[HIGH COURT OF AUSTRALIA.]

LLOYD AND OTHERS . . . . . APPELLANTS;

AND

THE FEDERAL COMMISSIONER OF TAXATION RESPONDENT.

H. C. OF A. 1936.

MELBOURNE, *June* 2, 3.

SYDNEY, *Aug.* 13.

Starke, Dixon, and McTiernan JJ.

War-time Profits Tax—Assessment—Deductions—Income tax—Trustees carrying on business of testator—Receipt of income by beneficiaries—Federal and State income tax paid by beneficiaries—War-time Profits Tax Assessment Act 1917-1918 (*No.* 33 *of* 1917—*No.* 40 *of* 1918), *sec.* 15 (4), (5)—*Income Tax* (*Management*) *Act* 1912-1918 (*N.S.W.*) (*No.* 11 *of* 1912—*No.* 27 *of* 1918)—*Taxation Act* 1915 (*S.A.*) (*No.* 1200)—*Income Tax Acts* 1902 *to* 1918 (*Q.*) (2 *Edw. VII. No.* 10 —9 *Geo. V. No.* 2).

Trustees of the estate of a testator carried on the business of the testator and distributed the profits of the business among the beneficiaries, who paid income tax thereon to the Commonwealth and to the States of New South Wales, South Australia and Queensland. The trustees did not pay any income tax in respect of the profits. The trustees were assessed to war-time profits tax for the four years 1916-1919 and claimed deductions for Federal and State income taxes.

Held:—

(1) By the whole court, that the trustees were not entitled to any deduction in respect of Federal income tax.

(2) By *Dixon* and *McTiernan* JJ. (*Starke* J. dissenting), that the trustees were entitled to deductions in each of the four years in respect of State income tax for New South Wales, South Australia and Queensland. The deductions were to be ascertained by computing the tax for which the trustees might have been assessed and made liable in each of the States if the profits of the accounting periods referable to the States had been the only income derived by the trustees as such.

Kuhnel & Co. Ltd. v. *Deputy Federal Commissioner of Taxation* (*S.A.*), (1923) 33 C.L.R. 349, and *Deputy Federal Commissioner of Taxation* (*S.A.*) v. *Kuhnel & Co. Ltd.*, (1925) 37 C.L.R. 141, considered and applied.

H. C. OF A. 1936. LLOYD v. FEDERAL COMMISSIONER OF TAXATION.

CASE STATED.

On the hearing of four appeals by Howard Watson Lloyd, Harold White Hughes and Edgar Bristow Hughes, trustees of the estate of Herbert Bristow Hughes, to the Supreme Court of South Australia from assessments to war-time profits tax for the years ending 30th June 1916, 1917, 1918 and 1919 respectively, *Reed* A.J. stated a case, which was substantially as follows, for the opinion of the High Court:—

1. On 29th November 1934 the Deputy Federal Commissioner of Taxation issued notices of amended assessment to the appellants as trustees of the estate of Herbert Bristow Hughes deceased, assessing them for war-time profits tax for the financial years ending 30th June 1916, 30th June 1917, 30th June 1918 and 30th June 1919.

2. The appellants objected to the assessments and eventually at their request the objections were treated as appeals and forwarded to the Supreme Court of South Australia.

3. The four appeals, consolidated, were heard by me on 10th December 1935.

4. The facts are all agreed between the parties and are set out in the statement of facts accompanying this case.

4A. The appeal was argued before me on 12th December 1935.

5. At the request of the appellants I am stating this case for the opinion of the High Court upon the following question arising in the appeal, which in my opinion is a question of law, viz.:—

> In assessing the appellants for war-time profits tax in respect of the four financial years ending 30th June 1916, 30th June 1917, 30th June 1918 and 30th June 1919 should there be allowed as deductions from the profits of each year respectively the amounts of Federal and State income taxes or either of them that would have been payable by the trustees or by the beneficiaries under the will of Herbert Bristow Hughes deceased if the amounts of income from the estate of the said deceased received by them in each year respectively had been the only income derived by them from sources within Australia?

The agreed statement of facts was substantially as follows:—

1. Herbert Bristow Hughes deceased died at Athelney near Adelaide in South Australia on 19th May 1892.

2. Probate of his will and two codicils was granted by the Supreme Court of South Australia on 19th June 1892 to Herbert White Hughes and Harold White Hughes.

3. Herbert White Hughes died on 26th October 1916, and probate of his will and codicil was granted by the Supreme Court of South Australia on 7th December 1916 to Harold White Hughes and Bagot's Executor and Trustee Co.

4. By indenture dated 7th November 1916 Edgar Bristow Hughes and Howard Watson Lloyd were appointed trustees of the estate of Herbert Bristow Hughes deceased in addition to Harold White Hughes, and these three have at all relevant times been trustees of the said estate.

5. At the time of his decease Herbert Bristow Hughes was a pastoralist, and had during his life and up to the time of his death carried on a pastoral business on three stations known as Kinchega, Booyoolee and Nockatunga.

6. The pastoral business was carried on by the trustees of his estate after his death and was so carried on by them up to and inclusive of the years in respect of which the war-time profits taxes in respect of which these appeals are brought were assessed.

7. On 22nd August 1892 the then trustees of the estate obtained an order from the Supreme Court of South Australia authorizing the carrying on of the said stations.

[The beneficiaries were described, and the statement proceeded :—]

20. In each of the years relevant to these appeals the profits of the estate of the said Herbert Bristow Hughes deceased were divided by the trustees between the above-mentioned beneficiaries entitled thereto and income taxes both Federal and State were assessed against each of the said beneficiaries including their respective shares in the said profits, and the said taxes were paid by such beneficiaries.

21. There are four assessments dated 23rd May 1933 for the years 1915-1916, 1916-1917, 1917-1918, and 1918-1919. In such assessments the Deputy Commissioner of Taxation allowed as deductions from the profits of each of the said years the amounts of income taxes that would have been payable by certain of the above-mentioned beneficiaries entitled to receive the income of the said estate if the

H. C. OF A. 1936.

LLOYD v. FEDERAL COMMISSIONER OF TAXATION.

profits had been the only income derived by them from sources within Australia.

22. There are four amended assessments dated 29th November 1934 for the years 1915-1916, 1916-1917, 1917-1918, 1918-1919 respectively, which are the assessments appealed from. In such assessments the Deputy Commissioner of Taxation has refused to allow as deductions from the profits of each of the said years the amounts of income taxes that would have been payable by the trustees or by the above-mentioned beneficiaries entitled to receive the income of the said estate if the profits had been the only income derived by them from sources within Australia.

Mayo K.C. (with him *H. B. Piper*), for the appellants. The *War-time Profits Tax Assessment Act* applies to all businesses (sec. 8). What the Act looks at is the notion of a continuing business. The Act makes a levy on the profits arising directly out of the business (sec. 14 (2), (3)). The person who receives the assessment will become liable even though he had no association with the business during the years in question (*McKellar* v. *Federal Commissioner of Taxation* (1) ; *Federal Commissioner of Taxation* v. *Hipsleys Ltd.* (2) ; *Anderson's Industries Ltd.* v. *Federal Commissioner of Taxation* (3)). All income taxes, State and Federal, paid in respect of profits, no matter by whom they are paid, may be deducted. The three cases referred to in sec. 15 (5) refer to a person whose relation to the business is such that he pays income tax in respect of profits in their guise of business profits. In the case of a company the shareholder will pay income tax on dividends, which are different from profits. Every beneficiary is an individual and he pays tax in respect of business profits which come to his hands, although the legal estate is vested in trustees. Sec. 15 (5) is quite impersonal, and the payment made should be brought into account as a deduction in estimating the war-time profits tax. The profit that the beneficiary receives is still a business profit (*Baker* v. *Archer-Shee* (4)). Pars. *e* and *f* of sec. 47 put a trustee on the same basis as an agent. A trustee is defined in sec. 4 to include a liquidator, who is nothing but an agent.

(1) (1932) 30 C.L.R. 198, at p. 205.
(2) (1926) 38 C.L.R. 219.
(3) (1932) 47 C.L.R. 354.
(4) (1927) A.C. 844.

" Agent " itself is, in sec. 4, defined to include only a particular class of agent. Where a beneficiary pays income tax on profits or on part of the profits, he may be dealt with under sec. 15 (5) (*a*). It is unnecessary to imply any word such as " owner " in sec. 15 (5). [Counsel referred to *Burt* v. *Commissioner of Taxation* (1) ; *Astor* v. *Perry* ; *Duncan* v. *Adamson* (2).] The following propositions accordingly hold :—(1) Where a business is carried on by trustees, the beneficiaries pay income tax in respect of the business profits as such and these taxes may be deducted. (2) This is so whether sec. 15 (5) implies the concept of ownership or not. (3) There is no need to read into that implications, if the result is to limit the scope of sub-secs. 4 and 5. (4) If a taxpayer must be shown to come within sec. 15 (5) as owner, (i) he is within the statutory meaning of " partner," (ii) he is an " individual," and (iii) he is a " shareholder."

Tait, for the respondent. The material words are in sec. 15 (4) (*b*), allowing a deduction of " Commonwealth and State income taxes paid in respect of the profits." That provision is limited to payment by the person who is liable to pay tax under the *War-time Profits Tax Assessment Act*. They mean liable to be paid by the taxpayer and do not refer to a tax paid by some person other than the person liable for the war-time profits tax. It is a tax on the person who carries on the business. The primary position is that the Act makes liable for tax the person who owns and carries on the business (Cf. *Income Tax Assessment Act* 1915). The frame of sec. 15 is that the amount to be allowed or deducted is the amount paid by the taxpayer in respect of a particular business. Sub-sec. 5 of sec. 15 is not intended primarily to extend or limit sub-sec. 4 ; its purpose is to affect the amount of the calculation by a deduction of the income tax paid. That is to allow a notional as opposed to an actual amount of income tax paid (*Hooper & Harrison Ltd.* v. *Federal Commissioner of Taxation* (3) ; *Kuhnel & Co. Ltd.* v. *Deputy Federal Commissioner of Taxation* (*S.A.*) (4) ; *Deputy Federal Commissioner of Taxation* (*S.A.*) v. *Kuhnel & Co. Ltd.* (5)). The beneficiaries

(1) (1912) 15 C.L.R. 469, at p. 482.
(2) (1935) A.C. 398, at pp. 416, 417.
(3) (1923) 33 C.L.R. 458, at p. 476.
(4) (1923) 33 C.L.R. 349.
(5) (1925) 37 C.L.R. 141.

H. C. OF A. 1936.

LLOYD v. FEDERAL COMMISSIONER OF TAXATION.

are not allowed a deduction of the aggregate of income taxes paid by them.

Mayo K.C., in reply, referred to *Commissioner of Taxes (S.A.)* v. *Robertson* (1); *Taxation Act* 1915 (S.A.), secs. 35, 36, 38, 39, 46; *Income Tax (Management) Act* 1912-1918 (N.S.W.), secs. 11 (1), 12, 13; *Income Tax Acts* 1902 *to* 1918 (Q.), secs. 28, 47.

Cur. adv. vult.

Aug. 13.

The following written judgments were delivered:—

STARKE J. Case stated for the opinion of this court by the Supreme Court of South Australia, pursuant to the provisions of sec. 29 of the *War-time Profits Tax Assessment Act* 1917-1918.

Herbert Bristow Hughes had carried on a pastoral business on three stations in South Australia, New South Wales and Queensland respectively. He died in 1892, and the pastoral business has been carried on since his death by his executors and trustees, under the terms of his will and orders of the Supreme Court. The appellants are the trustees of the estate of the deceased. They have been assessed to war-time profits tax for the financial years which ended on 30th June 1916, 1917, 1918, and 1919 respectively. (See Act, sec. 14 (2).) They claimed deductions in each of these years of Commonwealth and State income taxes paid in respect of the profits of those years. The claim is based upon the provisions of sec. 15, sub-secs. 4 and 5, of the *War-time Profits Tax Assessment Act* 1917-1918:—"(4) Deductions shall not be allowed on account of the liability to pay, or the payment of, war-time profits tax . . . Provided that a deduction shall be allowed from the profits of an accounting period of . . . (*b*) Commonwealth and State income taxes paid in respect of the profits. "(5) For the purposes of this section 'income tax paid in respect of the profits' shall be—(*a*) in the case of an individual the amount of tax that would have been payable if the profits had been the only income derived by him from sources within Australia."

In a statement of facts agreed upon between the parties, clause 20 is as follows: "In each of the years relevant to these appeals

(1) (1930) 44 C.L.R. 230, at p. 234.

the profits of the estate of the said Herbert Bristow Hughes deceased were divided by the trustees between the . . . beneficiaries entitled thereto and income taxes both Federal and State were assessed against each of the said beneficiaries including their respective shares in the said profits, and the said taxes were paid by such beneficiaries."

The provisions of sec. 15 (4) and (5) were considered by this court in *Kuhnel's Case* (1) in relation to a company registered under the *Companies Act* 1892 of South Australia. Sec. 15 (5) (*c*) is as follows :—" In the case of a company, the amount of the tax (if any) paid by the company, together with the aggregate of the amounts of tax that would have been payable by each shareholder if the share of the profits credited or paid to him had been the only income derived by him from sources within Australia." No difficulty arose in that case as to the deduction of the income tax paid by the company. It was admitted that it had been paid and must be deducted. The difficulty arose as to the income tax that would have been payable by the shareholders on the hypothesis stated in sec. 15 (5) (*c*). (See the admission (2).) The court held that the aggregate of the amounts of tax that would have been payable by each shareholder should be ascertained by reference to the profits credited or paid to the shareholder, and that the beneficiaries could not be substituted for him. But " in order to ascertain these amounts it is necessary to apply the provisions of the relevant Income Tax Assessment and Income Tax Acts to the case of each shareholder. . . . If the shareholder happens to be a trustee and to receive his share of the profits in that capacity, the ascertainment of the amount of tax that would have been payable by him requires the application of the provisions of the relevant Income Tax Assessment Act dealing with the case of trustees. These provisions vary in the Income Tax Assessment Acts of different years, and the provisions of the appropriate Act must be applied in each case " (*Knox* C.J., *Kuhnel's Case* (3)). It was not, therefore, the actual aggregate amount of tax paid by shareholders that was deductible, but an amount calculated in the manner prescribed by

(1) (1923) 33 C.L.R. 349; (1925) 37 C.L.R. 141.

(2) (1923) 33 C.L.R., at p. 354.

(3) (1923) 33 C.L.R., at p. 355.

H. C. OF A. 1936.

LLOYD v. FEDERAL COMMISSIONER OF TAXATION.

Starke J.

sub-sec. 5. But, in calculating what " would have been payable by each shareholder," the character of the shareholder and his liability under the appropriate Act were all-important. If the shareholder were a company, then it paid a flat and not a progressive rate; again, if the shareholder were a trustee, then liability depended on the provisions of the relevant Act. How could it be said that tax would have been payable by such a shareholder if the relevant Act imposed no liability? (*Isaacs* and *Rich* JJ., *Kuhnel's Case* (1)). The decision involves, I think, no inconsistency: rather a careful adherence to the precise language of sub-sec. 5 (*c*). In this case, however, the taxpayers—the trustees of Hughes' estate—are individuals, and therefore fall within the provisions of sec. 15 (4) and (5) (*a*), and not within those of sub-sec. 5 (*c*) relating to the case of a company. The amount of tax that " would have been payable " by an individual depends upon the Act relevant to his liability and his rate of tax.

But behind all this, the *War-time Profits Tax Assessment Act* contemplates in the first place that tax has already been paid. The words allowing a deduction are " Commonwealth and State income taxes paid in respect of the profits." These words must mean paid by the person chargeable with war-time profits tax. Income tax paid in respect of the profits, however, means not what the individual actually did pay, but what would have been payable if the profits had been the only income derived by him from sources within Australia. The reason is clear enough. Under the Income Tax Acts, income is treated as a whole, and in the case of individuals is often taxed at progressive rates. Under the *War-time Profits Tax Assessment Act*, however, each business is treated as a taxable entity, and the profits are segregated for that purpose (See *Kuhnel's Case* (2)). In this way, the amount of income tax actually paid in respect of the profits is ascertained. The Act does not provide that an amount which has been calculated according to the section, but not paid, shall be treated as paid and deducted.

The facts agreed upon in this case admit that the taxpayers never paid any income tax: the beneficiaries were assessed to, and paid, the income taxes involved in the case. But it is contended that the

(1) (1923) 33 C.L.R., at p. 361.

(2) (1923) 33 C.L.R., at p. 358.

profits really belong to the beneficiaries, and that the income taxes ultimately fall upon them. That may be so, but the trustees carry on the business as principals, and are chargeable in their own right, though entitled to an indemnity out of the estate in respect of payments lawfully made by them. More important, however, is the fact that the profits of a business are segregated for the purpose of war-time profits, and dealt with as a whole. The beneficiaries would not ordinarily be assessed to income tax in respect of the whole profits of the business, but only in respect of their individual shares or interests in the profits. It would lead to inextricable confusion if the income of beneficiaries had to be traced to its sources and the amount of income tax paid attributed to those various sources, including the profits of a business: it would seldom if ever result in the ascertainment of either the sum in respect of which their trustees would be assessed, or the tax that they would be liable to pay or would actually pay. The agreed facts destroy, I think, the trustees' claim to a deduction of Commonwealth and State income taxes: they have paid none. *Kuhnel's Case* (1) has no bearing on this question, for admittedly in that case all the taxes were paid by the taxpayer.

Were my view other than it is, still I think the claim of the taxpayers should fail. The claim to deduct the Commonwealth income tax is met by *Kuhnel's Case* (2), which is decisive in this court (*Income Tax Acts* 1915-1916, secs. 22, 27 (2), as to the year 1916-1917, *Income Tax Acts* 1915-1918, sec. 26, as to the years 1918-1919). The claim to deduct the New South Wales income tax depends upon the *Income Tax (Management) Act* 1912-1918 of New South Wales (Incorporated Acts, vol. II., p. 523). Both the beneficiaries and the trustees were liable to assessment under that Act, and a payment of the tax by either would be a discharge of the other (secs. 11-14). But the trustees were never assessed, nor paid any tax, under the Act, and "the amount of tax that would have been payable," their liability to pay it, depended upon assessment. Consistently with *Kuhnel's Case* (2), the conclusion, in these circumstances, should be that no liability attached to them under the Act. The claim to a deduction of the South Australian income tax depends

(1) (1923) 33 C.L.R. 349. (2) (1923) 33 C.L.R. 349; (1925) 37 C.L.R. 141.

H. C. OF A. 1936.

LLOYD v. FEDERAL COMMISSIONER OF TAXATION.

Starke J.

upon the *Taxation Act* 1915, No. 1200, of South Australia. Every party legally and equitably entitled to the receipt of income is a taxpayer, and trustees in their respective capacity are also taxpayers (See secs. 35, 36). But again the trustees in the present case have never been assessed, nor paid any tax, under the Act. The claim to deduction of the Queensland income tax depends upon the *Income Tax Act* 1902 of Queensland. Under this Act, the person to whom the income arises or accrues or who is legally or equitably entitled to the receipt thereof, and also trustees, are assessable to income tax (secs. 21, 47). Again, the trustees were not assessed, and paid no tax, under the Act.

The result bears hardly, I think, upon the persons beneficially entitled to the Hughes estate, but I must be guided by what I conceive to be the proper construction of the relevant Acts.

The question stated should be answered that the appellants are not entitled to deductions, in their assessment to war-time profits, of Commonwealth and State income taxes.

DIXON J. The question raised by this case stated relates to the proper method of computing the deduction for income tax in assessing for war-time profits tax the profits of a business carried on by trustees under a will or settlement. The last year of profit for which war-time profits tax was assessed closed seventeen years ago. To make substantially accurate assessments under the very complicated provisions of the *War-time Profits Tax Assessment Act* 1917-1918 turned out in many cases to be a task which took years to complete because of the nature and difficulty of some of the adjustments it involved. But so great is the time since the termination of the tax, that few if any other assessments can still remain open. Thus our decision may be expected to affect little more than the present case. The decisions of this court in the two cases of *Kuhnel & Co. Ltd.* (1) are based upon reasoning that is applicable, not only to the provision there in question, but to the material part of the analogous provision upon which the present case turns. I am aware that in some respects these decisions have been thought unsatisfactory and indeed that an inconsistency has been seen in the detailed

(1) (1923) 33 C.L.R. 349; (1925) 37 C.L.R. 141.

applications which the court gave to its interpretation of the provision. But, after this length of time, when the question has lost its general importance, it is very undesirable that we should depart from the reasoning of the decisions, or refuse to apply it to a provision *in pari materia* to which it appears logically applicable.

In the case of *Kuhnel & Co. Ltd.* (1) a company conducted the business the profits of which were under assessment. A claim was made under sec. 15 (4) and (5) of the *War-time Profits Tax Assessment Act* 1917-1918 for a deduction of the amounts of the Commonwealth and State income taxes paid in respect of the profits. Sub-sec. 5 defines the expression "income tax paid in respect of the profits" which sub-sec. 4 employs in giving the deduction. Par. *c* of the sub-section says that in the case of a company it shall be the amount of the tax (if any) paid by the company, together with the aggregate of the amounts of tax that would have been payable by each shareholder if the share of the profits credited or paid to him had been the only income derived by him from sources within Australia. At that time income tax was imposed on a company in respect of so much of the profits as it retained and on the shareholders in respect of so much as it distributed to them.

The shareholders of Kuhnel & Co. Ltd. were trustees. Under the Federal income tax law in force during the first two years of the war-time profits tax, trustees were liable to assessment for income tax as if beneficially entitled to the income of the trust. But, if a trustee had actually distributed income to the beneficiaries, then from the tax otherwise payable by him a deduction was made of an amount bearing to the total tax the same proportion as the income distributed bore to the total income (secs. 26 and 27 (2) and (2A) of the *Income Tax Assessment Act* 1915-1916).

A change in the law was made and during the last two years of the war-time profits tax trustees were liable to assessment for income tax under provisions corresponding to those in force now. Under sec. 26 of the *Income Tax Assessment Act* 1915-1918 the beneficiary, unless under a disability, was made liable to income tax in respect of that part of the income to which he was presently entitled. The liability of the trustee to income tax was limited to

(1) (1923) 33 C.L.R. 349; (1925) 37 C.L.R. 141.

H. C. OF A. 1936.

LLOYD v. FEDERAL COMMISSIONER OF TAXATION.

Dixon J.

that part of the income of the trust to which no person *sui juris* was presently entitled and of which no such person was in actual receipt (Cf. *Executor Trustee and Agency Co. of South Australia Ltd.* v. *Federal Commissioner of Taxation* (1)).

In the cases of *Kuhnel & Co. Ltd.* (2) it became necessary to apply to trustees who were shareholders the direction contained in par. *c* of sec. 15 (5) of the *War-time Profits Tax Assessment Act* 1917-1918 to take the amounts of income tax that would have been payable by each shareholder if the share of the profits credited or paid to him had been the only income derived by him. The cases decided how that direction worked out when the shareholder was a trustee liable to income tax in successive periods under the respective provisions of the income tax law I have summarized. It was decided that the steps were these. First, it was necessary to find what amount of the profits had been credited or paid to the shareholder, disregarding for that purpose the fact that he received them as a trustee. Then, it must be assumed that the amount so credited or paid was the shareholder's only income. Next, the amount of tax for which, on that assumption, he would have been liable must be ascertained. But, at that stage, it was decided that account must be taken of the fact that he was a trustee. From that fact it followed that under the law in force in the first two years he was liable, in effect, to be taxed only on profits he had not distributed to his beneficiaries, although at a rate in the graduated scale appropriate to the amount of the total profits, and, under the law in force in the last two years, to be taxed only on profits to which no beneficiary *sui juris* was presently entitled. The decision meant that in the first two years in calculating the amount of the deduction for income tax made from war-time profits, a part of the tax must be excluded proportionate to the profits paid over by the trustee to the beneficiaries. It meant that in the second two years the deduction would be limited to the amount of income tax payable upon so much only of the profits credited or paid to the trustee shareholder as were not the subject of a present right in a beneficiary who was *sui juris*. Thus, in applying the words " amounts of tax that would have been payable . . . if the share of profits . . . had

(1) (1932) 48 C.L.R. 26. (2) (1923) 33 C.L.R. 349 ; (1925) 37 C.L.R. 141.

been the only income derived by him," the court considered that his capacity of trustee must enter into the ascertainment of the liability postulated and the amount of tax only was covered which he, as trustee, was liable to pay. The amount for which his beneficiaries would be liable was not covered. It is true that the court also held that the rate of income tax was that appropriate to a company and not to an individual. The trustee, the shareholder, was a trustee company and it was for that reason that, in calculating the deduction, the company rate of tax was held applicable. In so holding, the court may appear to have deserted the theory upon which it proceeded in limiting the amount of tax to that which would have been payable by the shareholder considered as a trustee-taxpayer. It is in this respect that an inconsistency has been found in the decisions. But the explanation is not, I think, that the court meant to disregard the trust as a factor in determining the hypothetical amount of income tax. The explanation lies, I believe, in an assumption or supposition tacitly made that, to take one taxing Act as an example, par. *a* of the Fourth Schedule of the *Income Tax Act* 1917 applied to the income derived by a company as a trustee for individuals.

In the present case, we have to consider the application of words contained in par. *a* of sec. 15 (5) cast in the same form as those in par. *c* which were interpreted in the cases of *Kuhnel & Co. Ltd.* (1). The trustees in the present case were individuals and conducted the business. The beneficiaries were *sui juris* and presently entitled to the income and it was actually distributed to them. By par. *a* the income tax paid in respect of the profits and consequently deductible therefrom is defined to be, in the case of an individual, the amount of tax that would have been payable if the profits had been the only income derived by him from sources within Australia. The words " in the case of an individual " clearly refer to the case of an individual's owning or carrying on the business as opposed to a company's doing so. The person owning or carrying on a business is assessable to war-time profits tax under sec. 14 (2) of the *War-time Profits Tax Assessment Act* 1917-1918. The words defining the amount of the tax deductible in the case of an individual as that which would have been payable if the profits had been the only income derived by him are indistinguishable from those interpreted and applied in the cases of *Kuhnel & Co. Ltd.* (1). When the

(1) (1923) 33 C.L.R. 349; (1925) 37 C.L.R. 141.

H. C. OF A. 1936. LLOYD v. FEDERAL COMMISSIONER OF TAXATION. Dixon J.

individual is a trustee they mean, according to that interpretation, that, in ascertaining the amount of the tax deductible, the trust must be taken into account if that makes a difference in the liability to income tax otherwise flowing from the required assumption. The inquiry must be for what amount of tax would the individual be liable if the profits of the business had been his only income. As his character of trustee may or does determine his liability for tax, as distinguished from that of his beneficiaries, it follows, according to the interpretation placed on the same words in par. *c*, that for the purposes of the inquiry the nature of the trusts on which he holds and the distributions of profits he has made to the beneficiaries must be taken into account when relevant to his liability as trustee for income tax.

To find the amount of Federal income tax deductible, secs. 26 and 27 (2) and (2A) of the *Income Tax Assessment Act* 1915-1916 must be applied in relation to the profits for the years ending 30th June 1916 and 30th June 1917, and sec. 26 of the *Income Tax Assessment Act* 1915-1918 in relation to the profits of the years ending 30th June 1918 and 30th June 1919.

As the statement of agreed facts says that the profits were all distributed, sec. 27 (2) of the Assessment Act 1915-1916 applies in the two earlier years to make no income tax payable by the trustees when the assumption required by sec. 15 (5) (*a*) is made. As, according to the trust instruments, the beneficiaries were presently entitled to all the income and as none of them was under any disability, sec. 26 of the Assessment Act 1915-1918 applies in the two later years to make no income tax payable by the trustees on the required assumption.

The application to State income tax of the interpretation of par. *a* of sec. 15 (5) thus adopted depends upon the provisions of State law which at the relevant period affected the liability of the trustees to income tax. In the cases of *Kuhnel & Co. Ltd.* (1) the specific manner in which the court's interpretation of par. *c* applied to State income tax was not discussed in the judgments.

In the present case, the States in which income tax was payable upon various parts of the profits were New South Wales, South Australia and Queensland. We were referred to the relevant enactments of those States, but no argument was addressed to the question how they operated in relation to sec. 15 (5) (*a*).

(1) (1923) 33 C.L.R. 349; (1925) 37 C.L.R. 141.

The New South Wales statute appears to me on examination to occasion some difficulty. Sec. 11 (1) (*c*) of the New South Wales *Income Tax* (*Management*) *Acts* 1912-1918 imposes the liability to tax upon the person beneficially entitled to the income ; but it calls him the principal taxpayer and makes a trustee who receives income on his behalf also liable for the income tax thereon. Sec. 12 gives the trustee the same rights and subjects him to the same liabilities as the principal taxpayer and makes payment by him a discharge of the tax. But secs. 13 and 14 restrict the trustee's liability to the amount of the income in his receipt or disposal and give him a right of indemnity from the principal and a right to retain the tax out of the latter's income. As a result of these provisions, would any tax be " payable " by the trustee within the interpretation given to sec. 15 (5) by *Kuhnel & Co. Ltd.'s Cases* (1) ? On the whole, I think the trustee's collateral liability brings the New South Wales tax within the provision interpreted according to the doctrine of these two decisions. That doctrine is based upon the necessity of giving effect to the exact meaning of the language used in the enactment allowing the deduction. The exclusion of the tax payable by the beneficiaries on the profits did not at all depend upon any view that in principle the tax they bore or paid ought not to have been thrown against the profits. The words " would be payable " are capable of including a collateral or secondary liability to pay, and I see no reason for restricting their application any further than the decision in the case of *Kuhnel & Co. Ltd.* (1) requires. It appears to me to be nothing to the point that the beneficiaries and not the trustees may have paid the tax. It is true that sec. 15 (4) uses the expression " income tax paid in respect of the profits." But, in the first place, it does not say by whom, and the evident purpose is to take into account a tax borne by the profits whoever actually made the payment. In the second place, sub-sec. 5 proceeds to define the expression to mean not what was but what on a specified assumption would have been paid.

The ascertainment of the amount of Queensland income tax which would be payable by the trustee is governed by provisions of the law of that State in some respects analogous to, but not the same as, the Commonwealth provision relating to trustees. Sec. 21 (iii) and (iv) of the *Income Tax Acts* 1902 *to* 1918 makes income tax payable by a trustee when the income is that of a person under a disability and

(1) (1923) 33 C.L.R. 349 ; (1925) 37 C.L.R. 141.

H. C. OF A. 1936. LLOYD v. FEDERAL COMMISSIONER OF TAXATION. Dixon J.

when there is no person presently entitled to the income and in actual receipt thereof and liable as a taxpayer. Sec. 28 preserves the liability of the beneficiary who receives, or is entitled to receive, the income unless and until the trustee pays the tax. Sec. 47 provides that every trustee shall be assessed separately in respect of any income for which he is trustee and shall be chargeable with income tax payable in respect thereof in the same manner as if such income were the income of such trustee and shall be assessed in respect thereof as such trustee. Sec. 25 enables the trustee to retain the tax out of moneys arising from the trust, and, in combination with sec. 68, restricts his liability to the assets coming to his hands. Sec. 21 suggests that the liability of the trustee is restricted, as in the Commonwealth law. But secs. 28 and 47 show that this is not so. On the whole, I think that the result is the same as in the case of New South Wales.

In the case of South Australia, the ascertainment of the deduction is governed by the *Taxation Act* 1915 (No. 1200). Secs. 35 (*b*), 36 (*c*) and 38 (*b*) imposed a liability upon the trustee for income tax which results in making the tax on the total hypothetical income deductible under sec. 15 (4) and (5) of the *War-time Profits Tax Assessment Act* 1917-1918.

The question in the case stated is not framed in such a way as, in the view I have expressed, to allow of a categorical answer which would dispose of the controversy. I think it should be answered that, because the trustees distributed the income of the earlier two years to which the question relates, and, because in the later two years to which it relates there were persons not under any disability who were presently entitled thereto, there is no deduction from the profits of the accounting periods of Commonwealth income tax paid in respect of profits, but there are deductions in each of the said years of State income tax for the States of New South Wales, South Australia and Queensland. Such deductions are to be ascertained by computing the tax for which the trustees might have been assessed and made liable in each of those States if the profits of the accounting periods referable to the States had been the only income derived by the trustees as such.

McTIERNAN J. The appellants were trustees of a settlement and carried on a pastoral business. War-time profits tax was levied on the profits of the business for four successive accounting periods

commencing with the period 1915-1916. The beneficiaries were *sui juris* and presently entitled in the relevant periods to receive the profits of the business, and they were assessed respectively for Commonwealth and State income tax in respect of the income which they received from the trustees. The question is whether the appellants are entitled to a deduction for the income tax paid by the beneficiaries in respect of that income under the *War-time Profits Tax Assessment Act* 1917-1918. The relevant provisions of the Act are sub-sec. 4, par. *a*, and sub-sec. 5, par. *a*, of sec. 15. The latter provision is in *pari materia* with par. *c* of sub-sec. 4, and the case is governed by the reasoning in *Kuhnel & Co. Ltd.* v. *Deputy Federal Commissioner of Taxation* (*S.A.*) (1) and *Deputy Federal Commissioner of Taxation* (*S.A.*) v. *Kuhnel & Co. Ltd.* (2). In applying the principle of this decision it is necessary to inquire whether the Commonwealth or State income tax laws which were in force at the relevant times made the trustees liable to pay income tax on the income received by them as trustees, The Commonwealth Acts in force were the *Income Tax Assessment Act* 1915-1916 and the *Income Tax Assessment Act* 1915-1918. As the beneficiaries were *sui juris* and presently entitled, the appellants were not liable to Commonwealth income tax on the profits for any of the accounting periods for which they have been assessed. The provisions of the relevant State Acts of New South Wales, Queensland and South Australia governing the liability of trustees for income tax on income received by them as trustees were only brought to our notice and there was no argument as to the effect of these provisions. Upon a perusal of the New South Wales Act, which is the New South Wales *Income Tax (Management) Act* 1912-1918, it would appear to impose a liability both on the trustee and on the beneficiaries, but the amounts of taxation payable by trustee and beneficiaries are not cumulative. I agree that it is correct to say that the tax paid under this Act in respect of the profits for each accounting period was taxation which " would have been payable " by the trustees, the present appellants, under the *War-time Profits Tax Assessment Act* 1917-1918. The Queensland and the South Australian Acts are respectively the *Income Tax Acts* 1902 *to* 1918 and the *Taxation Act*

(1) (1923) 33 C.L.R. 349.

(2) (1925) 37 C.L.R. 141.

H. C. OF A. 1936.

LLOYD v. FEDERAL COMMISSIONER OF TAXATION.

McTiernan J.

1915 (No. 1200). I agree that the taxation paid under these Acts is also within the provisions of sub-secs. 4 (*a*) and 5 (*a*) of sec. 15 of the *War-time Profits Tax Assessment Acts* 1917-1918.

The question should be answered: No, in the case of Commonwealth income tax, and Yes, in the case of income tax paid in New South Wales, South Australia and Queensland. In the latter case the deductions are to be arrived at by calculation of what might have been the amount of the trustees liability in each of these States, if the profits arising therein had been the only income derived therein as trustees.

Question answered that because the trustees distributed the income of the two years ending 30th June 1917 *and because in the two years ending 30th June* 1919 *there were persons not under any disability who were presently entitled to the income thereof, there is no deduction from the profits of the accounting periods in respect of Commonwealth income tax paid in respect of the profits, but there are deductions in each of such four years in respect of State income tax for the States of New South Wales, South Australia and Queensland. Such deductions are to be ascertained by computing the tax for which the trustees might have been assessed and made liable in each of such States if the profits of the accounting periods referable to the States had been the only income derived by the trustees as such. Costs in the appeals.*

Solicitors for the appellants, *Piper, Bakewell & Piper.*

Solicitor for the respondent, *W. H. Sharwood*, Crown Solicitor for the Commonwealth.

H. D. W.