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to a charge. I concur in his view that those cases do not apply. Whether they are a correct application of the law or not does not concern us at present.

I agree in the judgment that the appeal should be dismissed.

STARKE J. I agree that the appeal should be dismissed.

*Appeal dismissed with costs.*

Solicitors for the appellants, *Symon, Browne & Symon.*

Solicitors for the respondents, *Isbister, Hayward, Magarey & Finlayson*; *McLachlan & Reed*, for *Spehr & Mackenzie*, Mount Gambier.

B. L.

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[HIGH COURT OF AUSTRALIA.]

THE ALLIANCE ASSURANCE COMPANY LIMITED . . . . . APPELLANT;

AND

THE FEDERAL COMMISSIONER OF TAXATION . . . . . RESPONDENT.

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SYDNEY, *Aug.* 12, 25.

KNOX C.J., Higgins, Gavan Duffy, Rich and Starke JJ.

*Income Tax—Assessment—Deductions—Outgoings—Insurance company—Premiums for reinsurance—Payment made outside Australia—"Proceeds of any business," meaning of—Income Tax Assessment Acts* 1915 (*Nos.* 34 *and* 47 *of* 1915), *secs.* 3, 10, 18.

By sec. 18 (1) of the *Income Tax Assessment Acts* 1915 it is provided that "in calculating the taxable income of a taxpayer the total income derived by the taxpayer from all sources in Australia shall be taken as a basis, and from it there shall be deducted (*a*) all losses and outgoings, not being in the nature of losses and outgoings of capital, including commission, discount, travelling expenses, interest, and expenses actually incurred in Australia in gaining or producing the gross income."

*Held*, that the words "losses and outgoings" are not qualified by the words "incurred in Australia in gaining or producing the gross income," and that those latter words refer either to the word "expenses" only, or at most to the words "commission, discount, travelling expenses, interest and expenses."

*Held*, therefore, that premiums paid by an insurance company carrying on business in the Commonwealth to other insurance companies for the reinsurance of portions of the risks insured by it, such reinsurance being necessary in order that the company might successfully carry on its business of insurance, were "outgoings" within the meaning of sec. 18 (1) (*a*), and were therefore properly deducted from the gross income of the Company under that section in ascertaining its taxable income, notwithstanding that the reinsurance premiums were paid outside the Commonwealth under contracts made outside the Commonwealth to companies incorporated outside the Commonwealth.

In sec. 3 of the *Income Tax Assessment Acts* 1915 "income from personal exertion" is defined as meaning "income derived in Australia consisting of earnings, salary, . . . and the proceeds of any business carried on by the taxpayer either alone or as a partner with any other person."

*Quære, per Knox* C.J., *Gavan Duffy*, *Rich* and *Starke* JJ., whether the phrase "proceeds of any business" in that definition includes only such portion of the gross receipts in the business as the taxpayer gets for himself having regard to the manner in which the business is usually carried on, or means the gross receipts in the business not being receipts of capital.

CASE STATED.

On the hearing of an appeal to the High Court from an amended assessment of the Alliance Assurance Co. Ltd. for income tax for the year 1915-1916, *Higgins* J. stated a case for the Full Court which was substantially as follows:—

1. This is an appeal of the appellant Company from an amended assessment, marked D in the appeal, based on income derived by the Company during the year 1914-1915 and assessed as for 1915-1916.

2. The appellant Company was at all material times a company registered in England and subsequently registered in each State of the Commonwealth and carrying on therein the business of fire and marine insurance.

3. In order to carry on successfully the said business in the Commonwealth, and in particular in order to avoid the accumulation of risks which the said Company might not otherwise have been able

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to pay, it was at all material times necessary to reinsure portions of the risks accepted.

4. Portion of the said reinsurance was effected by means of contracts known as treaty contracts.

5. The said treaty contracts were made beyond the Commonwealth, and provided for the acceptance by the treaty reinsurance companies of portion of the said risks in consideration of the payment of certain reinsurance premiums by the appellant Company.

6. The portion of the said risks to be accepted as aforesaid was not determined until the said treaty contracts were actually "declared upon" in Australia for each specific risk, that is to say, until the risk was "ceded to" the reinsuring companies in the Australian books of the appellant Company.

7. The said treaty reinsurance companies were incorporated outside the Commonwealth, but were also registered and carried on business within the Commonwealth.

8. In the said exhibit D the sum of £13,679 represents the net sums paid to the treaty companies as for the year 1915-1916, being the proportion of the premiums due to the said companies for 1914-1915, less the commission payable by the said companies to the appellant Company in respect of the reinsurance premiums for 1914-1915 and less the proportion of the losses payable by the said companies to the appellant Company for 1914-1915.

The question for the opinion of the Court is whether the said appeal can, in law, be sustained in whole or in part.

The effect of the amended assessment (exhibit D) and of the treaty contracts, a specimen form of which was annexed to the case, is sufficiently stated in the case and in the judgments hereunder.

The grounds of the notice of objection, which was also annexed to the case, were that (1) the amount on which additional tax of £1,025 18s. 6d. is levied is not taxable income derived by this taxpayer from sources within Australia during the period covered by the assessment or at all; (2) in the alternative the said amount is a deduction specially authorized by law from the taxable income of this taxpayer; (3) the said amount is an outgoing not

being in the nature of an outgoing of capital actually incurred in Australia in gaining or producing the assessable income of this taxpayer; (4) the said amount represents sums paid to companies carrying on business in Australia as premiums for the reinsurance of risks accepted by this taxpayer in the ordinary course of this taxpayer's business; (5) if the said amount or any part thereof is taxable such tax is leviable only upon the respective persons to whom the premiums for reinsurance were paid.

*Leverrier* K.C. (with him *H. E. Manning*), for the appellant. The words "proceeds of any business" in the definition of income from personal exertion in sec. 3 of the *Income Tax Assessment Act* 1915 means the profits of the business ascertained in the ordinary way, and not the gross receipts of the business. If that is so, the reinsurance premiums are properly deducted from the gross receipts in order to ascertain the proceeds of the business. If the words "proceeds of any business" have not that meaning, they mean the proceeds which the taxpayer gets for himself, and therefore do not in this case include so much of the insurance premiums as are paid away as premiums for reinsurance. Immediately the appellant insures a risk to which the agreement for reinsurance applies, it receives the premium partly for itself and partly for the reinsuring company. In any event the reinsurance premiums are properly deducted under sec. 18 (1) (*a*) as being "outgoings," for the words "incurred in Australia in gaining or producing the gross income" do not qualify the words "losses and outgoings."

*Brissenden* K.C. (with him *Pitt*), for the respondent. The whole of the premiums received by the appellant are proceeds of its business of insurance. The business of reinsurance is a separate business carried on outside the Commonwealth in pursuance of the treaty contracts, and the premiums paid for reinsurance are payments made in carrying on that business. All that is done here is fixing the amount of the liability already undertaken in those contracts. The words "proceeds of any business" in the definition of income from personal exertion mean the gross receipts from the business. The whole of the premiums received by the appellant are proceeds

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of its business, and *primâ facie* are liable to income tax. The reinsurance premiums cannot be deducted under sec. 18 (1) (*a*), because they were not incurred in Australia. The intention of the Legislature is that the words "incurred in Australia in gaining or producing the gross income" should qualify the word "outgoings." In order that payments should be outgoings they must be incurred in the production of income (*Russell* v. *Town and County Bank* (1); *Usher's Wiltshire Brewery* v. *Bruce* (2); *Smith* v. *Lion Brewery Co.* (3); *Moffatt* v. *Webb* (4)). Here the reinsurance premiums were not incurred in the production of the appellant's income, but were an expenditure of that income after it was earned.

*Cur. adv. vult.*

Aug 25.

The following written judgments were delivered :—

KNOX C.J., GAVAN DUFFY, RICH AND STARKE JJ. The question submitted by the special case is whether the appeal against the amended assessment of the appellant to income tax for the year 1915-1916 can in law be sustained in whole or in part. The effect of the amended assessment was to increase the amount of tax by £1,025 18s. 6d. by the inclusion in the income of a sum of £24,356 in respect of premiums alleged to have been received by the a pellant subject to a deduction therefrom of £6,089 in respect of commission which had been taken into account in the original assessment and of £4,588 representing losses paid on the risks covered by the premiums in question. The net addition to the taxable income of the appellant was thus reduced to £13,679. The circumstances under which the sum of £24,356 was received by the appellant, and the manner in which that sum was dealt with, are stated in the special case, and need not be repeated. The case also states "In order to carry on successfully the said business in the Commonwealth, and in particular in order to avoid the accumulation of risks which the said Company might not otherwise have been able to pay, it was at all material times necessary to reinsure portions of the risks accepted." By sec. 10 (1) of the *Income Tax Assessment Act* 1915

(1) 13 App. Cas., 418, at p. 425.
(2) (1915) A.C., 433.
(3) (1911) A.C., 150, at p. 159.
(4) 16 C.L.R., 120, at pp. 127, 133.

it is enacted that "subject to the provisions of this Act, income tax shall be levied and paid in and for each financial year upon the taxable income derived directly or indirectly by every taxpayer from sources within Australia during the period of twelve months ending on the thirtieth day of June preceding the financial year in and for which the tax is payable." By sec. 3 "taxable income" is defined as meaning "the amount of income remaining after all deductions allowed by this Act have been made." By the same section "income from personal exertion" is defined as meaning "income derived in Australia consisting of earnings, salary, . . . and the proceeds of any business carried on by the taxpayer either alone or as a partner with any other person." By sec. 18 (1) it is enacted that "in calculating the taxable income of a taxpayer the total income derived by the taxpayer from all sources in Australia shall be taken as a basis, and from it there shall be deducted (*a*) all losses and outgoings, not being in the nature of losses and outgoings of capital, including commission, discount, travelling expenses, interest, and expenses actually incurred in Australia in gaining or producing the gross income."

It was argued for the appellant that the phrase "proceeds of any business" in the definition of income from personal exertion contained in sec. 3 includes only such portion of the gross receipts in the business as the taxpayer gets for himself, having regard to the manner in which the business is usually carried on, and that in substance the appellant did not receive for itself any portion of the £13,679. It was further argued that, if this contention failed, the appellant was entitled, by virtue of sec. 18 (1) (*a*), to deduct all amounts paid by way of reinsurance premiums as "losses or outgoings, not being in the nature of losses or outgoings of capital," and that, if the section on its true construction confined the deduction to losses and outgoings incurred in Australia, these were so incurred.

For the Commissioner it was argued that the phrase "proceeds of any business" means the gross receipts in that business not being receipts of capital, and that the only deductions to be made from the amount of such total receipts in arriving at the taxable income of a taxpayer were (*a*) amounts representing income declared by

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the Act to be exempt from taxation and (*b*) deductions specifically authorized by the Act, and it was contended that the deductions authorized by sec. 18 (1) (*a*) were limited to outgoings incurred in Australia in the production of the income.

We do not propose to express any opinion on the first question raised by the appellant, a decision on that point being rendered unnecessary by the conclusion at which we have arrived as to the true construction of sec. 18 (1) (*a*). In our opinion the words "all losses and outgoings," which occur at the beginning of sub-clause (*a*), extend to all losses and outgoings of the business not being in the nature of losses and outgoings of capital and are not qualified by the words "incurred in Australia in gaining or producing the gross income." We think these latter words refer either to the word "expenses" only, or at most to the words "commission, discount, travelling expenses, interest, and expenses." In our opinion this is the natural grammatical construction of the words used. Moreover, the construction contended for by the Commissioner would lead to the result that the cost of goods purchased and paid for in England and afterwards sold in the carrying on of a business in Australia could not be allowed as a deduction from the proceeds of sale in arriving at the taxable income of the taxpayer. We can find nothing in the Act which would justify us in imputing to Parliament an intention to legislate to this effect.

Having regard to the statement in the special case that these reinsurances were necessary in order to carry on successfully the business of the appellant in the Commonwealth, we are of opinion that the appellant was entitled to deduct from its total income the amount of the reinsurance premiums in question.

The question submitted by the special case should be answered: Yes, in whole.

HIGGINS J. This is a case stated on an appeal from an amended assessment for 1915-1916, based on income derived by the Company during the year 1914-1915.

The question has to be decided on the *Income Tax Assessment Act* 1915 as amended by the Act No. 47 of 1915. There have been certain subsequent amendments (Acts No. 31 of 1916, No. 39 of

1916 and No. 18 of 1918); and some of these amendments apply to the Principal Act as from its date (see Act No. 39 of 1916, sec. 19; Act No. 18 of 1918, sec. 48), but it is not contended that any of the amendments which so apply affect the assessment now in question.

The Alliance Company is an English company; but it carries on the business of fire and marine insurance in Australia, and is registered in each of the States. Under "treaty contracts" with certain other British insurance companies the Alliance Company undertakes to cede to a company (which I shall call B company), and company B agrees to accept, one-fifth share of certain risks arising out of insurances effected. The liability of B company commences on the day on which the entry of the cession is made in the records of the Alliance Company or of any of its branches. The rates of premiums to be paid to B company are the same as those received by the Alliance Company after deduction of brokerage or other commission. The Alliance Company in England furnishes particulars of all such cessions to B company, and advises B company of any estimates of losses. B company's share of any losses is either remitted to the Alliance Company or is paid on adjustment of accounts. Quarterly accounts are rendered. B company pays to the Alliance Company a commission of 25 per cent. on the net premiums received.

Substantially, the Alliance Company by this arrangement protects itself from any huge loss on any one adventure. As Antonio says, in the "Merchant of Venice":—

> "My ventures are not in one bottom trusted,
> "Nor to one place; nor is my whole estate
> "Upon the fortune of this present year."

By paying over to the treaty companies four-fifths of the net premiums, the Alliance Company relieves itself of four-fifths of any loss within the cession. This is a good business; and, as admitted in the case, the practice was necessary in order to successfully carry on the business. Without the payment of the aliquot part of the net premium, the Alliance Company could not get the advantage of what is called in the case "reinsurance"—could not be indemnified against the corresponding aliquot part of the risk.

During the year 1914 it would appear that the share of the premiums payable by the Alliance Company to the treaty companies

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was £24,356; but from this sum the treaty companies had to be debited with commission and losses to the amount of £10,677. This left £13,679 as the actual payments of the Alliance Company to the treaty companies in respect of these risks, and the Company treated this sum as expenditure incurred in producing its income. The Commissioner, by his amended assessment, refuses to treat this sum as an outgoing that is to be allowed in ascertaining the taxable income; and, adding the amount to £747 admitted net income of the Alliance Company derived in Australia, he claims £1,081 19s. as being the income tax due by the Company instead of £56 0s. 6d., the tax actually paid on the £747. The question really is: Is the Alliance Company to be treated as deriving from Australia a net income of £14,426, although of this sum no less than £13,679 was paid to the treaty companies, and for value received? Does the *Income Tax Assessment Act* justify the Commissioner?

Under sec. 10 of the Act income tax is to be levied for each financial year upon the "taxable income" derived by the taxpayer from sources within Australia during the previous year. "Taxable income" means the amount of income remaining after all deductions allowed by the Act have been made (sec. 3). In calculating the taxable income the *total* income is to be taken as a basis, and from it certain deductions are allowed (sec. 18; also secs. 16, 27, &c.). By the "total income" I take it that the "gross income" is meant—that which "comes in" to the taxpayer irrespective of the taxpayer's necessary expenditure for stock, materials, wages, &c. Now, under sec. 18, the first deductions allowed are "all losses and outgoings, not being in the nature of losses and outgoings of capital, including commission, discount, travelling expenses, interest, and expenses actually incurred in Australia in gaining or producing the gross income." It is urged for the Commissioner that these expenses incurred under the treaty contracts were not "actually incurred in Australia," as the treaty contracts were made in England, and the payments were made in England by the head office of the Alliance Company to the treaty companies. In my opinion, the words "actually incurred in Australia" do not qualify or limit the words "all losses and outgoings," but only the words "commission, discount, travelling expenses, interest, and expenses," or it may be

(it is not necessary to decide this point) the final word "expenses" only. *All* losses and outgoings (of the business) are to be deducted; but the following words make it clear that these include outgoings in the nature of commission, &c. This is the plain grammatical construction; and if we depart from the grammatical construction, if no outgoings not "incurred in Australia" are to be allowed as deductions, the absurdity would follow that a tailor or a draper would not be allowed a deduction for the cost of the tweeds which he buys in England and imports for his Australian customers. There is nothing in the Act to justify such a deduction unless sec. 18 (1) (*a*) justifies it. The draughtsman of the Act probably treated such an outgoing as an obvious "outgoing" to be allowed; but to show that the deductions are not to be confined to such outgoings, he expressly includes "commission, discount, travelling expenses, interest, and expenses actually incurred in Australia in gaining or producing the gross income." If a tailor can charge the price of the tweeds which he imports as an outgoing, the insurance company can, in my opinion, charge the price of laying off or reinsuring its risks; and, *e converso*, the income derived by the treaty company from the same Australian risk is made, by sec. 17A of the Act, income of the treaty company for the purposes of the tax.

I am, therefore, of opinion that, on the facts stated in the case, the full sum of £13,679 should be treated as "outgoings" of the Alliance Company, and be deducted from the gross receipts or gross "income" of the Company. Several cases have been referred to by Dr. *Brissenden* for the Commissioner; but they were not decided on this Commonwealth Act. In *Moffatt* v. *Webb* (1) a question arose under a Victorian Act as to the allowance of a deduction for Federal land tax paid by a grazier in respect of his land used for his business; and it was held that the tax was "actually incurred in Victoria in production of income," and should be allowed as a deduction. The words in the Victorian Act were "all losses and outgoings *actually incurred in Victoria by any taxpayer in production of income*." But, in my view, the words italicized do not apply in sec. 18 of the Commonwealth Act to the words "losses and

(1) 16 C.L.R, 120.

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outgoings" at all. I base my decision on the distinctive language of sec. 18 (1) (*a*). If, however, in this section the Alliance Company had to rely on the words "actually incurred in Australia," if it had to show that the payments made in England by the head office of the Alliance Company to the treaty companies in pursuance of the treaty contracts made in England were "actually incurred in Australia," I am not prepared to say that the Alliance Company would succeed. The relevant meaning of the word "incur," according to the Oxford Dictionary, is "to become through one's own action liable or subject to." It is true that the portion of the risks to be accepted was not determined until each specific risk was ceded to the treaty company in the Australian books of the Alliance Company (par. 6 of case); but the ceding of the risk in a defined proportion was made obligatory by the treaty contract on the Alliance Company and on the treaty company. The risk was, of course, incurred in Australia; but the *expense* of the payments made to the treaty companies may have to be treated as incurred in England.

*Question answered*: *Yes, in whole.*

Solicitors for the appellant, *Norton Smith & Co.*

Solicitor for the respondent, *Gordon H. Castle*, Crown Solicitor for the Commonwealth.

B. L.