bought back off, nevertheless on an objective view of the evidence the company did continue with consenting through to lodging consents and being granted consents.

You'll see through the document the really quite complex analysis from 2846 onwards where the company goes through the kind of sophisticated risk assessments that you would expect to look at alternatives such as at 2854. One of the alternatives was to seek a low weighted average cost of capital buyer for the project, so the options were weighed but the company proceeded with the consenting.

ELIAS CJ:
Mr McLellan, where do you want to take us now? It's time to adjourn but if you want to finish off where you are.

MR McLELLAN QC:
I'm moving on, so if that suits Your Honour.

ELIAS CJ:
You're going to continue carrying on through the evidence.

MR McLELLAN QC:
I will have a little more evidence tomorrow, not a great deal, and then I'll go back and deal with the application of the principles to the factual findings and then move on to section D, so I think we're making relatively good progress.

ELIAS CJ:
Good. All right, thank you. We'll take the evening adjournment now.

COURT RESUMES ON THURSDAY 10 MARCH 2016 AT 10.02 AM

ELIAS CJ:
Yes, thank you, Mr McLellan.

MR McLELLAN QC:

Good morning, Your Honour. As I indicated yesterday afternoon I'm going to finish some relatively brief sections of evidence and then return to the main capital revenue point.

Now can we start, please, with the core bundle, volume 1, one of the white volumes, at tab 4. This is a generation development report from 2007. If you would go, please, to page 4166. A relatively short point in the middle of the page there about Wairau. The Wairau Project at 4.1.1. Just to put this in chronology, the Wairau consent had been through hearings and there'd been an interim decision and the final consent was granted in 2008.

So it says, "With a positive outcome from the hearing and the expected appeal, Trustpower will need to decide if the project will be taken to the Environment Court. It is suggested that subject to a positive outcome from the consent hearing, we hold discussions with a range of upper South Island councils and network companies with a view to selling them the consented scheme, with a 10-year Trustpower PPA to back the sale. Trustpower could retain some equity in the project."

GLAZEBROOK J:

Sorry, I've lost you.

MR McLELLAN QC:

I'm sorry, your Honour. That's at – are you on 4166, page 4166?

GLAZEBROOK J:

Yes, all right, thank you.

MR McLELLAN QC:

And 4.1.1. So just a short point there about Trustpower's options that it collected from the consenting process. The next related point is at Mr Campbell's evidence.

ELIAS CJ:

Sorry, what was this again? This was a report to the Board, was it?

MR McLELLAN QC:

That's a generation development report.

GLAZEBROOK J:
Report to the Board or…

MR McLELLAN QC:
Yes, I believe so. It's part of the strategic plan.

ELIAS CJ:
Yes, and indicating, you say, that the consents have value because they are anticipating they'll be able to –

MR McLELLAN QC:
It's just related to the point I was making yesterday that the consent adds value to the project as a whole and this was one of the options that Trustpower looked at.

Next, if I could ask you to go to Mr Campbell's cross-examination which is in volume 6 of the blue volumes at page 952 of his evidence, tab 41, and towards the bottom around line 28, this is Mr Campbell, who is Mr Kedian's replacement as general manager generation, "I'd like to talk to you about the references in the evidence to the potential sale of the four projects. Is that right that Trustpower's considered selling each of the projects at various times?" and he said, "I think part of our overarching strategic process is to look at what we've got in terms of opportunities and look at how best to monetise them. We've never done any real work in terms of getting too far down a sale process. Monetised options can include build them, obviously, in a context of an overall pipeline and how you might make shareholder value out of that pipeline. That's probably one consideration at a high level. Say it was a potential option. It's one of the considerations you have to give. I think I described our balance sheets can get a bit tight sometimes."

And you've heard evidence about the offer that was received to purchase one of the projects and I'll just take you to that letter because I don't think you've seen that yet. That's in volume 2 of the core bundle tab 38. As my friend has reminded me, unnecessarily given how often this has been referred to, this is a confidential document.

ELIAS CJ:
It's not headed that.

MR McLELLAN QC:

None of them are.

ELIAS CJ:

No, the first one we were taken to was headed.

MR McLELLAN QC:

Was that the land sale summaries?

ELIAS CJ:

I can't remember.

MR McLELLAN QC:

I think it was.

ELIAS CJ:

I had been sitting here thinking that everything –

MR McLELLAN QC:

That your life was going to be easier.

ELIAS CJ:

Yes. But it's not.

MR McLELLAN QC:

Sorry.

GLAZEBROOK J:

It is in the index.

MR McLELLAN QC:

It's in the case on appeal index in the right-hand column. There's a tick or a yes or something for confidential. Anyway, you might like to note that this one is and I'll just let you read that. The final aspect of evidence –

ELIAS CJ:

This 2010, where does that fit in the chronology?

MR McLELLAN QC:
That isn't one of the tax years.

ELIAS CJ:
No. It's just to show the method of operation?

MR McLELLAN QC:
Illustrative of value. So by that point, Kaiwera Downs was, of course, consented.

WILLIAM YOUNG J:
What are the consent costs for Kaiwera Downs?

MR McLELLAN QC:
I'm grateful to my friend. They are in the High Court judgment.

ELIAS CJ:
Is that your learned friend?

MR McLELLAN QC:
I'm grateful to my friend for this. Not in the judgment. It is in the first volume of the green case on appeal.

GLAZEBROOK J:
Does that mean the pleadings?

MR McLELLAN QC:
The pleadings at tab 6.

WILLIAM YOUNG J:
Those are globalised, aren't they?

MR McLELLAN QC:
Yes. That's right. In our submissions, paragraph 26.33 Kaiwera 891,000.

WILLIAM YOUNG J:
So what reason did Trustpower give for not proceeded with this?

MR McLELLAN QC:
Probably the best source of that is Mr Kedian's evidence, his brief of evidence which is at volume 5 tab 33 page 720 paragraph 4.56.

ELIAS CJ:
Is the answer obvious from that?

O'REGAN J:
Yes.

ELIAS CJ:
Is it?

WILLIAM YOUNG J:
Not enough.

MR McLELLAN QC:
Also in point C there seem to be some disadvantage to Trustpower selling the project to a competitor when that would put pressure on the other wind farm at Mahinerangi, which is the one that was built.

WILLIAM YOUNG J:
But Mahinerangi stage 1 has been built, not stage 2?

MR McLELLAN QC:
Stage 1 has been built, correct.

WILLIAM YOUNG J:
Why would it put pressure on stage 2?

MR McLELLAN QC:
Presumably if there was an intention to build stage 2.

WILLIAM YOUNG J:
Because of correlation of generating capacity?

MR McLELLAN QC:

Yes. So turning to Dr Harker's cross-examination, which is volume 4 tab 31, some reasonably short points on page 569, I was talking to Dr Harker about, over the previous page about the AEE, the assessment of environmental effects that was lodged with the application up the top of 569. "Having not seen this before it seems to be saying that we will put a quality report on the table and I would expect nothing less and that was the policy of Trustpower. It wasn't going to put money into applications for resource consents that didn't have a reasonable prospect of success?" "Yes, I agree with that." And then back a few pages to 566, previous page, please, 222, just to give it context, I was talking to Dr Harker about building a transmission connection around the middle of that page to which he said yes, it was hoped there might be an additional revenue float at that project and then towards the bottom, the theory behind the recommendation was to keep the option open. He said we should buy land that was available at that time and the only question put to the Board that it had to turn its mind to was whether to buy the land or not. That was the only question on the table on that day. This is about Arnold. And I accepted him, "And to move forward, the lodging of a resource consent application?" "No, that decision with Arnold was left with management." "But management took steps to progress that. They made the recommendation, didn't they? You can see that on page 4." "Yes, the Board left the decision with management. Perhaps to put it in context, the expectation was that land purchases would be at or only marginally above market value so it was not seen as a material issue in terms of dollars at risk for the company." Then a few lines down at 19, "It's your evidence that the Board didn't have anything to do with the decision to proceed with the application?" "I don't believe it came to the Board as a recommendation to approve. The Board could have intervened and said, 'Don't do it at any time.' It felt like that the Board was comfortable with the strategy of progressing this Arnold scheme."

Then over the page to 567, he was talking to me about MPVs and I asked him, "All those variables were considered by the Board and it was viable enough at least to approve it to the stage of land acquisition. That was the only question put to the Board." So you'll recall from that document we saw yesterday on the Arnold project that the Board had approved the acquisition of land at the same time as management was starting to progress the resource consent application. So again just referring to this item of evidence to demonstrate that the resource consenting and the land acquisition worked in tandem.

Just about three more passages, page 603, we've got some stuff at the top that we've already talked about, the blocking effect, and it's the same geographical area absent any expansion of transmission. Then at the middle of the page at line 17 we turn to the consenting process. He reiterated the point about how the Board left that to the management. Line 23, "You had confidence in the consenting process. You knew, or certainly expected, that applications would contain robust and compelling cases for consents?" "Yes." "And you expected those who were responsible for applying for consents to get them?" Perhaps just read to yourselves the passage at the bottom of that page and over the next down to about 8. Then Dr Harker said, "The confidence we had is that the management team did a good job of presenting – probably more so than presenting. They would actually do a good job of understanding what may be an acceptable proposition before they embark on the journey of applying for a consent."

Then we had a little argument about the terminology about feasibility or pre-feasibility and then at line 23, "What we mean by pre-feasibility is essentially there are no fatal flaws in the proposed project." "Yes." "And that there was an expectation that a consent on favourable conditions would be granted?" "Yes."

Over the page at 605 line 3 I asked Dr Harker, "The Board considered that was appropriate" – setting an appropriate budget, that is – "because it expected compelling and robust environmental cases to be put forward in support of applications for consents." His answer, "Because resource consents do cost money and engage the community. It would be foolish to do it without thinking you had an acceptable proposition to do that to that community and there was some prospect that at the end of it all it may have become an option that was useful."

Then the last passage is at 616, returning to the acquisition of land. If you go back one page, you'll see that I'm talking to him about a document which had a decision tree in it. You don't need to go to it but a decision tree showing the options available to Trustpower in relation to a particular project. At the bottom of that page it appeared to indicate that if the probability of acquiring all the land is 10% then you should sell the land and Dr Harker is saying, "No, I think it's saying if you fail to secure land all that you need then you will sell whatever land you've purchased. You'd have to sell the land you've purchased. It would be of no use to you." "If you're doing badly with land acquisition," I asked, "Give up and sell what you've bought?" "Yes." Whereas if you've got a 90% probability apply for a consent." "No, I

think the writer's saying they're 90% confident of securing all land." "Yes, we're saying the same thing, perhaps." "If you expect to get the land, apply for the consent. I think the decision to apply for consent, you would want to have that resolved before you table the consent," and then I had an exchange with him about how that's not how they did it on a couple of the projects and over the page that exchange continued down to about line 10 where he read from the document or I read from the document, "The expected value of the Arnold project is positive but the decision tree indicates, doesn't it, that if there's a 90% probability of securing land then the implication is apply for consent which would just be a very common sense way of looking at it, would it not?" "Yes." Then he answered as well, "There's some threshold of land which you may feel the land is no longer an issue inhibiting consent," and so the reason I've taken you to these passages is to demonstrate what perhaps is commercially fairly obvious, that the company didn't consider that it needed to have all land access or all land rights secured before it embarked on the consenting process because it carried out a risk assessment as to the prospects of getting all that it needed. Perhaps a case in point is the Mahinerangi wind farm where some of the land in that case was owned by the Dunedin City Council and when the consenting process started it was understood that there may not be agreement with all landowners, possibly not the Dunedin City Council but the consent application or rather the consenting process started, the application went in, there were hearings, and the issue with the Dunedin City Council couldn't be resolved and so the envelope of the wind farm was changed, the application withdrawn and a replacement application put in for the different envelope.

WILLIAM YOUNG J:

Has Trustpower sold consented developments?

MR McLELLAN QC:

I'm not aware of that. I'll need to check to give you a completely accurate answer.

WILLIAM YOUNG J:

If the Kaiwera project had been sold, was there any evidence addressed to the tax treatment of the proceeds of sale if the Kaiwera sale had proceeded?

MR McLELLAN QC:

It didn't go beyond the – I'm not aware of there having been any. I think it was just shut down. Not even sure if there was a response.

So the first point of this next section of my submissions on the capital revenue distinction is that the disputed expenditure was on capital account according to general principles, which is as far as the Court of Appeal felt the, it needed to go in resolving the capital revenue issue, obviously it is the case for the Commissioner that the main point is that the expenditure was on capital account, should have been treated as on capital account, because it was calculated to effect structural change in the business of Trustpower because the resource consents were an essential element of the proposal to build the capital projects.

It doesn't matter, in my submission, that at the time the expenditure was incurred by Trustpower they hadn't obtained the consents. Trustpower describes the consents are merely inchoate in the year in question. Of course, that speaks for itself that there were no consents when the consenting process started, but that is nevertheless what the expenditure was calculated to achieve, the grants of consents that would enable the construction and operation of the projects.

It is of course the connection between the expenditure and the process of creation of the assets, be it the resource consents or ultimately capital projects not the end result, and that appears to be accepted in Trustpower's written submissions although we'll come back to the Canadian cases that my friend referred to as where they appear to allow some outcome reasoning but certainly on the basis, for example, of the *Fullers* decision and numerous others, *Milburn*, which I'll take you to, whether resource consents are ultimately granted or not is irrelevant to the question of whether the expenditure is on capital or revenue account.

That aligns with the decisions in *Fullers* case, *Milburn*, the *Waste Management* decision that my friend has taken you to, the English case of *ECC Quarries* and the New Zealand taxation review authority case of Judge Barber's. Those decisions are summarised in paragraph 51 of my written submissions and I'll take you, if I may, to the *Milburn* decision.

ARNOLD J:

Just before you do that, trying to put this in a broader context, as I understand it, costs of feasibility studies, research and development, things like that, have caused some difficulty and there are a number of special regimes that deal with this type of cost in particular areas and you mentioned yesterday the provision that says you can

now deduct the costs of a failed resource application. There are special provisions for oil and gas exploration, are there?

MR McLELLAN QC:
Yes, there are.

ARNOLD J:
And what are the other areas where there are special – there are general R&D provisions?

MR McLELLAN QC:
I was going to mention that one because that's one of the few that I am aware of. Oil and gas certainly, research and development. No analogy has been drawn between those.

ARNOLD J:
No, I understand that but it's useful to have a structural overview of this and see how everything plugs in.

MR McLELLAN QC:
Yes and you can see – I won't say in each of those areas but certainly in that area, research and development, oil and gas, and here specifically tailored for resource consenting there are relief provisions specifically in relation to resource consenting as express overrides to the capital limitation.

ELIAS CJ:
Well, I think I asked about this yesterday, too, because maybe this statute, maybe tax, is subject to different interpretation principles but it's a general precept that you read statutes as a whole and so if there is any architecture or pattern from which some assistance can be derived in interpreting the more general provisions, is there any argument you want to address to us on that?

MR McLELLAN QC:
Not beyond the subpart EE which is the depreciation regime which I will come to shortly. But again, that is specifically because resource consents are treated in – well, they are given explicit treatment.

ELIAS CJ:

It's just that all of those provisions may indicate, provide clues to the policy behind the legislation which might be of more general assistance. Perhaps not. Perhaps they are all ad hoc.

GLAZEBROOK J:

I'm not sure they are. I think they now are actually fairly well set out if you look at the deductibility provisions. I mean, you can probably get quite a good idea of the scheme from those.

MR McLELLAN QC:

I was going to take you to the *Milburn* decision which is in volume 2 of the authorities, tab 24. Milburn and one of its subsidiaries, Fraser, wanted to expand its quarrying operations and it investigated – this is at paragraph 9 – a site in the Bombay Hills and one at Alpha Creek near Westport and another one in the Hawke's Bay, and you'll see at the end of paragraph 9 Justice Wild said that it's common ground that all the expenditure on three sites was for the purpose of obtaining necessary consents or licences. Milburn began investigating the Bombay site in August 1986 as a potential basalt quarry. Matters have progressed sufficiently by 1989 for the Board to approve expenditure of three million dollars to purchase land for the proposed quarry. Options were taken and lawyers and consultants were engaged to prepare a town planning application which was filed, declined, but eventually granted in 1993. Consultants were commissioned to undertake investigations for a water right applications. Water rights were granted. Clean air licence was sought and the other project, Alpha Creek, November 1989 Milburn's Board gave approval to apply for a mining licence. That was made. Then Fraser, the subsidiary, which was interested in the Hawke's Bay property, carried out investigations – this is at paragraph 12 – into an alternative site followed by a planning application. Fraser's application for planning permission was declined and its appeal was dismissed.

ARNOLD J:

Can I just understand something? In paragraph 8 the Judge makes the point that Milburn investigated 48 different sites and then he goes on in 9 as you've pointed out to talk about the four. Now, the other ones, the 44, were they just treated as the costs associated with that were just treated as deductible in the normal way, were they, or was there any argument about that?

MR McLELLAN QC:

24, Your Honour, the inspectors compared these three sites with the 48 other prospects and they drew up a development flowchart which goes over the page. At 25, none of the 48 projects progressed beyond stage 6 which was geomagnetic surveying, drilling, and core testing. In respect of each of Bombay, Alpha Creek, and Fraser decided that they had gone beyond the basic investigation or evaluation stages the taxpayers committing themselves to the purchase or development of an asset.

ARNOLD J:

I see, okay. Thank you.

ELIAS CJ:

So an investigation development line is observed here?

MR McLELLAN QC:

Correct.

ARNOLD J:

But that was accepted as a given. There's no argument about it, whether that was right or wrong. It's just the basis on which the case proceeded.

MR McLELLAN QC:

Proceeded.

ARNOLD J:

Yep.

MR McLELLAN QC:

The taxpayer wouldn't disagree with that.

So from 26 onwards you'll see that there's evidence called from an accountant. The taxpayer's Chief Executive, this is at 29, gave evidence that the tax inspectors and Mr Frankham had overlooked the critical importance to Milburn and Fraser of obtaining the resource consent. Without a consent, production could not begin. Further, a resource consent may be granted on terms so onerous as to preclude economic production. Therefore, until an acceptable consent is granted, they cannot

be confident that an economically recoverable resource is available, and Mr Williams instanced Fraser where, despite best efforts and the outlay of significant expenditure, a resource consent was refused, and Justice Wild dealt with that argument over the page at 34, "I am unable to accept the taxpayers' viewpoint." "It seeks to classify the expenditure dependant on the outcome of the various applications for consent. There is no logical nexus, and categorisation dependent upon outcome has been firmly rejected in New Zealand, Australia and England," and His Honour cited not only the *ECC Quarries* case but also the *John Fairfax & Sons Pty Ltd v Federal Commissioner of Taxation* (1959) 101 CLR 30 (HCA) case, which I have included in my submissions. Down the bottom, the Court of Appeal's judgment in *L D Nathan* and Justice Richardson's judgment in the *Waste Management* decision which you've heard about already, and over the page citing Justice Richardson, "Deductibility is to be determined when the expenditure is incurred. The deductibility is not affected by subsequent events," and, of course, importantly on that point here, Fraser's application was declined and the consenting costs up to the point of the application being declined and the failed appeal going ahead was on capital account. And then His Honour turned to the *ECC Quarries* case which I'll come to separately because there's another passage that I want to refer to in that. And at 42 His Honour referred to the *Waste Management* decision and the fact that *Waste Management's* expenditure was with a view to developing the site as a landfill to – for disposing of industrial waste. "The taxpayer had spent substantial sums investigating the feasibility of the site, designing a landfill and seeking the planning consents and water rights it needed." The issue was whether the expenditure came within a special deductibility provision in the Act. However, when referring to the expenditure Justice Richardson said that, "The expenditures in the present case are capital but that is not a bar to their deductibility". "Accepting that remark is strictly obiter, it is nevertheless a powerful indication of the Court of Appeal's view of expenditure identical in character to that in issue here." His Honour then went on to deal with the *BP Australia* criteria having already concluded that under the general principles the expenditure was on capital account and on the head count under the *BP Australia* indicia he reached the same view.

I'll just take you to one further paragraph in this judgment, 65, which is directed at the structural argument that I've started with, whether the expenditure is directed towards the structure through which the taxpayer earns its profits, and Professor Trow had expressed a view that it was part of income earning process. Justice Wild disagreed. "A significant part of Milburn's business was quarrying lime and aggregates for its

cement and concrete businesses. Bombay and Alpha Creek were integral and vital – or potentially integral and vital – parts of its business structure," potentially presumably because if consents weren't granted then the projects couldn't go ahead. Expenditure on one of the steps towards development quarries or aggregate resources for commercial production is capital in that it is expended on assets which will produce income from the taxpayer's businesses. The passage from ECC I've cited above demonstrates that Justice Brightman held the same view.

So all of the expenditure, whether it was described as feasibility or consenting costs, towards the development of the sites was on capital account and the Commissioner obviously reasoning by analogy takes some support from Justice Wild's reasoning.

O'REGAN J:

Do you accept that there is a difference between that case and this in that in this case the taxpayer says it wasn't looking necessarily to develop these projects, it was considering them along with a whole lot of other options in the *Milburn* case? It does seem one way or the other, they had to have another quarry for their operation to continue.

MR McLELLAN QC:

Not in conceptual terms. There is a factual difference, but not in principle because there are contingencies on both this case and in that case, for example, for Fraser, who didn't get a consent, we shouldn't actually be thinking about it in terms of the fact that they didn't get a consent. They may not have got a consent when they started the process, just as Trustpower may not have got a consent and, indeed, may or may not go ahead with the projects. So that again comes back to that which I consider to be quite a critical issue in this case, that outcome reasoning isn't permitted in understanding where the capital income line is drawn.

ARNOLD J:

So this distinction between basic investigation or evaluation stages which the Commissioner accepts are on revenue account, the cost of it, and the taxpayers committing themselves switches to capital account, that is simply a pragmatic line drawn by the Commissioner, is it?

MR McLELLAN QC:

It is according to the Court of Appeal, and because it is, as we discussed yesterday, an intensely factual issue then, yes, it is understandable that there would be a degree of pragmatism in it so as to ensure that the taxpayer isn't prejudiced by the line being drawn too sharply.

ELIAS CJ:

It's a pretty labour-intensive exercise, then, isn't it, with all the rights of appeal and review and as to where the line gets drawn.

MR McLELLAN QC:

Yes and that is why the Commissioner does support in general terms the guidelines that have been issued and the approach that she took in this case because while it has been described as pragmatic certainly in my submission and evidently in the view of the Court of Appeal the line could have been drawn further back into revenue territory but at least at the point that it was drawn it was very clear, according to the Court of Appeal and in my submission also. So they couldn't at that point be much room for doubt that it had become on capital account.

ELIAS CJ:

Well, I suppose that the very indeterminacy would push the Commissioner to a fairly – to not being too tough in this area because otherwise it is going to be productive of endless disputes.

MR McLELLAN QC:

Correct and section 6A is in the Act for that reason, including for that reason, which allows an approach which is, which takes into account factors such as encouraging voluntary compliance by taxpayers but of course we have to remember that the capital revenue describing something as capital doesn't necessarily always in the taxpayers' favour, of course, so the line sometimes has to be drawn the other way for incoming receipts of a taxpayer. So there needs to be a distinction which is capable of being understood by taxpayers and being pragmatically applied as the Commissioner considers it was in this case.

I'll turn to the ECC quarries case if I may, which is in the English authorities at volume 5 tab 49. You'll see from the headnote the taxpayer traded in extraction preparation for the selling of stone gravel and other quarries.

O'REGAN J:
It's tab 53.

MR McLELLAN QC:
Tab 53, sorry. So Justice Brightman's judgment at 1388, he explains that the taxpayer's principal activities were the extraction and preparation for sale and selling of stones and gravel. The taxpayer company operated some 30 sites. These sites contained deposits of sand and gravel. Over the page, there was a lease due to expire in 1975 with an option to renew for a further term to 1996. Planning permission existed for the winning and working of sand and gravel from 32 acres at Black Hill but there was no planning permission. Another of the taxpayer company sites was known as Rock Bear, a freehold site owned by the taxpayer, contained deposits of sand and gravel. Planning permission existed for the winning and working of sand and gravel from 56 acres there. The estimate was that in the permitted area the minerals would be exhausted by the mid '70s and also that by the same date Rock Bear would be wholly worked out.

A little later in section C to D the taxpayer began to prepare an application for permission to win and work sand and gravel at two sites and to win and work sand and gravel from the Black Hill site as a continuation of its existing activities. Applications were lodged in February 1967. In 1967 there was an inquiry and you'll see at the bottom of that paragraph E to F the Minister refused all three applications but he indicated, broadly speaking, they might be renewed but this case concerns the characterisation of the expenditure in applying for the planning permissions which were declined and after a review of the by-now well-familiar authorities such as *British Insulated*, *Anglo-Persian*, the Judge turned to his decision at 1397 section C. "It seems to me in the case which I have to decide the taxpayer company expended money for the purpose of securing a permanent alteration of the nature of the land domed or occupied. That is to say a change from land confined to its existing use and of little or no value to the taxpayer company being turned to account pursuant to the taxpayer company's subsequent trading activities. It was a lump sum for an enduring advantage, static in nature in the sense that it was not the planning permission which would produce the profits but the subsequent operations of working and winning the minerals. It is, I think, unbusinesslike to say that if planning permission had been granted no new asset would have belonged to the taxpayer company. The asset in respect of which planning permission was granted would

have been radically and enduringly changed viewed as an asset of the taxpayer company's business. It could be written up in value et cetera. It would be something which it was not before," namely land for which minerals and worked, so he's talking there about the land. Then he goes on to talk about guidance from the reported authorities and he refers to Lord Wilberforce's judgment in *Carron* and by analogy his Honour said that the planning permission, if obtained, would in some sense have been an intangible asset of a capital nature. If that is right, money expended in seeking to acquire such an asset must equally be expenditure of a capital nature, referring to Lord Diplock's judgment. He seems to have felt no difficulty at all in describing a planning permission granted by a local authority as a grant of a right to use the land and of course we say that resource consents are akin to a property interest in land or resources and as a result a resource consent has the characteristics of an asset and a capital asset.

Again in that case the expenditure was in respect of an application which ultimately was declined.

ELIAS CJ:
Where does he end up on the fact or law problem that he identifies in 1398? I'm trying to skim through.

GLAZEBROOK J:
I think the fact in law was what the accountant's position actually was and there was no finding of the Commissioner's on that factual question and he then goes through and says, well, it's for a different purpose, the accountancy evidence is for a different purpose.

MR McLELLAN QC:
I think under the English rule there could only be an appeal on a question of law.

GLAZEBROOK J:
Yes, it was just on what the accountancy position actually was.

MR McLELLAN QC:
You will see that the answer is on the final page of the judgment at 1402 where he refers to there having been unchallenged accountancy evidence but no finding by the Commissioner as to established accountancy practice he doesn't think it would help

to remit the case to the Commissioner. I am satisfied that the correct accountancy practice is a question of law. So he then is able to deal with the whole issue.

Just while we're on that, since accountancy is an issue here, "The accountancy evidence in section E to F is not sufficient to persuade me to alter that view in reaching this conclusion. I don't intend to say that it would be erroneous in drawing up a balance sheet for the purposes of the Companies Act to debit the costs of the unsuccessful applications against revenue, accounts which are drawn up to comply with the Companies Act, and to show shareholders what is the divisible profit involved in a somewhat different exercise from the drawing up of accounts on strict accountancy principles, but I'm not concerned with the statutory form of accounts." So it didn't alter his conclusion on the capital revenue conclusion.

If we could look briefly at *Waste Management*, please, which is in volume 2 tab 19, the important context or rider to this decision is that it, strictly speaking, concerned section 124 of the-then Income Tax Act which gave a deduction for certain landfill activities that would otherwise be capital expenditure because landfills were to be encouraged, it seems. At 12148 of the report you will see that the facts are summarised in the right-hand column where the company obtained a one year option to purchase a property as a potential landfill. It undertook preliminary site investigation and then exercised the option and it carried out quite lengthy investigations, detailed designs, development proposals, and a planning consent with the consent finally given by the Tribunal in 1992 and over the page there's a list of the costs that had been incurred and what they were for. You'll see the top one, the most significant individual figure was approval costs consisting primarily of legal costs incurred in obtaining the necessary statutory planning consents.

At the foot of that left-hand column Justice Richardson recorded that it's common ground that all of these expenditures were incurred in relation to landfill development. Then in the next column His Honour refers to Justice Speight's decision. He held in effect that survey costs, geology costs and landscaping costs were deductible under section 124, the preliminary engineering costs and design which is cost 3 and 7 above which concluded preliminary engineering costs and of investigating the feasibility of the development where they related solely to preparation and opinions to be given in evidence at planning hearings and were not relevant to construction plans. Then down the foot of that column he considered that different considerations governed expenditure incurred in seeking planning permission, emphasising the

words in section 124. He held that the cost of obtaining planning approvals was incurred in altering legal status of the land and was not an expense in construction on the land.

Over the page under the heading “deductibility test” in this case towards the foot of the first paragraph, the expenditures in the present case are capital but that is not a bar to their deductibility.

So firstly Justice Speight had held that the planning hearings’ costs were capital and it is, of course, an obiter observation by Justice Richardson because the issue of whether the costs were capital was not strictly before him but it is a statement of some authority that it is taken as read that those type of costs are capital in nature and of course Justice Wild referred to that in the *Milburn* decision. And if you would note, I don’t need to take you to it, but the decision of Judge Barber in *Case T53* (1998) 18 NZTC 8,404 (TRA) which specifically dealt with resource consents, it’s at volume 2, tab 20, and the relevant paragraph is at paragraph 27 where it was submitted to Judge Barber that, “On the facts of this case, no identifiable asset is produced by the expenditure. However, it seems to me that the reception is an intangible asset of the business of the objector… I observe that the expenditure actually relates to the obtaining of a right which did not previously exist before the granting of the resource consent.” So in my submission these authorities strongly point towards the expenditure in this case as being on capital account.

Now I’ll just briefly mention one or two of the Canadian cases, particular the *Bowater* decision which my learned friend has referred to, and that is at volume 5, tab 55. So the taxpayer had gone through the surveying or planning stage for a hydro electric project, but because another project came onto the scene which was going to develop an alternative hydro site, this is at page 835 of the decision, the taxpayer abandoned its plans and claimed the wasted expenditure as a deduction and at 837, towards the middle of the page, “These expenditures, it is true, did not materialise into any concrete assets for which capital allowances could have been obtained but they were made for the purpose of effecting an increase in the volume and the efficiency of its business and, therefore, for the purpose of gaining income.” So in my submission if that were, if they were the words of a New Zealand Judge it would be followed by a they are therefore on capital account.

O'REGAN J:

Whereabouts is that written on that page?

MR McLELLAN QC:

That's page 837 and just above half way down starting, "These expenditures."

O'REGAN J:

I see, thank you.

MR McLELLAN QC:

And then the final short paragraph at the bottom of that page, "I do not indeed feel that merely because the expenditure was made for the purpose of determining whether to bring into existence a capital asset, it should always be considered as a capital expenditure and, therefore, not deductible, regard must always be had to the business and commercial realities of the matter. While the hydroelectric development, once it becomes a business or commercial reality is a capital asset of the business giving rise to it, whatever reasonable means were taken to find out whether it should be created or not may still result from the current operations of the business as part of the every day concern."

WILLIAM YOUNG J:

So he's saying effectively there's nothing created, it's on revenue account?

MR McLELLAN QC:

Yes, even though all of the expenditure is directed at getting the new project to a point where it could be built and then some fatal flaw occurs –

WILLIAM YOUNG J:

It doesn't deal with the timing issue.

MR McLELLAN QC:

Pardon?

WILLIAM YOUNG J:

It doesn't deal with the timing issue, that the expenditure has to be classified as capital or revenue as incurred. Rather than retrospectively from the point at which the project succeeds or fails.

MR McLELLAN QC:

Correct, and I don't know how under Canadian's Acts law they would achieve that, because of course the expenditure, in New Zealand anyway, would need to be characterised in the year in which it is incurred, whereas this seems to require, as your Honour says, a retrospective approach. My friend referred to the *Wacky Wheatley* case. There's another Canadian authority which is referred to in our submissions called *Gartry v R* 94 DTC 1947 (TCC), which isn't in the book, and I'll just identify the reference for you. It's at footnote 88 of our submissions and in that case, I'll just briefly give you the facts. The taxpayer purchased a vessel and before delivery the boat sank but title had not passed but consideration had and the taxpayer sought to claim a deduction for the wasted cost of the vessel and the Judge in that case said that the cost of the vessel is, of course, a capital cost to the appellant of depreciable property. The respondent's argument, the Commissioner's argument there would consign this loss to a fiscal no-man's land on the basis that they were of a capital nature but because title remained in the vendor, nor terminal loss was available. "In determining whether the law unequivocally compels such an extraordinary result, it is useful to consider the analysis of another Canadian authority," and went on to conclude, "The Crown's position would relegate the appellants to the worst of both possible worlds. This position is inconsistent with ordinary fairness, common sense and commercial reality." So a nice sentiment but certainly not part of New Zealand tax law. So I say that the Canadian authorities are peculiar to that jurisdiction and that type of reasoning hasn't gained any traction in the United Kingdom, Australia or New Zealand jurisdictions.

One of the submissions that Trustpower makes in support of its wider submission that the consents don't give it anything of value is that Trustpower is under no compulsion to build. Now I don't fully understand that submission because it's contradicted by the value evidence that was available to the High Court and the Court of Appeal, that a lack of compulsion is one of the valuable aspects of resource consents. The fact that there is a 10 year lapse period means that the company is under no compulsion to build during that 10 year period. It merely has to take some steps to commence the development within the 10 year period. That ability to defer development is as Professor Evans, and indeed Dr Harker agreed is a thing of value to the company. There are also a couple of references in my friend's submissions to the prospect of the capital projects going ahead as being little more than chance and that's perhaps better put as there being a contingency that the projects will not go ahead. But again, I don't want to repeat myself, but –

GLAZEBROOK J:

I'm not, you can say that but in fact these aren't projects that they've decided to go ahead but mightn't because something might go wrong. These are projects, according to the evidence, that they may or may not go ahead with depending up on pricing et cetera. You can say it's analogous to it but I don't think you can say that that is the case.

MR McLELLAN QC:

What the evidence, in my submission, suggests strongly is that they spent this significant sum of money to position themselves to be able to build the capital projects. It was directed towards the development of the projects and was an essential element in doing so. Yes, it is now given that they did not decide to built and have not decided to build. But that, in the capital revenue area, that doesn't mean that the expenditure isn't on capital account because it was directed, it was calculated to effect structural change that would alter the way in which the company generated electricity if built and –

GLAZEBROOK J:

Well it might have been calculated. There are no cases, apart from *Bowater*, that have dealt with this position explicitly, that anybody's pointed us to. I suspect there may be cases in the R & D area that do because it was specifically thought to be necessary in the R & D provisions to override the capital limitation which is one of the points the Chief Justice was making, that there might be some help to be gathered from some of the other provisions, the same as the case with petroleum exploration expenditure. Now I haven't gone back and looked at cases prior to that, in terms of research and development. I don't know whether the parties have. Or, for that matter, exploration expenditure. One might have thought that they would have done given that they were warned that we were looking generally at feasibility expenditure.

MR McLELLAN QC:

Bowater firstly, Your Honour, I'm –

GLAZEBROOK J:

No, I understand, I'm saying that's the only case that deals with this specific thing. I'm not saying we would follow it but that's the only case that anybody has put forward dealing with this explicit situation.

MR McLELLAN QC:

Well while the project didn't go ahead in *Bowater* that doesn't mean that the company hadn't decided to build it. It just hadn't –

GLAZEBROOK J:

So even in *Bowater* it's not this case?

MR McLELLAN QC:

No.

GLAZEBROOK J:

Right.

MR McLELLAN QC:

Softwood, which I come to, is the Australian decision where there was no commitment to build. Well perhaps I'll come to that in a moment. But conceptually, your Honour, if we look at a case like *Hallstroms*, or indeed *Fullers*, there was there only the possibility of getting, in *Fullers*, a new contract. The expenditure didn't track through. There was no ability –

GLAZEBROOK J:

Well, what your friend would say was that they had committed to those projects.

MR McLELLAN QC:

In *Fullers* they couldn't commit to the project.

GLAZEBROOK J:

Well they have, in their mind, if they were going to get it, they were going to get it.

MR McLELLAN QC:

Yes, that's fair, but in terms of the contingencies. Whether it is a contingency in the mind of the taxpayer, namely the stars haven't aligned and therefore market conditions are not right for me to decide to build, or there is, as there was in *Fullers*, the contingency of a litigation risk, in conceptual terms they are the same thing because it is what the expenditure is calculated to achieve, or effect, and in my submission on these facts, as in *Fullers*, it was calculated to effect a structural

change, even though the decision had not been made to take advantage of that, because that did depend on contingencies.

GLAZEBROOK J:
All right, so why does the Commissioner draw a line then?

MR McLELLAN QC:
As to –

GLAZEBROOK J:
In its interpretation statement?

MR McLELLAN QC:
Because there is expenditure that is so preliminary that it is not calculated to effect structural change.

ARNOLD J:
But it's only, I mean all the expenditure in the pipeline is directed at capital assets, isn't it, in a broad sense?

MR McLELLAN QC:
In a very broad sense we – with a project that – I think, for example, the interpretation statement refers to evaluating one or more possible projects as to whether the company, whether the taxpayer might be interested in them, and then when they have evaluated them and made a decision that they are attractive and they wish to acquire them, then it becomes on capital account.

O'REGAN J:
Yes, no, I understand that, but I still don't quite understand the logical, or the policy, well I can understand the policy explanation for it, but I don't understand the logic of it really. If all the work you are doing is directed ultimately at a capital outlay, even though you're starting at the beginning and considering eight or nine or 10 projects and you gradually narrow down to two, I just don't understand what mysteriously happens that changes that from revenue to capital. Now you say it's the commitment but I just don't understand where that comes from.

GLAZEBROOK J:

And there isn't a commitment here, which everyone's agreed to, unless you're treating the resource consents as the assets.

MR McLELLAN QC:

And all we need –

GLAZEBROOK J:

Which I think you should ignore for the purpose of these questions.

MR McLELLAN QC:

You've described it accurately, it's like a funnel, and somewhere near the top of the funnel, or middle, wherever it might be, there has been no decision made to acquire the asset and on the facts of this case the Commissioner has accepted that that expenditure is deductible.

O'REGAN J:

Yes, well I understand that, I just don't really understand why.

MR McLELLAN QC:

Well –

O'REGAN J:

When you look at the way capital, things on capital account are described, in those very broad statements of principle in the old cases, if you take those as the signposts, the descriptors, it doesn't seem to me, I just don't understand why commitment becomes the key.

MR McLELLAN QC:

As has been pointed out, commitment doesn't feature in the older cases. In fact it features in very few of the cases. It features briefly in Justice Wild's decision and the interpretation statement does give it some greater prominence but it still only means, and in fact the word is used in the statement, as is similarly with a decision, a decision to acquire something.

WILLIAM YOUNG J:

Well why it's put in the cases is that money laid out for the purpose of a capital asset is on capital account and money can be laid out for the purpose of acquiring or producing a capital asset without necessarily an unequivocal commitment to go all the way and I think that's really the point that Justice Arnold is making. Commitment might be material as to whether it is really being laid out for that purpose or whether it's, in truth, a complete scoping exercise, or a whole range of exercises including the possibility of a buy decision as opposed to a build decision.

MR McLELLAN QC:

It is, I suggest, a means of identifying by evidence when expenditure has clearly come on capital account.

ELIAS CJ:

Well that's only though if you treat all of this as a continuum and that there's some point on which judgement has to be exercised that it tips over into capital account. But what's being put to you is that if the end purpose is a capital asset then it's on capital account.

WILLIAM YOUNG J:

That might be other tests, tests apart from commitment might involve unequivocal reference to, so that the money spent on a particular hydro scheme can't really be said to be referable to a buy decision except in a most general sense, or perhaps money that is spent in terms of advancing a project as opposed to just thinking about a project. I mean those might be ways you can limit it down and leave scope for a company, or a firm, to consider its options in a general sense and within, on the revenue side of the line.

MR McLELLAN QC:

Yes, it's not the Commissioner's case that there needs to be a commitment or decision in the most obvious sense of those words. There needs to be evidence that the expenditure has gone beyond evaluative preliminary work to be an outlay for the purpose of acquiring that asset, or laying out, as you say. Perhaps it will be helpful to look at the Australian decision in *Softwood* which is at volume 4, tab 44, and the facts are not straightforward but there was a proposal to build a new Softwood pulp or paper plant in South Australia and a foreign company, MacMillan, employed consultants to look into the feasibility of marketing the new product and therefore the

viability of building a mill, and that went on for some time until we see at page 108, second paragraph from the bottom, sorry, third paragraph from the bottom, after the testing, the reports having been made and further investigations of the kind that the Judge has described, and legislation having been enacted, MacMillan sends a telegram which stated it had lost interest in the project and was withdrawing its participation. "It referred to the 'long, difficult and unsuccessful forestry supply contract negotiations'. It is unnecessary for me" to find whether or not that reason was true or not. It's irrelevant. Efforts were made to persuade MacMillan to change their mind but that was unsuccessful. And then the final paragraph, "The only plans of the proposed mill which were ever prepared were the plans prepared by Sandwell," the consultants, "for the purpose I have indicated of obtaining quotes in Canada, and they were plans which were, as stated in the letter from Oswald Burt & Co., preliminary designs for the pulp mill. No plans were ever prepared in Australia by the taxpayer. No specific decisions or even proposals were made for plant and equipment. No sod was turned in the earth and all that had happened was what in substance I have described."

On additional factors is that MacMillan never committed themselves in any way to the project. MacMillan were a majority shareholder in the holding company. "They participated in investigations but beyond taking 50,000 £1 shares they never committed themselves to the project and never made a firm, let alone irrevocable, decision to go on with it. The second fact is that the taxpayer itself never committed itself to the project."

In terms of the work that had been undertaken, at 114, in the second to last paragraph, and the initial issue here was whether the equivalent of the general permission applied, but nevertheless in the second to last paragraph, half way down, "All that had happened had been that certain investigations had been made to decide whether or not the business was feasible and whether or not it was economically viable on a competitive basis, but nothing had been done which could be said to be carrying on a business".

And then over the page…

ELIAS CJ:
Sorry, I'm just saying what a terrible Act this is, just trying to look at anything like purposes and discretions and – I'll give up.

MR McLELLAN QC:

Well, the trouble with documents building up over a long period of time.

ELIAS CJ:

Yes.

MR McLELLAN QC:

Certainly the capital limitation doesn't give us a great deal of guidance on how to apply it.

ELIAS CJ:

Well, I thought I might just read through it but no.

GLAZEBROOK J:

You probably could read through Part D.

ELIAS CJ:

Okay, thanks.

GLAZEBROOK J:

Not all of it obviously.

MR McLELLAN QC:

No, no, but the early provisions are worthwhile.

ELIAS CJ:

Well, can I just say, what is occurring to me is that what is being – I don't actually understand the parties to be very different in their approach really. It's just where you draw the line that's the area of dispute. You might want to comment on that but that does seem to me the position, and that necessarily means that there is a discretion to be or a judgment to be made in every case on the approach that you take and I just wondered if there's anything in this legislation that indicates that the Commissioner has commission to adjust. Whether tax law is a matter of correctness or whether it's a scheme in which the Commissioner has a lot of discretion and alters it from time to time by things like the interpretation provision, is there anything that points me at something like that.

MR McLELLAN QC:

Can I come back to you after the break on that?

ELIAS CJ:

Yes, thank you.

GLAZEBROOK J:

Well, certainly the old cases would say no discretion, has to apply the law. There has been a modification because of section 6 and 6A but I doubt that they are intended to do anything other than give a discretion to settle, and that's certainly the way they've been interpreted so far, rather than a discretion general –

ELIAS CJ:

A more general –

GLAZEBROOK J:

– for the capital revenue boundary in any significant way.

ELIAS CJ:

Well, section 6A was mentioned by Mr McLellan but I can't even find it in the legislation so…

MR McLELLAN QC:

Well, that's because it's in the Tax Administration Act.

O'REGAN J:

It's in the Tax Administration.

ELIAS CJ:

It's in the Tax Administration Act. Oh yes, yes, that's right. No, I did –

GLAZEBROOK J:

Which again is a clue to the fact –

ELIAS CJ:

Yes.

GLAZEBROOK J:

– that's it not really intended to deal with the –

MR McLELLAN QC:

It is –

GLAZEBROOK J:

– the actual substantive law –

ELIAS CJ:

Yes.

GLAZEBROOK J:

– and that all of the cases are absolutely clear the Commissioner has to apply the law and can't limit him or herself by –

ELIAS CJ:

Right.

GLAZEBROOK J:

– by the way of policy statements. But that is now subject probably to 6 and 6A.

ELIAS CJ:

Right, thank you.

GLAZEBROOK J:

You might – that wasn't to stop you –

MR McLELLAN QC:

Coming back.

GLAZEBROOK J:

– coming back after the break but…

ELIAS CJ:

Well, you don't probably need to come back to it but again it's an indication. I would have thought it was a textual prompt to the interpretation which might be helpful or not.

GLAZEBROOK J:

You're not really suggesting, in any event, that there's a discretion. What you're saying is that there is a distinction between preliminary expenditure and what you were loosely calling a commitment but which you say doesn't need an actual commitment to purchase, doesn't even need necessarily a – well, certainly it doesn't have to have got rid of all of the contingencies that might be available, including a contingency as to whether the company itself or the taxpayer itself decides to continue. So really you're probably adopting one of the possibilities that Justice Young put, that you – it is a reference to a particular capital asset and it's advancing a project as against thinking about it, and while – and that will be a factual line to draw in particular cases upon which reasonable minds could differ –

MR McLELLAN QC:

Could differ.

GLAZEBROOK J:

– as to the exact place, it could be put. But the law, you're indicating there's a difference between preliminary and advancing?

MR McLELLAN QC:

Yes, I accept that description of the position. There is on the one hand the strict legal position which is difficult under capital revenue jurisprudence and given the factually intensive nature of the inquiry, and then there is the more pragmatic question of where the line is drawn in an individual case and I agree that there is no need for a demonstrative decision or commitment in the sense that that might be understood. There needs to be evidence of commitment, and that evidence could simply come from the expenditure itself, the – what is – what money is being spent on, and that's one of the reasons I'm referring to *Softwood* because there was no commitment in that case. The decision is referred to in the interpretation statement as being one of the guiding authorities and it's an exception – I won't, no, that's not the right word – it is a case where there was no demonstrative irrevocable decision or commitment to

proceed. Someone simply pulled out not having made a decision to proceed with the plant and –

ARNOLD J:
Wouldn't this be a DA 1 case, though, that it wasn't –

MR McLELLAN QC:
It's a DA 1 case but I was –

ARNOLD J:
– wasn't occurred –

MR MCLELLAN QC:
– but before that exchange I was just about to take you on to the bit that –

WILLIAM YOUNG J:
It says if I'm wrong –

ELIAS CJ:
If I'm wrong, yes.

WILLIAM YOUNG J:
– it was on capital.

MR McLELLAN QC:
Yes, unhelpfully a number of authorities stop with the first limb and at the general position point and don't go on but here Justice Menhennitt did and that's at page 117, line 21, "Applying those principles," and by that he's referring to Sir Owen Dixon's observations in *Sun Newspaper*, "I then ask whether if any of the losses or outgoings claim fell within either of the first limbs of s 51, they are nonetheless losses or outgoings of capital". "In my opinion, they clearly are. For the reasons that they were not losses or outgoings incurred in gaining or producing assessable income," they – gaining or – "For the purpose of gaining or producing such income, some aspects of this concept are difficult to apply for the basic reason that the losses or outgoings do not fall within 5 – 51(1) at all, because they were concerned with an anterior stage." "Insofar as they may be said to do so, it appears to me that they all fall within the concept of establishing or creating the profit-yielding subject. Insofar,

for example, as technical information was acquired, insofar as options were obtained over land, arrangements were made for the supply of water, electricity, other essential matters, arrangements were made for the supply of timber by options which would enable arrangements to be made, all those matters appear to me to be establishing or creating the profit-yielding subject." I don't think anyone would have any difficulty with that. There was no commitment to build the project but these activities described as anterior to the ultimate project nevertheless evidenced a capital purpose in paying out the moneys, and that is what I say in this case Trustpower's expenditure on the resource consents did as well.

Is that a convenient moment, your Honour?

ELIAS CJ:
Yes, that is, thank you. We'll take the adjournment, thank you.

COURT ADJOURNS: 11.32 AM
COURT RESUMES 11.50 AM

MR McLELLAN QC:
I've thought about your architectural point, your Honour, and conferred but I can't make any submission that there is a wider architectural interpretation clue on the point that's before us beyond subpart EE which I'll come to and those two relief provisions.

I'll just make a couple of points largely in reply to Trustpower's submissions and this relates to the submissions in paragraphs 2.8 and 9.28D of the submissions that Trustpower's consents merely provide it with a body of knowledge in an organised format and consents are mere conditional legal permissions which provide it with information as to what fuel is available for generation. In my submission that is a subjective and largely inaccurate assessment of what resource consents provide to a taxpayer such as a generation electricity retailer like Trustpower.

Of course, resource consents of the kind we're dealing with are conditional. They're heavily conditional but that provides nothing to assist Trustpower's argument. They do provide information to Trustpower about what it can build but that, of course, is inherent in any resource consent but that is not primarily what resource consents are

and it's not being unduly juristic to say that resource consents are the essential legal permissions that allow Trustpower to build new capital projects.

So the Court of Appeal was correct to hold that, 88 of the judgment, that the expenditure was incurred for the purpose of possible future projects. It was incurred for the purpose of enlarging the business structure and not in the course of the company's business as a generator and retailer of electricity.

GLAZEBROOK J:
You're not going back to the DA1 point, I presume, on that submission?

MR McLELLAN QC:
No.

GLAZEBROOK J:
Well, I didn't understand what you said last, then. What do you mean, not in the course of it? Just not on revenue account?

MR McLELLAN QC:
Not on revenue account. Not part of current operations and the next point I was going to come to is related to that.

In the Court of Appeal judgment, if you could get that, please, which is in the supplementary bundle, the pink bundle, 152, and also Her Honour's judgment in the High Court which is in the key pleadings bundle tab 25. The point allied to the not part of the current operations issue which I just mentioned from the judgment relates to paragraph 126 of the Court of Appeal's judgment and 137 of the High Court's judgment where her Honour referred to the consents not having generated any electricity. I've alluded to this and I support the reasoning in paragraph 126 which is ultimately that the Judge was wrong to describe these as revenue assets, that the expenditure was incurred as part of Trustpower's current operations and was therefore on revenue account and the straightforward reasoning in the Court of Appeal's judgment towards the end of 126 is that obtaining the resource consents was a critical step or integral component of the development of the capital projects. The expenditure for that purpose was clearly on capital account. The fact that no electricity was generated or income created from the expenditure simply confirms that it was not on revenue account. In other words, of course resource consent –

GLAZEBROOK J:
Well, that's nonsense, isn't it?

MR McLELLAN QC:
Which part?

GLAZEBROOK J:
Well, the fact that they haven't generated income shows it wasn't on revenue account.

MR McLELLAN QC:
It's an exaggeration.

GLAZEBROOK J:
Because an indication of a capital asset is it's part of the structure which will generate revenue.

MR McLELLAN QC:
Which will, exactly. That's what the Court of Appeal meant. That's what I take from it, that it's not part of current operations. These resource consents cannot by themselves generate income at the moment but that is exactly what they are designed or intended to do in conjunction with the other components of the capital projects.

GLAZEBROOK J:
You've read a lot into that last sentence.

MR McLELLAN QC:
Perhaps I've read it too many times. No, I think it's shorthand for it's not on current operations because right now these consents cannot generate income but that's what – it's implicit in that sentence that they're part of structure, not current income-earning processes.

GLAZEBROOK J:
Well, the fact that they don't earn income means they're part of structure when the whole point of structure is that it does earn income. I mean, you're not supporting that anyway. You're saying it's possible future income.

MR McLELLAN QC:
Possible future income, precisely.

The final point I make under this section is to reiterate that the consents operate in conjunction with other assets such as the land which is being accumulated at the same time as the consenting process. Trustpower accepts that the land acquisition costs including, for example, lawyers' fees and overseas investment offers fees are on capital account. Yet if you apply Trustpower's argument across the board, at that point those costs, that expenditure, is as unfunctional as the resource consents are to Trustpower and I'm not suggesting that the land, of course, is not capital. But for a similar reason that those kinds of land acquisition costs are capital so should the resource consenting costs because they are all directed towards the same capital end.

I can deal briefly with the specific section in my submissions on identifiable capital assets. We've cited House of Lords, Lord Wilberforce's decision in *Tucker v Grenada Motorway Services* where it was said that the key to the present case is to be found in those cases which have sought to identify an asset. In them it seems reasonably logical to start with the assumption that money spent on the acquisition of the asset should be regarded as capital expenditure and the genesis for that idea was *British Insulated & Helsby Cables* which is in the authorities and it's specifically referred to in paragraph 88 of our submissions and the dicta there was, "That when 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 trade, [then] there is very good reason (in the absence of special circumstances leading to an opposite conclusion)' for treating the expenditure as attributable to capital." And Justice Rowlatt in the first instance decision in *Anglo-Persian* explained the enduring benefit this way, as enduring in the way that fixed capital endures and, of course, the important aspect of Viscount Cave's statement in *British Insulated* was that it's not restricted to identifying an asset, but it can include an advantage.

GLAZEBROOK J:

And the position the Commissioner takes is that the resource consents in themselves are assets. They may not be able to be used outside of having other things such as the land use consents, but that could be the same with a component in a factory, for instance, that can't be used without, and I'm speaking of a large component rather than a smaller component.

MR McLELLAN QC:

Yes, there is a complementarily to the way these, particularly intangible assets, operate with each other. So the resource consents stand alone, if you like, as intangible assets, but in capital revenue terms they are identifiable assets of a capital nature because of what they are designed to do in trade, just as a patent may not have a great deal of value by itself, or it gets most of its value once the inventor actually builds the invention and markets it but it doesn't mean that the patent isn't a capital asset in the first place.

Perhaps while we're on the subject of patents, my friend has referred you to the *Goodman Fielder* Federal Court Australia decision where there was a discussion about, or the judgment proper was about research costs which were held on revenue account. There was an observation in the judgment at page 390 that research and development may, in a particular case, be directed towards obtaining patentable rights which can be seen as of an enduring kind and may, for that reason, be of a capital nature. Which seems to me, with respect, to be a fairly self-evident proposition, but I would say that equally resource consents of the nature acquired here by Trustpower are intangible assets that have value and are of a capital nature.

Just two or three authorities that I want to refer to that my friend has relied on. Firstly, the *Anglo-Persian* decision, which I don't need to take you to, but I think the facts are reasonably well appreciated. The expenditure in that case was held to be on revenue account and my friend, I think, tries to draw an analogy with this case. There was a period of 20 years was the relevant period, but the main point about *Anglo-Persian* is that the character of the advantage that the payment obtained, was not of a capital nature. You might recall that it was a compensation payment made to the taxpayer's agent, who'd previously undertaken the marketing for the company, and the company decided that that was a disadvantageous arrangement, and it wished to do marketing in house, so it made a compensation payment to the agent, and the Court held that that was, that didn't create an enduring benefit for the trade, it

merely, it didn't expand or extend or alter its structure, it merely allowed it to do its marketing itself, so if wasn't, however long the benefit was for it didn't have a capital, the advantage gained didn't have a capital characteristic.

The other decision, the other Australian decision relied on is *Ampol*, the facts of which are complex, described in the *Goodman Fielder Wattie* case as peculiar, and by Justice Lockhart as, no it was one of the witnesses, as unique and that decision is at tab 45 of volume 4. The relevant facts are set out at page 554 of Justice Lockhart's majority decision and you'll see half way down the paragraph starting, "The taxpayer and Ampolex Queensland thus entered into a deed of assessment which provided that, subject to the taxpayer obtaining all necessary consents and approvals… the taxpayer assigned to Ampolex Queensland the whole of its rights, including the right to tender and bid for right to further explore, develop and exploit any one or more of the areas in question." So the taxpayer would be undertaking these initial examination of the survey data, but it was Ampolex Queensland that had assigned to it all of the exploration rights and then further down that paragraph, about two-thirds of the way through, "In consideration of the assignment Ampolex Queensland covenanted to pay to the taxpayer fees calculated in accordance with the formula provided in the deed. The fee was to be an amount to be agreed in writing … the amount expended by the taxpayer … plus 15 per cent." So on those quite unusual facts, which mean that the taxpayer wasn't going to be exploring, it was doing its initial stage, but the income that it, that the enterprise earned for the taxpayer was the fee payable under the deed of assignment with Ampolex Queensland and at 562 Justice Lockhart about seven lines down said, "The true legal character of the expenditure was that of the ordinary business activity of the taxpayer as a petroleum exploration company. From a practical and business point of view the taxpayer sought to adopt one of a number of possible methods in which it engaged for the purpose of its exploration business to obtain, if all went well, the possibility of a right to bid to undertake further seismic and exploration work. The expenditure could not lead to the establishment of an income-producing asset for it to exploit and it was recurrent and in the nature of operating expenses of the taxpayer's prospecting and exploration business."

Then after the reference to *Sun Newspapers*, "The payments in question were in truth part of the outgoings of the taxpayer in the course of carrying on its ordinary business activities. It was not expenditure incurred for the purpose of creating or enlarging a business structure or profit-yielding or income-producing asset. There is

no presumption that prospecting or exploration expenses are of a capital nature. It is a question of fact. Ordinarily the purchase by a taxpayer of a right to mine is expenditure of a capital nature and would not be deductible in the absence of special statutory provision. Preliminary expenses incurred in the establishment of a mine also would ordinarily be in the nature of capital expenditure. In general, expenses incurred with a view to setting up a business or extending a business are not allowable deductions. Where expenses are incurred in establishing, developing, extending or rejuvenating a mine they will generally be of a capital nature since they are incurred for the purpose of bringing a capital asset into existence or enhancing it." So I say that the observations just stated there are close to the Trustpower case but the facts of *Ampol* are a very long way away from Trustpower.

Now, yesterday and I am sorry I can't remember where it came from but there was an exchange from my learned friend, I think, about what one of the decisions that referred to the relevance of no asset being created by the expenditure and that may have been a reference to the dissenting judgment of Justice Beaumont, which is at 569. In the second-to-last paragraph His Honour said, firstly he said, "The expenditure was recurrent and made over an indefinite period but if the expenditure can be fully characterised as the payment of consideration for a capital asset or advantage it will be of a capital nature, notwithstanding that payments are recurrent." And then, "No tangible asset may have been created as a consequence of the taxpayer's expenditure. It is also possible that the exploration may have proved to have been abortive but it does not follow that the expenditure was not on capital account." So the absence of an asset doesn't mean that it's not on capital account and Justice Beaumont considered that it ought to be on capital account.

Perhaps just note over the page at 570 – sorry, back to 569 for the moment, to use Chief Justice Dixon's words, it's not right to say that because you obtain nothing positive, nothing of an enduring nature for an expenditure account cannot be on capital account. The deductibility of an outlay cannot be made to depend upon the success or failure of what the outlay was intended to achieve. The same principle has been applied in disallowing deductions for unsuccessful applications for licences to carry on a business activity. Then nearer to the present cases ECC Quarries were a quarrying company unsuccessfully sought to deduct the cost of an aborted application for planning permission to extract minerals from lands owned or leased by it.

Then finally the *Carron* House of Lords decision which is volume 5 tab 52. At about section F on page 74, Lord Wilberforce saw *Anglo-Persian* and *Mitchell* as the closest cases to *Carron*. *Mitchell* involved the payment made to get rid of the disadvantageous employee managing director where Lord Justice Lawrence said that the company neither enlarged the area of its operations nor improved its goodwill nor embarked upon a new enterprise. It merely effected a change in its business methods, leaving its fixed capital untouched. So if that's the analogy with *Carron* then *Carron* has no analogy with this case and in fact what I would add to that is that *Mitchell* was cited by Justice Richardson in his judgment in the *Buckley* decision which is in the authorities. I don't need to take you to it but at first glance *Buckley* had a similarity to *Mitchell* because it involved a payment to, I think it was a managing director there, to persuade him to leave and therefore reasoning by analogy would suggest that if *Mitchell* was right then it was a revenue payment in *Buckley* but it was held to be a capital payment and the distinguishing feature was that in *Buckley* the managing director also agreed to a restraint of trade so the company got what Justice Richardson considered was a capital advantage in the absence of competition.

One short note, intangible versus tangible assets, something is made of this by my learned friend in his submissions. There may be cases and *Regent Oil* may have been a case where the intangibility of the assets or advantage in question made the characterisation more difficult. Here of course we have a rather more straightforward case where a resource consent is surely and indeed, as accepted by Trustpower's expert witness, John Hagen, an intangible asset and as Lord Morris said in *Regent Oil*, this is at 329, no different result is reached according to whether an asset or advantage is tangible or intangible so there might be an identification difficulty in some cases, not here I say, but it makes no difference to the characterisation of the asset.

Now, I will turn to the scheme of the Income Tax Act and what I say is the, at least, consistency between the scheme of the Act and the Commissioner's assessment of this expenditure as on capital account and if you could get volume 1 of the authorities. At tab 1 after DB14 you will see the section dealing with subpart EE and there is EE1 which starts "what this subpart does". What it does is to quantify the amount of depreciation lost for a person for which a person is allowed a deduction if the provisions of part D, deductions, are met and quantified as the amount of depreciation. So a person has an amount of depreciation lost for an item if a person

owns an item of property as described in EE2 to EE5, the item is depreciable property as described in EE6 to EE8, the item is used or is available for use and you'll recall that the Court of Appeal held that the consents are available for use upon grant, and then go over the page to EE6 which described what depreciable property is in normal circumstances. Property that might reasonably be expected to decline in value and then subsection (3), "An item of intangible property is depreciable property if it is within the definition of depreciable intangible property." Then if we go over, skip the next page, that's duplication, and then go to the page which has on it at its foot, 811, meaning of depreciable intangible property means the property listed in schedule 17. Over the page, "The criteria for listing in schedule 17 is that the property must be intangible, must have a finite useful life," and then subsection (3), "Property that is listed in schedule 17 is depreciable intangible property even if the criteria are not met." And if we go forward to the last page, no, the second to last page in that section of the booklet, schedule 17 you will see is item 9, "A consent granted under the RMA to do something that would otherwise contravene sections 12 to 15, being a consent granted in or after 1997." So sections 12 to 15 are, of course, the discharge permits, use of a river or lake bed, water permits, but it excludes land use permits under section 9, and if I can just take you back two pages from the table in schedule 17, the general definition in the Act under section OB 1, property, down the bottom, (b), in subpart EE includes consents granted under the Resource Management Act 1991 without limitation.

So as the Court of Appeal said, I think the Court of Appeal described the scheme as not irrelevant but perhaps at 101 and 102, "Expenditure on an unsuccessful application may still be on capital account," and at 102, "This conclusion is also supported by the scheme of the ITA. As we have already noted, the ITA recognises that certain resource consents are depreciable intangible property and expenditure on them may be depreciated under subpart EE. Now it's not determinative of the capital and revenue issue under DA 2 but it is in my submission an indication that resource consents of the kind obtained by Trustpower are capital in nature. The two are consistent.

And the other point that I want to refer to is two other provisions which you've already heard about, and I'll take you to them, in the same section of that volume, about four, five pages, six pages in from the front, section DB 13B, "A person who applies for the grant of a resource consent," we've already been over this but this again is in my submission consistent with the interpretation of these consents as being capital

nature. There would have been no need for this provision if there was not a – if there was not a need for relief for consents which were capital in nature and applications were refused or applications were withdrawn, and you'll see in (3), subsection (3), that it's an express override to the capital limitation.

And D –

ELIAS CJ:
So that does require a retrospective view to be taken?

MR McLELLAN QC:
By definition because it will only –because the deduction has to be claimed or is allocated to the income year in which the grant is refused. So it's, it alters the usual position that the assessment needs to be made in the tax year in question. It could only work that way because it's not until you know that the application is refused or is withdrawn that there is a right to a deduction.

ELIAS CJ:
I just wonder whether that speaks to where you don't know.

MR McLELLAN QC:
I'm sorry, to?

ELIAS CJ:
To where you don't know what the outcome is going to be.

MR McLELLAN QC:
Well, it could include – well, no one knows that they're going to be granted a consent. There will be degrees of confidence but I don't think that's to the point of it because it covers –

ELIAS CJ:
Well, it just seems that it's odd if you have a retrospective, retrospective consideration if you're denied consent and that it would not equally be relevant if you get consent, if you see what I mean. The retrospectivity point, I'm talking about.

MR McLELLAN QC:
Well, as I said, it is necessarily retrospective.

ELIAS CJ:
Yes.

MR McLELLAN QC:
At the time that the consent, consenting starts, that is at least in my submission where capital expenditure is first incurred and that expenditure has to be treated for tax purposes within that tax year. It can't be adjusted later except, of course, by a relief provision such as this.

WILLIAM YOUNG J:
So what happens if a consent is granted but on conditions that make it untenable?

MR McLELLAN QC:
Under DB 13B there would have – and assuming that it was valueless to the applicant as a result and couldn't be – depreciation couldn't be claimed, then it would be effectively black hole.

The position is different under the 2007 provision, which is at tab 5, DB 19. Sorry, it covers the same ground as DB 13B but more, it is more liberal in –

WILLIAM YOUNG J:
Does this – which applies?

MR McLELLAN QC:
Which applies?

WILLIAM YOUNG J:
To these. Does DB 19 apply retrospectively to early – to expenditure occurred in earlier years?

MR McLELLAN QC:
DB 19B applies from the – it applies. I can't remember the exact year that it comes into force but it is after 2000. So you'll see that in – it's the same language in subsection (1) other than (a), applies for the grant of a resource consent, or when a

person who incurs expenditure for the grant of a resource consent does not obtain the grant because the application is not lodged or is withdrawn.

WILLIAM YOUNG J:
So what I'm interested in, does it apply to when there – is it applying to where the expenditure is incurred or does it apply when the consent is abandoned or surrendered?

MR McLELLAN QC:
When it's abandoned or surrendered –

WILLIAM YOUNG J:
Okay.

MR McLELLAN QC:
– under…

ELIAS CJ:
What do you mean by apply?

WILLIAM YOUNG J:
Well, isn't this a 2014 amendment?

MR McLELLAN QC:
Yes, it is.

WILLIAM YOUNG J:
Okay.

MR McLELLAN QC:
And…

WILLIAM YOUNG J:
So say – all right, sorry?

GLAZEBROOK J:

Well the expenditure will be incurred in the year so it presumably does apply to any future surrenders.

WILLIAM YOUNG J:

Okay, so it doesn't matter that expenditure was incurred in 2006

MR McLELLAN QC:

Precisely, the answer is in subsection (2).

WILLIAM YOUNG J:

All right.

MR McLELLAN QC:

The deductible is allocated in the income year in which –

WILLIAM YOUNG J:

All right, okay, yes, thank you, I see that.

ELIAS CJ:

Ah.

MR McLELLAN QC:

So again if Trustpower, or if any taxpayer obtains, or doesn't use the grant, so in your example, Justice Young, if the conditions were so onerous that it goes in the bin then this, then it is not used before it lapses or is surrendered. So there is relief under that provision.

ELIAS CJ:

So what, that must be significant, you know, in terms of scheme here.

MR McLELLAN QC:

Yes, well I say it is in terms of interpreting –

ELIAS CJ:

As being on capital account.

MR McLELLAN QC:

– what Parliament considers to be capital –

ELIAS CJ:

Yes.

MR McLELLAN QC:

And particularly where, in my submission, there isn't anything unusual about Trustpower's consents for a company of that kind. So presumably Parliament was trying to give some meaningful relief to businesses in particular and –

WILLIAM YOUNG J:

Is this a response to the Trustpower case? No.

MR McLELLAN QC:

Not as far as I'm aware.

GLAZEBROOK J:

I think it was just that general black hole expenditure that they promised in the 2013 budget.

WILLIAM YOUNG J:

Okay.

GLAZEBROOK J:

And that included patents and various things I think as well.

MR McLELLAN QC:

Yes, patents is an example.

GLAZEBROOK J:

And I don't know where that proposal has got to actually refund research but –

MR McLELLAN QC:

Yes.

GLAZEBROOK J:

Research losses.

MR McLELLAN QC:

So that is the significance that I submit these two provisions have. That they are –

ELIAS CJ:

Well it removes any potential unfairness of a black hole, is that right?

MR McLELLAN QC:

Yes.

ELIAS CJ:

Yes, so – yes, okay.

WILLIAM YOUNG J:

It is after the fact, in a sense, because it's the 2014 amendment and we're looking at 2006/2007 tax years, aren't we?

MR McLELLAN QC:

Yes, section DB 13B was in the Income Tax Act 2004 but perhaps the fact that it comes into – or that it comes into force after the tax years in question is not so significant, or is not really against my point because it is an acknowledgement by Parliament of a need for some relief in this area, acknowledging, well, with the inherent acknowledgement in the amendment that this expenditure would typically be on capital account, hence the need for the override.

Now I'm not going to deal with the specific, the *BP Australia* facts because I think that it's inherent in the other areas that we've covered that those factors are also covered.

ELIAS CJ:

Wouldn't it bear particularly on the approach – doesn't it obviate the need to be too precise about what the nature of a resource consent is?

MR McLELLAN QC:

The *BP Australia* factor?

ELIAS CJ:

No, no, this legislation.

MR McLELLAN QC:

Sorry, oh, I see.

ELIAS CJ:

Because you're right, there is a wrapped up assumption in it that expenditure to obtain resource consents will be on capital account.

MR McLELLAN QC:

Well that's my submission.

ELIAS CJ:

Yes.

MR McLELLAN QC:

The only *BP Australia* facts that I was going to address is the accounting treatment point and I think I can deal with this quite briefly. In my submission, as I said in the Court of Appeal, and as I think the Court of Appeal said, it's a neutral factor on these facts. It's not inconceivable that it may have some relevance, but there seems to have been a fairly strong shift away from paying too much attention to accounting treatment. I suggest that may be in part because of the very prescriptive of current accounting standards, and the fact that they don't, that there isn't parity between the accounting, the proper accounting treatment and tax law. But there are perhaps two points that I can refer to and probably the most convenient place to look at this is the High Court's judgment which again is in green volume 3, 25, and at paragraph 129.

ELIAS CJ:

Sorry, what's the tab?

MR McLELLAN QC:

25.

ELIAS CJ:

So it's not volume 3?

WILLIAM YOUNG J:
Yes it is.

ELIAS CJ:
Right.

MR McLELLAN QC:
Green 3, paragraph 129, so you'll see that the first, the definition of "asset" is, "A resource controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity." And over the page, "An intangible asset shall be recognised if, and only if it is probably that the expected future economic benefits will flow, costs can be measured reliably," and one of the reasons why that will be difficult for a taxpayer – well, firstly, of course, the taxpayer has the obligation to get the, get its financial reporting correct and that may require it to err on the conservative side but the difficulty with a resource such as a, an intangible asset like a resource consent, or patent, is that they may, and in Trustpower's case, took years to develop so it would be difficult for a reporter to say reliably that it controls the resource in any given year until the grant and that it is probable, for example, in year 1 that expected future economic benefits will flow. So while I have submitted, strongly I hope, and as Justice Andrews held, that the resource consents have characteristics that provided an enduring benefit to the company. This IAS 38 in its very prescriptive terms doesn't fit very well with the principles of capital and revenue.

The other factor that may be relevant here, coming back to section DB 19 that we've just looked at, is that that provision assumes that the taxpayer doesn't control the consent in the year in which expenditure is incurred because, of course, relief is provided for simply withdrawing an application which presupposes that no asset has yet been created. That's all I wish to say on the accounting treatment.

Commitment which is question D. My submissions on this are at page 31 of our written submissions and they are brief but they have two relevant appendices, 1 and 2. Appendix 1 sets out a summary of the evidence which the Commissioner says provides a basis for the line in the sand between revenue and capital and then appendix 2 is the chronology with the Commissioner's additions.

As I've already said, the theory applied by the Commissioner to commitment is that it is at the commitment point that revenue expenditure becomes or, perhaps putting it a better way, is the point at which expenditure is on capital account. In principle on the facts of this case that must, in my submission, mean that point at which expenditure is directed at obtaining a resource consent. Given that the process for obtaining a resource consent is to apply for one, then the application costs start when Trustpower specifically starts doing work towards compiling an application. While that doesn't exclude internal employee costs, of course, a strong indicator in my submission that Trustpower embarked on that process was when it had undertaken its scoping studies and it had decided to apply for resource consents or at least had taken steps to start that process, particularly by instructing consultants to compile the AEEs.

GLAZEBROOK J:
You said it doesn't exclude internal costs but the Commissioner doesn't suggest that salary has to be apportioned to that, does it?

MR McLELLAN QC:
No. The Christchurch Press case of Justice Gallen which is in the submissions would indicate that the costs of employees in installing capital plant or working on a capital purpose is itself capital. So there's no issue of allocation.

WILLIAM YOUNG J:
So Justice Gallen said that the costs of employees was on capital account?

MR McLELLAN QC:
Correct. That was where the Christchurch Press was installing a new press and his Honour held that the costs of the employees specifically working on that aspect would be –

GLAZEBROOK J:
So you do suggest that salaries are capitalised? You just said you didn't suggest that.

ELIAS CJ:
You don't seek them here.

MR McLELLAN QC:

No, it's not an issue. I shouldn't have mentioned it. It's merely confusing.

ELIAS CJ:

No, but –

GLAZEBROOK J:

I asked a question and you said no it's not and then you gave a case which says yes they were capitalised. Which is it?

MR McLELLAN QC:

On the facts of this case, I don't think it's an issue at all. There's no suggestion of that. It was just as a result of that exchange with your Honour that I went on a flight.

WILLIAM YOUNG J:

So the Commissioner is not seeking to capitalise any employment remuneration costs.

MR McLELLAN QC:

I'm not sure whether that is the case. I'll check that. It's not an area of dispute.

WILLIAM YOUNG J:

Okay. Where do we find in the material the interpretation, the Commissioner's interpretation?

MR McLELLAN QC:

That's in that pink supplementary bundle at 157. I've probably got about four or five documents on each project to go to or items of evidence. It'll be useful if you keep appendix 2 to my submissions available and also the two blue volumes of evidence which are 4 and 5. In part, my submissions respond to my learned friend Ms Armstrong's submissions yesterday. I'm going to start with the Arnold project. I wonder whether it would be helpful if we just went through this exercise first. In appendix 1 we have half-helpfully told you what the Commissioner's commitment date is but I'll invite you to write in for convenience the comparison date for Trustpower.

WILLIAM YOUNG J:

The November 2005 date, that's the date you've selected. That's the date you rely on.

MR McLELLAN QC:

That's the Commissioner's date, correct, and Trustpower's date is March 2007. In each case for Trustpower it's the date when they lodged the consent applications.

Over the page, Wairau Trustpower's date is June 2005. I've started rather badly here. Can you go back a couple of pages to Arnold? That should be March 2006.

ELIAS CJ:

Are you asking us to change something?

MR McLELLAN QC:

No. I don't think you've written anything yet so if you could just write Trustpower March 2006. Wairau over the page, your Honour, is June 2005.

WILLIAM YOUNG J:

It's always the last date, is it? Oh, no, not quite.

MR McLELLAN QC:

No. Then Kaiwera is November 2007. Mahinerangi is December 2006. I'll just take you to a few items of evidence about this issue. The first is in the core bundle, volume 1. This is a development project status report dated September 2005.

ELIAS CJ:

What tab?

MR McLELLAN QC:

I'm sorry, your Honour, 13. A report dated September 2005 as against the Commissioner's commitment dated November 2005. Down at the bottom, last paragraph, since purchase Trustpower have carried out a preliminary feasibility study. Wok to date has identified that a window of opportunity exists for this project to reinforce a much need infrastructure for industry on the West Coast. Over the page, under the heading, "Resource Consents. Political support for the scheme is high." Next paragraph, "Considerable work has been undertaken to ensure that the

scheme achieves the requirements of the Resource Management Act. Pleasingly, and somewhat surprisingly, the abstraction of water… will greatly enhance the river's ability to support both the native and exotic/sports fishery." The next paragraph, "The resource consents process is likely to require an Environment Court hearing… and will take a minimum of two years from the lodgement." Over the page, "Land Access. Access agreements have been entered into with all relevant land owners to enable ourselves and our consultants access, 27 parties with land interests are directly affected by the current proposed scheme. We have begun discussions/negotiations with almost all the landowners. So far all have shown at least some level of support for the scheme subject to suitable commercial arrangements. Almost half of the effected land is owned by two landowners. We are currently discussing easement arrangements."

Skip the next paragraph then, "From initial discussions, most landowners are non-willing sellers or participants in the scheme and will therefore expect 'disruption' premiums for their land if they are to enter an arrangement with Trustpower."

And then to the last page of that tab, "Recommendation: That the Board approve the expenditure of $5.5 million for the acquisition of the necessary land for Phase 1… and to proceed to lodge the resource consent application prior to the end of 2005." And you'll recall I took you to Dr Harker's evidence where he, and I think it was about this document that I was cross-examining him, and he confirmed that resource consenting would be in the hand of management, that is the Board who approved the expenditure for the acquisition of the necessary land.

Then if you can go to blue volume 5, tab 35.

O'REGAN J:
So what are you asking us to draw from all this?

MR McLELLAN QC:
Well it's going to be the collective of the few documents that I'm going to take you to that the commitment date in each case was conservatively and evidence-based in terms of when the consenting process started. So if the Court agrees with the Commissioner that the commitment date approach is an appropriate one, and that it was overall capital, then this question is about whether the commitment date was an appropriate one to set.

I'm at tab 35 at volume 5 and at page 789. Sorry, 790. Line 3, if you go to page, where you see the heading resource consents, political support for the scheme is high, so that's the document that I've just taken your Honour's to, and then down at line 25, I put to Mr Kedian that this is the point at which you have decided to proceed to apply for a resource consent? "No, I don't agree." Issue over purchase of land. Very extensive analysis done of the probabilities. If we purchased it now or later wouldn't make any difference. Probably better to go ahead and do it immediately. Then over the page, "Go ahead and acquire the land?" "Yes." And then more discussion until half way down the page where I asked him, "We now start the resource consenting process because that's got perhaps two years to go through?" "No," he said, "we started the process when we lodged the application." So in my submission that is Trustpower's subjective position that Mr Kedian was maintaining and I'm inviting the Court to hold that the consenting process started –

ELIAS CJ:
Well, when the application was lodged?

MR McLELLAN QC:
That's Trustpower's position.

ELIAS CJ:
Yes.

ARNOLD J:
But what is it? Is it instructing the consultants to do all the work? I mean what is it?

MR McLELLAN QC:
That's the beginning of process of putting together the AAEs. That's the Commissioner's position.

ARNOLD J:
Right.

MR McLELLAN QC:

Slightly more nuanced in relation to the hydros, as we'll see, but it's still evidence-based as to when the application process started. Whereas Trustpower's is in each case when they put the application over the counter.

ARNOLD J:

Do we have the instructions to the –

MR McLELLAN QC:

I'm going to take you, I'm not going to take you to all of them, but I'll take you to some examples.

ARNOLD J:

Thank you.

MR McLELLAN QC:

The next document is the chronology itself in appendix 2. Now on page 3 of that appendix you'll see down the bottom 24th of November, so just to remind you, that report that I took you to first was the 29th of September so I'm now taking you to the 24th of November 2005. A report was presented to the Board. The report concluded, "The Board approve expenditure for necessary land purchases." We're now on page 4, equivalent to phase 1 referred to in the September project status report. Second bullet point, to lodge a consent application around the end of 2005, long-term monitoring, and then fourth bullet point, "To purchase or secure options the Board approves the recommendations for land acquisitions and completion of the consent application." Then in November 2005, second from the bottom, briefs of work are sent to consultants in respect of the Taramakau diversion, and November 2005 is when the Commissioner considers that Trustpower was committed to the consenting application. Perhaps if you go one more page over to page 5 you'll see the yellow line, that's when Trustpower considers itself to have committed to the applications, but if you have a look at the paragraph above that, that the scheme is in the consenting engineering design phase, that land negotiations are progressing, so in my submission prior to November the company had already started the consenting process, the Board had approved it, and had approved also expenditure for land acquisition.

Then one more document if I may, which is that same core bundle, tab 15 that is the core bundle that I took you to a moment ago. Core bundle, volume 1, tab 15.

ELIAS CJ:
Do you want to just complete where you're at. I just notice it's time to take the adjournment.

MR McLELLAN QC:
I was just cheekily taking you to this final document for this project. Tab 15, 2845, and I think we've already seen this, page 2845, that is the Board's approval of the expenditure for land acquisition and the lodging of the resource consent, and that's signed off by Mr Kedian who maintained in cross-examination that they weren't, they hadn't decided to start consenting until later than this.

GLAZEBROOK J:
That was the recommendation. Where are the Board minutes approving it?

MR McLELLAN QC:
I don't know at the moment.

GLAZEBROOK J:
Because I think your friend's position is that was just an approval for the land acquisition and you've just said yourself that the consents were left to management. So the Board, as I understand it, raised some issues with it, and whether they applied for them was left to management, there wasn't a resolution to that, but maybe you can check over…

MR McLELLAN QC:
I'll check on that but as I've mentioned briefs of work were sent to the consultants in November 2005 so it's implicit in that, that the Board –

GLAZEBROOK J:
Is it just whether the Board made the decision or whether left it to management and management decided to carry on?

MR McLELLAN QC:
I'll tidy that up.

GLAZEBROOK J:
I don't know that it matters particularly –

MR McLELLAN QC:
I say it doesn't but I'll see what I can do.

ELIAS CJ:
Thank you. We'll take the adjournment.

COURT ADJOURNS: 1.01 PM

COURT RESUMES 2.16 PM

MR McLELLAN QC:
In response to Justice Glazebrook's question, I'll take you to volume 1 of the core bundle tab 16 which are the Board minutes, Board agenda for the 15th of December. So the second page is the minutes of the meeting on 24th of November 2005 and on page 2687 you'll see a reference to the Arnold hydro project. Management provided a brief presentation confirming that the company would be seeking a 35 year resource consent with a 10 year option to commence construction concerns about landowners and some additional concerns raised by the Board going through that page.

Over the page, some advice from management and then resolved the management's recommendation for land acquisition and completion of resource consent application be approved. So that's one down.

Now I'll go to Wairau. Starting with core bundle 2 tab 45, the Commissioner's commitment date is September 2004.

In the minutes of the Board meeting, if you could go to 2627 and in the second paragraph the draft AEE report is complete. Lodgement of the resource consent application will be subject to secure access easements to all land in key positions. The option for easement agreement is now finalised. We plan to start negotiations on Monday next week.

The comment in my learned friend Ms Armstrong's submissions yesterday was the Board approval was required for the consenting process. It may be that there was Board approval required before the consent application went over the counter but it's clear from that generation development report that the consenting process had already started under management's guidance and if I can take you to volume 4 of the evidence, the blue volume, tab 31, cross-examination of Dr Harker, line …

O'REGAN J:
Sorry, you're just going to have to slow down a bit.

MR McLELLAN QC:
Volume 4, tab 31.

O'REGAN J:
Yes.

MR McLELLAN QC:
Page 632. About half way down, line 16, I said to Dr Harker, "Board approval was required before Trustpower," or rather, "You say in your brief of evidence that board approval was required before Trustpower could be said to be committed to making the application for consent?" "Board approval was required, yes," and then I took him to the document that I've just taken you to and asked him, at 26, "Just orientate yourself. It starts at the top," and then I put to him, "No indication that board approval is required for that?" "No." And then over the page, "And, obviously, the process of getting an application completed has been under way for some time because the AEE, the draft AEE is complete?" "That's what it says, yes."

So my submission that the consenting process had started and that the September 2004 date was an appropriate one for the Commissioner to take but I will just take you to another document. I'm sorry, you might have – I hope you haven't closed it up but core bundle, volume 2 again, and the next tab after that which I took you to which is tab 46. This is a generation development report, September 2004, on the first page, second paragraph, "Outcome of the feasibility assessment warrants the progressing of the development into resource consenting and final design stage."

Next page, down the bottom, under "Project Risks," "Project is robust, environmentally, technically and economically viable proposition." Two major risks

that could halt the development, firstly denial of resource consent and denial of easement by one or more landowners.

Next page, third paragraph, first round of easement negotiations has finished. Legal review of agreements, consultation on compensation ongoing. Overall reaction of landowners is positive. About four of the 67 involved have negative attitude. Negotiations ongoing. "Next Steps", lodging a resource consent application in November 2004, subject to receiving board approval.

And that is approximately the point in time at which the Commissioner has set the commitment date for Wairau.

The third project is Mahinerangi and the same volume, tab 42, and this is one of the very many briefing letters that's in the discovery, and this is to the overall environmental consultant setting out the brief of work, and in the introduction you will see that, "Trustpower is currently undertaking an environmental feasibility study for MWF. The study will identify the visual and ecological parameters. The preliminary results of the feasibility study are such that Trustpower is now in a position to begin the consenting."

ELIAS CJ:
What does that mean, "Begin the consenting"?

MR McLELLAN QC:
That's the shorthand they use in all these briefing letters. Means the consenting process, if you have a – see down under "Key Tasks", those four, and then go over the page to – 8 is the most relevant, "Prepare a draft landscape/visual assessment for inclusion in the AEE," and then finalise the assessment by the 17th of February. And –

ELIAS CJ:
No, sorry, I meant by consenting. Oh, you mean that is the consent process?

MR McLELLAN QC:
The consent process, correct.

ELIAS CJ:

I see. Not a different consenting, no.

MR McLELLAN QC:

No, not in that sense.

ELIAS CJ:

Thank you.

MR McLELLAN QC:

And then blue volume 5, Mr Kedian's cross-examination at volume 5, tab 35. Sorry, at the bottom of 819, I took Mr Kedian to the letter that we've just seen to Boffa Miskell, line 31, I've just referred him to that opening sentence that you've just seen, "'Please note this brief,' which would mean they would have to do the AEE or their part of the AEE, yes?" Answer, "Do the work necessary for inclusion in the AEE." And then over the page, down at line 10, "Public open days," I put to him, "draft landscape, et cetera. That is a clear indication from Trustpower that it has embarked upon the commissioning of experts from this point?" "Correct." "For the purposes of completing the application?" "For doing the necessary research work that would allow us to design a scheme about which we would write an AEE." And then at line 19, "Yes, it is for inclusion in the AEE but that doesn't mean it's its only purpose." "I'm saying that it's its principal purpose." "Correct." "To prepare something that's going to comply with the RMA?" "Correct."

And then back to the core bundle next – no, tab 44 of the core bundle.

ELIAS CJ:

By which bundle?

MR McLELLAN QC:

The second core bundle. The one we were just –

ELIAS CJ:

Yes, right. Thank you, yes.

MR McLELLAN QC:

– looking at, and this is an internal Trustpower email dated the 15th of November. Mahinerangi's commitment date, according to the Commissioner, is November '05, and in the last sentence of the second paragraph, "The aim is to have the AEE and resource consent applications lodged by Tuesday, the 28th of February 2006."

And then because Mahinerangi is a little bit unusual I'll take you back to the chronology in appendix 2 to my submissions at page 12 of the appendix. So that email was dated the 15th of November so the second row in the table on page 12, "Trustpower engages consultants." We've seen that, and that's the point at which the Commissioner considers that Trustpower is committed, and we go down the page, in the line 26th of January. I'm taking you to the uncontroversial, unredlined parts just to avoid difficulty. "Management reports to the Board that it is still on target to lodge a consent application late February/early March '06." Final row, "Turbine sites have been identified." Over the page – sorry, "Agreements have been signed with two landowners. Negotiations continuing with four landowners, one of which is the Dunedin City Council." Final sentence, "A consent application is expected to be lodged in early April 2006." Over the page, 3rd of April, board report records that, "Negotiations with the four landowners are continuing." We've got a consent application is expected to be lodged in May. 27th of April, expressions of interest from turbine manufacturers. 12th of May, Trustpower issued a media statement recording that it expected to lodge a consent application within the next month. June '06, "Management reports to the Board that lodging of the application has been delayed at the request of the Dunedin City Council." And then 31st of August, Trustpower internally decided that it was considering reducing the consenting window to exclude the Dunedin City Council and the next line, consultants were asked to revise earlier reports to allow for that change. Meeting proposed with the council. Then over the page –

WILLIAM YOUNG J:

Just going back a bit, some of the references talk about the resource consents will be capitalised.

MR McLELLAN QC:

Ah, yes, you've – yes I recall that.

WILLIAM YOUNG J:

For instance, the top of page 14.

MR McLELLAN QC:

Yes. I can't, the context isn't there. I recall that now. I don't know why they were – certainly not the – it may be intended that that's a reference to –

GLAZEBROOK J:

They may have hoped that was the accounting treatment and then been told it wasn't right.

MR McLELLAN QC:

Correct. Yes, I was just thinking about section 13 DB – well that may well be that they were thinking about a deductible under DB 13B, because that is what happened, so a deductible was granted after the consent application was withdrawn, as you can see over the, on page 16, November 2006. So Trustpower has taken the position well we didn't actually get that one over the line and we had to withdraw it and replace it with a new application and so the commitment date should be extended a year out. But in my submission the change was a possibility and the substance of the wind farm remained the same but it was smaller. So that's Mahinerangi.

Last one, Kaiwera, which is again that core volume, core bundle volume 2, tab 26. No, sorry, 25. Commissioner's commitment date is May '07. This letter is to two consultants dated the 18th of December, five months before the Commissioner's commitment date, and the reason I've put this in is to contrast it with the letters that we will see in a moment. This brief to the consultants says under the introduction heading, "Trustpower is investigating the possibility of developing a wind farm… Investigations undertaken to date have lead to the identification of several possible ridgelines… No indicative layouts have been developed." And then on page 4154 under the heading, "The Approach to Consenting. Prior to launching into a full consenting phase, Trustpower wishes to identify the environmental constraints that could modify the proposed development envelope… Once all of this information is available, the viability of the KDWF will be reassessed and a decision made as to whether we should proceed with the necessary resource consents."

So the tasks for the consultants for the scoping phase, as opposed to the consenting phase, are set out on the next couple of pages. Paragraph 6, the draft report needs

to be sent to Trustpower's legal counsel and then a decision as to whether – sorry, this is at the bottom of 4155, "A decision as to whether to progress with the KDWF will be made in the last week of February 2007."

The next document is at tab 32, and this is the memorandum that Ms Armstrong referred to, 28th of May 2007, so in the month in which the Commissioner says the company decided to proceed with consenting and at 4234 the recommended path ahead, very last line or row in that table, table 4, "Determine the viability of the wind farm based upon the fatal flaw identified by the landscape and visual report."

And then to the last page, 4238.

ELIAS CJ:
Which tab?

MR McLELLAN QC:
I'm sorry, your Honour, 32.

WILLIAM YOUNG J:
It's tab 32.

MR McLELLAN QC:
So that was at 4234, your Honour.

ELIAS CJ:
Yes, thank you.

MR McLELLAN QC:
And now we're at 4238. Reference to the resource consents in the second to last paragraph. They will be publicly notified. The probability of consent being declined is 30%. Some reasons for that, or, sorry, the costs set out. "Therefore, based upon the initial scoping studies and the experience of the Environment Team, it is recommended that Task A is first undertaken before further work is commissioned." So that's what I just took you to. And, "Provided that the further analysis indicates that the proposed wind farm I was both viable and environmentally sustainable, the Environment Team recommends that Trustpower commit to preparing and lodging the necessary resource consent application."

And then in the very tab is a letter from Trustpower to the Department of Conservation, in the second paragraph, this is the 20th of June, "Trustpower has since moved into the next phase and has commissioned a team of consultants to undertake further studies. These studies will provide the necessary information to prepare the technical reports that will be used to compile a technically robust AEE which will make up the bulk of the resource consent application documentation."

And then volume 5. Mr Kedian's evidence, volume 5, 35, page 813. At 813 I was cross-examining Mr Kedian about that internal memorandum that we just looked at. Page – sorry, line 9, "This was the memorandum that refers to a potential fatal flaw?" "Correct." "It turned out not to be but –" "Yep." "You were being cautious, well, the author was?" "Yes." "If you just have a look at page 567, this is a summary of potential environmental effects and fatal flaws. The primary concerned raised," et cetera, and then at line 21, "So it certainly didn't get to the level of fatal flaw but it needed to be checked to make sure that you were going to be – that your expenditure remained soundly based?" "Correct." "As it was, the issue was resolved and the application continued on its intended course?" "Correct."

And finally, core bundle, volume 2, number 34, one final brief of work to one of the consultants.

GLAZEBROOK J:
Sorry, I missed the tab number.

MR McLELLAN QC:
That was core bundle, volume 2, tab 34.

GLAZEBROOK J:
Thank you.

MR McLELLAN QC:
So that internal memorandum about the fatal flaw was the 28th of May. We've seen the document letter and now on the 27th of June, a week after that letter to DOC, here's one of the briefing instructions going out to a consultant, and this is headed, "Consenting". "Letter sets out the brief of work for the provision of planning and

consultation services." "Extends only to the lodgement of the resource consent applications necessary for the wind farm to proceed."

"Objective", at the bottom of the page, "To prepare and lodge a robust and compelling AEE with the application resource consent applications," and over the page more detail about what was required. Consultation, at 5. 6, technical assessments. 7, draft AEE, send it to the lawyers. Then 8, final and lodge the AEE taking into accounts the comments of Trustpower. So in my submission those contemporaneous documents join the dots leading up to the commitment dates which the Commissioner has included in its assessment.

ELIAS CJ:
These internal documents you're taking us to presumably came out in the course of this litigation, did they? They weren't ones that the Commissioner had?

WILLIAM YOUNG J:
The Commissioner would have got them in the investigation, I assume.

MR McLELLAN QC:
I can't tell you which ones were because the discovery was voluminous.

ELIAS CJ:
Before the assessment?

WILLIAM YOUNG J:
There would have been an investigation and documents would have been obtained at that stage.

MR McLELLAN QC:
There was of course an investigation and the usual dispute documents were exchanged and I think even draft briefs of evidence were submitted by Trustpower but I can't tell you exactly which documents they provided.

ELIAS CJ:
It's just that you're not saying to us this is the material that the Commissioner relied on in identifying the date. You're saying that the evidence supports that the date was well within, what, well, was reasonable, as it turned out?

MR McLELLAN QC:

Correct. That it was evidence based then and that the litigation has been able to demonstrate that through the discovery and cross-examination and such things. your Honour, those are my submissions unless your Honour has any questions.

ELIAS CJ:

No, thank you, Mr McLellan. Yes, thank you, Mr Harley.

MR HARLEY:

To commence my reply, your Honour, I want to pick up on the exchange between my friend and Justice Glazebrook about the Court's leave terms and comments and her disappointment that neither party had proffered to the Court a principle-based explanation of what was feasibility expenditure, to beg the question, meaning research development that is deductible as distinct from development on the other side subject to the capital limitation.

My observation about that exchange with my learned friend is that it was in one sense illuminating in the sense that the Commissioner was clear that she seeks to uphold the Court of Appeal's judgment in her favour because she won the appeal but is unable to advance in this Court precisely what the legal principle is that she actually seeks to advance that it's truly and clearly reconcilable and consistent with principle as set out in her interpretation statement.

That statement, not particularly well-written as it is, will treat as deductible research expenditure using the term research generically here to avoid begging the question for an existing business where that business in the process of evaluating whether it might develop future capacity or new products and what form that might take.

The Commissioner will require the taxpayer to capitalise expenditure where it can be shown that the taxpayer has in the practical and business sense spent money in fact or committed to spend money now to carry that identified and actual subject matter into development, defining what is from that time an identifiable capital asset within the established case law conception of that term.

My submission is, as recognised in the exchange, the Court of Appeal's judgment is in basic conflict with the notion of what is expenditure or commitment to expenditure

to acquire the relevant asset instead of adopting the sufficiently-connected notion which is referable to possible capital projects.

In the exchange yesterday, counsel for the Commissioner was unable to resolve that conflict, instead resorting to what is supporting of an open-ended power for the Commissioner to act in a way that he says is pragmatic, whatever that might actually mean, simply being able to make up whatever it suits the Commissioner on the day, any day, indifferently for the same taxpayer as it happens to be the case dealing with these four projects because the approach in respect of each of them taking the commitment point is different but there's no consistency of approach in respect of any different taxpayer. Stripped, really, of the obfuscation that surrounded that exchange in truth my submission is that the Commissioner's approach advances that there is no legal rule here, that the decision-making for the Commissioner is about discretionary power to do as she pleases as the occasion suits, reflecting the ad hoc. There's no basis for consistency and therefore the basic principles of horizontal equity between the myriad of different business taxpayers affected by the issue before the Court there will be no like-for-like treatment.

WILLIAM YOUNG J:
That's a bit over the top, isn't it, really? The counsel for the Commissioner is pretty much stuck with the interpretation document that the Commissioner has put forward and constrained by the course that the dispute has taken, and for that reason has tried to, I suppose, build an argument around the ambiguities and the expression "commitment" and ambiguities in what constitutes the capital project whether in this case it's the hydro dam or it's the resource consent. But I don't think he was really saying it's open slather and the Commissioner can do what she likes on the day.

MR HARLEY:
Your Honour, he didn't say that in those words but I'm looking for the principle and I'm trying to extract from the exchange, particularly with her Honour Justice Glazebrook, what the proposition actually was.

WILLIAM YOUNG J:
I think what he's saying is sufficiently connected in the slightly smudgy area. It's not a million miles removed from commitment. That is, if you commit to a project, if you spend a lot of money on a project you commit to it. The money is sufficiently connected to a capital project to be treated as being on capital account.

MR HARLEY:

Sufficient connection has nothing to do with the Commissioner's interpretation statement and is fundamentally incompatible with the spending of money on the acquisition, modification, or disposal of a capital asset.

WILLIAM YOUNG J:

Well, it's the Court of Appeal's expression.

MR HARLEY:

Well, exactly and I can understand why he seeks to support it. He won the case. But what I am saying to you is that he was unable to articulate a legal principle that is consistent with the interpretation statement at the same time as articulating to the Court why the Court of Appeal's judgment should be upheld.

WILLIAM YOUNG J:

Well, l maybe the interpretation statement is too generous to taxpayers.

MR HARLEY:

Well, it may be.

WILLIAM YOUNG J:

And that's perhaps what the Court of Appeal was gently alluding to in its own judgment.

MR HARLEY:

Well, there's absolutely no doubt that it's not alluding to it. It flat contradicts the ability of a taxpayer to deduct expenditure incurred when it is considering the acquisition of a future capital project. If your Honours go to the heart of the interpretation statement which begins at about paragraph 180 and goes through to about 187 –

WILLIAM YOUNG J:

The interpretation statement?

MR HARLEY:

Yes.

GLAZEBROOK J:

I think to be fair Mr McLellan is actually trying to say that he's upholding the interpretation statement so we have had a bit of a contretemps as to whether the Court of Appeal was actually doing that but the actual position, as I understand it, was uphold the interpretation statement. Now, we did have the difficulty that I was complaining about that we hadn't managed to articulate a test. Mr McLellan was articulating the commitment test as being – but commitment in a broader banner than contended by Trustpower, as I understand it.

MR HARLEY:

Let me now confront Your Honour directly the proposition that we say is the correct legal principle.

ELIAS CJ:

Before you get to that, please bear in mind that I wouldn't want you to think that everyone thinks that there has to be a test because it may simply be a question of application of the statute so that the only test is whether it's of a capital nature and that may be as good as you can get. It may be that it is intensely contextual which is not to say that it's arbitrary because it'll have to be justified, but that you can't get better than that. You have to look at all the circumstances.

MR HARLEY:

I couldn't have put that better myself, your Honour, and several of the leading authorities, particularly in the House of Lords and Privy Council and, indeed, Sir Ivor Richardson's jurisprudence, make that very point. There is no silver bullet here in terms of a test but the identifiable capital asset test is a critical one in terms of helping to resolve most problems. I say to you, really reflecting back to you the conception of capital and where it comes from, as your Honours will know, it's a trust law concept that's been imported from trust law into income tax law. The difference between the interest of the life tenant, that's the person who receives the income, and the remainder man, that's the person who enjoys the benefit of the trust estate when the life tenant has died. It's Lord Wilberforce who's the exponent of the identifiable asset test, as he refers it, to distinguish between fixed capital and operating revenue. But it is all about a meticulous appreciation of the relevant facts and Sir Owen Dixon is the author of the proposition of the need for a clear appreciation of the actual place in the business of those facts. What is capital is

actually blunt. It either is or it isn't and there is no policy conception behind what it is or isn't beyond the commercial idea that's reflected in the basic accounts.

So with that I would say that the position is by way of submission and agreement with the Chief Justice and Justice Glazebrook. This has got nothing to do with section 6 and section 6A of the Tax Administration Act. Those provisions do not provide any warrant to the Commissioner or, indeed, a taxpayer to assess or self-assess other than according to the law. The collecting taxes after an assessment is a care and management process and that's what those provisions are about.

The conundrum in terms of what is capital or not and the difficulty with it was captured by the Judge in her judgment at 44 to 47 when she used some of Lord Green's tossing of the coin and also there's a good passage in terms of the difficulty of resolving the conundrum at Justice Dixon's judgment in *Hallstroms*. But your Honour the Chief Justice is a firm exponent of the need for a Court to identify what is the principle and to explain the outcome by logic and reason. We support that approach.

To answer your Honour's question as to whether the income tax can ever satisfactorily define what is capital, the answer to that question from my perspective is not in my lifetime because of the very different nature of firms and people and how they conduct their affairs and until someone has a magic elixir that does better than that then we're left with what is the basic concept.

WILLIAM YOUNG J:
The basic concept of commitment seems to have come, been extracted from remarks made by Justice Wild in *Milburn*. Is that right? In rejecting the sort of scoping argument advanced in that case he said Milburn made a decision to proceed.

MR HARLEY:
Yes.

WILLIAM YOUNG J:
That's where commitment comes from. That's where – there isn't anything before him about commitment, is there?

MR HARLEY:
I think there is, your Honour.

WILLIAM YOUNG J:
Is there?

MR HARLEY:
Yes, there would be in the earlier *Softwood* case.

WILLIAM YOUNG J:
I thought the *Softwood* case would – the fact that there was no commitment didn't prevent it being on capital account.

MR HARLEY:
I understand that but I think that language is referred to or used by Justice Minhinnick in his judgment.

WILLIAM YOUNG J:
Yes, what I meant, before Justice Wild in *Milburn*, no one was saying that commitment is the test for whether it's on revenue or capital account.

MR HARLEY:
I'm not aware of any, no. But I think to take up Justice Arnold's – if I could use the word "frustration" with this idea, it's taken on a life of its own that's actually bigger than the proposition. We can all see when a firm has spent money, in fact, to buy something. That's not very hard and it may be hard to determine what it is that the money has bought.

The prior proposition is when the firm has decided that it will start spending money to buy the thing and that's all commitment's about and that's what *Fuller* reflects. It's just that simple.

WILLIAM YOUNG J:
Well, it might be a very good reason for saying that expenditure is on capital account but it's not – absence of commitment isn't a conclusive reason, so it seems to me, anyway, for saying it's not on capital account, particularly if commitment means a subjectively-held intention to go ahead come hell or high water.

MR HARLEY:
But that'll all emerge from the facts.

WILLIAM YOUNG J:
What I'm saying is, in *Milburn* there was a commitment to go ahead so that was a good reason for saying, yes, it's on capital account.

MR HARLEY:
Well, it's more than that because they spent the money going ahead. They'd bought the land and they spent the money to develop a mine.

WILLIAM YOUNG J:
But your client has done some of that, has bought some of the land or has acquired access rights and it's spent money. It's got resource consents that run alongside those property rights.

MR HARLEY:
Yes. So the issue in the case is what is the nature of the expenditure and whether or not that expenditure has purchased what are identifiable capital assets.

WILLIAM YOUNG J:
But it doesn't have to have purchased identifiable. It has to have been laid out for the purpose of acquiring or developing a capital asset.

MR HARLEY:
Well I don't understand the difference between being laid out for the purpose and spending the money to buy –

WILLIAM YOUNG J:
No, but you're assuming, your language assumes an asset is acquired. I mean the *ECC Quarries* case shows that you don't need to be successful. If you lay it out for a capital purpose it's on capital account even though your purpose is frustrated.

MR HARLEY:
Well it depends on the perspective your Honour. In *ECC Quarries* the company spent the money to develop the mine. It's got nothing to do with whether it was

successful or not, that's what they spend the money for. Lord Nolan, or Mr Nolan as he was when he argued the case, put to the Judge three propositions which he said were incontrovertible in that case. He was right. And Lord Brightman as the trial Judge should have stopped there and said, he's right. As should Justice Wild in *Milburn*. And that's exactly where Justice Richardson got to without even articulating a reason in *Waste Management*. The company owned the land and spent the money to develop it to build the landfill. They're all mining cases.

WILLIAM YOUNG J:
Well *Softwood* wasn't.

MR HARLEY:
A mining case?

WILLIAM YOUNG J:
Yes.

MR HARLEY:
Well, in a sense it kind of is. The process that is adopted in that case, can we put the preliminary expenditure –

WILLIAM YOUNG J:
Yes.

MR HARLEY:
– aspect, which is what the case turns on, to the side, and just look at the idea in respect of *Softwood* as an existing business in the pulp and paper industry. If that money was spent in the process of examining the prospectivity of the new pulp and paper business expansion, that cost would have been deductible and Justice Minhinnick is wrong in that part of the judgment where he says he would have said that's subject to the capital limitation. The point is, and the reason that his Honour was wrong in that respect is, in the example in the way I restated the facts, is once the company is already in the business, and is looking at the prospect of expanding it, that expenditure is deductible until it gets to the point that the money is being spent to acquire the asset. And that is the identifiable capital asset test on those facts. And the reason we know the answer, and it is that blunt, is that at the point the company spends the money to acquire the plant and equipment, that is

creating the fixed capital of the business. It would be expanding the existing fixed capital of the business to the new facilities. And that's where *Bowater* gets to, and it's right.

WILLIAM YOUNG J:
What's – the shipping case. I mean that goes, is liked by all the – there must have been a fixed commitment to the capital asset because they bought the vessel.

MR HARLEY:
Yes. That's *Fullers*.

WILLIAM YOUNG J:
No, it's the Canadian case.

MR HARLEY:
Yes, I understand, but it's *Fullers*, the same idea. In *Fullers* what was offered for purchase was the ferry contract. The company made the bid to purchase the ferry contract and then went into litigation to try and secure the right. It's spending the money to buy the asset.

WILLIAM YOUNG J:
Sorry, I think you missed the point I'm making. In the Canadian case, which makes me doubt the relevance of the Canadian cases, in the boat case, the vessel that sunk, there had been a commitment.

MR HARLEY:
Yes.

WILLIAM YOUNG J:
So it should have been on capital account?

MR HARLEY:
Yes.

WILLIAM YOUNG J:
So that case is wrong?

MR HARLEY:

If the Court, I haven't read it, but if the Court held that expenditure was deductible I can't understand it.

WILLIAM YOUNG J:

Well they say because otherwise it goes into a black hole.

MR HARLEY:

Well, ah –

WILLIAM YOUNG J:

That, as I understand it, is the rationale.

MR HARLEY:

Well it if goes into a black hole, so be it. That's exactly what happened in *Milburn*.

WILLIAM YOUNG J:

With the one project. The one that didn't go on?

MR HARLEY:

Yes. And that is the genesis of DB, whatever it was, 13.

WILLIAM YOUNG J:

So that's a response to *Milburn*, not this case?

MR HARLEY:

Yes, *Milburn* was well before this case.

WILLIAM YOUNG J:

Yes, I appreciate that. Okay.

MR HARLEY:

So in order to hopefully satisfy, particularly your Honour Justice Glazebrook, as to what we say the principles are here, I'm not inviting you to accept that this is right. I'm trying to articulate here what the principles are.

GLAZEBROOK J:

I think we have understood your identifiable capital asset contention from your submissions which is probably why I didn't grizzle quite so much at you as I did at your friend.

MR HARLEY:

I'm not –

GLAZEBROOK J:

So it was articulated. Whether it'll be accepted or not, of course, is what we have to decide.

MR HARLEY:

I am not going to risk trespassing into that, your Honour. The submissions that I have made are intended to be as clear as is possible as to what we say the correct approach is using the identifiable capital asset test in these circumstances.

That then gets me to the specific points of reply that have occurred both late yesterday and during the course of today. The first point that I wanted to take up with your Honour, Justice Arnold, is whether or not there was evidence in the record that Trustpower had, in fact, reduced its customer base. Yes it is in evidence and yes it did reduce its customer base by approximately 20 to 25% in the period.

ARNOLD J:

Yes, I thought I'd read that.

MR HARLEY:

That evidence is in Dr Harker's brief.

ARNOLD J:

Right.

MR HARLEY:

Moving from there I wanted to deal with now the scope or effect of the section DB 19 amendment and the Chief Justice's observation as to whether or not there was a wrapped up assumption within that provision, and these are my words not yours

Chief Justice, so as to provide a comprehensive code dealing with these kinds of consent conditions lapsing, failing or being withdrawn.

ELIAS CJ:

I don't think I meant that but it's an interesting thought.

MR HARLEY:

Well you were using the wrapped up assumption language.

ELIAS CJ:

The wrapped up assumption was that it was not a code but that it was of a capital nature. I'm not saying that DB 19 applies or nothing.

MR HARLEY:

No, I understand that, and I didn't take it that way.

ELIAS CJ:

Yes, right.

MR HARLEY:

Let me respond to that by saying that the problem with the Commissioner's proposition in respect of DB 19 is exactly the same problem that she had with relying on DB 13 for the same reasons. In each of the provisions there is an express caveat so that those taxpayers who are able to and have, in fact, taken deductions for the relevant expense, don't qualify for the amelioration offered by the provision. So it doesn't get you to answer the question as to whether –

WILLIAM YOUNG J:

But it doesn't determine the question –

MR HARLEY:

No.

WILLIAM YOUNG J:

– but it provides a context of, perhaps gives the respondent more assistance than you.

MR HARLEY:

I don't believe that it offers the respondent assistance one way or the other because the question here is, is Trustpower entitled to a current deductible.

WILLIAM YOUNG J:

Well maybe that's the question I think .

MR HARLEY:

And that is what these provisions expressly allow for and disqualify Trustpower from the benefit of that amelioration if that's the position. So it doesn't answer the question.

WILLIAM YOUNG J:

All it means is there isn't a black hole, in this case.

MR HARLEY:

In those circumstances.

WILLIAM YOUNG J:

In these, for Trustpower there wouldn't be a black hole if it abandoned the resource consents.

MR HARLEY:

If it abandoned the resource consents, yes.

WILLIAM YOUNG J:

That it doesn't wish to abandon the resource consents suggests that have a value to Trustpower that exceeds the tax benefit of their surrender?

MR HARLEY:

Or they are looking for the opportunity to see whether the chance comes into the money –

WILLIAM YOUNG J:

Sure, yep.

MR HARLEY:

– and they'll take the risk, and that was Mr Hagen's Lotto ticket analogy. He'd sooner have a Lotto ticket than not.

GLAZEBROOK J:

Quite an expensive lottery ticket.

WILLIAM YOUNG J:

Not if the alternative is to get a tax – get 28% of 17 million. I think I'd take the 28% of 17 million probably.

MR HARLEY:

But if the power project, when the Lotto ticket comes home, is worth –

WILLIAM YOUNG J:

We might have to block this metaphor actually.

O'REGAN J:

Yes. You'd have to hope the odds are better than in Lotto.

ELIAS CJ:

Metaphors are always a bad idea.

MR HARLEY:

I'll move on. My point about it is it's simply not permissible for the Court to have regard to DB 19 in respect of the amendment and what it provides for because it isn't retrospective in effect and it is not declaratory by Parliament.

WILLIAM YOUNG J:

But it's retrospective in effect in that if Trustpower surrendered the resource consents it would be able to claim a deduction for the costs.

MR HARLEY:

But that's in the current period. It can't re –

WILLIAM YOUNG J:

Yes, yes, yes.

MR HARLEY:

– back to 2008 to, sorry, 2006, 2008 –

WILLIAM YOUNG J:

I understand.

MR HARLEY:

– and the authority for that proposition is that unless Parliament has expressly resolved an ambiguity as the correct application of legislation then it's not legitimate for the Court to have regard to it. That's *Databank*.

O'REGAN J:

I think the point was more does it imply some underlying assumption about the deductibility of this expenditure? In other words, has it identified a problem to fix, and I think Mr McLellan was saying, "Well, there wouldn't have been a problem to fix if your interpretation of the capital limitation is correct."

MR HARLEY:

Correct.

O'REGAN J:

So – I mean, I don't think – it's not attributing to Parliament any kind of specific law making in relation to what the capital limitation is.

MR HARLEY:

Correct.

O'REGAN J:

It's just asking is – does it illustrate that there was perceived to be a problem?

MR HARLEY:

With some taxpayers and the answer in the context of the black hole consequences is yes, there was.

O'REGAN J:

Yes, but you say but it doesn't illustrate a more general problem than that?

MR HARLEY:

Correct. Your Honour, Justice Young, asked whether Trustpower had ever sold any of the consented projects. The answer is no, never.

WILLIAM YOUNG J:

So it did have a rough offer for the Mahinerangi project?

MR HARLEY:

I believe that there was some kind of inquiry as to whether or not that might be on offer but it never got off the ground.

WILLIAM YOUNG J:

Well, in any event, Trustpower was developing Mahinerangi 1?

MR HARLEY:

I'm not sure at that time whether that was the case.

WILLIAM YOUNG J:

I think it would just – I was just looking at the timeline in the appendix 2 to the respondent's submissions. The reason given by Dr Harker for not accepting the Kaiwera Downs offer was that it was only a quarter of the net present value.

MR HARLEY:

Plus the other reasons that were given by –

WILLIAM YOUNG J:

Well, that implies a net present value over $30 million?

MR HARLEY:

Yes, for a completed project.

WILLIAM YOUNG J:

No, no, but that was for the sale of the project.

MR HARLEY:

No, for a completed project. The comparison that he was offering was the net present value for a completed project against the price.

WILLIAM YOUNG J:

But then all they would be selling, the net present value is of the assets now and you bill them what it would cost and what it would be worth in that exercise, don't you?

MR HARLEY:

That's not my understanding of the evidence at all, your Honour. The comparison was taking Kaiwera to its completed and operable phase, what was its expected net present value?

WILLIAM YOUNG J:

The net – that would be the net future value. That would be what it would be worth once completed.

MR HARLEY:

Brought back to net present value terms compared to the price that was on offer.

WILLIAM YOUNG J:

Yep, yeah, well, that's what I understand.

MR HARLEY:

And the range –

WILLIAM YOUNG J:

That's what I thought it meant, assumed it meant.

MR HARLEY:

The range of that NPV, depending on the resolution of the HVDC issue, was between minus 30 million to plus 30 million, and so the evidence that was given was that it's the prospective NPV compared to the price, and remember that it's –

WILLIAM YOUNG J:

I think there's something – I think there's a contradiction in terms in talking about a prospective NPV. An NPV takes into account all the risks one way or another in relation to the future.

MR HARLEY:

No, your Honour, that's not right. The prospective NPV assumes that the project is built for a price and it assumes from that point what the operating revenue is into the future and then applies the discounted cash flow to produce what is the prospective –

WILLIAM YOUNG J:

Current value, yep.

MR HARLEY:

– the prospective NPV compared to the offer price. We don't need to –

WILLIAM YOUNG J:

Is that explained in the evidence anywhere?

MR HARLEY:

Yes.

WILLIAM YOUNG J:

I just assumed that you're offered $8 million, you say it's a quarter of what you want, that it implies that you think that what you've currently got is worth $32 million.

MR HARLEY:

No. It's what you would have expected it was worth if you had completed the project and had it operating, and yes, that is in the evidence.

GLAZEBROOK J:

And the value would only be related to the future earnings in any event.

WILLIAM YOUNG J:

Yes, of course it is, yes.

GLAZEBROOK J:

Yes.

WILLIAM YOUNG J:

But I mean they obviously – I thought that basically they do everything by reference to NPVs and it's heavily affected by the weight of average cost of capital.

MR HARLEY:
Absolutely.

WILLIAM YOUNG J:
And sometimes it's negative, sometimes it's positive, sometimes it's neutral.

MR HARLEY:
Depending on what the risk factors are and they're weighting, absolutely, and the model that was put to Dr Harker, which he'd never seen before, went through all those assumptions, the range between minus and plus 29 million, from memory.

The answer to your question is had they ever sold – have they ever sold any of these consented projects, the answer's no.

The next point I wanted to make really is to hopefully relieve your Honour, the Chief Justice, of the burden of looking at Part D of the Income Tax Act. Don't. Let me tell you what it contains quickly. It has petroleum mining, timber and forestry, mining, farming, insurance and film regimes, and all you can take from it is that Parliament has spoken specifically to industries, but it doesn't get to where you'd love to be, and I'd be in your camp too if we got there and rather than you, to take that information up from Justice Glazebrook, I would say you should not do that and preserve the good relations –

ELIAS CJ:
Very happy not to.

MR HARLEY:
– between members of the Court. It won't help you.

ELIAS CJ:
All right. So there is no reason in the scheme of the Act? Well, there is. It's a response to specific industry needs?

MR HARLEY:
Yes.

ARNOLD J:

Well –

GLAZEBROOK J:

What about research – sorry?

ARNOLD J:

Well, I was just going to say, to what extent do these regimes allow deductions for things that might otherwise be thought to be on capital account, sort of expiration activities, that type of thing?

MR HARLEY:

The answer is each one of them does both.

ARNOLD J:

Right.

MR HARLEY:

I think, without getting into the detail of it, the way I would put it, your Honour, is that a group of economists, industry expert accountants, the Inland Revenue, have sorted through the smorgasbord of typical expenses and revenues and categorised them for what I would call bright-line purposes. Now there'll be a contest as to who was right and who was wrong but it's pretty clear who usually wins those arguments across the road, and that's the outcome. They are black and white definitional rules and that's the outcome.

ARNOLD J:

Right, so it just removes a whole load of uncertainty, yep.

GLAZEBROOK J:

But Part D does more than just look at those particular industries. It also looks at categories of expenditure such as research and development, which is probably the most relevant, and with specific – accepting them specifically from the capital limitation.

MR HARLEY:

That is correct, your Honour, and by way of confession there I have a substantial role in their authorship. The point about them is really getting back to the exchange between her Honour, the Chief Justice, and Justice Young about the attempt to bring better prescription and bright-line rules in what were highly contested areas relating to computer software development, research and pharmaceuticals and the like, and the policy debate turned on whether or not Parliament should reach to what is now NZ IAS 38 and adopt it as part of the tax prescription in circumstances where the taxpayer had itself adopted NZ IAS 38 in its financial statements. I am not aware, but this may not be correct, but I am not aware of any other provision in the Income Tax Act that explicitly reaches across to the NZ IAS standards.

There are two provisions, your Honour. One deals with scientific research. I think that's DB 26, and the others research and development in respect of DB 27. I'm not too sure about those numbers because I can't remember between 2004 and 2007 and they renumbered them. But the scheme is clear enough and they are very prescriptive in terms of if the taxpayer adopts a treatment for its financial reporting purposes in accordance with the standard, that defines the outcome in respect of the capital income boundary, and so the submission that I put to the Court of Appeal, which it basically ignored, was that is the instance of where Parliament has recognised that internationally accepted accounting standards are actually quite important, and where those provisions apply are prescriptive. That's not the same thing as saying that they must be prescriptive in respect of the general permission, or capital limitation. The submission was simply that the case law recognises that the accounting treatment and standards can be relevant and helpful.

One reason, particularly in respect of DB 26 and 27 in the regime, was the concern with what was start ups.

GLAZEBROOK J:

Is 33 and 34 in the –

MR HARLEY:

2007 Act.

GLAZEBROOK J:

I think so, yes, let me just think that I'm in the, yes. Just in case people are looking for them. 2004 they probably were earlier.

MR HARLEY:

I think they are, 26 and 27.

GLAZEBROOK J:

And you'd say it doesn't, again the same submission, it doesn't say anything about what the treatment would be under the general law?

MR HARLEY:

No, it doesn't.

GLAZEBROOK J:

In fact it leaves the general law in place, if people don't apply the accounting standards.

MR HARLEY:

Yes. my next point really is to pick up and correct my friend in terms of his assertion that Viscount Cave's language in the *Helsby Cables*, the *Atherton* case, he uses the expression "asset or advantage" and my friend expressed the proposition that the word "advantage" meant something that was different or conceptually of a different nature from asset. It's just not so. And Lord Wilberforce makes that absolutely clear in his speech in the *Carron* case saying it means an asset and that was how he treated the *Atherton* case.

WILLIAM YOUNG J:

Well one of the Judges in *Ampol*, was it *Ampol*, discusses this at length saying that it doesn't necessarily mean an asset.

MR HARLEY:

Well you're doing better than me, your Honour, I can't remember that. But that may well be right. But it would be right, your Honour, for the reason that there's the Federal Court taking the Dixon approach.

WILLIAM YOUNG J:

Yes, they are taking it, it was taking the Dixon approach.

MR HARLEY:

Yes, and for all the reasons we've gone over in the cases, no one else accepts the proposition that if you can't identify an asset as a capital asset –

WILLIAM YOUNG J:

Well I don't agree with that because in the case we have, the *Regent Oil* case, three of the Judges didn't require it to be a lease issue.

MR HARLEY:

Well we're going back over –

WILLIAM YOUNG J:

I know, and then you may finesse it by saying oh, but it shows an action, and that's an asset, and if it's long enough it's a capital asset. So I mean it just may be a matter of semantics.

MR HARLEY:

Look I don't think it's appropriate for me now to start re-arguing where we've been.

WILLIAM YOUNG J:

No, but we haven't been over that. But I don't know that, to say that what those three Judges said was pretty similar to what Justice Dixon said.

MR HARLEY:

Well, Your Honour –

WILLIAM YOUNG J:

You don't agree.

MR HARLEY:

My proposition is that what they're reaching to is that there is a structural alteration to the fabric of the business and that affects the asset, which is the fixed capital.

GLAZEBROOK J:

The, getting out of long-term agreements cases, or buying out somebody else, it's really because it's related to the structure of the business, isn't it, rather than necessarily identifying an asset. Because buying out someone else doesn't really have a direct effect on goodwill in the way that you would normally say you're buying an identifiable capital asset.

MR HARLEY:

There are two –

GLAZEBROOK J:

Probably, you wouldn't be able to do those things now anyway but –

MR HARLEY:

Well there are two ideas behind that, your Honour. The first would be running along with Justice Young's first formulation in respect of the idea, which was that if there was an explicit contract or covenant in restraint of trade, and the purchase price, or receipt, is in respect of the covenant, that would be the asset, and that's the Richardson view in *Buckley & Young*.

GLAZEBROOK J:

Yes, it's the buying out of – the more difficult question is where you're buying yourself out of something, but the idea there would be you're buying yourself out of a capital asset in the first place I suppose.

MR HARLEY:

Yes, and that's the negative asset idea which fortunately we don't have to get into. Finally, and in closing, I wanted to deal with briefly my friend's points about commitment and what the Judge actually said in respect of that.

GLAZEBROOK J:

Before you do, is this dealing with the timing question?

MR HARLEY:

Yes.

GLAZEBROOK J:

Before you do, can you just in terms of the consents themselves, it's accepted by the witnesses that they had some value to Trustpower, not necessarily in monetary value but some value in having them.

MR HARLEY:

Yes.

GLAZEBROOK J:

They are identifiable assets.

MR HARLEY:

As things.

GLAZEBROOK J:

If I want to set up a laboratory and buy a microscope, that's not going to do me much good unless I have all of the other equipment as well, because one of your arguments, as I understood, with the resource consents, is that they weren't of any use by themselves, which is true, you had to have all of the other consents as well. But my microscope, I can't set up a laboratory until I buy a whole lot of other things and then presumably employ some people who can do what I certainly couldn't. But that doesn't make the microscope any less a capital asset, the fact that it's not any use to me until I have the other assets.

MR HARLEY:

I agree.

GLAZEBROOK J:

So where is the difference with the resource consents in this case? I know there is an argument that they're only there to get information, and that's true as well, except that there is still an asset at the end of that information gathering process.

MR HARLEY:

To take the real facts in Trustpower's circumstances, it owned a scientific equipment such as wind monitoring masts, which it put on other people's land to measure the wind, and it did the same with water data collection land equipment, capital. Capital

because the nature of the thing is itself reflective of operating capacity. It's functional and is used in the business.

GLAZEBROOK J:
Well, but what say it's not, it's put in the shed because you might need at some time in the future?

MR HARLEY:
It's capable of use in the business because you've put it in the shed and will draw on it when you wish.

GLAZEBROOK J:
The obvious question will come from somebody, why isn't the resource consent put in the shed to be functional when it's of use?

MR HARLEY:
And the obvious answer to that question is that unless and until Trustpower is able to complete the stapling what we're talking about is the future possibility of the thing, not the thing itself, and it's for that reason that I've advanced the submission relying primarily on the language used in *Carron's* case. It is a misconception to focus on the resource consents themselves as being ends in themselves. They're not.

GLAZEBROOK J:
But it doesn't have to be an end in itself. My microscope wasn't an end in itself. It was a component that I would need later for my laboratory that I'm busy setting up and –

MR HARLEY:
It's a –

GLAZEBROOK J:
– and I'm afraid I'm using a laboratory because I have tried more industrial things and got a bit lost in terms of the requisite machinery but…

MR HARLEY:
It's a physical thing in itself. It's different in nature from, for instance, the *BP* type of contractual tie which we've agreed is property and in that sense is commercially of

value. What we're trying to do is to explain in respect of an intangible what is its nature in the business and what does it affect in the business. So –

ELIAS CJ:

Sorry, is the short answer that the difference between the microscope and the resource consent is simply that the resource consent is intangible?

MR HARLEY:

Well, that's not going to satisfy Justice Glazebrook –

ELIAS CJ:

No, I wouldn't have thought so.

MR HARLEY:

– because she's going to say we'll have the same principle applying between tangibles and intangibles and I'm in agreement with that.

ELIAS CJ:

Right.

MR HARLEY:

There can't be a different rule depending on whether it's tangible –

ELIAS CJ:

Yes.

MR HARLEY:

– or intangible.

ELIAS CJ:

Yes, I'm sorry, that's fine. I just wanted to clear that up.

MR HARLEY:

And so to respond further to why is it different it being the resource consents, where they are legal permissions and the Income Tax Act refers to them as being property, just as in *Carron's* case so was the constitution. It's not the thing in itself that's the end. It's for what the money was spent having regard to what I would call the fabric

of the business, and they can't create separately what is functional fixed capital assets. They can't earn money for the company, which is why my submission is that all the costs are properly treated as research expenditure and deductible.

GLAZEBROOK J:
Well, it can earn money for the company when combined with the rest of the factory in my example and put to use in that way.

MR HARLEY:
And my answer to you in those circumstances is, your Honour, it's all the difference between a future possible capital project and not here.

GLAZEBROOK J:
Well, we come back to whether you have to have an actual capital project or whether going a long way down the line it – that's the fundamental that's here and actually as your friend pointed out even in *Bowater*, that's actually not the situation even in *Bowater*.

MR HARLEY:
Yes, and there is one – yes, the idea I say to conceptualise from the practical and business point of view is really embodied in Justice Andrew's judgment at paragraph 120 where she accepted the submission that I made to her – it might be 140. Yes, it was 140. The submission I put to her was the expenditure was indiscriminate as part of the general operations expenses and the reason for that submission was to reflect the entire by-side appraisal which all this information assisted. The Court of Appeal –

ELIAS CJ:
Assisted whether to buy, you mean?

MR HARLEY:
And costing the buying decisions.

ELIAS CJ:
Yes.

MR HARLEY:

The Court of Appeal never addressed that side of the business and my friend's kept right away from it in practically every submission that he's made in this Court.

ELIAS CJ:

But if you get to the stage where you've gone past that gathering of information, maybe that's a good enough proxy for your commitment.

MR HARLEY:

To what?

ELIAS CJ:

To, well, to the ultimate purpose.

MR HARLEY:

Being?

ELIAS CJ:

The hydro development or the wind farm or the what –

MR HARLEY:

But we know on the evidence that this company was nowhere close to being able to proceed to bring any of these projects to fruition at the time it was spending money to simply buy or obtain the consents. Its conception from an engineering perspective was –

ELIAS CJ:

No, but at that stage it wasn't trying to work out whether to buy from the grid or whoever you buy electricity from.

MR HARLEY:

Yes, it was. It was doing that every day.

ELIAS CJ:

No, but it wasn't – it was going – once it was going ahead seeking resource consents it had got beyond gathering sufficient information to decide whether it did want to pursue that opportunity.

MR HARLEY:

In respect of obtaining the consents, yes, but not in respect of –-

ELIAS CJ:

Well, I know it wasn't committed to going through with the whole project but – anyway.

MR HARLEY:

No, no. No, your Honour, it's not a question of commitment. It's a question of the suite of information that was available to it to be able to decide whether or not the fuel definition was sufficient so that it could then proceed to its second step feasibility study. It is, to use a bad metaphor, a light year away from the project itself, and the point I wanted to make to your Honour, Justice Glazebrook, which comes back to me, is in *ECC* and *Milburn* the Judges there conceive of the planning approvals as being better seen in respect of the underlying projects themselves. I agree with that, which is why for all the reasons that are advanced in the submission we say that the focus on the consents themselves is just misconceived. It doesn't reflect their true nature when you understand what this business is doing and trying to do in respect of costing its supplies.

That then gets to the response in respect of my friend's commitment submissions in respect of the four projects.

O'REGAN J:

This is commitment to –

MR HARLEY:

Timing.

O'REGAN J:

But it's commitment to get the resource consent as opposed to commitment to do the development.

MR HARLEY:

Yes. The Judge's findings in respect of this are at 154 and 156 of the judgment where she says she accepts the evidence that was given by the Trustpower witnesses. It's perfectly true that the company was, for the reasons that are identified

in the documents, going through a process of the preparation of all the information that could be needed for the preparation of the respective AEEs and Mr Kedian said in evidence there was never any secret about that. He also said that he was working on his plan in respect of that process and he asserted that that did not equate to him making any decision about whether that process was or wasn't complete until he had the body of information in front of him to make a decision.

GLAZEBROOK J:
That would have to be true with any resource consent, wouldn't it –

MR HARLEY:
Yes.

GLAZEBROOK J:
– because there would always be the concern that when you did the work the consent wasn't going to work in a way that was going to be suitable for you.

MR HARLEY:
Or, as we've seen, as did happen here, we have a Board over the top of this saying in respect of Arnold, hang on a minute. We are not happy.

GLAZEBROOK J:
Well didn't we have a, didn't we go to the Board paper which said, go ahead with the resource consent?

MR HARLEY:
Yes, yes we do, and then subsequently we have a Board saying, hang on a minute. We are concerned about the Taramakau diversion and we should –

GLAZEBROOK J:
I thought that was the same Board meeting or was that the earlier minutes, maybe the November minutes, and then the December Board meeting. Sorry I've obviously got slightly lost.

MR HARLEY:
And subsequently a lot more work was done in respect of the viability of the diversion and what it meant to project economics. And so all his evidence was that if he

disregarded the Board's caution, it would have been a career limiting move for him. But more substantively, when you understand the business decision-making process that's going on between management and the Board, it's completely symbiotic, and so when he gave the evidence that he did, which the Judge accepted, he did not make a decision to proceed with that resource consent application until the date that he said. Now the Judge was either entitled on the basis of the evidence that he gave to believe him, and accept it, in which case the obligation on my friend is to show that that evidence was insufficient, it was not, she was wrong to come to that conclusion. And my submission is he can't make that case. The Judge was well entitled to come to the views that she expressed in the judgment and she can't be shown to be wrong in respect of them, and hasn't been. Please don't read part D Your Honour.

ELIAS CJ:
No, I won't do that.

MR HARLEY:
Those are the submissions.

ELIAS CJ:
Yes, thank you Mr Harley. Thank you very much counsel for your submissions in this matter. We'll reserve our decision.

COURT ADJOURNS: 3.44 PM