[HIGH COURT OF AUSTRALIA.]

UNION THEATRES LIMITED . . . . APPELLANT;
DEFENDANT,

AND

MARRICKVILLE BUILDINGS LIMITED . RESPONDENT.
PLAINTIFF,

ON APPEAL FROM THE SUPREME COURT OF NEW SOUTH WALES.

H. C. OF A. 1924.

SYDNEY, *Mar.* 25; *Aug.* 4.

Knox C.J., Isaacs, Gavan Duffy, Rich and Starke JJ.

Landlord and Tenant—Lease—Covenant by lessee to pay taxes—Whether income tax a tax on or in respect of rent—Measure of lessee's liability—Income Tax Act 1911 (*N.S.W.*) (*No.* 24 *of* 1911), *secs.* 8, 9, 10—*Income Tax* (*Management*) *Act* 1912 (*N.S.W.*) (*No.* 11 *of* 1912)—*Income Tax* (*Amendment*) *Act* 1914 (*N.S.W.*) (*No.* 8 *of* 1914)—*Income Tax Management* (*Amendment*) *Act* 1922 (*N.S.W.*) (*No.* 22 *of* 1922).

By a lease the lessee covenanted to pay all taxes, whether imposed by the Parliament of the Commonwealth or of the State of New South Wales, which were then or might thereafter be "assessed charged or imposed upon the demised premises or upon the rent thereof or on the owner occupier or lessee in respect thereof" except Federal land tax. In an action by the lessor against the lessee for breach of the covenant the lessor alleged in the declaration that income tax had been duly assessed, charged and imposed by the taxation authorities of New South Wales upon the lessor as owner of the premises in respect of the rent thereof received by the lessor, that the lessor had been compelled by law to pay the said tax and had duly demanded payment by the lessee of the amount so paid, and that all times had elapsed, &c., to entitle the lessor to the performance by the lessee of the covenant, yet the lessee repudiated any obligation in respect thereof. A demurrer to the declaration having been overruled, on appeal to the High Court,

Held, by *Knox* C.J., *Isaacs* and *Rich* JJ. (*Gavan Duffy* and *Starke* JJ. dissenting), that the demurrer was properly overruled:

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By *Knox* C.J., on the ground that in the phrase "on the owner in respect thereof" the word "thereof" meant "of the premises or the rent" and that the State income tax was a tax in respect of rent received by the lessor.

By *Isaacs* and *Rich* JJ., on the ground that the State income tax was a tax "upon the rent" within the meaning of the covenant.

Per Isaacs and *Rich* JJ.: The measure of the lessee's liability under the covenant was the amount of income tax which the lessor would have had to pay if the rent received from the lessee had been the lessor's only income.

Per Knox C.J.: The measure of that liability was the amount by which the income tax paid by the lessor was increased by reason of the receipt of the rent from the lessee.

Decision of the Supreme Court of New South Wales (Full Court): *Marrickville Buildings Ltd.* v. *Union Theatres Ltd.*, (1923) 23 S.R. (N.S.W.) 581, affirmed with a variation.

APPEAL from the Supreme Court of New South Wales.

An action was brought in the Supreme Court by Marrickville Buildings Ltd. against Union Theatres Ltd. in which by one count of the declaration it was alleged, so far as is material, as follows:—

"That by memorandum of lease under the provisions of the *Real Property Act* 1900 duly registered under the said Act made between the plaintiff and the defendant on 28th August 1922 the plaintiff leased to the defendant certain land therein described to be held by the defendant as tenant of the plaintiff for the term of twenty-one years from 22nd July 1921 upon certain terms and conditions therein contained and by the said memorandum of lease the defendant covenanted with the plaintiff as one of the said terms and conditions that the defendant did thereby for itself its successors and assigns covenant with the plaintiff its successors and assigns that the defendant would at all times during the continuance of the term thereby granted pay discharge and perform all rates taxes charges assessments duties and outgoings whatsoever whether imposed by the Parliament of the Commonwealth or of the State or by any municipal or local body or authority or of any other description which were then or might at any time thereafter be assessed charged or imposed upon the demised premises or upon the rent thereof or on the owner occupier or lessee in respect thereof except always Federal land tax . . . and the defendant was

the tenant of the plaintiff under the provisions of the said memorandum of lease at all times on and since the said 28th August 1922 and still is such tenant and by and under the provisions of the income tax legislation of the Parliament of the State of New South Wales in force in the said State income tax has been duly assessed charged and imposed by the taxation authorities acting under the provisions of the said legislation upon the plaintiff as owner of the said premises in respect of the rent thereof received by the plaintiff from the defendant under the provisions of the said memorandum of lease and the plaintiff has been forced and compelled by law to pay the said tax so assessed charged and imposed as aforesaid to the said authorities and the plaintiff has duly demanded payment by the defendant to the plaintiff of the amount of the said tax so assessed charged imposed and paid as aforesaid and all times elapsed and all conditions were fulfilled and all things happened necessary to entitle the plaintiff to the performance by the defendant of its said promises and to sue for the breaches thereof hereinafter alleged yet the defendant has neglected and refused and still neglects and refuses to pay the same or any part thereof to the plaintiff or to any other person or to make any provision whatsoever therefor and has repudiated and still repudiates any obligation to make any payment to any person in respect thereof or to make any provision therefor whereby the plaintiff has lost the said sum and otherwise been damnified."

The defendant demurred to this count of the declaration on the ground (*inter alia*) that the income tax assessed upon the plaintiff was not within the meaning of the covenant assessed, charged or imposed upon the demised premises or upon the rent thereof or on the owner, occupier or lessee in respect thereof.

The Full Court made an order " that the defendant's demurrer herein be and the same is hereby overruled and that judgment be entered herein for the plaintiff on the said demurrer " : *Marrickville Buildings Ltd.* v. *Union Theatres Ltd.* (1).

Ferguson J., in stating his reasons (with which *Campbell* J. and *Ralston* A.J. agreed), said (2) :—" The words of the covenant so

(1) (1923) 23 S.R. (N.S.W.) 581.
(2) (1923) 23 S.R. (N.S.W.), at pp. 583-584.

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far as they are material are that the defendant is to pay all taxes whatsoever imposed by the Parliament of the State which were then or might at any time hereafter be imposed upon the demised premises or upon the rent thereof or on the owner in respect thereof. The defendant contends that the income tax is not imposed on premises, that it is not imposed on rent, and that in so far as it is imposed on the person it is imposed upon him in respect of his whole income and cannot be treated as being imposed in respect of any item of his income. It seems to me however that where a man's income tax is increased by reason of the fact that he has received income from the rent of premises, then that may properly be described as income tax imposed upon him in respect of that rent, or at any rate that in reading a contract for repayment, it is a fair assumption that that is what the parties meant when they used that language. Then Mr. *Abrahams* contends that there is no covenant to pay a tax imposed upon the owner in respect of the rent, that the grammatical reading of that part of the covenant is that it refers only to taxes imposed upon the owner in respect of the premises, that the word 'thereof' in the phrase 'on the owner in respect thereof,' has the same meaning as the word 'thereof' in the phrase immediately before 'on the rent thereof'; that is to say that in both cases the reference is to the demised premises. But I think that the real meaning of the covenant is that whether the tax is imposed upon the premises or upon the rent, or upon the holder in respect of the premises or the rent, the covenant is to repay it, that in effect it is a covenant to pay taxes which are imposed upon or in respect of the demised premises or the rent thereof."

From that decision the defendant now, by leave, appealed to the High Court.

Leverrier K.C. (with him *Abrahams*), for the appellant. The word "thereof" in the phrase "on the owner occupier or lessee in respect thereof" has the same meaning as in the phrase "upon the demised premises or upon the rent thereof," and that meaning is "of the premises." Consequently, there is no covenant to pay taxes imposed on the owner, occupier or lessee in respect of the rent of the premises. Income tax as imposed by the Income Tax Acts of New South

Wales is a tax upon the whole income of a person, and not upon any component part of that income. It is neither a tax upon the premises in respect of which the owner receives income nor a tax upon the owner, occupier or lessee in respect of that rent.

Maughan K.C. (with him *Weston*), for the respondent. The words of the covenant are sufficient to include income tax (*Festing* v. *Taylor* (1); *Lord Lovat* v. *Duchess of Leeds* [*No.* 1] (2)). Income tax is a tax in respect of rent which forms part of a man's income, and it is also a tax upon such rent.

Leverrier K.C., in reply.

Cur. adv. vult.

The following written judgments were delivered :—

Aug. 4.

KNOX C.J. The appellant as lessee of certain premises covenanted with the respondent, the lessor, to "pay discharge and perform all rates taxes charges assessments duties and outgoings whatsoever whether imposed by the Parliament of the Commonwealth or of the State . . . which were" at the date of the lease or might at any time thereafter be "assessed charged or imposed upon the demised premises or upon the rent thereof or on the owner occupier or lessee in respect thereof" except Federal land tax. The question for decision is whether the respondent is entitled under this covenant to recover from the appellant the amount by which the State income tax paid by the respondent was increased by reason of the receipt by it of the rent payable under the lease.

I agree with the learned Judges of the Supreme Court in thinking the respondent is so entitled, and with the reasons given by *Ferguson* J. in support of that conclusion.

In my opinion the appeal should be dismissed.

ISAACS J. I have come to the judicial conclusion that the judgment must be affirmed. I arrive at that conclusion with some misgivings as to whether the technicalities of the pleadings represent the real facts of the case. If they do not, the Supreme Court, by reason of the variation of the judgment, will be able, if necessary, to subordinate form to substance. I apprehend, however, that the parties, once the

(1) (1862) 3 B. & S. 218, at p. 228. (2) (1862) 2 Drew. & Sm. 62.

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law is ascertained, will adjust the facts, if adjustment be needed. The covenant sued on is one which, when applied to the New South Wales Income Tax Acts (secs. 1, 8, 9, 10 of No. 24 of 1911 as amended by No. 8 of 1914 and No. 22 of 1922 and the whole of No. 11 of 1912), is susceptible according to circumstances of the breach alleged, but is also, to my mind, in other circumstances, not susceptible of such a breach. Such covenants are to be construed in the way stated by *Channell* J. in *Baylis* v. *Jiggens* (1), where it is said: "In considering cases of this kind it is necessary, in the first place, to notice what the payment sought to be recovered is for, and next the exact words of the covenant." Unless that is observed, there is likelihood of error. For instance, I entertain no doubt that what the landlord desired was to get his stipulated rent, as a net sum free from diminution by taxation. On the other hand, I entertain no doubt that the tenant, while willing to do that, was not in the least intending to pay the landlord's income tax occasioned by the receipt of rent from other property, or by the receipt of income utterly foreign to the tenant, or on the basis of absenteeism. In order then to determine the matter justly it is proper to keep the parties to the bargain as constituted by the very words used. In *Drughorn* v. *Moore* (2) Viscount *Haldane* observes: "The jurisprudence of this country allows people a large latitude in bargaining about property, but they must understand that if they make contracts they must be judged as to their intentions by the words they have used and not by their intentions otherwise conceived."

I think from the collocation of the words of the covenant that this case must depend on the effect given to the word "rent" by the rest of the covenant. I shall assume that, though the income tax of New South Wales is levied, not on rent *eo nomine*, but on "income derived from the produce of property," meaning "income derived from any source in the State other than from personal exertion," the word "rent" in the covenant would attract that Act if the rest of the covenant is appropriate (see *Hurst* v. *Hurst* (3)). I refer to *Nova Scotia Steel and Coal Co.* v. *Minister of*

(1) (1898) 2 Q.B. 315, at p. 317. (2) (1924) A.C. 53, at p. 57.
(3) (1849) 4 Exch. 571, at p. 576.

Finance and Customs (1), but I think it distinguishable. It seems to me, however, perfectly proper to say that "rent" is under the income tax legislation "assessed" and "taxed" and is as "income" taxable if over £300 (sec. 16 (1) (*a*) of the Act No. 11 of 1912) or £250 (sec. 5 of the Act No. 9 of 1914) and except so far as subject to any other statutory deduction. But the governing words of the covenant by the appellant are to "pay, discharge and perform," &c. That is not a covenant to "repay" as is assumed in the judgment under appeal. If the obligation were broken and the covenantee had to pay in the first instance, there would, no doubt, be an obligation on the covenantor to repay, not as a covenant, but as the consequence of breach, that is, as *damages* for breach. The repayment would not be performance, but reparation for non-performance. That seems to me an important element for the purpose of delimiting the obligation. Whatever tax, &c., is included must be one which as between the parties could in the first instance be "paid, discharged or performed" by the covenantor either directly or through the covenantee, but without waiting for the covenantee to pay and afterwards sue for breach of covenant. "Rent" as a subject of income tax does, in my opinion, fall within that sphere of contractual obligation. If the "rent" of that property were the whole income of the covenantee, then, either it would be free as being under £300 or £250, or there would be an ascertainable amount which the covenantor could directly or indirectly pay to the Crown and so discharge his contractual liability. But if that rent be taxable only with other income—that is, only as a component part of a distinct integer and at rising amounts dependent on aggregate income and on circumstances beyond the covenantor's control—it would be legally impossible for the covenantor to know how much to pay, if the measure of his obligation is the varying liability of the covenantee. Imagine the covenantor asking the Commissioner of Income Tax or the lessor the amount attributable to that rent. All he could find at best would be that, according to variable total income and according to variable sources of that income, the tax, if that rent were absent, would be so much less. That is to say, the tax on the "rent"

(1) (1922) 2 A.C. 176.

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inflated by extraneous elements of income and extraneous sources of income, and possibly by absenteeism, might be mathematically represented by an ascertainable sum. But, even if that were ascertainable, it would, in my opinion, be a tax not on the rent *simpliciter*, but on the rent as a factor of a composite sum and as affected by other factors. I am of opinion that such a case is entirely outside the ambit of the covenant. Upon the whole, my construction of the covenant is that the contractual obligation of the covenantor is to pay (possibly through the covenantee) the amount of income tax that would be chargeable in respect of the rent, if that were the only income of the covenantee. The allegations of the declaration are consistent only with that simple form. They are that the tax was assessed "in respect of the rent" and that the respondent was forced to pay it, that all conditions &c. were fulfilled and so on, and that the respondent repudiates its obligation; and damages are claimed. These simple allegations are admitted by the demurrer, and for that reason I see no legal ground for denying the accuracy of the judgment. As the pleadings stand, the appeal should, therefore, in my opinion, be dismissed. But, having regard to the reasons above stated, the order of 8th November 1923 should, in my opinion, be varied by striking out all the words after "overruled." This will enable the Court, if necessary, to permit a proper adjustment.

GAVAN DUFFY AND STARKE JJ. The first count of the declaration alleges a covenant by the defendant company in the following words: "That the defendant did thereby for itself its successors and assigns covenant with the plaintiff its successors and assigns that the defendant would at all times during the continuance of the term thereby granted pay discharge and perform all rates taxes charges assessments duties and outgoings whatsoever whether imposed by the Parliament of the Commonwealth or of the State or by any municipal or local body or authority or of any other description which were then or might at any time thereafter be assessed charged or imposed upon the demised premises or upon the rent thereof or on the owner occupier or lessee in respect

thereof except always Federal land tax." The count further alleges a breach of the covenant in the following words: "Income tax has been duly assessed charged and imposed by the taxation authorities acting under the provisions of the said legislation upon the plaintiff as owner of the said premises in respect of the rent thereof received by the plaintiff from the defendant under the provisions of the said memorandum of lease and the plaintiff has been forced and compelled by law to pay the said tax so assessed charged and imposed as aforesaid to the said authorities and the plaintiff has duly demanded payment by the defendant to the plaintiff of the amount of the said tax so assessed charged imposed and paid as aforesaid and all times elapsed and all conditions were fulfilled and all things happened necessary to entitle the plaintiff to the performance by the defendant of its said promises and to sue for the breaches thereof hereinafter alleged yet the defendant has neglected and refused and still neglects and refuses to pay the same or any part thereof to the plaintiff or to any other person or to make any provision whatsoever therefor and has repudiated and still repudiates any obligation to make any payment to any person in respect thereof or to make any provision therefor."

The question for our consideration is whether the word "thereof" in the phrase "or on the owner occupier or lessee in respect thereof" refers only to the premises and not to the rent of the premises. In our opinion it refers only to the premises, and the alleged breach is not, therefore, a breach of the covenant.

This disposes of the question actually determined by the Supreme Court of New South Wales; but it has been suggested that, even if the breach as laid is bad, still there has been a breach of the obligation to pay a tax imposed on the rent of the demised premises within the meaning of the covenant. In our opinion there has been no such breach; we think that the State income tax in New South Wales is not a tax imposed on the rent of demised premises merely because such rent is part of the income taxed by the Act. To constitute such a tax there must be an imposition immediately directed to the rent and attaching to it as such.

In our opinion the appeal should be allowed.

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Rich J.

RICH J. This is an appeal from a judgment of the Supreme Court of New South Wales overruling a demurrer to a declaration in an action on a covenant contained in a lease—not, I would observe in passing, a covenant of indemnity. It is admitted by the pleadings that income tax was imposed on the plaintiff in respect of the rent of the premises in question and was paid by him. The second ground of the demurrer was not pressed. The covenant in question has already been stated, and I need not restate it. The question for us is to ascertain the intention of the parties from the words of the covenant. The words of the covenant—" pay taxes assessed or imposed upon the rent "—are wide enough to include income tax imposed by the New South Wales Income Tax Acts on " income derived from the produce of property " as therein defined.

I am unable to agree with the contention made on behalf of the appellant that because income tax is imposed on an individual in respect of his whole " income "—that being the generic term—it is not imposed on any of its component parts, being various species of the larger designation. The tax is imposed on income from all sources; but that is to prevent any of the species, not specially exempted, from escaping. Every item of every species is separately shown in the return made by the taxpayer, and the sum of these, after subtracting any allowable deductions, constitutes the amount on which the tax is payable. What, then, is the measure of the obligation placed on the covenantor ? The words of the covenant are not, I think, to be read in the widest sense of which they are literally susceptible. The burthen which the tenant undertakes to discharge is limited by the amount of the rent, which during the currency of the lease is fixed and certain. The " facts " are fixed as between the parties, the rent being taken as between the parties to the obligation as unassociated with any other items of income which the lessor might have and as the only source of his income assessable. Applying the law as it stands at the relevant time to the facts so fixed, the extent of the lessee's obligation is arrived at.

I agree with the order proposed by my brother Isaacs.

Appeal dismissed. Order appealed from varied by striking out all the words after " overruled."

Case remitted to Supreme Court to be dealt with as may be considered just. Appellant to pay costs of appeal.

Solicitors for the appellant, *John Williamson & Sons.*
Solicitors for the respondent, *W. R. & F. B. Jones.*

B. L.

[HIGH COURT OF AUSTRALIA.]

THE DE GREY RIVER PASTORAL COMPANY LIMITED . . . . . } APPELLANT;

AND

THE DEPUTY FEDERAL COMMISSIONER OF TAXATION FOR WESTERN AUSTRALIA . . . . . } RESPONDENT.

Income Tax — Assessment — Company — Assessable income — Pastoral business — Reduction of pastoral areas — Effect of Act of Parliament — Sale of cattle — Profits from sale—Realization of assets—Proceeds of business—Earnings— Income Tax Assessment Act 1915-1918 (*No.* 34 *of* 1915—*No.* 18 *of* 1918), *secs.* 3, 14—*Land Act Amendment Act* 1917 (*W.A.*) (7 *Geo.* V. *No.* 19), *sec.* 30 (2).

A pastoral company which owned several large stations in Western Australia being compelled by the *Land Act Amendment Act* 1917 (W.A.) to reduce the area of its holding, resolved to sell, and did sell, two of its stations and (to other purchasers) the bulk of the cattle upon those two stations.

Held, that the company was assessable to Federal income tax in respect of the profit made on the sale of the cattle as being proceeds of the business carried on by the company and also earnings of the company.

APPEAL from the Federal Commissioner of Taxation.

The De Grey River Pastoral Co. Ltd., having been assessed for Federal income tax for the year 1920-1921 by the Deputy Federal