FEDERAL COURT OF AUSTRALIA

Commissioner of Taxation v Messenger Press Proprietary Limited [2013] FCAFC 77

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| Citation: | Commissioner of Taxation v Messenger Press Proprietary Limited [2013] FCAFC 77 |
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| Appeal from: | Messenger Press Proprietary Limited v Commissioner of Taxation [2012] FCA 756 |
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| Parties: | **COMMISSIONER OF TAXATION v MESSENGER PRESS PROPRIETARY LIMITED (ACN 007 563 439)**  **COMMISSIONER OF TAXATION v LOWER BURDEKIN NEWSPAPER COMPANY PTY LTD (ACN 010 191 367)**  **COMMISSIONER OF TAXATION v MIRROR NEWSPAPERS PTY LIMITED (ACN 000 015 976)**  **COMMISSIONER OF TAXATION v NATIONAL RUGBY LEAGUE INVESTMENTS PTY LIMITED (ACN 081 778 538)**  **COMMISSIONER OF TAXATION v WESPRE PTY LIMITED (ACN 008 669 841)**  **COMMISSIONER OF TAXATION v NEWS FINANCE PTY (IN LIQUIDATION) (ACN 008 549 095)**  **COMMISSIONER OF TAXATION v RUGBY INTERNATIONAL PTY LTD (ACN 000 369 326)**  **COMMISSIONER OF TAXATION v HARPERCOLLINS PUBLISHERS (HOLDINGS) PTY LIMITED (FORMERLY HARPERCOLLINS PUBLISHERS (AUSTRALIA) PTY LIMITED) (ACN 008 431 730)**  **COMMISSIONER OF TAXATION v HARPERCOLLINS PUBLISHERS AUSTRALIA PTY LIMITED (FORMERLY HARPERCOLLINS PUBLISHERS PTY LIMITED) (ACN 009 913 517)**  **COMMISSIONER OF TAXATION v HERALD AND WEEKLY TIMES PTY LIMITED (ACN 004 113 937)**  **COMMISSIONER OF TAXATION v DAVIES BROTHERS PTY LIMITED (ACN 004 113 937)**  **COMMISSIONER OF TAXATION v DAVIES BROTHERS PTY LIMITED (ACN 009 475 754)**  **COMMISSIONER OF TAXATION v NATIONWIDE NEWS PTY LIMITED (ACN 008 438 828)**  **COMMISSIONER OF TAXATION v NEWS LIMITED (ACN 007 871 178)**  **COMMISSIONER OF TAXATION v NEWS HOLDINGS PTY LIMITED (FORMERLY THE NEWS CORPORATION LIMITED AND NEWS HOLDINGS LIMITED) (ACN 007 910 330)**  **COMMISSIONER OF TAXATION v THE NORTH QUEENSLAND NEWSPAPER COMPANY PTY LIMITED (009 655 690)**  **COMMISSIONER OF TAXATION v LEADER ASSOCIATED NEWSPAPERS PTY LIMITED (ACN 004 337 446)**  **COMMISSIONER OF TAXATION v ADVERTISER-NEWS WEEKEND PUBLISHING COMPANY PTY LIMITED (ACN 007 562 950)**  **COMMISSIONER OF TAXATION v ADVERTISER NEWSPAPERS PTY LIMITED (ACN 007 872 997)**  **COMMISSIONER OF TAXATION v NEWS AUSTRALIA HOLDINGS PTY LIMITED (ACN 105 197 028)** |
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| File number: | NSD 1257 of 2012 |
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| Judges: |  |
|  |  |
| Date of judgment: | 25 July 2013 |
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| Catchwords: | **TAXATION** – income tax – deductibility of loss to extent to which attributable to currency exchange rate fluctuations – deduction available only when loss realised – what amounted to realisation of loss – whether necessary for there to have been a transaction involving the exchange of Australian and foreign currencies – whether deduction available where foreign currency debt discharged by tender of promissory note, in that currency, obtained by expenditure in Australian currency, or equivalent |
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| Legislation: | *Acts Interpretation Act 1901* (Cth) s 23  *Income Tax Assessment Act 1936* (Cth) Part III Div 3B, ss 20, 51  *Income Tax Assessment Act 1997* (Cth), s 8-1  *Taxation Administration Act 1953* (Cth) Pt IVC  *Taxation Laws Amendment Act 1987* (Cth) |
|  |  |
| Cases cited: | *Armco (Australia) Pty Ltd v Federal Commissioner of Taxation* (1948) 76 CLR 584  *Avco Financial Services Ltd v Commissioner of Taxation* (1982) 150 CLR 510  *Bank of New South Wales v Brown* (1983) 151 CLR 514  *Caltex Ltd v Federal Commissioner of Taxation* (1959) 106 CLR 205  *Colonial Mutual Life Assurance Society Ltd v Federal Commissioner of Taxation* (1946) 73 CLR 604  *Commercial and General Acceptance Ltd v Federal Commissioner of Taxation* (1977) 137 CLR 373  *Commissioner of Taxation v Energy Resources of Australia Ltd* (1994) 54 FCR 25  *Commissioner of Taxation v Energy Resources of Australia Ltd* (1996) 185 CLR 66  *Royal Insurance Company, Ltd v Stephen* (1928) 14 TC 22  *The Texas Company (Australasia) Ltd v Federal Commissioner of Taxation* (1940) 63 CLR 382  *Westminster Bank, Ltd v Osler* [1933] AC 139 |
|  |  |
| Date of hearing: | 14, 15 February 2013 |
|  |  |
| Place: | Sydney |
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| Division: |  |
|  |  |
| Category: | Catchwords |
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| Number of paragraphs: | 100 |
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| Counsel for the Appellant | J De Wijn QC, AT Broadfoot, LA Hespe |
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| Solicitors for the Appellant | Maddocks Lawyers |
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| Counsel for the Respondent | NJ Young QC, M Richmond SC, CA Burnett, CJ Peadon |
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| Solicitors for the Respondent | Allens |

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| IN THE FEDERAL COURT OF AUSTRALIA |  |
| NEW SOUTH WALES DISTRICT REGISTRY |  |
| GENERAL DIVISION | NSD 1257 of 2012 |

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| ON APPEAL FROM THE FEDERAL COURT OF AUSTRALIA |

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| BETWEEN: | COMMISSIONER OF TAXATION  Appellant |
| AND: | MESSENGER PRESS PROPRIETARY LIMITED (ACN 007 563 439)  First Respondent  LOWER BURDEKIN NEWSPAPER COMPANY PTY LTD (ACN 010 191 367)  Second Respondent  MIRROR NEWSPAPERS PTY LIMITED (ACN 000 015 976)  Third Respondent  NATIONAL RUGBY LEAGUE INVESTMENTS PTY LIMITED (ACN 081 778 538)  Fourth Respondent  WESPRE PTY LIMITED (ACN 008 669 841)  Fifth Respondent  NEWS FINANCE PTY (IN LIQUIDATION) (ACN 008 549 095)  Sixth Respondent  RUGBY INTERNATIONAL PTY LTD (ACN 000 369 326)  Seventh Respondent  HARPERCOLLINS PUBLISHERS (HOLDINGS) PTY LIMITED (FORMERLY HARPERCOLLINS PUBLISHERS (AUSTRALIA) PTY LIMITED) (ACN 008 431 730)  Eighth Respondent  HARPERCOLLINS PUBLISHERS AUSTRALIA PTY LIMITED (FORMERLY HARPERCOLLINS PUBLISHERS PTY LIMITED) (ACN 009 913 517)  Ninth Respondent  HERALD AND WEEKLY TIMES PTY LIMITED (ACN 004 113 937)  Tenth Respondent  DAVIES BROTHERS PTY LIMITED (ACN 004 113 937)  Eleventh Respondent  DAVIES BROTHERS PTY LIMITED (ACN 009 475 754)  Eleventh Respondent  NATIONWIDE NEWS PTY LIMITED (ACN 008 438 828)  Twelfth Respondent  NEWS LIMITED (ACN 007 871 178)  Thirteenth Respondent  NEWS HOLDINGS PTY LIMITED (FORMERLY THE NEWS CORPORATION LIMITED AND NEWS HOLDINGS LIMITED) (ACN 007 910 330)  Fourteenth Respondent  THE NORTH QUEENSLAND NEWSPAPER COMPANY PTY LIMITED (009 655 690)  Fifteenth Respondent  LEADER ASSOCIATED NEWSPAPERS PTY LIMITED (ACN 004 337 446)  Sixteenth Respondent  ADVERTISER-NEWS WEEKEND PUBLISHING COMPANY PTY LIMITED (ACN 007 562 950)  Seventeenth Respondent  ADVERTISER NEWSPAPERS PTY LIMITED (ACN 007 872 997)  Eighteenth Respondent  NEWS AUSTRALIA HOLDINGS PTY LIMITED (ACN 105 197 028)  Nineteenth Respondent |

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| JUDGES: | JESSUP, ROBERTSON AND GRIFFITHS JJ |
| DATE OF ORDER: | 25 JULY 2013 |
| WHERE MADE: | SYDNEY |

THE COURT ORDERS THAT:

1. The appeal be dismissed with costs.

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

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| IN THE FEDERAL COURT OF AUSTRALIA |  |
| DISTRICT REGISTRY |  |
|  | NSd 1257 of 2012 |

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| ON APPEAL FROM THE FEDERAL COURT OF AUSTRALIA |

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| BETWEEN: | COMMISSIONER OF TAXATION  Appellant |
| AND: | MESSENGER PRESS PROPRIETARY LIMITED (ACN 007 563 439)  First Respondent  LOWER BURDEKIN NEWSPAPER COMPANY PTY LTD (ACN 010 191 367)  Second Respondent  MIRROR NEWSPAPERS PTY LIMITED (ACN 000 015 976)  Third Respondent  NATIONAL RUGBY LEAGUE INVESTMENTS PTY LIMITED (ACN 081 778 538)  Fourth Respondent  WESPRE PTY LIMITED (ACN 008 669 841)  Fifth Respondent  NEWS FINANCE PTY (IN LIQUIDATION) (ACN 008 549 095)  Sixth Respondent  RUGBY INTERNATIONAL PTY LTD (ACN 000 369 326)  Seventh Respondent  HARPERCOLLINS PUBLISHERS (HOLDINGS) PTY LIMITED (FORMERLY HARPERCOLLINS PUBLISHERS (AUSTRALIA) PTY LIMITED) (ACN 008 431 730)  Eighth Respondent  HARPERCOLLINS PUBLISHERS AUSTRALIA PTY LIMITED (FORMERLY HARPERCOLLINS PUBLISHERS PTY LIMITED) (ACN 009 913 517)  Ninth Respondent  HERALD AND WEEKLY TIMES PTY LIMITED (ACN 004 113 937)  Tenth Respondent  DAVIES BROTHERS PTY LIMITED (ACN 004 113 937)  Eleventh Respondent  DAVIES BROTHERS PTY LIMITED (ACN 009 475 754)  Eleventh Respondent  NATIONWIDE NEWS PTY LIMITED (ACN 008 438 828)  Twelfth Respondent  NEWS LIMITED (ACN 007 871 178)  Thirteenth Respondent  NEWS HOLDINGS PTY LIMITED (FORMERLY THE NEWS CORPORATION LIMITED AND NEWS HOLDINGS LIMITED) (ACN 007 910 330)  Fourteenth Respondent  THE NORTH QUEENSLAND NEWSPAPER COMPANY PTY LIMITED (009 655 690)  Fifteenth Respondent  LEADER ASSOCIATED NEWSPAPERS PTY LIMITED (ACN 004 337 446)  Sixteenth Respondent  ADVERTISER-NEWS WEEKEND PUBLISHING COMPANY PTY LIMITED (ACN 007 562 950)  Seventeenth Respondent  ADVERTISER NEWSPAPERS PTY LIMITED (ACN 007 872 997)  Eighteenth Respondent  NEWS AUSTRALIA HOLDINGS PTY LIMITED (ACN 105 197 028)  Nineteenth Respondent |

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| DATE: |  |
| PLACE: |  |

# reasons for judgment

# THE COURT:

## Introduction

1. This appeal is from orders made by a single judge of the Court on 6 August 2012, allowing appeals in thirty related matters under Pt IVC of the *Taxation Administration Act 1953* (Cth). In the decisions then under appeal, the present appellant, the Commissioner of Taxation (“the Commissioner”), had disallowed objections to assessments of income tax in respect of the years ending on 30 June 2001 and 2002. By an order made on 24 August 2012, the Commissioner was permitted to lodge a single notice of appeal in respect of all of these matters. As a result, there are 19 respondents to the present appeal. Each is a taxpayer to which currency exchange losses, alleged to have been made by News Publishers Holdings Pty Ltd (NPHP) in the 2001 and 2002 financial years (in the sums of $A629,662,666 and $A1,419,051,871 respectively), were subsequently transferred. The question which arose was whether there were such losses and, to the extent that there were, whether the losses were an allowable deduction for income tax purposes under Div 3B of Pt III of the *Income Tax Assessment Act 1936* (Cth) (“the 1936 Act”). The reasons of the primary judge were, and these reasons likewise will be, concerned with the circumstances of NPHP.
2. Division 3B of the 1936 Act was repealed in 2003, but its provisions govern the disposition of the matter now before the Court. At the centre of those provisions was s 82Z(1) of the 1936 Act which, in 2001 and 2002, read as follows:

Subject to this section, a currency exchange loss incurred by a taxpayer in a year of income under an eligible contract is an allowable deduction in respect of the year of income.

Section 82Y made a corresponding provision in the case of a “currency exchange gain”. Associated with ss 82Y and 82Z were four adjectival provisions which are of some importance in the present case. The first was s 82U(2), by which Div 3B did not “apply to a loss incurred by a taxpayer except to the extent to which, if the loss were not of a capital nature, a deduction would be allowable to the taxpayer under s 8-1 of the *Income Tax Assessment Act 1997* in respect of the loss”. The second was the definition of “currency exchange loss” in s 82V(1), namely, a “loss to the extent to which it is attributable to currency exchange rate fluctuations”. The third was s 82V(2), which provided that, for the purposes of Div 3B:

(a) a currency exchange gain made, or a currency exchange loss incurred, in respect of currency purchased under a contract shall be taken to have been made or incurred under that contract;

(b) a gain shall be taken to have been made, or a loss to have been incurred, at the time when it was realised; and

(c) a reference to a person acquiring rights or obligations arising under a contract is a reference to the person acquiring such rights or obligations otherwise than by reason of having entered into the contract.

The fourth was the definition of “eligible contract” which provided that such a contract was –

(a) a contract entered into by the taxpayer on or after the commencing day, other than a hedging contract; or

(b) a hedging contract entered into by the taxpayer, on or after the commencing day, in relation to a contract to which paragraph (a) applies ….

How these provisions became relevant in the present case will become apparent in the reasons which follow.

# The facts of the case, and their characterisation by the primary judge

1. The following account of the facts of the case is based substantially on the findings of the primary judge, whose meticulous attention to the detail of those facts we would acknowledge.
2. The relevant facts commenced in 1989, when the ultimate holding company of the News Group was The News Corporation Ltd (“TNCL”), a company listed on the Australian Stock Exchange. In Australia, the local holding company was News Limited (“News”). Most of the group’s interests in the United States were held by News Publishers Australia Pty Ltd (“NPAL”). The group’s interest in the publisher of the South China Morning Post was held by News Publishers Limited (“NPL”), a company incorporated in Bermuda. News owned 100% of NPAL and 48% of NPL. News was the chief holding, management and operating company for the group.
3. In the late 1980s, News had borrowed large amounts to fund its overseas operations, the interest costs associated with which having resulted in News incurring substantial losses which had significantly depleted its reserves. By 31 March 1989, News’ capital and reserves were negative to the order of approximately $239m. News’ debt, however, was to a substantial extent owed to other companies in the group. Its principal creditors were News Finance Ltd (“News Finance”) and News Group Holdings Pty Ltd (“NGH”). News owed News Finance two debts of $A176,593,000 and $US758,652,000. At the exchange rates prevailing at the time, these two debts would have required $A1,194,918,000 to discharge. There were also two debts owed to NGH: one of £278,024,000 and another of $US391,404,000. These would have required $A1,104,590,000 to discharge.
4. It seems that the debt being carried by News compromised its ability to demonstrate to financial institutions and other counterparties that it was a company of good financial standing, particularly when it came to fund raising. The financial controller of News at the time had no concerns about its financial position, but he took the view that its balance sheet had the potential to cause lenders to question its ability to meet its obligations, to generate negative media coverage of its financial position and thereby to impact upon TNCL’s share price and fund raising capacities. These concerns led to the proposal which lay at the centre of the proceeding before the primary judge.
5. What was to happen was that News would sell its 48% holding in NPL and its 100% holding in NPAL to other members within the group. The proceeds of these sales would be used to reduce News’ intra-group debt. It was proposed that the NPL holding be sold for $US2,270,000,000 (then equivalent to $A3,046,980,000) to a new entity, News Publishers Investments Pty Ltd (“NPIP”), which was to be a wholly-owned subsidiary of NPHP. The capital which NPHP subscribed to NPIP would provide the funds required to acquire the shares in NPL. NPHP, in turn, would obtain the necessary funds by way of loans of $US1,815,284,000 and £292,972,000 from News Finance. Upon being paid for its shares in NPL, News would be in a position to repay the debts owed to NGH and News Finance. The primary judge observed that, in effect, these existing News debts would be transferred to NPHP, and the 48% interest in NPL would end up with NPIP which would be owned by NPHP.
6. The resolutions necessary to authorise these transactions were made on 26 May 1989. On the same day, the directors of NPHP and News Finance resolved to execute a standby credit agreement pursuant to which News Finance would provide NPHP with a revolving standby credit facility. The agreement was to apply to any loans made between 31 May 1989 and 31 March 1992. News Finance agreed with NPHP that it would make advances to NPHP up to a maximum principal sum outstanding of $US4bn or its equivalent in other currencies acceptable to News Finance. Also on 26 May 1989, the directors of NPHP resolved to apply to News Finance for loans of up to $A3bn and the directors of News Finance resolved to lend NPHP funds up to that amount or its foreign currency equivalent.
7. This agreement between NPHP and News Finance was executed on 31 May 1989. On the same day, the proposed transactions mentioned in para 7 above took place. There were certain variations to the proposals outlined above, in that, instead of lending $US1,815,284,000 and £292,972,000 to NPHP, News Finance actually lent $US1,033,643,102 and £292,971,509; and, at the same time, an additional loan of $A1bn was extended.
8. In findings made, in part by inference, which were not challenged on appeal, the primary judge said that the following happened at settlement on 31 May 1989. News Finance handed a cheque in the sum of $A2,974,708,426, payable to NPHP, to a person representing NPHP, who then attached it to an application by which NPHP subscribed for 50,000 ordinary shares and 19,400 preference shares in NPIP, and handed both to a person representing NPIP (the relevant share certificates being issued by NPIP on 5 June 1989). By this stage, according to his Honour’s findings, the cheque either had been endorsed to NPIP or, if it was a bearer cheque, was negotiated by delivery to NPIP, in discharge of NPHP’s obligation, denominated in Australian dollars, to pay the subscription moneys due on the allotment of the shares in NPIP. The News Finance cheque was then delivered by NPIP to News, which accepted the cheque in discharge of NPIP’s obligation to pay the sum of $US2,270,000,000 for the purchase of the 48% interest in NPL. The same cheque was then delivered by News to News Finance. Thus News Finance was both the drawer of the cheque and ultimately its holder. News Finance presented the cheque, and its banker both debited and credited News Finance’s account accordingly.
9. The News Finance cheque represented the Australian currency equivalent of loans thereby made by News Finance to NPHP pursuant to the agreement between them, and the resolutions made by their respective boards, on 26 May 1989. The primary judge found that it was three sums, namely, $A1bn, $US1,033,643,102 and £292,971,509, that were lent by News Finance to NPHP, and that NPHP accepted the Australian dollar cheque as performance of the payment obligation. In return for the cheque, NPHP incurred a liability to repay to News Finance those three interest-bearing amounts in the currencies in which they were denominated. On the other hand, the agreement between NPIP and NPHP for the allocation of shares in the former was exclusively an Australian dollar affair.
10. His Honour said at [30]:

Although it is certainly true that liabilities to pay foreign moneys were created by these events it is equally clear that no foreign currency in the sense of coin, cash or money held on deposit with a bank or other deposit-taking financial institution actually changed hands. NPHP neither received nor passed anything on but cheque 272461 for A$2,974,708,426. At the moment of settlement NPHP’s Australian dollar liability to NPIP (for the shares) was replaced by a multicurrency debt to News Finance.

The primary judge characterised the transactions of 31 May 1989 as follows at [141]:

Keeping in mind the mechanics of payment by tendering performance in discharge of a pre-existing monetary obligation what happened at settlement was this: News Finance paid NPHP three multicurrency sums by tendering a chattel in discharge of an obligation to make those payments; NPHP then paid an equivalent Australian dollar sum to NPIP by tendering the same chattel in discharge of its obligation to pay an Australian dollar sum. At the moment of completion NPHP’s liability to pay Australian dollars to NPIP was transformed into a debt obligation to News Finance denominated in three currencies. This was a conversion of a liability denominated in one currency to one party into a liability denominated in three currencies to another. The event which triggered the conversion was the receipt and instantaneous delivery of the cheque.

The chattel to which his Honour was here referring was, of course, the cheque mentioned at the end of the passage, ie that in the sum of $A2,974,708,426. In the result, his Honour accepted, at [142], that “what occurred was a conversion between liabilities denominated in various currencies”; but there was no “exchange of cash or coin nor of deposit funds held with banks”.

1. It was then decided that NPHP would acquire further shares in NPIP. For that purpose, NPHP would receive funds on loan from News (not, this time, News Finance). Whether such a transaction occurred, and if so how it occurred, were controversial at first instance, and required the primary judge to make some difficult discriminations of fact. However, since his Honour’s factual conclusions were not challenged on appeal, we shall proceed on the basis of the findings which his Honour ultimately made.
2. His Honour found that, on 21 June 1989, the directors of NPIP noted that NPIP would receive direct from News the sum of $US168,456,000 on or about 28 June 1989, as the price of further shares to be allotted to NPHP. The directors also resolved that, subject to the receipt by NPIP of that sum, NPHP be allotted 5,000 $A1 ordinary shares at a premium of A$9,999 and such number of $A1 redeemable preference shares at a premium which would ensure that the cost of the allotment would equate to the Australian dollar value of $US168,456,000. The way these transactions were implemented did not, however, involve US currency. His Honour found that, on 28 June 1989, NPHP requested News to pay the sum of $A226,571,621 (which was, as at 20 June 1989, the equivalent of $US168,456,000) to NPIP in payment for shares in NPIP. That request was complied with, and produced the result that NPHP was indebted to News in that sum. His Honour held at [146] that, “[h]ad it been necessary News … could have sued NPHP on a common money count for ‘money payable by the defendant to the plaintiff for money paid by the plaintiff for the defendant at his request’ ….”
3. As to how the payment from News to NPIP was made, his Honour said at [50]:

I conclude, therefore, that News … paid NPIP by some mechanism which the evidence does not directly disclose. Given that NPIP did not maintain a bank account and that it had no antecedent indebtedness to News … I infer that the payment was made by the delivery of a payment instrument such as a cheque or promissory note. I am not able to determine the precise nature of that instrument or the currency in which it was denominated or what NPIP subsequently did with it.

However, his Honour went on to find that, as a result of the funds received for the shares allotted to NPHP, “NPIP did acquire further shares in NPL ….”

1. His Honour held that the transactions of 28 June 1989 were wholly implemented in Australian dollars, and that there was no “exchange transaction” involved.
2. On 28 December 1989, NPHP borrowed the Australian dollar equivalent of $US204m from News Finance to purchase more shares in NPIP. Although this loan was, as between NPHP and News Finance, denominated in US currency, his Honour inferred that the consideration required by NPIP from NPHP was in Australian currency. His Honour said at [56]:

I am unable to determine the precise mechanics of the settlement but, by whatever means News Finance satisfied its obligations to NPHP, I am clear that this was not done by anything which might be called a payment of coin, cash or debts owed by deposit-taking financial institutions. At the end of this transaction, NPHP had exchanged an Australian dollar liability to NPIP for the allotment of shares in it for a debt obligation to News Finance denominated in US dollars.

His Honour also noted that this advance by News Finance to NPHP was governed by the standby credit agreement of 31 May 1989. Again, he found that the funds received by NPIP were used to buy further shares in NPL.

1. With respect to the transactions of 28 December 1989, the primary judge said at [148]:

The advance of 28 December 1989 was made by News Finance pursuant to the standby credit facility of 31 May 1989. Whatever the mechanism by which the transaction was settled (most likely the delivery of some form of payment instrument) the effect of the settlement was to discharge NPHP’s Australian dollar liability to NPIP by replacing it with a US dollar liability to News Finance. In other words: an exchange of liabilities denominated in different currencies.

1. The next events of relevance in the proceeding before the primary judge took place in 1991. During the 1990 financial year the News group’s current borrowings had increased by 500% from $A500m to $A3bn. The group’s long-term debts were in the order of $A7.5bn. What was described as a “liquidity crisis” brought about by this debt burden and a downturn in the world economy was resolved by a renegotiation of terms with the group’s external creditors. In the result, the group undertook a reorganisation of its worldwide operations in 1991. The purpose of the reorganisation, from the Australian operations’ perspective, was to enable News Finance to retire about $US2bn owed to an English member of the group, Ordinto Investments.
2. In May 1991 the directors of TNCL, News, NPIP and NPHP agreed to a reorganisation of the News group’s assets in order to reduce foreign related party debt. What was to happen was that NPL would redeem the shares held by NPIP for a price of $US3,020,000,000. Part of those funds would then be lent by NPIP to NPHP and thereafter used by NPHP to reduce the extent of its debt to News Finance and News. In turn, News Finance would use the funds to reduce its liabilities to Ordinto Investments.
3. On 4 June 1991 NPIP and NPL entered into an agreement entitled “Share Redemption/Purchase Agreement”, governed by the laws of Bermuda. The price for the redemption of NPIP’s shares in NPL was agreed to be $US3,020,000,000 “in lawful currency of the United States”. However, payment for the shares was not made in that currency. Instead, the obligation to make the payment was satisfied by the delivery, on 6 June 1991, of a note for $US3,020,000,000 issued by NPL to NPIP. The note was entitled “Unsecured Demand Loan Note”. On the same day, NPL satisfied its liability on the note by distributing to NPIP 16 promissory notes, issued by various companies in the News group, then held by NPL. These notes were endorsed by NPL to NPIP, and the unsecured demand loan note was redelivered to NPL resulting in its satisfaction. Of the 16 promissory notes, 12 were denominated in US dollars and four were denominated in other currencies. The parties agreed upon the exchange rates by reference to which the latter would be given then current US dollar values, the result of which being that the value of all 16 promissory notes was agreed to be $US3,034,026,944. The face value of the unsecured demand note was, by contrast, $US3,020,000,000, the difference of $US14,026,944 being accounted for by NPIP assuming a liability that NPL had to another News entity, Festival Books & Associates Limited.
4. The next step, which the primary judge described as important, involved NPHP incurring a liability to NPIP in the sum of $US2,847,080,544. First, NPIP endorsed to NPHP seven of the notes endorsed to NPIP by NPL. The issuers of those notes, and their face values, were as follows:

|  |  |
| --- | --- |
| News Securities BV | $US1,635,507,911 |
| News Times Holdings Ltd | $A564,859,027 |
| News Group Newspapers Ltd | £10,582,902.55 |
| News Group Newspapers Ltd | DM 239,995,527 |
| NPL Investments I (Cayman) Ltd | DM 27,577,190 |
| News Group Holdings Pty Ltd | $US500,000,000 |
| News Limited | $US111,345,000 |

The combined value of these notes was $US2,847,080,544. Secondly, and upon receipt of these promissory notes, NPHP delivered to NPIP, in recognition, an unsecured demand note by which, in consideration of NPIP making a loan of $US2,847,080,544 to NPHP by the endorsement and delivery of the above promissory notes, NPHP promised to pay the bearer on demand the sum of $US2,847,080,544.

1. Of the transactions just referred to, the primary judge said:

An uncontroversial, or at least minimalist, characterisation of these events would be to say that NPHP incurred a liability of some description to NPIP which was agreed between them to be measured in the amount of $US2,847,080,544. The agreement or acknowledgment is demonstrated by NPHP’s issue of the unsecured demand note in that sum and NPIP’s willingness to accept that note. What NPHP received for incurring this liability was not, however, $US2,847,080,544. It was instead the endorsement to it of the seven promissory notes denominated in the three currencies set out above.

1. According to his Honour, it remained for NPHP to reduce the inter-company debt which it owed to News Finance and News (which had been incurred in May, June and December 1989). Interest had been paid on those loans, that is, on the sterling, US-dollar and Australian-dollar denominated debts, between 1989 and 30 June 1999. In the transactions of 6 June 1991, NPHP endorsed to News Finance the first six of the promissory notes in the list above which it had received from NPIP (ie not including the note issued by News). In its accounting records, NPHP treated the delivery of these notes to News Finance as resulting in discharges of the three foreign currency debts referred to in para 9 above to the following extents:

Australian dollar debt – $A866,770,753.72

US dollar debt – $US1,454,489,697.08

Sterling debt – £370,833,623.88

The primary judge accepted evidence that, by the delivery of these promissory notes to News Finance, the whole of the US dollar and sterling principal components was extinguished, approximately 87% of the Australian dollar principal component was extinguished, the whole of what was described as the “capitalised” US dollar interest was extinguished and approximately 75% of the capitalised sterling interest was extinguished.

1. With respect to NPHP’s debt to News, incurred in June 1989 in the sum of $A226,571,621, on 6 June 1991, the seventh promissory note in the list above – that issued by News in the sum of $US111,345,000 – was endorsed by NPHP to News. The primary judge noted that NPHP (mistakenly) treated the June 1989 debt as denominated in US dollars, which explained why it would have used a promissory note also denominated in US dollars for part discharge of the debt. That was the intention of NPHP, and it was, it seems, the assumption of News when it accepted the promissory note for that purpose.
2. With respect to the transactions of 6 June 1991, the primary judge first rejected a submission made on behalf of the Commissioner that the unsecured demand note had been issued by NPHP as the consideration for the purchase by it of the seven promissory notes from NPIP. His Honour held that what was transacted as between NPHP and NPIP had the character of a loan made for consideration, not that of a sale and purchase. The consideration moving from NPHP, his Honour held, was the promise, evidenced by NPHP’s unsecured demand note delivered to NPIP, to pay, on demand, the sum of US$2,847,080,544 together with interest at a specified rate. The consideration moving from NPIP was payment of that sum, the relevant act of performance, as accepted by NPHP, being the delivery of the seven promissory notes. His Honour held that NPHP then paid to News Finance the sums of A$866,770,753.72, US$1,454,489,697.08 and £370,833,623.88 and to News the Australian dollar equivalent as at that date of US$111,345,000. Those payments were used to reduce elements of the pre-existing debts in the currencies concerned.
3. His Honour continued at [155]:

The effect then is that a portion of NPHP’s antecedent debts to News Finance and News … were converted into a new debt to NPIP denominated in US dollars. Contrary to the submissions of the Commissioner this conversion was achieved by means of acts which, in law, constituted payments On the other hand, the Commissioner is correct to submit that no ‘currency’ changed hands. The exchange which occurred was an exchange of liabilities or, more precisely, an exchange of monetary obligations. It was not an exchange of ‘money’.

1. The primary judge then provided, in point form, a summary of what had occurred down to 6 June 1991, and said that, “at the end of this process NPHP had extinguished some of its prior liabilities in several currencies to News Finance and News … and replaced them with a liability in US dollars to NPIP.”
2. There followed a transaction which was, according to the primary judge, the subject of “some confusion”, both in the submissions made on behalf of the respondents and in the way the transaction was dealt with in the books of NPHP. The confusion was, however, resolved by his Honour, and no complaint is made about the way in which he did so. His Honour held that NPHP intended to increase its US dollar liability to NPIP by $US56,191,657 on 29 June 1991 by issuing a promissory note having that value, and to receive in return six promissory notes, denominated in Deutschmarks, having a value then equal to $A73,405,169 (the then Australian dollar equivalent of $US56,191,657). NPHP intended to use these notes to reduce its Australian dollar liability to News Finance on 29 June 1991. However, although ledger entries to that effect were made on or around 28 June 1991, no such transactions then took place. Rather, it was only on 12 March 1992 that NPIP endorsed six promissory notes, denominated in Deutschmarks, to NPHP in return for a promissory note issued by NPHP in the sum of $A73,405,169 – not, as was intended in late June 1991, $US56,191,657. The March 1992 transactions were backdated to 29 June 1991. The primary judge also inferred that the promissory notes were negotiated to News Finance. The net result, his Honour found, was that NPHP increased its US dollar indebtedness to NPIP by decreasing its Australian dollar debt to News Finance. This occurred in March 1992, notwithstanding the backdating of the documents concerned.
3. The final relevant transaction in this general time period occurred on 8 July 1992. It was an advance to NPHP by NPIP in the amount of $US32,120,958, effected by way of the transfer to NPHP of a promissory note issued by News Datacom Limited with a face value of that amount. The purchase price was to be left outstanding and added to the inter‑company account. The note was in turn transferred by NPHP to News in reduction of its debt to that company.
4. With respect to the transactions of 12 March 1992 and 8 July 1992, the primary judge held that NPIP had promised to lend the sum of $US56,191,657 to NPHP, and that the latter accepted the six Deutschmark promissory notes in satisfaction. That was, according to his Honour at [156] –

… a payment by NPIP to NPHP although it did not involve a payment of actual currency; it was instead the discharge of a monetary obligation denominated in US dollars (an obligation to lend) by the endorsement of promissory notes in exchange for another monetary obligation, namely, the promise to repay.

His Honour also held that NPHP then used some of the promissory notes to discharge its antecedent Australian dollar debts to News Finance and to News.

1. Taking stock of the situation which existed at this stage, in all of the transactions into which NPHP had entered since late May 1989 it had acquired shares in NPIP: originally 50,000 ordinary shares and 19,400 preference shares, then a further 5,000 ordinary shares and some unstated number of redeemable preference shares, and then finally some unstated further number of shares of an unidentified class. Correspondingly, the liabilities which NPHP had incurred remained outstanding to the following extent:

* of the original $A1bn and sterling debts to News Finance, $A133,229,246.28 plus interest still outstanding on the former and some (unstated) amount of interest still outstanding on the latter;
* $A226,571,621 loan from News;
* $US204,000,000 loan from News Finance;
* $US2,847,080,544 on the unsecured demand note delivered to NPIP, and presumably still held by NPIP at all material times thereafter.

With respect to the last three of these liabilities, interest may also, presumably, have accrued.

1. The events which were relevant in the proceeding below then moved to 8 June 2001. On that day, NPHP purchased from TNCL two interest-bearing promissory notes with face values of $US750m and $US265m. The purchase price was $A1,983,453,267, satisfied by NPHP’s Australian dollar debt to TNCL being increased on the inter-company account. The promissory notes were then endorsed by NPHP to NPIP in repayment, to the extent of $US1,023,453,698, of the US dollar liabilities of NPHP to NPIP. That sum was the then US dollar equivalent of the purchase price of the promissory notes, $A1,983,453,267. It exceeded, by $US8,453,698, the sum of the face values of the notes, the difference being, it seems, referable to accrued interest.
2. With respect to the transactions of 8 June 2001, the primary judge held that NPHP acquired two promissory notes, with face values of $US750m and $ US265m from TNCL by increasing its liability in Australian dollars to TNCL. His Honour continued at [157]:

Those promissory notes were then used by it to discharge partially its antecedent US dollar debt to NPIP. These events occurred simultaneously through the negotiation of the two promissory notes. That process transformed a liability in US dollars to NPIP into a liability in Australian dollars to TNCL. What occurred was an exchange of liabilities denominated in different currencies. There was, however, no exchange of actual cash or of liabilities otherwise exhibiting the qualities of money.

1. The final relevant transaction occurred on 28 June 2002, at which time the total amount of the US dollar debt owed by NPHP to NPIP was $US3,481,527,042.08. Additionally, NPIP was at that time in debt to NPHP in the sum of $A7,403,425,151, a liability which had, it seems, arisen to a large extent because of a dividend which had been declared in favour of NPHP and the redemption of preference shares held by NPHP (as well as what the primary judge described as “other matters”, a grasp of which “would not increase the clarity” of the account of facts given in his Honour’s reasons).
2. On 28 June 2002, NPIP issued to NPHP two interest-free demand promissory notes of $US3,481,527,042 and $A1,230,504,859. These were paid in satisfaction of the debt of $A7,403,425,151 then owed by NPIP to NPHP. As the primary judge pointed out, after allocating the Australian dollar promissory note to the debt, there remained $A6,172,920,292 of the debt which was notionally satisfied by the US dollar promissory note. The latter was, of course, in the same sum as that then owed by NPHP to NPIP (disregarding, as his Honour did, the 8 cents). NPHP then (still on 28 June 2002) handed the US dollar note to NPIP in satisfaction of the whole of the former’s US dollar debt to the latter. As his Honour pointed out, the promissory note was then discharged by operation of law without funds changing hands (NPIP being both its issuer and holder).
3. The primary judge characterised the transactions of 28 June 2002 as follows at [158]-[159]:

In substance, NPHP converted A$6,172,920,292 of debt owed by NPIP to it into a US$3,481,527,042 discharge of its US dollar debt to NPIP. … Again this is a conversion of a liability in one currency into a liability in another. It did not involve an exchange of actual cash or money in the sense described above.

# The conclusions of the primary judge

1. The primary judge identified the controversies which arose under s 82Z of the 1936 Act and the provisions associated with it in Div 3B of Pt III of that Act. His Honour first considered the “exchange loss issues”, in which respect he identified three “primary questions”, namely –

(i) whether Division 3B applies to losses arising from exchanges in liabilities denominated in foreign currency for liabilities denominated in Australian dollars where neither set of liabilities otherwise qualifies as ‘money’;

(ii) whether the scope of the phrase ‘currency exchange loss’ in Division 3B limits its operation to the traditional conception of an exchange loss – that is a loss arising from the execution at different times of two opposite exchange transactions where there has been an adverse movement in the exchange rate in the intervening period – or whether it can encompass other losses which relate to exchange rate fluctuations;

(iii) the nature of the losses claimed by NPHP and whether, in light of the answer to (ii), they may be claimed under Division 3B.

1. As a preliminary to addressing those questions, his Honour dealt with the question whether accounting evidence was relevant to the matter of whether there had been a “loss” as a result of the transactions in which NPHP had entered. He held that an accounting standard on which the respondents relied – and how the transactions would have had to have been treated under it – was “relevant to the task at hand although not determinative”. His Honour said at [181]:

In this case the issue which divides the parties is whether the losses with which s 82Z is concerned are sufficiently broad to encompass losses arising from exchanges of liabilities or whether they are confined instead to exchanges of currencies in the sense of money. The Standard plainly proceeds on the basis that such losses arising from the exchange of liabilities are to be treated as losses for accounting purposes.

1. The primary judge answered the first question set out in para 38 above in the affirmative. By reference to the text of the statute, his Honour said at [185]:

Those provisions provide little support for the idea that the losses contemplated by Division 3B do not extend to encompass losses arising out of exchanges between liabilities denominated in foreign currency and liabilities denominated in Australian currency. Indeed, the word ‘loss’ in s 82U(1) would, as a matter of ordinary English, encompass losses arising from such an exchange. Because the question at hand is the proper construction of Division 3B it is not necessary, at this juncture, to seek to confine more precisely what is meant by concepts such as ‘Australian money’ and ‘foreign currency’. The question rather is whether there is anything in Division 3B which might require a narrower reading of the words ‘loss’ and ‘gain’. The only constraint which emerges from s 82V is the necessity for the loss to be ‘*attributable* to currency exchange rate *fluctuations’*. That limitation, however, would cover losses arising from an exchange of liabilities just as much as it covers losses arising from an exchange of actual currency. This is because requiring losses to arise from fluctuations says nothing about the manner of their incurring. Fluctuations in exchange rates will cause losses not only to those involved in actual exchanges of currency but also to those who have exchanged monies held on deposit with one bank where the bank’s debt is denominated in one currency for monies held on deposit with another bank where that debt is denominated in another currency. Indeed, it will cover many other situations too, including those where the ‘money’ or ‘currency’ exists as a debt owed by an entity other than a bank.

His Honour was not much assisted by references to other provisions in Div 3B – which were, for the most part, facultative – where money exchanges appeared to be in contemplation. Neither did his Honour find any assistance in the secondary materials to which he had been referred.

1. His Honour said at [190]:

In the end, the determinative matter is the breadth of the definition of ‘currency exchange loss’ in s 82V(1). All that it requires is a loss attributable to a fluctuation in a rate. It does not require an exchange of anything. The expression ‘currency exchange’ qualifies the word ‘rate’ (‘currency exchange rate fluctuations’) but does not import any requirement, of itself, about the necessity or otherwise for an exchange of anything. Its language is too broad to be consistent with the Commissioner’s submission. Approached purely as a question of statutory construction I conclude that Division 3B will be satisfied so long as there has been a loss attributable to exchange rate fluctuations. I see no reason why a loss arising from an exchange of liabilities will not satisfy the requirements of Division 3B. It is not limited in its operation to exchanges of foreign currency and Australian money.

1. His Honour distinguished *Commissioner of Taxation v Energy Resources of Australia Ltd* (1996) 185 CLR 66 (“*ERA HC*”) (to which further reference will be made below) upon the basis that it said nothing on the question “whether the exchange had to be one of currencies or whether an exchange of liabilities would suffice”. He proceeded to hold that Div 3B would be satisfied “where there is an exchange of a liability denominated in foreign currency for an Australian dollar liability”.
2. With respect to the second question set out in para 38 above, the primary judge foreshadowed that he would proceed to find that the losses claimed by the respondents were exchange losses arising from two conversion events. In the result, he did not need to determine whether Div 3B was limited as asked in this question. His Honour did proceed to give some limited consideration to that question but, given the way the parties’ cases were conducted on appeal, that consideration does not require further illumination at this point.
3. With respect to the third question set out in para 38 above, the primary judge’s reasons were structured by reference to what the respondents had submitted were “conversion events” – three “outward conversion events” and two “inward conversion events”. The outward conversion events were:

(i) the incurring by NPHP on 31 May 1989, 28 June 1989 and 28 December 1989 of debts to News Finance and News … denominated in US dollars, pounds sterling and Australian dollars which secured discharges of its obligations denominated in Australian dollars to pay subscription moneys to NPIP;

(ii) the incurring by NPHP on 6 June 1991 and 12 March 1992 (the [respondents] claimed 28 June 1991) of US dollar liabilities to NPIP in return for securing a partial discharge of NPHP’s antecedent Australian dollar, US dollar and sterling debts to News … and News Finance; and

(iii) on each of the dates upon which interest was debited in Australian dollars to NPHP’s general ledger on its US dollar indebtedness to NPIP by virtue of s 20 of the 1936 Act.

1. The primary judge accepted that the events of 31 May and 28 December 1989 involved the conversion of Australian dollar liabilities into liabilities denominated, in part, in foreign currencies. His Honour said at [206]: “On each occasion NPHP’s liability to pay NPIP an Australian dollar sum was acquitted by acts of tender for which it was required to incur liabilities in foreign currency.” However, the events of 28 June 1989 did not fall into the same category because, as noted in para 14 above, only Australian dollar liabilities and transactions were involved.
2. The primary judge dealt with the events of 6 June 1991 at different levels. His Honour accepted that there was a conversion event to the extent that NPHP discharged 87% of its Australian dollar indebtedness to News Finance by incurring a US dollar liability to NPIP. His Honour held that there was no conversion event when NPHP discharged its US dollar debt to News Finance, as it did so by incurring a liability that was also denominated in US dollars. And his Honour held that there was a conversion event on 6 June 1991 when NPHP reduced its Australian dollar liability to News by increasing its US dollar indebtedness to NPIP.
3. Regarding the sterling debt which NPHP had incurred to News Finance in May 1989, and which had, on 6 June 1991, been discharged as to capital and 75% of the interest by the endorsement of six promissory notes (see para 24 above), his Honour said at [211]:

The initial conversion of Australian dollars into pounds sterling was certainly a conversion event. Once that conversion had occurred NPHP was exposed to the potential of fluctuations in the value of the Australian dollar. The exchange rate in which that fluctuation risk initially arose was the Australian dollar – pound sterling rate. The exchange by NPHP of its liability in pounds sterling for a liability in US dollars simply changed the exchange rate in which the fluctuation risk existed to another exchange rate (the US dollar – Australian dollar exchange rate).

His Honour rejected the Commissioner’s submission that what relevantly happened on 6 June 1991 was the making of a “fresh loan disconnected from the antecedent transactions”. His Honour held that it was, rather, a case of “one liability [being] used to extinguish the other”, that is to say, a “refinancing”.

1. The primary judge held that the (backdated) transaction which occurred on 12 March 1992 was a conversion event because its effect was that “NPHP reduced its antecedent Australian dollar debt to News Finance by incurring a US dollar liability to NPIP”.
2. There had been no suggestion by the respondents that the transaction of 8 July 1992 was a conversion event.
3. There next arose the question whether the debiting of interest owing from time to time on NPHP’s debts to NPIP, and the expression of that liability in Australian dollars pursuant to s 20(1) of the 1936 Act, amounted to an (outward) conversion event. The primary judge held that it did. Subject to a particular submission which he made, the Commissioner did not, it seems, “really doubt” that conclusion. The particular submission was that “the interest had been capitalised by being added to the loan principal and had thereby lost its character as income”, with the result that s 20(1) did not apply to it. His Honour rejected that submission. He held that “[t]he mere fact that interest is added to principal and interest charged thereon does not create, in an ordinary case, an entirely new debt”, in which respect his Honour relied on *Bank of New South Wales v Brown* (1983) 151 CLR 514, 523 per Gibbs CJ.
4. Turning to the inward conversion events (here referred to mistakenly by the primary judge as “outward events”), his Honour held that the transaction of 8 June 2001 constituted such an event in the sense that NPHP “converted a US dollar liability to NPIP into an Australian dollar liability to TNCL”; and that the transaction of 28 June 2002 was too in the sense that “NPHP effectively discharged the remaining US dollar debt to NPIP using an Australian dollar debt owed by NPIP to it … [thereby discharging] a US dollar liability with an Australian dollar debt”.
5. Thus, subject only to there being no exchange of currencies on 28 June 1989 (but there having been a conversion event in respect of the liability incurred on that day on 6 June 1991), to the sterling to US dollar conversion not having been a conversion event and to the conversion event backdated to 28 June 1991 actually having occurred on 12 March 1992, the primary judge accepted that the losses claimed by the respondents were losses within the meaning of Div 3B.
6. The next issue with which the primary judge dealt was whether the losses were incurred under an “eligible contract” as required by s 82Z(1) of the 1936 Act. For presently relevant purposes, there is nothing that needs to be noted about the definition of “eligible contract” in s 82V: it will be sufficient if there was a contract under which the losses arose.
7. The primary judge upheld a submission made on behalf of the respondents that, immediately preceding the transaction of 6 June 1991 in which NPHP delivered to NPIP the unsecured demand note in the sum of $US2,847,080,544, there had been an agreement between the parties that NPHP would borrow, and NPIP would lend, the money the subject of that note. His Honour said at [227]:

One begins with the physical reality of what occurred on 6 June 1991 in London. By the time the settlement meeting had arrived at this transaction [the solicitor for NPHP and NPIP] was acting for both NPIP and NPHP. Wearing his hat as NPIP’s attorney he delivered to NPHP the seven promissory notes …. In return, wearing his hat as NPHP’s attorney, he delivered the unsecured demand note. This was a process of exchange and it was simultaneous. Such a process of exchange is consistent both with the existence of an anterior contract and with the inconsistent proposition that the terms of the loan were to be sourced exclusively in the unsecured demand note itself. Put another way, the exchange event may reflect the playing out of events ordained in a pre-existing agreement.

However, it remained to determine whether that event did in fact reflect the playing out of events ordained in a pre-existing agreement. It was to that question that his Honour next turned.

1. Here his Honour found the terms of the demand note itself inconclusive. But he accepted that the documentation preceding settlement on 6 June 1991 showed, “to a tolerable degree of clarity”, that the parties had intended there to be a loan agreement. That documentation consisted of the minutes of a meeting of the Board of NPIP on 31 May 1991 and the minutes of a meeting of the Board of NPHP on 5 June 1991. There was also a facsimile of 6 June 1991 from a Mr Traill of Arthur Andersen & Co (referred to previously by his Honour as having been a witness to the transaction of the same date in which the 16 promissory notes were endorsed to NPIP by NPL) to Peter Macourt, the financial controller of News, in which it was stated: “Today, the following transactions will occur…The remaining notes will be assigned [by NPIP] to NPHP by way of loan to NPHP for US$2,847,080,544”. On the strength of these documents, the primary judge held that there was a contract between NPIP and NPHP on or shortly before 6 June 1991 under which NPHP incurred a liability to NPIP for an on-demand US-dollar-denominated interest-bearing debt, the terms whereof were reflected in the unsecured demand note which was delivered by NPHP to NPIP on 6 June 1991.
2. The next issue was whether the losses had been incurred “under” that contract. The primary judge held that they had. In this respect, rejecting the Commissioner’s argument that it was necessary that the contract contain a term requiring or authorising NPHP to convert currency, his Honour relied upon what had been said by Gummow J when *ERA* was decided by the Full Court – *Commissioner of Taxation v Energy Resources of Australia Ltd* (1994) 54 FCR 25 (“*ERA FC*”) at 53 and 54 – and distinguished *ERA HC*. It will be necessary to return to these judgments below. His Honour accepted that it was sufficient for the purposes of Div 3B for a loss to result from the repayment of a foreign currency loan when there had been a decline in the value of the Australian dollar. In such a case, the loss would have arisen under the loan agreement. That conclusion was sufficient to entitle the respondents to the losses which resulted from the decline in the comparative value of the Australian dollar between 6 June 1991 and June 2002.
3. His Honour next turned to the situation as between the original advance in US dollars and pounds sterling in 1989 from News Finance and the transactions of 6 June 1991. For two reasons, his Honour took the view that exchange rate losses arising over this period were also within the terms of s 82Z. The first reason was explained by his Honour in the following terms at [246]:

The first reason … relates to an obvious avoidance issue. Bearing in mind the fact that the present debate applies equally to gains as well as losses, the scheme of Division 3B could be defeated if a substantial proportion of the loss could be confined to a different eligible contract to the one under which the final realisation event occurs. For example, if A borrows US dollars from Bank X and uses this to buy Australian dollars and there is thereafter a substantial increase in the Australian dollar then the ensuing gain which would be made on reconversion and repayment may be evaded, on the Commissioner’s arguments, by refinancing the debt with a new bank, Bank Y, just before repayment.

The second reason was based on the presumption that, in legislation, the singular includes the plural (s 23(b) *Acts Interpretation Act 1901* (Cth)) which produced the result that the reference to “eligible contract” in ss 82Y and 82Z included a reference to eligible contracts. Thus, it was possible for there to be more than one eligible contract under which relevant gains or losses arose. In the case at hand, the contracts included the 1989 facility agreement between NPHP and News Finance under which the May 1989 advances occurred and the original standby credit facility of 26 May 1989 under which the advance of 28 December 1989 by News Finance was made. His Honour finally rejected a submission made on behalf of the Commissioner that the events of 6 June 1991 operated as a complete severance from the events of 1989, and were not to be seen as a refinancing of the obligation which arose under those events.

# DIVISION 3B

1. Division 3B of Pt III of the 1936 Act was introduced by the *Taxation Laws Amendment Act 1987* (Cth). It is useful to consider first the state of the law with respect to the taxation treatment of foreign exchange gains and losses before the making of that amendment.
2. In *The Texas Company (Australasia) Ltd v Federal Commissioner of Taxation* (1940) 63 CLR 382 (“*Texas*”), it was held that an increase in the Australian currency amount required to pay, in foreign currency, for trading stock that had previously been invoiced was on current account and deductible under s 51 of the 1936 Act, in circumstances where the deferred payments were necessary to maintain the working capital of the Australian taxpayer. In the later case of *Caltex Ltd v Federal Commissioner of Taxation* (1960) 106 CLR 205 (“*Caltex*”), Kitto J described the result of *Texas* in the following terms (106 CLR at 229):

The case of *Texas* *Co. (Australasia) Ltd. v. Federal Commissioner of Taxation* ((1940) 63 CLR 382) shows that where a trader in Australia buys stock-in-trade for a price payable in United States dollars: (1) the price, expressed in terms of Australian pounds at the rate of exchange ruling at the time of the purchase, is an outgoing incurred in gaining or producing the trader's assessable income, and accordingly is an allowable deduction by virtue of s. 51 (1) of the *Income Tax Assessment Act* 1936-1940 (Cth) in the year of the purchase; and (2) if the rate of exchange moves against Australia so that when the trader comes to pay the price in dollars he has to forego more Australian pounds than those which formed the allowable deduction under (1), the excess pounds constitute a loss or outgoing incurred in gaining or producing the trader’s assessable income in the year of the payment (assuming that his business is still continuing), and accordingly are an allowable deduction under s. 51(1) in that year.

1. The result achieved by the taxpayer in *Texas* would have been replicated in *Armco (Australia) Pty Ltd v Federal Commissioner of Taxation* (1948) 76 CLR 584 (“Armco”) were it not for an important factual point of distinction. There too the Australian taxpayer made purchases, in foreign currency, of stock in trade from its overseas parent. Dixon J said (76 CLR at 618):

If there were no further facts there would be enough to afford a prima facie foundation for the claim that the increased amount required to purchase the exchange formed a trading loss or outgoing, which would be an allowable deduction from the assessable income of the accounting period in which it was incurred. But it is important to see how that result would be reached. It would arise from the fact that it is a continuing business, depending upon the purchase or manufacture of goods and their resale. The accounts are, of course, made up, not on a basis of receipts and disbursements, but upon the commercial basis of valuation and credit. Nevertheless in such a case actual expenditure in a later accounting period arising from a fortuitous increase in the amount of the liabilities taken into it from the prior period may form a proper debit in the later period, notwithstanding that the item relates to purchases or costs of manufacture included in an earlier accounting period.

However, there were other facts. The parent company had allowed the trading stock debt to build up with a view to enabling the taxpayer to take a shareholding in another Australian company. Of the situation thus produced, Dixon J said (76 CLR at 620):

The purpose of allowing the liability for the steel sheets to stand over was simply to enable an investment to be made. One purpose in view when the goods were supplied was that of creating a fund in Australia, which, supplemented by the loans, would be applied for something outside trading altogether, viz., investment in the shares of another company, an operation exclusively of fixed capital.

In the case itself, the Court was evenly divided, in which circumstances the appeal from Williams J was dismissed. The member of the Court, additionally to Dixon J, who would have dismissed the appeal, McTiernan J, said (76 CLR at 622) merely that the judgment of Williams J had been right. That judgment, which is also reported, was based on reasoning not materially different from that of Dixon J to which we have referred (see 76 CLR at 596).

1. Where the Australian taxpayer was a finance company which borrowed funds in foreign currency, the answer to the question whether any resulting exchange gains or losses were assessable or deductible depended upon the purpose to which the funds were put. Where the funds were used to strengthen the capital base of the taxpayer so as to enable it more readily to borrow money by way of the public issue of debentures and notes, a movement in the exchange rate as between the date of the borrowing of the foreign currency funds and the date of their repayment was regarded as a matter of capital: *Commercial and General Acceptance Ltd v Federal Commissioner of Taxation* (1977) 137 CLR 373 (“Commercial and General”). In that case, Mason J (whose reasons were effectively those of a majority of the Court) said (137 CLR at 383):

The exchange gain was in reality a saving or reduction in the amount of Australian currency equivalent which the taxpayer required to repay its indebtedness. In essence it was a windfall advantage stemming from a reduction in a liability to repay a borrowing of capital. I can see no persuasive reason for saying that the gain was a receipt of income.

1. On the other hand, where the funds were used in the ordinary course of the borrowing and lending operations of the finance company, exchange gains and losses would normally be on revenue account. Distinguishing *Commercial and General*, in *Avco Financial Services Ltd v Commissioner of Taxation* (1982) 150 CLR 510, Mason, Aickin and Wilson JJ said (150 CLR at 527):

There is therefore an important and material difference between borrowing by a finance company in the ordinary course of its business and borrowing by a manufacturing or trading company. In general the finance company's borrowings provide money which it turns over at a profit. Borrowing otherwise than for on-lending or for the repayment of funds borrowed for on-lending, that is, borrowing undertaken for capital rather than revenue purposes, as in *CAGA* ((1977) 137 CLR 373), is an exception to the general rule. On the other hand, borrowing by a manufacturing or trading company is often undertaken to strengthen the capital or profit-earning structure of the company. A finance company usually borrows in order to increase its working capital which is then turned over at a profit; the manufacturing or trading company frequently borrows to strengthen its permanent capital.

Their Honours continued (150 CLR at 527-528):

Exchange gains and losses are an ordinary incident of overseas borrowings by a finance company. If an overseas loan, the proceeds of which are to be used in the Australian business of the finance company, is to be repaid in the foreign currency, the company has, in the first instance, to exchange the foreign currencies for Australian dollars, and later to buy the foreign currency with Australian dollars. Exchange gains and losses are therefore an incident of the borrowing.

And (150 CLR at 530):

As we have already observed, the borrowing and repayment of a loan in an overseas currency involves connected exchange transactions when the proceeds of the loan are to be employed in Australia — the finance company first buys Australian dollars with the foreign currency and later buys the foreign currency with Australian dollars in order to effect repayment. Like the borrowing transactions with which they are associated, the foreign exchange transactions are entered into by the taxpayer in the ordinary course of its business and form an integral part of that business. The gains and losses made and sustained in these transactions are therefore made in the ordinary course of carrying on that business, the more so because the gains and losses are an ordinary incident of transactions of this kind.

Exchange gains and losses of this kind were, therefore, on revenue account.

1. A different dimension of the problem was exposed in *Caltex*. As it happened, the taxpayer was the same one as had been involved in *Texas*. It had built up a trading stock debt, in foreign currency, to its overseas parent. As a result of a reorganisation of some kind, the parent company was replaced by a new company, also based overseas. The new company lent the Australian taxpayer (in two transactions) sums sufficient for the repayment of the latter’s foreign currency debt to the previous company. These loans were in the foreign currency, and the repayments were made in that currency. The commercial effect of the whole undertaking was to replace a foreign currency debt to the previous company with a foreign currency debt to the new company. It was held that there had been no loss or outgoing within the meaning of s 51 of the 1936 Act. There not having been any repayment in Australian currency, the substitution of one overseas currency debt with a new corresponding debt, also in that currency, did not amount to the incurring of a loss or outgoing: see 106 CLR at 218 (Dixon CJ), 227-228 (Fullagar J), and 231 (Kitto J).
2. It was against this background of case law that the 1987 amendments were introduced. Although not mentioned in as many terms in the legislative materials to which we refer below, we would infer that the discriminations between the capital account and the revenue account which emerged from the cases referred to above were not regarded as entirely satisfactory (in this respect, see also *ERA FC* 54 FCR at 67-68 per Hill J). The other significant factor, of course, was the introduction of income tax on capital gains, announced by the Treasurer on 19 September 1985. That put squarely on the agenda, so to speak, the taxation treatment of foreign exchange gains and losses on capital account, such as the losses in *Armco* and in *Commercial and General*. But the Treasurer’s 1985 announcement did not deal with such matters. They were left until 18 February 1986, when a statement by the Treasurer foreshadowed the introduction of the amendments that eventually became the Act of 1987. That statement read:

TAXATION TREATMENT OF FOREIGN EXCHANGE GAINS AND LOSSES

In the 19 September 1985 Statement on Tax Reform, under the proposed arrangements for the capital gains tax (CGT), it was noted that the taxation treatment of foreign exchange gains and losses was an outstanding issue yet to be decided.

The Government has now decided that all future foreign exchange gains and losses which are in the nature of interest are to be treated on revenue account, ie. gains would be assessable and losses deductible for income tax purposes.

Specifically, foreign exchange gains and losses realised after today in respect of:

borrowings or loans contracted for after today,

all delayed payments for acquisition of assets and delayed receipts for sales of assets under contracts entered into after today, ie. exchange rate effects between the contract dates and the dates of actual payment or receipt of purchase moneys, or instalment purchase arrangements contracted for after today,

are to be assessable and deductible respectively for income tax purposes.

1. The Explanatory Memorandum for the Bill which introduced the 1987 amendment stated that the effect of the amendment was:

… to treat as assessable income certain realised foreign exchange gains of a capital nature and allow corresponding income tax deductions for losses, to the extent that the gains or losses are related to the production of assessable income or in carrying on a business for that purpose (proposal announced on 18 February 1986); ….

At the detailed level, the memorandum stated:

This Bill will implement the proposal, announced on 18 February 1986, to treat foreign exchange gains as assessable income or to allow an income tax deduction for foreign exchange losses (i.e., gains and losses due to foreign exchange rate fluctuations) of a capital nature realised on or after 19 February 1986.

It is established law that foreign exchange gains and losses are assessable income or allowable as deductions where the gain or loss is of a revenue nature, e.g., where the gain or loss arises from the receipt or payment of an amount on the sale or purchase of trading stock or on the repayment of borrowings to purchase trading stock. Gains or losses on interest receipts are also revenue items. A gain or loss is of a capital nature where it arises from the receipt or payment of an amount such as the proceeds from the sale of a business or from repayment of principal on borrowings to expand a business.

In the case of a financial institution, foreign exchange gains and losses on the repayment of borrowings for use in the ordinary course of business in lending to customers are of a revenue nature. Borrowings made to strengthen the capital structure are of a capital nature.

“Gains and losses” realised from forward cover or other currency hedging contracts derive their character as an income or capital transaction from the nature of the underlying transactions which necessitated the hedge or forward cover. Exchange gains and losses realised by financial institutions from participation in hedging contracts with other businesses are generally on revenue account.

The measures proposed in the Bill are to apply to foreign exchange gains made and losses incurred on contracts for borrowings to the extent to which the money borrowed is used for the purpose of producing assessable income or in carrying on a business for that purpose. A foreign exchange gain made or loss incurred on a loan made by a taxpayer is also to fall within the new provisions where the loan was made for the purpose of producing assessable income and the foreign exchange gain or loss on the loan would not be assessable income or an allowable deduction under the existing law (as it would be where the lender is in the business of lending money).

The proposed measures are also to apply to foreign exchange gains and losses made on certain contracts entered into on or after 19 February 1986 for the purchase or sale of an asset, the price of which is specified in foreign currency. Under the proposed provisions, any gain made or loss incurred due to foreign exchange rate fluctuations between the time of purchase of a capital asset (e.g., a building) and the later time of payment of the purchase price will be assessable income or an allowable deduction where, if the taxpayer had borrowed money and paid for the asset at the time of purchase, interest on that borrowing would have been an allowable deduction to the taxpayer. Corresponding rules apply to a gain made or loss incurred, due to such fluctuations, on the sale of a capital asset.

….

An exchange gain will not be assessable, nor an exchange loss deductible, until the gain or loss is realised. In broad terms, in the case of a borrowing or loan, this will be when the borrowing or loan (or an instalment) is repaid and, in the case of a contract for the sale or purchase of an asset, when the taxpayer receives or makes the payment for the asset (or an instalment of the payment).

1. Generally, the purpose of the amendment was to remove the distinction between revenue and capital account in the area of foreign exchange gains and losses. The new provisions, relevant extracts from which are set out at para 2 above, applied only to gains and losses of a capital nature (s 82U(1)), but, in relation to losses, applied only to the extent that, had they not been of a capital nature, they would have been allowable as a deduction under s 51 of the 1936 Act (s 82U(2)).
2. The requirement, in s 82V(2)(b), that the gain or loss was to be taken as having been made or incurred at the time it was “realised”, is important. As the authorities show, in trading stock situations the significance (for taxation purposes) of movements in the relevant exchange rate lay in the conventional assumption that a deduction would have been claimed at the Australian currency equivalent of an invoice expressed in foreign currency in the year in which the invoice was received. It would have been then that the outgoing would have been incurred for the purposes of s 51 of the 1936 Act. Any subsequent movement in the exchange rate would not have affected the foreign currency indebtedness of the Australian taxpayer. But the exchange rate gain or loss as such would be made or incurred in the later year when the debt was discharged by payment (assuming, unlike the situation in *Caltex*, that the discharge required the outlay of Australian currency to purchase the necessary foreign currency). Using the Australian currency value of the debt when incurred as the reference point, there might have been either a gain from a favourable movement in the exchange rate, or a loss from an unfavourable movement, as between that time and the later time when the debt was discharged.
3. Moving from such situations to gains and losses on capital account, the point at which a capital outgoing or liability was incurred, such as at the receipt of an invoice (in foreign currency) in respect of the purchase of an item of capital equipment, did not (as traditionally) represent the occasion for the allowance of a deduction. Section 51 did not enter the picture. As a result of the 1987 amendment (and subject to satisfying the requirement of s 82U(2)), a deduction became available, but only for a currency exchange loss, namely, the loss represented by the excess of the sum, in Australian currency, required to discharge the debt arising on the purchase of the equipment over the Australian currency sum which was the equivalent of the liability at the point when it had been incurred. Prior to the discharge of the debt, the loss had not been realised. Of course, and correspondingly, if less Australian money were required to discharge the debt than was the equivalent of the liability at the point when it had been incurred, the difference would be a gain assessable in accordance with the new s 82Y. These situations were what the Treasurer described in his statement of 18 February 1986 as “delayed payments for [the] acquisition of assets”.
4. Another category of transactions referred to in that statement was “borrowings or loans contracted for after” 18 February 1986. In the Explanatory Memorandum accompanying the Bill which introduced the 1987 amendments, it was said to be “established law” that a foreign exchange gain or loss would be assessable or deductible, respectively, as revenue “where the gain or loss arises … on the repayment of borrowings to purchase trading stock”. Thus, if the foreign currency trading stock invoice were paid immediately on receipt, but funds were borrowed for that purpose, a currency exchange loss, for example, would be allowable as a deduction if the Australian currency later required to repay the loan were more than the Australian currency equivalent of the sum originally borrowed. It will be apparent that this scenario was confined to a situation in which the borrowing undertaken to pay the invoice was in foreign currency: had it been in Australian currency, subsequent movements in the relevant currency exchange rate would have been irrelevant. That is to say, it was necessary for there to have been a repayment in Australian currency of a loan originally taken out in foreign currency for the question of exchange rate gains or losses to have arisen at all.
5. The 1987 amendment made the circumstances described above applicable also where the borrowing was to pay for a capital item, or (to adopt an expression from the Explanatory Memorandum) “to strengthen the capital structure” of the business concerned. Now, and ignoring interest for the sake of analysis, where the taxpayer was obliged to repay more in Australian currency than represented the equivalent of the foreign currency amount borrowed, the excess would be allowable as a deduction under the new s 82Z. If the taxpayer were obliged to repay less in Australian currency than represented the equivalent of the foreign currency amount borrowed, the difference would be assessable as income under the new s 82Y. The same applied to loans by an Australian taxpayer: if the loan were denominated in foreign currency and the Australian currency equivalent of the amount repaid were less than the Australian currency equivalent of the amount lent, the difference would now be deductible under s 82Z; if it were more, the excess would be assessable under s 82Y.
6. The foregoing summary of the 1987 amendments, limited though it is, is one that might well have been made at the time of the legislation. The introduction of the capital gains tax, the Treasurer’s statement of 18 February 1986 and the Explanatory Memorandum made sense of the amendments in the way we have set out. What was the experience of the new laws in the courts?
7. We were referred only to a single instance of significant litigation on the provisions introduced in 1987: *ERA HC*. The background to the case is succinctly expressed by the reporter for the Commonwealth Law Reports in the following terms (185 CLR at 67):

The Commonwealth Commissioner of Taxation appealed to the High Court, by special leave granted by Dawson, Gaudron and McHugh JJ from the judgment of a Full Court of the Federal Court (Beaumont, Gummow and Hill JJ) *Federal Commissioner of Taxation v Energy Resources of Australia Ltd* (1994) 54 FCR 25 which varied the judgment of Davies J (*Energy Resources of Australia Ltd v Federal Commissioner of Taxation* (1994) 28 ATR 67: 94 ATC 4.225) upon an appeal by Energy Resources of Australia Ltd from the dismissal of objections against assessments of income tax for the years ended 30 June 1987 and 30 June 1988, but which otherwise dismissed the Commissioner's appeal from that judgment.

The assessments were made under Pt III, Div 3B of the *Income Tax Assessment Act* 1936 (Cth) on the footing that the taxpayer company had realised foreign exchange currency gains and losses under certain promissory note transactions in US dollars. On the appeal before Davies J and the further appeal before the Full Court of the Federal Court the Commissioner contended, in the alternative, that the taxpayer company's gains were assessable under s 25(1) and its losses were deductible under s 51(1).

The Full Court held that Pt III, Div 3B had no application to the transactions and that since the transactions were of a capital rather than a revenue character no questions of assessability under ss 25(1) and 51(1) arose.

The first of the “promissory note transactions” referred to was the issue, at a discount, of a series of 90-day promissory notes, denominated in US dollars, to members of a consortium of European banks. Upon maturity, the notes were retired by the payment of their face values in US dollars. The funds to do so were secured by the issue of the second series of 90-day promissory notes, also denominated in US dollars. And the same process was repeated a number of times. All of the transactions were in US dollars. The Commissioner accepted that the cost of funds associated with the issue and retirement of these promissory notes was allowable as a deduction under s 51 of the 1936 Act.

1. The High Court first dealt with the matter on the basis of that concession by the Commissioner; that is to say, their Honours considered the situation arising on current account, which took no account of the 1987 amendments or of Div 3B. They held that the taxpayer’s outgoing on each promissory note was represented by the Australian dollar equivalent of the US dollar discount allowed on that note. The outgoing was incurred, and was allowable as a deduction, on the issue of the note. Their Honours approved (185 CLR at 76) the way the matter had been put by Hill J in the Full Court (54 FCR at 62):

In my view, where a discounting transaction is conducted wholly in a foreign currency, the proper way of determining the amount of deduction to which a taxpayer is entitled by virtue of the discounting, will be to take the discount in the foreign currency and then translate the result into Australian dollars for the purpose of then computing the taxable income.

The justification for so proceeding was that the liability to pay the face value of a promissory note was incurred, for the purposes of s 51, upon the issue of the note and not upon its payment (185 CLR at 76). Their Honours in the High Court said (185 CLR at 76):

Upon the foregoing analysis, questions concerning the conversion of the proceeds and payments in discharge of the Euronotes from US dollars to Australian dollars are irrelevant. This case has nothing to do with currency gains and losses, for the simple reason that the taxpayer dealt only in US dollars. The taxpayer made no currency gains or losses because it never converted any of the proceeds of the notes into Australian dollars. For Australian tax purposes, the only relevant conversion was the cost in Australian dollars of the loss made in US dollars when the taxpayer incurred its liability to pay the face value of the notes.

The High Court rejected the Commissioner’s contention (185 CLR at 77) that “a notional conversion of the proceeds of each issue and a notional conversion of the payments in discharge of each issue had to be made on the day that each of those events took place and that the difference between the respective sums was the taxpayer’s gain or loss”. Their Honours said that there was nothing in the 1936 Act that required “the making of notional conversions of the taxpayer’s transactions”.

1. In the course of their reasons, the High Court dealt with an argument of the Commissioner which relied on s 21(1) of the 1936 Act, which provided (and provides):

Where, upon any transaction, any consideration is paid or given otherwise than in cash, the money value of that consideration shall, for the purposes of this Act, be deemed to have been paid or given.

The argument was that, since US dollars were not cash, every reference to that currency in the promissory note transactions undertaken by the taxpayer had to be converted to Australian currency. Their Honours said (185 CLR at 78) that the argument “would have practical significance for this case only if the taxpayer had incurred its loss when the notes matured”. They continued (185 CLR at 78-79):

Once the conclusion is reached that the taxpayer’s loss was incurred upon the issue and not the maturity of the notes, the Commissioner's argument has no practical significance. Acceptance of his argument would be significant only if there was a time gap between the taxpayer acquiring the legal right to receive the proceeds of the discounted issues and the taxpayer incurring the liability to pay the face value of the notes. Even then it would be significant only if the rate of exchange had moved during that period. However, there appears to have been no time gap between the acquisition of the right to receive the proceeds of an issue and the incurring of the liability to repay the face value of the notes in the present case.

The reference to the necessity for there to have been a “time gap” between the incurring of the relevant outgoing and the acquisition of the right to receive the proceeds of an issue reflects the traditional jurisprudence under s 51 with respect to exchange rate fluctuations, as we have attempted to explain it above.

1. The next argument of the Commissioner in *ERA HC* was (185 CLR at 69) “that in calculating the gain or loss occasioned to a taxpayer by reason of the payments made on maturity of the notes in a case such as this, there is to be taken into account the value in Australian dollars of the proceeds of the notes, at the time of receipt of such proceeds, as well as their value in Australian dollars at the time of maturity ….” Their Honours said (185 CLR at 79) that the short answer to the submission was that the taxpayer’s loss was incurred at the time of issuing the promissory notes. However, in a passage upon which the Commissioner strongly relied in the present appeal, their Honours provided a second answer to the submission (185 CLR at 79):

Another answer is that, since the taxpayer dealt only in US dollars, any loss or gain could only be in US dollars, and it was that loss or gain that the Act required to be converted into Australian dollars, not some hypothetical loss or gain arising from fluctuations in the US/Australia exchange rate. The taxpayer received US dollars, paid in US dollars, and did not convert the US dollars into Australian dollars. Where a taxpayer borrows money on capital account in US dollars and repays the loan in US dollars, it makes no revenue profit or loss from the borrowing even though the exchange rate may be different at each date. Indeed, arguably it makes no profit or loss (*Pattison v Marine Midland Ltd* (1984) AC 362 at 372-373). If it converts the US dollars that it receives into Australian dollars and then converts Australian dollars into US dollars to repay the loan, it may make a profit or loss on the transaction. But the profit or loss results from the exchange transaction and not from the borrowing. Where there is no exchange transaction and the loan is on capital account, the taxpayer makes no loss or gain for the purpose of s 25 or 51 of the Act simply because the rate of exchange has changed between the date of borrowing and the date of repayment. There was, therefore, no revenue loss or gain to the taxpayer from fluctuations in the rate of exchange during the ninety day periods. For income tax purposes, the fluctuations of the US/Australia exchange rate were as irrelevant to the taxpayer’s transactions as the fluctuations in the Japan/Australia exchange rate.

1. The High Court then turned to what had become the Commissioner’s alternative argument (although it had reflected the original assessment), that any gain or loss on capital account arising from exchange rate movements was assessable, or deductible, under Div 3B. That argument was rejected also, their Honours saying (185 CLR at 81):

Division 3B has no application to the present case. In so far as the cost of the discount represents a loss to the taxpayer, it was a revenue loss. Consequently, Div 3B has no application (s 82U(1)). Furthermore, for the reasons that we have already given, the taxpayer made no currency exchange gain or loss. The unit of account and the unit of payment under the contract or contracts involved in this case were US dollars. The taxpayer made no gain or loss under those contracts that was “attributable to currency exchange rate fluctuations”.

The “reasons … already given” were, of course, those articulated in the passage which we have set out in the previous paragraph.

1. It is against this understanding of the operation of Div 3B that it is now necessary to consider the Commissioner’s case in the present appeal.

# The first issue: Realisation of currency exchange loss

1. The first of three broad issues identified by the Commissioner related to the following grounds in his Notice of Appeal:

3. The learned primary judge erred in concluding that a currency exchange loss can be realised (and thus incurred) for the purposes of Division 3B of the ITAA 1936 without an exchange of anything. His Honour ought to have concluded that in order to realise a currency exchange loss it is necessary for there to be a payment or outgoing involving exchanges of foreign and Australian currency.

4. The learned primary judge erred in concluding that a currency exchange loss was realised (and thus incurred) for the purposes of Division 3B of the ITAA 1936 where there was a discharge of one liability and an incurrence of another liability (characterised by his Honour as an “exchange” or “conversion” of liabilities). His Honour ought to have concluded that a currency exchange loss cannot be realised and thus incurred where there is a discharge of one liability and an incurrence of another liability without any exchanges of foreign and Australian currency.

The issue itself was explained in the Commissioner’s written outline as follows:

[W]hether the trial judge erred in concluding that NPHP realised “currency exchange losses” in circumstances where it and other subsidiaries of … TNCL merely issued and transferred promissory notes between themselves which were not presented for payment. Section 82V(2) provides that a currency exchange loss is taken to have been incurred “at the time when it was realised”. In the Commissioner’s submission, the transfer or issue of promissory notes in satisfaction of USD liabilities and the making of book entries recording the incurrence and satisfaction of liabilities do not result in a loss being *realised*. More is required to realise a loss than an exchange of promises and the extinguishment of liabilities denominated in foreign currencies. It is submitted that there must be an outflow of Australian money which can be relevantly compared to an inflow of Australian money for a gain or loss to be realised, and thus incurred for the purposes of Div 3B. The Commissioner contends in these circumstances that the claimed losses, which the respondent claims exceed $2billion, were not allowable deductions.

1. As the issue came to be developed in the oral submissions of counsel for the Commissioner, little or no emphasis was given to what was said to be the ordinary meaning of “realised” as that word is used in s 82V(2)(b) of the 1936 Act (a circumstance which was unsurprising in the light of *Royal Insurance Company Ltd v Stephen* (1928) 14 TC 22, *Westminster Bank Ltd v Osler* [1933] AC 139, 149, and *Colonial Mutual Life Assurance Society Ltd v Federal Commissioner of Taxation* (1946) 73 CLR 604, 620-621). Rather, it was submitted that, since the discharge of NPHP’s US dollar indebtedness in 2001 and 2002 was done by the tender and acceptance of promissory notes denominated in US dollars, there had not been an exchange loss within the meaning of Div 3B. The whole affair was played out in US dollars – Australian currency did not enter the picture at any point.
2. In arguing this ground of appeal, counsel for the Commissioner relied heavily upon the facts and the reasoning in *ERA HC*. In that case, it will be recalled, the question was whether the taxpayer made an exchange gain or loss on each occasion when it retired a US dollar promissory note with funds obtained from the issue of a later US dollar promissory note. The Court held that it did not. In the present case, counsel for the Commissioner emphasised particularly what their Honours said in the passage commencing “Where a taxpayer borrows money on capital account …” in the extract set out at para 75 above. Although their Honours were there concerned directly with revenue account, the relevance of what they said to the present circumstances lies in their later adoption of this aspect of their reasoning for the purposes of Div 3B (see the passage set out at para 76 above) and in the requirements of s 82U(2). In the submission of the Commissioner, for the provisions of Div 3B to be brought into play, there must have been “an exchange transaction”, which he further submitted required there to have been an exchange of currency, either as such or by way of transfers to and from accounts with banks or like institutions in which funds denominated in different currencies were held. Specifically in the context of the present case, the discharge of an obligation by the tender of a promissory note would not do.
3. Before considering the applicability of the reasoning in *ERA HC* to the present case, it is well to turn to the words of the statute itself. If the term were undefined, it would make grammatical sense to read “currency exchange loss” in s 82Z as a loss arising on an exchange of currency; that is to say, to read “currency exchange” as adjectival apropos “loss”. That would provide a plausible basis for requiring that there be a currency exchange for the section to be activated. But the term is defined, and the grammatical sense of the provision is materially affected by the definition. A “currency exchange loss” is “a loss to the extent to which it is attributable to currency exchange rate fluctuations”. Considering the definition, the loss must be attributable to fluctuations in the currency exchange rate; that is to say, “currency exchange” is now to be read as adjectival apropos “rate”. Such a reading of the provision appears to have been what informed so much of the primary judge’s reasoning as is set out in para 41 above. In relevant respects, we agree with what his Honour said. Lest it be thought that this approach to the meaning of s 82Z is one that would make more sense to the grammarian than to the legislator, reference should be had to the passage in parenthesis in the very first paragraph in the relevant section of the Explanatory Memorandum to the amendment of 1987, set out in para 65 above. Neither the text nor the purpose of the statute, therefore, provides support for the Commissioner’s submission that Div 3B is not activated unless there has been an actual exchange of currency.
4. Does the submission derive support from *ERA HC*? In the passage from the reasons of the High Court upon which the Commissioner relied, their Honours were concerned to point out what the case was not about. The taxpayer referred to was a hypothetical one. To highlight the weakness of the Commissioner’s argument in the case, their Honours identified what would be the paradigm instance of a taxpayer who made a currency exchange gain or loss, and set that against the situation with which they were in fact confronted, namely, one in which no currency other than US dollars had been involved at any stage. The paradigm instance was a tool in their Honours’ reasoning, rather than an attempt to define the limits of Div 3B in relation to facts which were not before the Court. There was no investigation of what might have constituted a sufficient “exchange transaction” on other facts; nor of what the result would be in a case where the taxpayer relied on facts other than a mere movement in the exchange rate.
5. The respondents submitted that a loss had been “realised” for the purposes of s 82V(2)(b) when, on 8 June 2001, two promissory notes were endorsed by NPHP to NPIP in repayment, to the extent of $US1,023,453,698, of the US dollar liabilities of NPHP to NPIP. Those promissory notes had just been purchased, on the same day, by NPHP for the sum of $A1,983,453,267. That is to say, assets which the creditor was prepared to accept in partial discharge of the debt owed by NPHP had been obtained, for the very purpose of being so used, with Australian currency. This submission should be accepted. The circumstances take the present case outside anything said by the High Court in *ERA HC*. If there be a need to identify an “exchange transaction”, it was satisfied by the exchange of the assets for which NPHP had paid in Australian currency for the discharge of the debt. As it happens, we do not think that the Court in *ERA HC* intended the expression “exchange transaction” to be a term of art, and that, whether or not there was such a transaction in the present case, what happened on 8 June 2001 would qualify as the realisation of a loss on NPHP’s US dollar borrowings, assuming, as the Commissioner’s submissions implicitly accepted that we might, that there had been a relevant adverse movement in the exchange rate since the borrowings were originally made.
6. With respect to the events of 28 June 2002, the respondents submitted that a loss on the repayment of NPHP’s remaining debt to NPIP – $US3,481,527,042 – had been realised when the repayment was effected by the tender of NPIP’s own promissory note in the same sum. On the same day, NPHP had accepted that promissory note in satisfaction of NPIP’s debt to it in the sum of $A6,172,920,292. Thus, it was put, NPHP had obtained the promissory note for a consideration measured in Australian dollars. If, because of an adverse movement in the exchange rate, the relevant sum was more than the Australian dollar benefit which NPHP had originally derived from obtaining the funds on loan, the excess was a loss for the purposes of s 82Z. Although the mechanism for repayment was somewhat more involved than the expedient resorted to in June 2001, once it is understood in these terms – which we consider reflect the commercial reality of the matter – we consider it to be no different conceptually from the situation dealt with in the previous paragraph. If the facts otherwise support the respondents’ position, we are persuaded that what happened on 28 June 2002 amounted to a realisation of any loss which appears. Neither do we think that there is anything in the reasons of the High Court in *ERA HC* which stands in the way of such a conclusion.
7. Moving to the second of the two grounds of appeal set out in para 78 above which were associated with the broad “realisation” issue, it was submitted on behalf of the Commissioner that the primary judge was wrong to have held that the provisions of Div 3B were activated where there was only “an exchange of liabilities”. In a number of places, his Honour did invoke the concept of an exchange of liabilities, and perceived in some of the relevant transactions a situation in which NPHP had exchanged liabilities of one character, or to one creditor, for liabilities of another character, or to another creditor. It was submitted on behalf of the Commissioner that the concept of an exchange of liabilities was an “odd” one, and implied a transaction of a kind that was unknown to the law. One might exchange assets or currency, it was said, but one could not exchange liabilities in the sense that, as a result of the exchange, the parties involved would end up with each other’s original liabilities. On behalf of the respondents, it was submitted that the primary judge introduced the concept of exchange of liabilities into his reasons only to emphasise his rejection of the Commissioner’s submission that Div 3B was not activated unless there had been an exchange of currencies.
8. It is necessary first to place this controversy into the compartment of the case to which it relates. As the relevant ground of appeal makes clear, the Commissioner’s point is concerned with the kind of transaction that might qualify as the “realisation” of a currency exchange loss. The only two transactions which the primary judge held to be realisations were those of 8 June 2001 and 28 June 2002. As to the former, his Honour clearly looked at the financial reality of what occurred, in that NPHP commenced with a US dollar debt to NPIP, and ended with that debt reduced, but with its Australian dollar debt to TNCL increased. He said that the process “transformed a liability in US dollars to NPIP into a liability in Australian dollars to TNCL”. From the perspective of NPHP, of course, that was what effectively happened. It was in this sense that his Honour said (as he immediately did) that “[w]hat occurred was an exchange of liabilities denominated in different currencies”.
9. For our own part, with respect, we do not consider that whether there has, in a particular case, been an “exchange”, or “transfer”, of liabilities is responsive to the terms of s 82Z. But, ultimately, we doubt whether anything turns upon the terminology employed by the primary judge in relevant respects. Once it is realised that his Honour was not suggesting that one entity might transfer its liability to a second entity, much of the Commissioner’s criticism becomes moot. What matters is whether a difference is made if the taxpayer in question funds the discharge of his or her existing foreign currency debt by supplying a note obtained in return for an increase in his or her Australian currency borrowings rather than borrowing Australian money as such and using that money to discharge the debt. The primary judge considered not, and we agree. We accept that the whole debate was not greatly advanced by his Honour’s invocation of the concept of exchanging liabilities, but we would not accept that this gave rise to an error of the kind that would require the reversal of any aspect of his Honour’s judgment in this appeal.
10. The facts were somewhat different, but ultimately the conclusion should be the same, with respect to the transactions of 28 June 2002. Here again a promissory note was accepted by the creditor in discharge of the remaining part of the debt, but, instead of becoming more indebted on an Australian dollar account to obtain the note, NPHP had accepted the note in satisfaction of an Australian dollar debt owing to it. The primary judge’s description of this as amounting to “[the discharge of] a US dollar liability with an Australian dollar debt” was not, in the circumstances, inapt, but, again, what matters is that NPHP used an asset denominated in Australian dollars (the debt owing to it by NPIP) to obtain a note which the creditor was prepared to accept in discharge of the US dollar debt.
11. For the above reasons, we would reject the Commissioner’s case on the first broad issue in the appeal.

# The second issue: Under an eligible contract

1. The second broad issue identified by the Commissioner related to the following ground in his Notice of Appeal:

The learned primary judged [sic] erred in concluding that any losses incurred by NPHP in the 2001 year and the 2002 year were incurred “under an eligible contract” as required by s 82Z of the ITAA 1936. His Honour ought to have concluded that any loss incurred was not under an eligible contract.

On the hearing of the appeal, it was made clear that there was no suggestion that the contract on which the respondents relied was not an eligible one. Rather, the point was that any loss incurred by them had not been incurred under that contract. Put another way, the Commissioner’s appeal did not challenge the reasoning of the primary judge as referred to in paras 54-55 above, it challenged his Honour’s reasoning as referred to in paras 56-57 above.

1. The sense in which it was submitted on behalf of the Commissioner that NPHP’s loss, assuming there to have been one, was not incurred under an eligible contract was a narrow one. In the case of the demand note of June 1991, it was submitted that the contract neither required nor facilitated an exchange of currency. That the loss had to be incurred under a contract which did require or facilitate an exchange of currency was said to flow from the reasons of the High Court in *ERA HC*, particularly (about half way through) the passage quoted in para 75 above. However, once it is held, as we would for reasons given above, that Div 3B does not require there to have been an exchange of currency as such, the proposition that an admitted loss should not be regarded as having been incurred “under” an admittedly eligible contract because the contract neither required nor facilitated an exchange of currency becomes an untenable one.
2. In the case of the loss presumptively incurred by NPHP between May 1989 and June 1991, no attack was made on the two reasons given by the primary judge (see para 57 above) for incorporating that component into the overall loss which his Honour held to come within the terms of s 82Z. The contract “under” which that part of the loss was incurred, as his Honour held, was the facility of 26 May 1989. Again, no suggestion was made on appeal that that was not an eligible contract. With respect to this second broad issue on appeal, the Commissioner’s point was, in essence, no different from that made with respect to the 1991 demand note, and we would deal with it consistently with our reasoning in the previous paragraph. The Commissioner’s argument should likewise be rejected.
3. Some reliance was placed by the primary judge, and by the respondents on appeal, upon the reasons of members of the Full Court in *ERA FC*. For reasons which follow, we would prefer to base our conclusion on this second issue upon the considerations dealt with in the two previous paragraphs above rather than upon what was said by their Honours.
4. In the judgment below, the primary judge said:

A safer approach in my opinion is to adopt the approach of Gummow J in *Energy Resources* (Full Federal Court) where his Honour said this of the provisions (at 53B & 54D):

In ordinary parlance, to speak of a gain being made “under” an eligible contract suggests that the gain was made in exercise of a right or discharge of an obligation conferred or imposed, as the case may be, by the terms of the eligible contract.

…

In my view, a currency exchange gain, for the purposes of the Division, shall be taken to have been made or incurred under an eligible contract when realised in respect of currency purchased in the exercise of rights or the performance of obligations arising under the terms of the eligible contract.

One such example would be a contract for the sale of goods by an Australian buyer or seller where the money of account and of payment, or the money of payment, was not Australian currency. Another would be a hedging contract entered into in relation to the primary contract.

As counsel for the respondents pointed out, Gummow J was here concerned to distinguish between the sense of “under” the contract conveyed in the first indented passage set out above and the following sense (54 FCR at 53D):

More loosely, a gain may be made under a contract where this has come about by reason of the existence of the contract or the performance of the contract, whether or not the gain was made in exercise of a right or discharge of an obligation conferred or imposed upon the party or some other person.

His Honour was not concerned with the question presently under consideration, namely, whether an exchange of currency as such was a necessary requirement of Div 3B in relation to a transaction in which a loss of value measured in Australian dollars is otherwise realised. The respondents sought to derive comfort from Gummow J’s postulate that a gain might be regarded as having been made “under” a contract if it were made “in … discharge of an obligation … imposed … by the terms of the eligible contract”. The difficulty is that, when his Honour came to the point of expressing his own view, he said (54 FCR at 54D) that a gain would have been incurred under such a contract “when realised in respect of currency purchased in … the performance of obligations” arising under the contract. A requirement that there have been a purchase of currency would lie closer to the Commissioner’s, than to the respondents’, case in the present appeal. Doubtless for this reason, counsel for the respondents did not emphasise the relevant passage in Gummow J’s reasons. The fact is that *ERA FC* did not involve the kind of discriminations which must be made in the present case, and we doubt the utility of having recourse to the rather high level terminology employed by his Honour as though it provided the lodestar for the making of those discriminations.

1. Counsel for the respondents relied also upon the following passage in the reasons of Hill J in *ERA FC* (54 FCR at 72-73):

Where a taxpayer borrows in overseas currency, uses the borrowed funds in its business and ultimately repays the borrowing in the same overseas currency, an exchange gain or loss arises where there has been a movement in the exchange rate between Australian dollars and United States dollars, between the date of borrowing and the date of repayment. By way of an example, if a taxpayer borrows United States dollars and there is a devaluation of the Australian dollar against the United States dollar, the number of Australian dollars that would be required to fund the repayment of the indebtedness will be greater than the Australian dollar value of the amount received. Such a case involves, for the purposes of Div 3B, the making of a currency exchange loss under the contract of loan and it matters not that that loss was not derived from an actual exchange transaction involving the conversion of currency.

The difficulty here is that this passage fell within so much of his Honour’s reasons as differed from those of the other members of the Full Court. Although the judgment of the Court was a unanimous one, Hill J would have decided the case on a point different from those which were accepted by Beaumont and Gummow JJ. The presently relevant part of Hill J’s reasons was concerned with the alternative situation that would have obtained if his primary view did not prevail, and in that, alternative, respect his Honour was a dissentient.

1. We would also advert to what Beaumont J said in *ERA FC* (54 FCR at 48):

It may be accepted that Div 3B should not be limited to hedging contracts or to contracts which either require or contemplate a conversion of currency. That is to say, there could conceivably be circumstances where a taxpayer so planned its affairs that the object or consequence of its entry into a contract of another kind was the realisation of an exchange gain or a loss by reason of its entry into the contract. But in the present case, there is no evidence that ERA had this in mind, as an object or a consequence, in entering into the Euronote facility.

That is to say, a loss might be realised under a contract for the purposes of Div 3B where the contract neither required nor contemplated the conversion of currency. That is helpful for the respondents so far as it goes, of course, but the sense in which Beaumont J made that observation was to allow for the possibility that such a contract might qualify under Div 3B. The case itself was not decided by reference to such a possibility having represented the reality of what occurred.

1. We take the view that the respondents’ reliance on *ERA FC* is problematic for the reasons canvassed above. However, we would reject the Commissioner’s case under his second broad issue for the reasons given at paras 91-92 above.

# The third issue: The respondents’ Notice of Contention

1. In his written outline, the Commissioner said that the third issue in the appeal was related to the first, and was the subject of a Notice of Contention filed on behalf of the respondents. According to the Commissioner’s outline:

The Commissioner contends that the learned trial judge was correct in concluding, that the promissory notes in this case did not give rise to payments of money and did not involve an exchange of foreign currency or money and Australian money. In these circumstances the Commissioner submits that no exchange loss was realised as required by Division 3B.

The relevant paragraph in the Notice of Contention was as follows:

His Honour should … have held that if a “conversion event” involving an exchange of foreign currency or money for Australian money is required in order for a currency exchange loss to be realised, the delivery of promissory notes denominated in a foreign currency or Australian dollars is sufficient for the purpose of realising a currency exchange gain or loss under Division 3B and, accordingly, the currency exchange losses claimed by NPHP were realised by the exchange of foreign currency and Australian money.

1. In their written outline, the respondents foreshadowed a submission in the alternative that the delivery of a negotiable instrument should, for Div 3B purposes, be treated as the payment of “money” or “currency”. In his outline in reply, the Commissioner made no reference to this contention. A submission corresponding with the Notice of Contention was not, in fact, made on behalf of the respondents on the hearing of the appeal. The respondents’ outline, relevantly, raised some fine points of distinction as between what should, and what should not, be treated as “money” in various contexts, but the point was not the subject of detailed submissions by counsel. As it seems to us, the third “issue” identified by the Commissioner did not become an issue at all. In the circumstances, we take the view that it is neither necessary nor appropriate to deal with it.

# Disposition of the appeal

1. For the above reasons, we shall dismiss the appeal with costs.

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| I certify that the preceding one hundred (100) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justices Jessup, Robertson and Griffiths. |

Associate:

Dated: 25 July 2013