# GOODMAN FIELDER WATTIE LTD v FEDERAL COMMISSIONER OF TAXATION

**22 ATR 26**

Headnote | Catchwords | Holdings | Action | Counsel | Decision

FEDERAL COURT OF AUSTRALIA - GENERAL DIVISION

Hill J

15, 17 April, 20 May 1991 - Sydney

## Headnote

### Catchwords

Losses and outgoings - Allowable deductions - Business - Research and development - Whether taxpayer carrying on a business at the relevant time - Characterisation of business activity - Commencement of business activity - Commitment to project - *Income Tax Assessment Act 1936* s 51(1), s 73A(1) - Research and development expenditure - Research and development into monoclonal antibodies - Allowable deductions - Meaning of "scientific research" - Meaning of "applied science" - Wide interpretation of s 73A - *Income Tax Assessment Act 1936* s 51(1), s 73A(1) - Apportionment - Salary - Whether salary apportioned where employee spends time on capital activities - *Income Tax Assessment Act 1936* s 51(1)

### Facts

The taxpayer was a company which carried on its business in several divisions. On 14 August 1981 the taxpayer contracted with the Queensland Institute of Technology (QIT) to fund the establishment of a monoclonal antibodies development centre (MADC). The advantages of commercial involvement in the application of scientific discoveries concerning monoclonal antibodies were perceived by Dr W, an employee of the taxpayer.

In 1982 separate premises were leased at Slacks Creek for the taxpayer's Mabco Division to set up development and production facilities. Sales of the first monoclonal antibody product occurred in December 1982 and January 1983. Many technical problems arose and the taxpayer eventually sold the Mabco Division on 28 June 1985.

The issue in these appeals was the disallowance by the Commissioner of deductions claimed by the taxpayer for the income years 1982-85 inclusive. The deductions fell into two categories: (1) payments, between September 1981 and October 1982, made by the taxpayer to fund research carried on by the QIT (the first period); (2) expenditure incurred thereafter by the taxpayer (the second period). The expenditure was variously described in the taxpayer's income tax returns as being for manufacturing, administration, research and development or merely expenditure shown as such in the operating statement of the taxpayer in respect of its Mabco Division.

The Commissioner asserted that the taxpayer had not commenced its business until the setting up of the premises in Slacks Creek. The taxpayer submitted that the income producing activity in which it was engaged during the first period should be characterised as an activity of researching and developing monoclonal antibody products for manufacture and sale, as opposed to manufacturing and selling the products.

In respect of the second period, the Commissioner submitted that each new product of a company such as

the taxpayer engaged in manufacturing and marketing as well as regular research was to be seen separately. Alternatively the Commissioner claimed that the taxpayer had not satisfied the burden of proof of showing that the expenditure incurred by it was not of a capital nature.

## Holdings

**Held**, allowing the appeals in part:

(i) An essential element of identifying the point of commencement of business activity is commitment to the project. The necessary commitment by the taxpayer was lacking in this case. The taxpayer was engaged in activities of a provisional kind only during the first period: at 36-40. 22 ATR 27

*Softwood Pulp and Paper Ltd v FCT* (1976) 7 ATR 101; 76 ATC 4439; *Inglis v FCT* (1979) 10 ATR 493; 40 FLR 191, applied .

(ii) Notwithstanding that the taxpayer accounted for the funding activity as a separate division, it was not possible to characterise the activity during the first period as a business or as an activity of gaining or producing assessable income within s 51(1) of the *Income Tax Assessment Act 1936* (the Act): at 37-6.

(iii) In relation to the second period, the whole of the expenditure of the Mabco Division was deductible under either s 51(1) or s 73A(1): at 42-42.

*Sun Newspapers Ltd and Associated Newspapers Ltd v FCT* (1938) 61 CLR 337; 1 AITR 353, 403; *Hallstroms Pty Ltd v FCT* (1946) 72 CLR 634; 3 AITR 436, applied.

(iv) It was not necessary to decide whether the research and development component of apportionable expenditure was of a capital nature for, to the extent to which the outgoings were of a capital nature, they were deductible under s 73A of the Act: at 40-35.

(1972) 18 CTBR(NS) *Case 51*; *D81* 72 ATC 480, applied.

(v) Research, for the purposes of s 73A, extends to the stage where there is a practical product able to be produced: at 42-27.

(1972) 18 CTBR(NS) *Case 51*; *D81* 72 ATC 480, applied.

(vi) A wide interpretation should be given to s 73A. The section is not confined to expenditure on scientific research, that is, to expenditure which is directly on such research. Thus, in this case, expenditure such as a researcher's salary, leasing costs in relation to a car provided for the researcher's use, expenditure on equipment and cleaning, would fall for deduction under s 73A if not otherwise deductible: at 42-42.

(vii) The question whether expenditure on wages is on revenue account, notwithstanding that during a period of ordinary employment the employee is engaged on activities of a capital nature, is a question of fact and degree. Where a person is employed for the specific purpose of carrying out an affair of capital, the mere fact that that person is remunerated by a form of periodic outgoing would not make that outgoing revenue in nature. On the other hand, where a person is employed and engaged in activities which are part of the recurring business of the employer, the fact that on a particular day the person is engaged in an activity which viewed alone would be of a capital kind does not operate to convert the periodical outgoing for salary and wages into an outgoing of a capital nature. The question is not to be answered merely by counting the number of hours in which the employee is engaged in activities which are in themselves of a capital nature. It is necessary to determine whether the essential character of the expenditure is that it is a working expense: at 43-31.

(viii) In the present circumstances the salary of Dr W was clearly part of the recurring outgoings of the company on its business activities. The fact that he spent some time dealing with patent attorneys did not convert the expenditure to expenditure of a capital nature: at 43-8.

### Appeals

These were appeals to the Federal Court from the disallowance by the Commissioner of objections to

assessments for the relevant income years. The facts appear sufficiently from the judgment.

## Counsel

A R Emmett QC and R F Edmonds for the applicant.

A H Slater for the respondent.

Cur. adv. vult.

# Judgment - Hill J

Hill J

The applicant, Goodman Fielder Wattie Ltd, appeals against the disallowance by the respondent Commissioner of Taxation of objections to assessments made by the Commissioner for the years of income 1982-85 inclusive.

At issue in the appeal is the disallowance by the Commissioner of deductions claimed by the applicant which fall into two categories. The first category of 22 ATR 28 deduction constitutes payments made by the applicant to fund research carried on by the Queensland Institute of Technology, those payments being for the period September 1981 until approximately October 1982. The second category of deductions comprises expenditure incurred thereafter by the applicant which is variously described in its income tax returns as being for manufacturing, administration, research and development or merely expenditure shown as such in the operating statement of the applicant in respect of its Mabco Division.

To understand the nature of the issue that arises between the parties it is necessary to set out in some detail the background to and activities of the applicant's Mabco Division. There was no real dispute between the parties as to the relevant facts. What is in dispute is the characterisation of those facts.

The background facts

At all relevant times the applicant carried on its business in a number of divisions. One of those divisions was the poultry division. Employed in that division in 1980 was Dr Watson, a veterinarian and the technical manager for an operation carried on in Queensland specialising in intensive animal production. Dr Watson had, prior to that time, extensive experience both in industry and in academia. As subsequent events demonstrated, he was also a man of vision, able to perceive the advantages of commercial involvement in the application of scientific discoveries concerning monoclonal antibodies.

Monoclonal antibodies are specific antagonistic agents to particular antigens. Their value lies in the detection and assay of various organic matter, be it disease processes or enzyme levels in food materials. By introducing the antibody to, for example, a sample of blood of an animal or a human, it is possible to detect by means of the ensuing reaction whether a particular disease is present. In theory at least, monoclonal antibodies may be produced against any organic matter. However, apparently certain groups of chemicals are more potent in this regard than others. Continuing production and specificity are obtained by fusing the agent to a tumour cell to produce a hybrid cell which retains the characteristics of both partners. The resulting cell is then cloned to retain purity and provide volume.

The first scientific paper describing research into monoclonal antibodies and its potential application in immune reactions, was presented in 1975 and emanated from research carried on at Cambridge University. The scientific and/or commercial community, however, was slow to accept the possibility that this research could revolutionise the manipulation of diagnostic, prophylactic and therapeutic regimes. The scientific literature continued through into 1980 and was the subject of discussion at scientific seminars.

Research in the area in Australia had been undertaken by Mr Wyatt at the Queensland Institute of Technology who had had some practical experience of the technology in the USA. In 1981 that Institute wished to establish a monoclonal antibody development centre. The purpose of the proposed centre was to develop for commercial exploitation by Australian companies a range of highly specific monoclonal antibodies for diagnostic, therapeutic and industrial applications in both the medical and veterinary fields. There was a possibility of government funding but only if the Institute could demonstrate that the research

project was in the public interest and there was no Australian company prepared financially to back the initial research and development work. Thus, the Institute set out to approach Australian business to ascertain its interest.

Following discussions between Mr Wyatt and Dr Watson, the latter became convinced that monoclonal antibodies could, in the long run, provide a new era in 22 ATR 29 diagnostic medicine. He perceived the research contemplated by the Institute as having great commercial potential. He formed the view that the applicant should become involved in this new biomedical technology field, and that the applicant should seek to apply the new technology and research to form the basis of a diagnostic producing company for medical and veterinary professions.

The managing director of the applicant, Dr Knight, expressed enthusiasm at the idea and in the result Dr Watson prepared a proposal which Dr Knight presented to the board of directors of the applicant. That proposal, dated 7 July 1981, was entitled:

"A scheme for Fielder Gillespie to enter an arrangement with the Queensland Institute of Technology to establish and maintain a Monoclonal Antibody Development Centre."

The proposal expressed the view that an opportunity presented itself for the applicant to enter the field of high technology. The synopsis to the proposal reads in part as follows:

"Proposal for the company to enter into a contractual arrangement with the Queensland Institute of Technology (QIT) School of Health Science, to establish and maintain a Research and Development Centre for the production of monoclonal antibodies and related products suitable for commercial development.

"The company to fund the Centre for a period of three years at an agreed rate to pay for staffing, materials and facilities. In return the Company has the exclusive right to use and market all or any of the products emanating from the centre.

"A system of financial return to the Centre from the profits resulting from the sale by the company of products originating in the Centre, to be agreed."

The proposal estimated that staffing and equipment costs of the centre would amount to approximately $200,000 per annum for a three year initial period. The proposal claimed that a range of products that were already feasible and ready to be fabricated for the medical and industrial fields existed. It said:

"Because of the immense range of products opening up it is necessary to establish an area of expertise from which a defined range of marketable products will emanate."

Detailed in the report under the heading "Product Development" were the following:

"Brucella abortus. A MAB is in stock at the Centre and this product could be used to obtain market information. It is a relatively simple product to accurately detect a well researched disease of world-wide significance. Current diagnostic agents are inaccurate leading to great wastage of food animals, for instance ($150m loss to the Australian meat industry). The public health significance of this disease is also important, and would be useful for gaining marketing experience in this area. The product will be ready for commercial development into a diagnostic kit within six months.

"Campylobacter foetus. A MAB is in stock at the Centre. This organism is now the second most important food poisoner and is an indicator of the significance of the whole range of entero-pathogens which have world-wide potential. The range includes Salmonella, Staph, E coli, Shigella, vibrio cholera and enteroviruses. The aim is to specifically detect the toxins producing the disease and produce a range of MAB to suit. This is the main area of effort for the three year period and the Centre is confident of producing materials for development into marketable components in the short term. 22 ATR 30

"Products under consideration for further development or parallel concurrent development from which the management committee will guide the research effort include filariasis (heartworm) and diagnostic reagents for sexually transmitted disease and meningitis.

"Concurrently the diagnosis of respiratory disease is poor and the Centre is keen to establish research and

development in this area."

The proposal indicated that it was not possible to give a meaningful estimate of markets and profit potential but the world market for MAB was estimated to be between $500m-$1000m at the current stage of development with new markets opening up daily. It was, however, estimated that over 500,000 faecal samples were examined annually in Australia for entero pathogens which would constitute a worthwhile market. Present cattle testing for brucella abortus in Australia was said to average about 5m tests per year.

The board of the applicant, after considering the proposal, was of the view that a more specific proposal should be prepared including marketing prospects, the physical and financial aspects of production, packing and distribution of MCA products with emphasis being placed on those products capable of generating an early cash flow. In the result a further proposal was prepared and presented to the board under the heading:

"Proposal to Fund a Research Centre at the Queensland Institute of Technology School of Health Science."

In the introduction the proposal stated:

"The proposal has concentrated on the production of MAB to microbiological agents which may be used for research and diagnostic purpose (ie not therapeutic, prophylactic or industrial).

"The expertise of the QIT research team is in the area of microbiology related to public health.

"The number of potential products of this type are sufficient to occupy us for at least the initial three years. This is not to say that priorities may be accorded to products related to other biological materials particularly those useful in industrial processes. In fact our opinion is that the value of MAB in industry will be considerable, but will take some development."

The proposal set out sales figures for projected sales in Australia (not overseas) projecting sales commencing in the second half of the first year for the brucella abortus products and in the veterinary eradication scheme area. It indicated that if such sales were not achieved it would be because of technical reasons rather than the availability of markets or competition.

It was suggested that after the arrangement had been entered into with QIT, attempts should be made to approach an established multinational pharmaceutical/biological-producing/marketing company to establish a joint company for the development and marketing of high technology products. Such course would relieve the applicant of having to set up its own marketing system. The proposal said:

"Fielder Gillespie would have then established themselves in a completely new market with immense potential by funding the initial research (which would be serviced by pay back royalties) and then relinquishing a part of the proceeds by combining with an established market leader."

The proposal contemplated that there be a management committee comprising two representatives from the applicant and two from Queensland Institute of Technology and an outside chairperson to direct work priorities, control expenditure and staff. 22 ATR 31

The proposal suggested that once a reagent was adequately researched and understood and "given reasonable fortune" the development of a monoclonal antibody to commercial stages would take about six weeks. Of the brucella abortus monoclonal antibody it was said that:

"This is a relatively simple MAB ready for development and one which would be a useful indicator for promotion and market intelligence. Likely to be quickly understood and not being complicated should receive official support without excessive delays."

This product was expected to carry the sales for the first year whilst the next group is being developed.

The board ultimately approved the proposal, subject to certain conditions to be hereafter noted, and in the result on 7 September 1981 there was held the first meeting of the "Fielder Gillespie/QIT Planning Committee". A draft letter of agreement on the funding of the centre was in the course of preparation, a decision was made to appoint a technical director of the centre, Dr Bundesen, who was to take up that

position on the first working day in 1982. The minutes of the meeting disclosed that the committee considered it was important to initiate activity immediately on getting the product, monoclonal antibody-brucella abortus, into a state where it could be tested in some laboratories.

The first payment by the applicant to fund the centre was made shortly after that meeting. The agreement between the applicant and the Institute for the establishment of the research centre was exchanged on 7 October 1981. On the next day a press release announced that agreement had been reached to establish a research centre "within the School of Health Science to be known as the Centre for Applied Immunology". The funding agreement was to be a research grant of $1m over five years. The press release said:

"A new Division will be set up within Fielder Gillespie known as the Imtec Division, to acquire and market products of the Centre having commercial application. This new Division will be supervised by Dr Richard Watson who has considerable experience in preventive medicine, having previously been employed by Glaxo Laboratories and Tasman Vaccine Laboratories."

Although the heads of agreement was signed on 6 October 1981, it is clear from the minutes of meetings of the Board of Directors of the applicant, that the applicant had committed itself to funding the research centre at its meeting on 14 August 1981. This commitment, like the heads of agreement itself was, however, conditional. The applicant reserved the right to review its contribution after the end of the first twelve month period as well as at the end of three years. Thus, in a letter written by the Managing Director of the applicant, Dr Knight, to the Institute on 14 August 1981, the following was communicated:

"After a board meeting of the Company today, it was agreed that:

"Fielder Gillespie Ltd will participate in an agreement with the Queensland Institute of Technology whereby Fielder Gillespie will contribute about $200,000 pa for five years to establish a Monoclonal Antibody Development Centre. In return the QIT will undertake to produce a range of highly specific Monoclonal Antibodies for commercial exploitation by Fielder Gillespie.

"When the project has been established for (1) 12 months (2) 36 months the progress will be reviewed with the opportunity for Fielder Gillespie to revise its financial commitment if the project does not show promise of commercial exploitation. However, Fielder Gillespie does undertake to pay the salary of the Australian Scientist, now working in Canada, for a period of three years, in any event."

**22 ATR 32**

The heads of agreement recited the objective of the centre as being "to develop techniques leading into improved biotechnology products". It recited that initially the centre would investigate hybridoma technology and the production of monoclonal antibodies with extension into genetic engineering at an early date. The centre was to be developed and maintained jointly by the applicant and the Institute, with administrative control being effected by a management committee. The management committee was to have responsibility inter alia for the determination of the general direction and objectives of the research and development effort as well as for the supply of budgets. The applicant retained the right to withdraw financial support in December 1982 and December 1984. For the contribution set out in the agreement, the applicant was to have the exclusive right to all materials and products within the centre at no further cost and these were to remain the property of the applicant. The applicant was to return to the Institute, in the form of royalties, 5% of gross sales for products researched and developed fully by the centre.

Thereafter the centre was set up, a laboratory was equipped and staff recruited to conduct research. In fact research did not commence on a full time basis until the early months of 1982. Some research was however conducted during the equipping of the laboratory.

The official opening of the centre occurred on 3 June 1982 and attracted some television and newspaper publicity. By that time, research was well under way.

The minutes of a scientific sub-committee meeting of the centre on 8 April 1982, apparently the second meeting of its kind, gave progress reports on research into six product areas. It indicated that progress on the brucella project had not been as quick as had been hoped. By 18 May 1982, it was recorded that the first products from the division were estimated to reach market stage in January 1983, with product development continuing until December. The delay was said to be due to technical reasons in the research area. By then it was clear that there would be at least 12 month delay on the achievement of the original budget.

A memorandum from Mr Pattison, who served on the management committee at the time, to Mr Green, expressed the conviction that products could be developed. Mr Pattison, however, expressed concern with marketing which, he said in the true sense of the word, would not commence until 1983. Mr Pattison was not sure what state and federal laws would require for testing before the products could be made available commercially. Nevertheless, he was of the view that the project had real potential to be a money spinner.

By October it was clear that the first products would be launched in December 1982, these being research reagents which Dr Watson regarded as of limited commercial value, but "useful in putting the company name into the international market place and opening the channels for advertising and promotion". It was said that the first of the commercial reagents would be launched in January of 1983 being veterinary commercial reagents applicable to semi-tropical and tropical areas in Australia and overseas. Final proving tests were under way and looked promising. In October 1982 a decision was made to lease separate premises and for the Mabco Division of the applicant, as it was then named, to set up commercial development and production facilities in these premises. The premises ultimately leased were factory premises at Slacks Creek, a southern suburb of Brisbane, close to the White Wings Hatchery at Rochdale, presumably the headquarters of the poultry division in Queensland. A short term lease was entered into around November 1982.

The months of November and December were occupied by cleaning up these premises and real operations began there in January 1983. The first product ready for sale was known as Dirokit, being a test for dog heartworm. It was advertised in 22 ATR 33 the Australian Veterinary Practitioner in December 1982 and first offered for sale at a conference of the Australian Immunology Society in Adelaide on 8 December of that year.

All was not plain sailing thereafter. There were initial problems with the heartworm detection kit, which included a propensity to leak, and the packaging was changed in early 1983 to overcome this problem. There were difficulties experienced by veterinarians in conducting the testing themselves and as a result a service was offered at the Slacks Creek premises to conduct the tests using blood samples forwarded by the veterinarians. This service was known as Diromail. Further research and development was carried out by the Queensland Institute of Technology on the heartworm product in 1983 and 1984.

The monoclonal antibody product forming the basis of a test kit for brucella abortus was the subject of further tests carried out in 1983. The kits were manufactured at Slacks Creek but ultimately came to nothing because the clinical trials proved unsuccessful. As a result no brucella abortus product was marketed during the period of the applicant's involvement with the technology.

A further monoclonal antibody showing potential was known as "D Dimer", an antibody for the protection of disseminated introvascular coagulation in the general field of blood coagulation and thrombosis. Test kits were developed and manufactured at the Slacks Creek operation and large scale clinical trials were conducted in conjunction with doctors at the Royal Brisbane Hospital and the Princess Alexandra Hospital in Queensland, as well as at a private testing laboratory in Brisbane. Clinical trials were also conducted in London at the National Biological Institute there.

Not surprisingly, there were, from time to time, tensions between the applicant and the Institute, resulting from the different aims of the Institute and the applicant, one being geared ultimately to education and the other to commercial development. Contemporaneous memoranda also show that a patent problem had arisen when another institution had sold a monoclonal antibody for $6m. There were, at this time, discussions with patent attorneys and lawyers on the question of an infringement of the patent owned by the applicant, which involved Dr Watson, in discussions and meetings, not only with the legal advisers but also with scientists. Dr Watson gave evidence that his involvement in this activity was approximately 40 hours spent in internal discussions and 10 days in discussions with patent attorneys. Involvement by scientists from the centre was presumably considerably greater.

In the first six months of 1983, in addition to Dr Watson, four employees were working at the Slacks Creek premises, a clinical diagnostician and biochemist and three technicians. There was, in addition, a technician/office manager who was also engaged in technical work involving the development of products. During 1983 the majority of the time of the Slacks Creek staff was devoted to the heartworm product. The balance of the time was spent looking at brucella, tuberculosis and cystic fibrosis and "D Dimer" products. The work on these products sought to reproduce the results obtained by the centre under ordinary commercial manufacturing conditions.

Technical problems were experienced, it is unnecessary to elaborate upon them, and work continued at

Slacks Creek with a view to endeavouring to overcome these problems during 1983, 1984 and 1985.

Dr Watson was involved at attendances at conferences and promotional lectures, both in Australia and overseas. During 1983 approximately 30% of his time was spent promoting products to potential clients, although the level of promotion accelerated through to 1985. In late 1983 a graduate scientist was employed as a sales person, in 1984 another sales person was employed as well as two further 22 ATR 34 technicians who were engaged in quality control. In 1984 also two additional office staff were engaged who helped with packaging and transportation from time to time. In 1985 a graduate scientist was employed as an addition to the sales force, as well as two further technicians and a further member of the office staff. The premises occupied also expanded. The Slacks Creek premises had initially only been one unit of a factory building there. A second unit was rented in 1984 and a third unit in 1985.

In the first half of 1985 it became apparent that if the applicant's Mabco Division was to become profitable it would be necessary to inject large sums of money. The applicant was reluctant so to do and ultimately sold the division to AGN Ltd on 28 June 1985.

The assessments under appeal

The assessment for the year of income ended 30 June 1982 disallowed to the applicant the whole of its contribution towards the centre. The Commissioner did so on the basis that the expenditure was incurred prior to the time when the applicant commenced to carry on business and accordingly was neither deductible under s 51(1) of the Act, nor was it available as an allowable deduction under s 73A(1) of the Act.

In the assessment for the year of income ended 30 June 1983, the Commissioner disallowed all contribution to the Institute for the period from 1 July 1982 until approximately November 1982 when the Slacks Creek premises were obtained. Contributions made by the applicant thereafter to the centre were allowed to the applicant as an allowable deduction under s 73A(1) of the Act.

It will be recalled that sales of the first monoclonal antibody product occurred in December 1982 and January 1983. For the balance of this year of income, and indeed in each of the years of income ended 30 June 1984, and 30 June 1985, the Commissioner allowed as deductions expenditure incurred by the applicant's Mabco Division (as it came to be known) only to the extent that such expenditure was not in excess of the sales made by the applicant in these periods. The Commissioner did so apparently on the basis that he was not satisfied that expenditure in excess of the amount of sales was an allowable deduction under s 51(1) or s 73A(1) of the Act. This was because, in each of these periods, the company was, so the Commissioner saw it, engaged in the development of new products with the result that, in his view, the expenditure was of a capital nature and did not qualify for deduction under s 73A(1) of the Act as research and development expenditure.

The statutory background

Section 51(1) of the Act provides relevantly as follows:

"All losses and outgoings to the extent to which they are incurred in gaining or producing the assessable income, or are necessarily incurred in carrying on a business for the purpose of gaining or producing such income, shall be allowable deductions except to the extent to which they are losses or outgoings of capital, or of a capital ... nature."

Section 73A(1) of the Act provides as follows:

"The following payments made, and expenditure incurred, during the year of income (other than any amount which is allowable as a deduction under any other section of this Act) by a person carrying on a business for the purpose of gaining or producing assessable income shall be allowable deductions:

(a) Payments to -

(i) an approved research institute for scientific research related to that business; or 22 ATR 35

(ii) an approved research institute, the object of which is the undertaking of scientific research related to

the class of business to which that business belongs; and

(b) Expenditure of a capital nature on scientific research related to that business (except to the extent that it is expenditure on plant, machinery, land or buildings or on alterations, additions or extensions to buildings or in the acquisition of rights in or arising out of scientific research)."

The disallowance of contributions to the centre until November 1983

The Commissioner submitted that the contributions made in this period by the applicant to the centre were not allowable deductions under s 51(1) of the Act, both because the amounts in question did not fall within the positive limbs of that subsection, and because the payments in question were outgoings of capital or of a capital nature. It was submitted that the applicant had not commenced business or its income producing activity until the setting up of the premises in Slacks Creek, so that its pre-business expenditure was not deductible.

It was conceded that the payments were payments to an approved research institute for scientific research as those words are used within s 73A(1), but because the applicant was not at the relevant time carrying on a business for the purpose of gaining or producing assessable income, the provisions of s 73A(1) did not afford to it an allowable deduction.

The question of when a business or income producing activity commences, will often be one of difficulty, turning as it does on the facts of the particular case.

An intention to carry on a business will not determine that a business is in fact carried on: see *J & R O'Cain v IRC* (1922) 12 TC 303 per Lord Buckmaster. As that case pointed out: "The intention of a man cannot be considered as determining what it is that his acts amount to."

However, this is not to say that intention may be wholly irrelevant. So, in *Fairway Estates v FCT* (1970) 123 CLR 153; 1 ATR 726, Barwick CJ found the taxpayer's intention relevant to a determination that a particular transaction was not an isolated one but rather one intended to be repeated and thus as having constituted the first step in the money lending business there under consideration: see too the judgment of Lord Esher concurred in by Lopez and Kay LJJ in *Re Griffin; Ex parte the Board of Trade* (1890) 60 LJQB 235 at 237 quoted in *Fairway Estates* at (CLR) 165.

What constitutes a business has been the subject of much discussion in the cases. In this court, Bowen CJ and Franki J summarised the applicable principles in *Ferguson v FCT* (1979) 9 ATR 873; 37 FLR 310 at 314 as follows:

There are many elements to be considered. The nature of the activities, particularly whether they have the purpose of profit-making, may be important. However, an immediate purpose of profit-making in a particular income year does not appear to be essential. Certainly it may be held a person is carrying on business notwithstanding his profit is small or even where he is making a loss. Repetition and regularity of the activities is also important. However, every business has to begin and even isolated activities may in the circumstances be held to be the commencement of carrying on business. Again, organisation of activities in a business-like manner, the keeping of books, records and the use of system may all serve to indicate that a business is being carried on. The fact that, concurrently with the activities in question, the taxpayer carries on the practice of a profession or another business does not preclude a finding that his additional activities constitute the carrying on of a business. The volume of his operations and the amount of capital employed by him may be significant ... 22 ATR 36

The concept of business does not equate with being busy. The case of *FCT v Walker* (1984) 2 FCR 283; 15 ATR 847 in this court demonstrates that a business may be found to exist where the partnership there in question had contracted with another for the production of trading stock in circumstances where the partnerships in question had an intention to continue thereafter to breed and sell cattle. In *Hope v Bathurst City Council* (1980) 144 CLR 1; 12 ATR 231, Mason J (at (CLR) 8-9), with whose reasons Gibbs, Stephen and Aickin JJ agreed, placed emphasis on the question whether the activities in question could be seen as a: "... commercial enterprise in the nature of a going concern, that is, activities engaged in for the purpose of profit on a continuous and repetitive basis."

His Honour suggested that for a business to be carried on the activities must possess something of a permanent character.

Critical to the resolution of the present controversy, is the characterisation of the business activity itself which is said to have commenced. It was conceded properly by the applicant that if the business claimed to be carried on by it was to be characterised as one of manufacturing and selling monoclonal antibody products, then that business did not commence until around November 1982 when the move to the Slacks Creek premises took place.

There are two English cases decided under war time legislation (*The Finance (No 2) Act* 1915 5 & 6 GEO 5 Ch 89), concerned with excess profits duty which suggest that in determining whether a taxpayer was carrying on a trade or business (whether continuously or not) pre-war over a relevant period, the point of time of commencement of the trade or business equates with the time of commencement of selling: see *The Birmingham and District Cattle By-Products Co Ltd v IRC* (1919) 12 TC 92 and *The Cannop Coal Co Ltd v IRC* (1918) 12 TC 32 . These cases somewhat depend upon the legislation with which they are concerned and are not, in my view, of great assistance, although *The Birmingham Cattle case* was cited with approval by Menhennitt J in *Softwood Pulp and Paper Ltd v FCT* (1976) 7 ATR 101; 76 ATC 4439 at 4451.

The last mentioned case was concerned with the familiar problem of expenditure on feasibility studies, although some of the items in question involved expenditure in testing of raw materials. The expenditure was held not to be deductible. Critical to the decision in that case was a finding that the taxpayer had not yet committed itself to the project nor made a final definitive decision to do so (see at (ATC) 4447). Hence the expenditure in question could not be said to be, in the words of Menzies J in *John Fairfax & Sons Pty Ltd v FCT* (1959) 101 CLR 30 at 49; 7 AITR 346: "part of the cost of trading operations".

The element of commitment to the income producing or business activity is emphasised as well in the decision of Davies J with whom St John J agreed in *Inglis v FCT* (1979) 10 ATR 493; 40 FLR 191 at 201 in the analogous context of determining whether there had been a cessation of a business in a period of quietude.

For the applicant it was submitted that the income producing activity or business activity in which the applicant was engaged in the relevant period, should be characterised as an activity of researching and developing monoclonal antibody products for manufacture and sale. The difficulty in the path of the applicant, however, is that during the relevant period the element of commitment was absent. The evidence, which I have summarised above, makes it clear that the applicant was engaging in activities of a provisional kind only. It is true that it was contemplated that, if the research work funded by the Institute proved successful, there would be products to market and that it was hoped (and this hope was reflected in the initial budget with Dr Watson's proposal) that sales could be embarked upon at an early 22 ATR 37 time. However, the funding of the centre in which research was to be carried on, was directed at research into such products as the work of the centre might show to be commercially viable. It was research, to quote the proposal of 7 July 1981, "from which a defined range of marketable products will emanate". In fact, the July proposal identified two products, that concerned with brucella abortus and that concerned with campylobacter foetus which, in fact, were never marketed at all by the applicant in the period in which it was concerned with monoclonal antibodies.

The activity in which the applicant was engaged through until November 1982, can only be described as an activity of funding a research project in which it was an essential collaborator, both as to the provision of funds and as to serving on the management committee. Notwithstanding that the applicant accounted for this activity as a separate division, it is not possible, in my view, to characterise the activity as a business, or for that matter, as an activity of gaining or producing assessable income so as to fall within the first limb of s 51(1). It follows accordingly, that it is unnecessary to determine whether the expenditure in question is of a capital nature, although in my view this would the expenditure in question is of a capital nature, although in my view this would follow because the applicant was not carrying on a business in the area in which the research was carried being a business directed at gaining or producing assessable income. Its claim to a deduction under s 73A(1) must fail for the same reasons.

The expenditure after November 1982

For the applicant, primary reliance was placed on s 51(1) of the Act. It was submitted that, at least in the period from November 1982, the applicant was carrying on a business which included not only the manufacture and marketing of its heartworm product, but also research into and development of other products. For the Commissioner it was submitted broadly that each new product of a company such as the applicant engaged in manufacturing and marketing as well as regular research in the field of its activity, was to be seen separately. In the result, any work it did in researching or developing a new product for

manufacture and sale, notwithstanding that the product was in the same general area as that manufactured and sold by it, involved it in expenditure of a capital nature. If the submission were taken to its extreme, no deduction at all would be available (unless it fell within s 73A(1)) to a pharmaceutical company engaged extensively in research and development for the purpose of marketing new products or making improvements to existing products.

An alternative submission was that the taxpayer had not satisfied the burden of proof of showing that the expenditure incurred by it was not of a capital nature. Reference was made in particular to the time devoted by Dr Watson to a patent infringement matter. It was submitted that I should not accept Dr Watson's evidence, to the effect that his involvement in the litigation surrounding an alleged infringement of the patent was only 40 hours in internal discussions and approximately 10 days in Brisbane and Sydney involving discussions with patent attorneys. It was said that this evidence was inherently improbable.

I accept Dr Watson's evidence of the times he spent. Even if it be accepted that that evidence involves the disallowance of a small amount of the expenditure representing his salary for the relevant period as being of a capital nature, it does not involve the result that the applicant has failed to satisfy the burden of proof in respect of the balance of the expenditure which concerns inter alia salaries of staff at the Slacks Creek premises, costs of overseas visits including living expenses of Dr Bundesen and Dr Watson, motor vehicle expenses for vehicles provided to Dr Bundesen, Dr Watson and Dr Rylatt, as well as commercial vehicles at the Slacks 22 ATR 38 Creek premises and in the 1984 and 1985 year a further motor vehicle for use of office staff, subscriptions to technical journals, cleaning of the Slacks Creek premises and travel expenses of outside consultants as well as transportation of trial material by courier services and entertainment of overseas visitors to the company's operation. Nor does it suggest that laboratory supplies and consumables or expenditure on computer systems must necessarily be disallowed.

It is true that the applicant's evidence as to the types of expenditure in question is not as full and detailed as it might wish to be. In part, this is because of the death of the accountant who summarised the expenses into various categories. It is not in dispute that the amounts in question were expended and the evidence satisfies me that the expenditure was of the kinds which I have already outlined.

A further submission of the Commissioner, was that some part, unidentified in quantum of the expenditure, related to the development of markets and that such expenditure, even by a company carrying on business, was of a capital nature. It is always useful to return to the classic tests of Sir Owen Dixon in *Sun Newspapers Ltd and Associated Newspapers Ltd v FCT* (1938) 61 CLR 337 at 359-63; 1 AITR 353, 403. It will be recalled that in that judgment, his Honour pointed out that the distinction between expenditure and outgoings on revenue account and on capital accounts (at (CLR) 359):

corresponds with the distinction between the business entity, structure, or organisation set up or established for the earning of profit and the process by which an organisation operates to obtain regular returns by means of regular outlay, the difference between the outlay and returns representing profit or loss.

Thus, expenditure upon establishing, replacing and enlarging the "profit-yielding subject" was of a capital nature and it differed from the continual flow of working expenses which involved outlays of a revenue nature.

His Honour distinguished between widespread advertising campaigns conducted at the beginning of a patent medicine business, carried out upon a scale not intended to be maintained or repeated, and outlays over a period of time by continual advertisement which were on revenue account, notwithstanding that such outlays involved the building up of goodwill.

In the classic passage (at (CLR) 363) his Honour said:

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

So far as the outlays involved in developing markets are concerned, in my view the evidence did not establish that these outlays were analogous to the outlays on an initial widespread advertising campaign not intended to be maintained or repeated, but rather were such as to form part of the recurring outlays

necessary for the applicant to carry on the business which it did carry on in a field of high technology.

The judgment in the *Sun Newspaper case* makes it clear that it is necessary to consider carefully the nature of the business which is carried on, so as to be able to distinguish between recurrent expenditure, that is to say "expenditure which is made to meet a continuous demand" (per Rowlatt J in *Ounsworth v Vickers Ltd* [1915] 3 KB 267 at 273) and that expenditure which is made once and for all. A pharmaceutical company, the business of which includes continuing research and 22 ATR 39 development as part of the continuous or constant demand for expenditure in its business, does not each time that expenditure is incurred make an outlay of capital or of a capital nature. Its business, when properly analysed, includes its research and development, at least in the ordinary case. No doubt, there are matters of degree involved, and in a particular case the research and development may be concentrated on a product so far removed from the day to day products of the taxpayer, that the expenditure cannot be properly seen as part of its working expenditure.

Counsel for the applicant relied heavily upon the decision of the full court of this court in *FCT v Ampol Exploration Ltd* (1986) 13 FCR 545; 69 ALR 289. In that case, it was held that the taxpayer, the exploration arm of the Ampol Group, was carrying on a business of exploring for petroleum and the expenditure it incurred in its China venture was held to have been necessarily incurred in the carrying on of that business and as not being of a capital nature. As Lockhart J said (at (FCR) 562):

The true legal character of the expenditure was that of the ordinary business activity of the taxpayer as a petroleum exploration company ... It was recurrent and in the nature of operating expenses of the taxpayer's prospecting and exploration business.

See too per Beaumont J (at (FCR) 570) and per Burchett J (at (FCR) 574-7).

By analogy it was said that where a company such as the applicant here is engaged in an activity where research and development forms part of its activity, part of the constant demand upon the enterprise, then expenditure on research and development is on revenue account.

Research and development expenditure does differ somewhat from the exploration expenditure involved in the *Ampol* case. In general terms, one difference that is of significance is that the expenditure in *Ampol* was not expenditure directed towards the obtaining of rights of an enduring kind. On the peculiar facts of that case, the expenditure was directed merely at obtaining the right to negotiate, that not being a right of a proprietary kind. Research and development may, in a particular case, be directed towards obtaining patentable rights which can be seen as of an enduring kind and may, for that reason, be of a capital nature. It was not suggested here by counsel for the Commissioner that the applicant's expenditure was directed towards the obtaining of patent rights nor was this even put to any witness.

The cases, however, do make it clear that the outcome of expenditure, that is to say, whether in fact property rights are ultimately obtained, will not be determinative. What is required, as Dixon J observed in *Hallstroms Pty Ltd v FCT* (1946) 72 CLR 634 at 648; 3 AITR 436 depends upon:

what the expenditure is calculated to effect from a practical and business point of view, rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process.

In the same case his Honour summarised the principles applicable to a determination of when expenditure is on capital or revenue account in the following words (at (CLR) 647):

the contrast between the two forms of expenditure corresponds to the distinction between the acquisition of the means of production and the use of them; between establishing or extending a business organisation and carrying on the business; between the implements employed in work and the regular performance of the work in which they are employed; between an enterprise itself and the sustained effort of those engaged in it.

There is, in my opinion, much to be said for the view that the whole of the expenditure in issue in the present case, except perhaps so much of it as concerned 22 ATR 40 the salary of Dr Watson, in the time he was involved in the patent dispute, was expenditure on revenue account rather than on capital account. A company engaged in an enterprise involving new technology such as the applicant, where the nature of its activity requires as part of its business ongoing research into product development incurs expenditure which is recurrent, expenditure which is part of the regular cost of its trading operations. That expenditure is, to adopt the words of Dixon J in *Sun Newspapers*, part of the process by which the

organisation (being an organisation where research is part of its business activity) operates to obtain regular returns by means of regular outlays.

It is interesting to note that in a survey of the tax treatment of research and development expenses prepared by the KPMG International Tax Centre for the International Bureau of Fiscal Documentation, [Tax Treatment of Research and Development Expenses Netherlands, 1990] the authors, in discussing the position in Australia comment (at p 5):

"In general, before the introduction of the concession (ie s 73A), the only companies clearly entitled to deduct research and development expenditure which did not fall within the scientific research provision, were those companies whose business was dealing in research and development. Where a company is not dealing in research and development, but is, for instance, a manufacturer and is creating new technology, expenditure in creating that technology may be capital in nature (except perhaps where research and development does not create a permanent or significant asset, but is keeping up to date with competitors in an industry where the pace of change is so rapid that new technology quickly becomes obsolete). Nevertheless, in Australia the distinction between capital and recurrent expenditure is now less clear than it was. Consequently, the deductibility or non-deductibility of research and development expenditure for companies not dealing in technology is an open question."

Some of the items in question in the present appeal, on any view, fall within s 51(1). Some of the expenditure was concerned with the manufacture and sale of existing products or the carrying out of services for veterinarians in relation to those products. Expenditure on subscriptions to technical journals, cleaning expenses of the premises and entertainment of overseas visitors would also seem to fall within s 51(1). Other items, however, might admit of apportionment. Some of the salaries no doubt might be said to relate to the business of manufacturing and selling of existing products, but in part be referable to what may loosely be described as "research and development activities".

I do not believe, however, that it is necessary in the present case to decide whether the research and development component of apportionable expenditure is of a capital nature and not deductible under s 51 (1) of the Act, for I am of the view that to the extent to which outgoings here were of a capital nature, they are deductible under s 73A of the Act.

The Commissioner urged upon me a narrow construction of s 73A. I do not think, however, that that section should be given a narrow construction. The evident purpose of s 73A was to grant a concession to taxpayers in cases where expenditure was not otherwise deductible, for example, if it was of a capital nature. To qualify, the expenditure must be for scientific research, whether that expenditure is made to an approved research institute (s 73A(1)(a)) or is expenditure incurred by the taxpayer itself on scientific research. There must also be the necessary relationship between the research and the taxpayer's business. In (1972) 18 CTBR(NS) *Case 51*; *Case D81* 72 ATC 480, Mr O'Neill, then of the Taxation Board of Review No 1, with whose reasons Mr Burke (the Chairman) agreed, said (at (ATC) 491): **22 ATR 41** The primary purpose of the section may be described as the purpose of offering encouragement for the initiation and expansion of scientific research in industry etc by conceding an allowable deduction in respect of what would otherwise be non-deductible expenditure incurred by a person carrying on business for the gaining of assessable income. It is mainly concerned to encourage the establishment and use of facilities for research directly undertaken by or on behalf of the taxpayer: the expenditure must be incurred by a person carrying on a business for the purpose of gaining assessable income and the scientific research must be "related to that business". ... Broadly then the section aims at encouraging "in company" research or at least "contract" research related to the taxpayer's particular business.

By giving this concession, parliament has sought to encourage research and development activities. As the publication Tax Treatment of Research and Development Expenses, to which I have already referred, points out in the foreword:

"Given the current internationalisation of the marketplace, it is generally in the best interests of a country that it should encourage, and even stimulate, research and development activities among companies and universities. The tax laws of most countries, if applied in a pedantic fashion, would actually discourage research and development activities ... Most countries, however, recognising the folly of such a strict approach to taxation, now permit a current deduction for research and development activities."

The first submission of the Commissioner was that the work carried out by the applicant in the relevant period was not "scientific research" as that expression is defined in s 73A(6) as meaning: "Any activities in the fields of natural or applied science for the extension of knowledge."

The definition of "scientific research" follows closely the terms of legislation enacted in 1946 in the United Kingdom: see *Income Tax Act 1952* (UK) s 340. Similar provisions were enacted in the same year in Canada, South Africa and India as well as Australia.

It should perhaps also be noted that subs (8) of s 73A provides that:

"any reference to scientific research related to a business or class of business shall be read as including a reference to -

(I) any scientific research which may lead to or facilitate an extension, or an improvement in the technical efficiency, of that business, or, as the case may be, of businesses of that class, ..."

For the Commissioner it was submitted that the activities carried on at the Slacks Creek premises were, or included, merely practical matters involving improvements in the technical efficiency of the products already arrived at as a result of the research conducted by the Queensland Institute of Technology. It was said that the activities involved no more than bringing the proposed products into marketable form. Particular reference was made to evidence concerning the heartworm detection kits which had a propensity to leak.

The evidence showed that one of those products, Dirokit, would not work because the antibodies could not be attached to what was described in evidence as an "EIA well plate" in a stable and regular fashion so as to get reproducible results. This arose, apparently, because of a lack of uniformity in the plates which were imported from overseas. A similar problem occurred with the Dirostic product which would not work because of difficulties in attaching the antibodies to a dip-stick in a stable and regular fashion. Despite the devotion of considerable time and energy to achieving this object, no success was achieved. In the case of the Dirokit product, there was difficulty in binding the antibody in a stable and regular manner to the 22 ATR 42 delivery system plastic, either the plate or the stick. Work was carried out to adapt a system already used for human testing for the heartworm testing.

In a supplementary statement in evidence, Dr Watson referred to the general problem for the propensity for the heartworm kits to leak in the following terms:

"The problem is that under negative pressure (such as in an aeroplane hold) the liquid boils and escapes through the screw of a cap. Accordingly, under my supervision, Jenkins and the technicians, approached numerous suppliers with alternative storage containers. We then experimented over a considerable period of time with the various forms of containers by sending them to Perth and back by aeroplane with a view to testing the results. We found that it wasn't only negative pressure. Another factor which caused problems was engine vibration and electrical discharges which blew the antibody off the plastic. We engaged in experimentation at Slacks Creek with a view to endeavouring to overcome those problems. Each time the kit was changed, it was necessary to test again the new format to ensure that the physical properties of the package and kit were not interfering with the efficiency of the antibody."

As the definition of scientific research makes clear, for an activity to be scientific research it must be an activity in the field of applied science for the extension of knowledge. It was not suggested that extension of knowledge was not involved, for the problems faced were in an area of new technology and the solutions unknown. What was involved was the obtaining of new knowledge. However, it was submitted that the activity was not in the field of "applied science". Applied science is not a term defined in the legislation. It has its ordinary meaning of putting scientific discovery to practical use. As Mr O'Neill observed in *Case 51; Case D81* (supra at 494) in a passage which I would adopt:

Applied science is the practical application of science directed to a solution of practical problems in industry and commerce.

The devising of ways to put the technology involved in monoclonal antibodies to practical use does not stop upon the discovery of a monoclonal antibody and its reproduction. But the monoclonal antibody is still in a form where it cannot be put to practical use for commercial purposes. The research extends, in my view, to the stage where there is a practical product that is able to be produced.

The carrying on of clinical trials, another activity undertaken by the applicant at the Centre, is likewise, in my view, within the ambit of scientific research. So too, was experimentation with latex with a view to devising a means which produce regularly-reproducible results as a preliminary to commercial

manufacture.

As already indicated, a deal of the expenditure was concerned with activities which were clearly not scientific research. For example, activities of manufacture and production or of analysing veterinary samples for heartworm would not fall within the expression, but such expenses, were on any view clearly deductible under s 51(1). Likewise, periodical expenditure on promotional displays for conferences would be an allowable deduction under s 51(1) and not constitute scientific research.

The next submission, albeit perhaps encouraged by comments from the bench, was that all that was deductible under s 73A was expenditure on scientific research, that is to say expenditure which is directly on such research. Some of the expenditure, for example, expenditure on cleaning the premises to the extent to which not otherwise deductible under s 51(1), leasing expenditure on cars for employees working on the Centre by way of example, might not be able to be said to be expenditure on research, for the amounts lacked a direct relationship with the actual research itself. 22 ATR 43

The section cannot, however, be given such a narrow interpretation. If such an interpretation were taken to its extreme, it would entirely negate the provisions of s 73A(1)(b) of the Act. In one sense, expenditure on the salary of a person conducting research is not itself expenditure on research, yet it clearly falls within the section. Once this is accepted, there is no reason to doubt that leasing expenditure on a car provided for the use of that employee cannot also qualify as expenditure on research. So too the cleaning expenditure of a research facility, as well as expenditure on equipment, will fall for deduction under the section, if not otherwise deductible.

It follows, in my view, that the totality of the expenditure of the Mabco Division, except perhaps for the salary of Dr Watson in relation to the patent matter, was deductible either under s 51(1) or s 73A, and it is unnecessary to distinguish under which heading the various amounts are deductible.

As regards the salary of Dr Watson during the time in which he was devoted to the patent matter, there seems to me to be something totally unreal about apportioning his salary, which is itself part of the ordinary recurrent expenditure of the appellant, so that the time he spends, as an employee, in conferences concerning a patent infringement matter, take upon themselves the character of capital. No doubt the Act directs that an apportionment be made between expenditure on revenue account and expenditure on capital account just as an apportionment must be made between expenditure incurred in gaining or producing assessable income and that incurred in gaining or producing exempt income; cf *Ronpibon Tin NL NL & Tongkah Compound NL v FCT* (1949) 78 CLR 47 at 60; 54 AITR 236. A similar argument was raised in the case of *Lister Blaxtone Pty Ltd v The Commissioner of Taxation* (1976) 134 CLR 457; 6 ATR 499. That case concerned the cost of removal of trading stock to new premises. Part of the expenditure in question consisted of outgoings on wages, that expenditure being of a kind that normally is of an income character. Having reached the conclusion that the expenditure in any event was on revenue account, the court found it unnecessary to deal with the subsidiary argument of the taxpayer that in any event the expenditure on wages were on revenue account, notwithstanding that during some period of ordinary employment they were engaged on activities which looked at on their own were on capital account.

I am aware of no case where the problem has been squarely addressed, nor has counsel referred me to any. In the United Kingdom the learned authors of *Simons Taxes* (Butterworths, 1983) advert (at B3 1424) to the problem and remark that the Revenue does not normally seek to deny a deduction on this basis. Reference is made to *Robinson v Scott Bader Co Ltd* [1981] 1 WLR 1135, but perusal of that case does not reveal any discussion of principle on the issue and on one view of the matter, it did not arise in that case. There is a question of fact and degree involved. Where a person is employed for the specific purpose of carrying out an affair of capital, the mere fact that that person is remunerated by a form of periodical outgoing would not make the salary or wages on revenue account. On the other hand, where an employee is employed and engaged in activities which are part of the recurring business of a company, the fact that he may, on a particular day, be engaged in an activity which viewed alone would be of a capital kind, does not operate to convert the periodical outgoing for salary and wages into an outgoing of a capital nature. In between, there will be cases where it may be difficult to determine whether the expenditure should properly be regarded as on capital account or as on revenue account. Each case will depend upon its facts but the answer will not be derived merely by counting the number of hours in which the employee is engaged in activities which themselves may be said to involve matters of capital. Further, it will 22 ATR 44 be necessary to determine whether the essential character of the expenditure is that it is a working expense. If it is, then it will ordinarily be on revenue account. In the present circumstances, however, I think that the salary of Dr Watson can be seen to be clearly part of the recurring outgoings of the company on its business activities. The fact that he spent some time dealing with patent attorneys does not, in my view, convert that expenditure to expenditure of a capital nature.

Accordingly, I would allow the appeals in respect of the years of income ended 30 June 1983, 1984 and 1985 and order that the assessments in respect of those years be remitted to the Commissioner for amendment in accordance with these reasons.

As each party has been partially successful, I make no order as to the costs of the application.

FAY G SMITH