[HIGH COURT OF AUSTRALIA.]

TARIFF REINSURANCES LIMITED . . APPELLANT;

AND

THE COMMISSIONER OF TAXES (VICTORIA) RESPONDENT.

ON APPEAL FROM THE SUPREME COURT OF VICTORIA.

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MELBOURNE, *Mar.* 4, 7;

SYDNEY, *April* 4.

Latham C.J., Rich, Starke, Dixon and McTiernan JJ.

Income Tax (Vict.)—Income—"Profits earned in or derived in or from Victoria"—Contract of reinsurance made in England with English company—Consideration for reinsurance risks paid to English company in Melbourne—Income Tax Act 1928 (*Vict.*) (*No.* 3701), *sec.* 42.

The appellant, a company incorporated in England, carried on the business of a reinsurer of risks accepted by other persons. A company incorporated in Victoria, which carried on in that State the business of motor-car insurance, entered into a treaty agreement in England with the appellant under which the appellant reinsured the Victorian company in respect of two-thirds of the risks to which the contract applied, the consideration being two-thirds of the gross premiums received by the Victorian company less certain deductions. The moneys payable to the appellant were to be paid into its account at a bank in Melbourne.

Held that the sums paid by the Victorian company into the bank in Melbourne were not "profits earned in or derived in or from Victoria" by the appellant within the meaning of sec. 42 of the *Income Tax Act* 1928 (Vict.) and, accordingly, were not taxable under that provision.

Decision of the Supreme Court of Victoria (Full Court): *Commissioner of Taxes* v. *Tariff Reinsurances Ltd.*, (1938) V.L.R. 17, reversed.

APPEAL from the Supreme Court of Victoria.

On objections by Tariff Reinsurances Ltd. to assessments to income tax under the *Income Tax Act* 1928 (Vict.) the Commissioner of

Taxes transmitted the objections to be determined by a judge of county courts, who stated a special case, which was substantially as follows, for the opinion of the Supreme Court :—

1. Tariff Reinsurances Ltd. (hereinafter called " the reinsurer ") is a company incorporated in the United Kingdom and carrying on the business of reinsurer of insurance risks accepted by other persons. It is not registered as a foreign company under the *Companies Acts* (Vict.) and has no representative in Victoria, except in so far as the facts hereinafter stated may constitute the Automobile Fire and General Insurance Co. of Australia Ltd. its representative.

2. The Automobile Fire and General Insurance Co. of Australia Ltd. (hereinafter called " the company ") is a company incorporated in Victoria and carrying on in Victoria the business of insurance. Its principal business at the material times was the insurance of motor vehicles against damage and other risks.

3. The company, being unable to secure in Australia suitable reinsurances of portion of the risks accepted by it, sent the manager of the company to England in 1928 to arrange for such reinsurances by a reinsurer in England. He was authorized by the board of directors of the company to enter into an agreement with a reinsurer in England to undertake such reinsurances, and on or about 22nd August 1928 in London he entered into an agreement on behalf of the company with the reinsurer, which agreement was reduced to writing and executed by the reinsurer in London on or about 22nd August 1928 and by the company in Melbourne in October 1928.

4. The agreement contained the following provisions :—Article II. : " When the company shall effect an insurance covered by this agreement the reinsurer hereby reinsures the company in respect of such insurance in the proportion of two-thirds of the risk so accepted." Article VIII. :—" The reinsurer shall be deemed to have reinsured the risk insured by the company upon the same conditions as may for the time being be subsisting with regard to the policies of insurance issued by the company whether printed, written, ordinary or special, the intention being that the reinsurer shall follow the fortunes of the company in regard to the policies of insurance, of which the reinsurer by virtue of this agreement takes part. Provided always that as and from the 1st day of January

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1929 the rates of premium to be charged under each and every motor policy subject to this agreement shall be those charged from time to time by the Tariff Accident Underwriters' Associations operating in Victoria and/or South Australia." The rates fixed by those associations provided for premiums covering (*inter alia*) third-party risk up to a limit of £1,000 and for an additional premium of 10s. for unlimited third party risk. After the agreement of 22nd August 1928 was executed, the company, to meet competition from another insurer, accepted such unlimited third-party risks without charging any additional premium. On 5th April 1929 the reinsurer in London executed an addendum to the agreement of 22nd August 1928 and forwarded such addendum to the company in Melbourne, where the company executed the same on or about 23rd May 1929. The addendum limited the liability of the reinsurer in respect of any third-party claim to two-thirds of £1,000 and provided that the reinsurer should continue to receive premiums in accordance with article VIII. of the agreement.

5. During the year ended 30th April 1931 and the year ended 30th April 1932 the company from time to time in the course of its business accepted in Victoria proposals for the insurance of motor vehicles against damage and other risks, and issued policies of insurance in respect thereof and received in Victoria premiums therefor. In accordance with the agreement varied as aforesaid, the company in Victoria made out and rendered to the reinsurer in London a monthly statement of account crediting the reinsurer with $66\frac{2}{3}$ per cent of the gross amount of such premiums received by the company during the month, and debiting the reinsurer with $66\frac{2}{3}$ per cent of premiums returned by the company to insurers during the month, and a commission calculated in accordance with the agreement on the net amount of premiums received, and also $66\frac{2}{3}$ per cent of all losses paid by the company during the month in respect of such insurances, less the amount of third party claims in excess of £1,000. The resultant balance of such monthly statement, if in favour of the reinsurer, was in accordance with the agreement paid within the time limited thereby by the company to the reinsurer by paying the same to the credit of the account of the reinsurer at the Bank of New South Wales at Melbourne. The Bank of New South Wale

from time to time, pursuant to instructions from the reinsurer transmitted such moneys to the reinsurer in London. If the resultant balance of such monthly statement was in favour of the company, the amount was remitted to it by the reinsurer from London. The company did not operate on the bank account of the reinsurer and had no authority to operate on the account. In addition to the commission charged in the monthly statement, the company was paid or allowed by the reinsurer a profit commission of ten per cent of the net annual profits calculated as provided by the agreement.

6. The total amounts respectively credited and debited to the reinsurer during the years ended 30th April 1931 and 30th April 1932 respectively and the difference between such amounts for each such year were as follows :—

Year ended 30th April 1931—

Premiums credited to reinsurer		£68,079 11 1
Returned premiums debited ..	£2,577 12 2	
Commission	22,995 2 4	
Profit and commission	1,249 8 3	
Claims for losses	34,557 4 2	
Balance	6,700 4 2	
	£68,079 11 1	£68,079 11 1

Year ended 30th April 1932—

Premiums credited to reinsurer		£57,011 16 7
Returned premiums debited ..	£1,906 11 8	
Commission	19,279 12 3	
Claims for losses	26,444 12 8	
Balance	9,381 0 0	
	£57,011 16 7	£57,011 16 7

7. The reinsurer did not make any return under the Act of its income for the year ended 30th June 1931, nor for the year ended 30th June 1932, but the commissioner, having ascertained from the company the figures set out in the preceding paragraph hereof, assessed the income of the reinsurer under the Act at £6,700 for the

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year 1931-1932, and the tax payable thereon at £630 4s. 4d., and at £9,381 for the year 1932-1933, and the tax payable thereon at £882 7s. 11d.

8. On 27th February 1933 the commissioner issued a notice of the assessment for the year 1931-1932, being assessment No. 206,086, to H. M. Brindley, the public officer (for the purpose of the Act) of the company, as agent for the reinsurer.

9. On 28th February 1933 the reinsurer by Messrs. Buckley and Hughes of Melbourne as its agents, lodged with the commissioner notice of objection to the assessment, the grounds of objection being set out as follows : (1) That Tariff Reinsurances Ltd. did not derive any income in Victoria from premiums of reinsurances received from the Automobile Fire and General Insurance Co. of Australia Ltd., such income being derived ex Australia ; (2) without prejudice to ground 1, that Tariff Reinsurances Ltd. did not derive a taxable income of £6,700 from reinsurance premiums from the Automobile Fire and General Insurance Co. Ltd., and, if taxable at all, is taxable only on such premiums less the expense actually incurred in gaining or producing them.

10. On 4th April 1933 the commissioner issued notice of assessment for the year 1932-1933, being assessment No. 1604, to H. M. Brindley, public officer of the company, as agent for the reinsurer.

11. After correspondence between the company, by its public officer, and Messrs. Buckley and Hughes and the commissioner, the commissioner, on 8th June 1934, wrote to the public officer of the company and enclosed therewith a notice of his decision on the objections. On the same day the commissioner sent a copy of the letter, together with a copy of the notice of his decision on the objection to the assessment No. 206086 for the year 1931-1932, to Messrs. Buckley and Hughes.

12. The company, by its public officer, on 11th June 1934, gave the commissioner notice that the reinsurer was dissatisfied with the commissioner's decisions on the objections and required the matter referred to the court.

13. After the agreement referred to in par. 3 hereof had been entered into and the company began to pay into the bank account of the reinsurer in Melbourne the amounts referred to in par. 5

hereof, the account at certain times was in credit to a substantial amount, and from time to time certain amounts so to the credit of the account were placed upon fixed deposit for a period at interest with the bank. In the year ended 30th June 1932 the reinsurer received a sum of £383 as interest on such fixed deposits.

14. On 19th July 1935 the commissioner amended the assessment No. 1604 for the year 1932-1933 by allowing a deduction from the taxable income, as assessed, of the sum of £1,383 referred to in the notice of objection to the assessment dated 28th February 1933 and by adding to the taxable income the sum of £383 referred to in the last preceding paragraph hereof, and accordingly reduced the taxable income assessed to £8,381 and the tax thereon to £778 6s. 8d.

15. The commissioner has intimated to the reinsurer that he is prepared to amend the assessment No. 206086 for the year ended 1931-1932 upon being furnished with satisfactory evidence of any expenses actually incurred by the reinsurer in gaining or producing the income assessed which have not been allowed for as a deduction in the assessment.

16. The commissioner transmitted the objections to be heard and determined by a judge of county courts in accordance with the provisions of the Act.

The question for the opinion of the Supreme Court was :—

> Was the commissioner right in disallowing the objections to the assessments for the years 1931-1932 and 1932-1933 respectively upon the ground marked 1 set out in the notice of objection to assessment No. 206086 for the year 1931-1932 ?

The ground marked 1 set out in the notice of objection to assessment No. 206086 for the year 1931-1932 was that Tariff Reinsurances Ltd. did not derive any income in Victoria from premiums on reinsurances received from Automobile Fire and General Insurance Co. of Australia Ltd., such income being derived ex Australia.

The Full Court of the Supreme Court held that the commissioner was right in disallowing the objections : *Commissioner of Taxes* v. *Tariff Reinsurances Ltd.* (1).

From that decision the reinsurer appealed to the High Court.

(1) (1938) V.L.R. 17.

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O'Bryan K.C. (with him *Moore*), for the appellant. The question is whether the profits which the taxpayer received were " earned in or derived in or from Victoria " within the meaning of sec. 42 of the *Income Tax Act* 1928 of Victoria. The reinsurers insured two-thirds of the risk which the Victorian company would take, and they fixed the premium at two-thirds of the premiums received by the Victorian company, subject to certain deductions. The reinsurer is an English company conducting its business in England, and the profits it makes under the contract are profits made in carrying out its ordinary business in England. There is no evidence of agency on the part of the Victorian company, nor is there any evidence of the transaction being a joint venture. The majority judgments in the Supreme Court look at this contract either as an agency contract or as a profit-sharing contract, but it cannot be regarded in either of such ways. The Victorian company in no way acts as agent for the English company. Income derived in or from Victoria means income arising or accruing from Victoria (*Commissioner of Taxation* v. *Kirk* (1); *Federal Commissioner of Taxation* v. *W. Angliss & Co. Pty. Ltd.* (2); *Federal Commissioner of Taxation* v. *Clarke* (3)). The essence of the business of the reinsurer is to make contracts. The source of profit of a particular contract is the country where it is made. The real business carried on by the appellant is the selection of risks (*Grainger & Son* v. *Gough* (4)). Not only is the contract made outside Victoria, but the appellant has no business premises in Victoria at all. [He referred to *Commissioner of Taxation* (*W.A.*) v. *D. & W. Murray Ltd.* (5).] The source of income is either the country where the contracts are habitually made or else the country where the particular contract is made (*Premier Automatic Ticket Issuers Ltd.* v. *Federal Commissioner of Taxation* (6); *Studebaker Corporation of Australasia Ltd.* v. *Commissioner of Taxation* (*N.S.W.*) (7)). The acts which are to be looked at are the acts of the taxpayer, and not the acts of somebody else.

(1) (1900) A.C. 588, at p. 592.
(2) (1931) 46 C.L.R. 417, at p. 421.
(3) (1927) 40 C.L.R. 246.
(4) (1896) A.C. 325.
(5) (1929) 42 C.L.R. 332, at pp. 349, 350.
(6) (1933) 50 C.L.R. 268, at pp. 285, 297.
(7) (1921) 29 C.L.R. 225.

Tait (with him *Adam*), for the respondent. The words of the Act are that the income to be taxed is that derived in or from Victoria. Income is defined in sec. 4. The taxpayer need not do any acts in Victoria as long as he derives income in Victoria. Sec. 42 separates the transactions for the purpose of taxation. The expression "in or from" Victoria contemplates a taxpayer either in or outside Victoria. A person can "derive" income though he may not do any act which gives rise to that income (*Smidth & Co.* v. *Greenwood* (1); *Sixsmith* v. *Commissioner of Taxation* (2)). There is a distinction between the English and the Victorian Acts (*Commissioner of Taxation (N.S.W.)* v. *Hillsdon Watts Ltd.* (3)). One must look at the substance of the Act and at the place at which the income actually arose; that is the place with which it has the most real connection (*Murray's Case* (4)). It was the performance of the contract that gave rise to the profits, and the contract was completely carried out in Australia. The fundamental thing that gave rise to the profits was the fact that the English company indemnified the Victorian company. The contract made in England was only an overriding contract to indemnify the Victorian company up to two-thirds of its losses. Under the Victorian Act it is not a criterion to consider where the company is carrying on its business (*Maclaine & Co.* v. *Eccott* (5)). The fundamental thing is the performance of the contract, and that took place wholly in Victoria. [He referred to *Lovell & Christmas Ltd.* v. *Commissioner of Taxes* (6).] The Victorian company has deducted from its Victorian income the amount it has paid to the English company (*Nathan* v. *Federal Commissioner of Taxation* (7)). The substantial thing that the English company did was to make money available in case of losses. In *Premier Automatic Ticket Issuers Ltd.* v. *Federal Commissioner of Taxation* (8) the central fact was that the Australian company owned certain rights and made a contract disposing of those rights. The court held that that was a pooling arrangement. The present case is a pooling arrangement also, but, if the companies had agreed to do the

(1) (1921) 3 K.B. 583, at p. 593.
(2) (1928) 28 S.R. (N.S.W.) 456; 45 W.N. (N.S.W.) 125.
(3) (1937) 57 C.L.R. 36, at pp. 42, 43.
(4) (1929) 42 C.L.R., at p. 351.
(5) (1926) A.C. 424.
(6) (1908) A.C. 46.
(7) (1918) 25 C.L.R. 183.
(8) (1933) 50 C.L.R., at pp. 285, 291, 294.

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reinsurance for a fixed sum, it would have been more difficult to allege a pooling arrangement. There is no analogy between the *Studebaker Case* (1) and the present. The real nature of the contract must be determined. This can be regarded only as a pooling arrangement. The English company came in and took an interest in a business conducted in Victoria (*Sixsmith's Case* (2)).

O'Bryan K.C., in reply. What is taxed by sec. 42 is profits earned or derived by the taxpayer. Profits suggest some business carried on by the taxpayer. The place where the contract is made by the taxpayer is the place where the business is carried on. The English company earns its premiums at the place where it conducts its business, that is, in England (*Commissioner of Taxation (N.S.W.)* v. *Cann & Sons Ltd.* (3)). This contract cannot be read as an agreement to share profits. A floating policy of marine insurance is one contract and does not create several contracts on a declaration of interest (*Robinson* v. *Touray* (4)). Here there is only one contract of insurance and not several contracts.

Cur. adv. vult.

April 4. The following written judgments were delivered :—

LATHAM C.J. This is an appeal from a judgment of the Full Court of the Supreme Court of Victoria upon a special case stated by a learned judge of the County Court for the opinion of the Supreme Court under sec. 66 of the *Income Tax Act* 1928 of Victoria. The Supreme Court held by a majority (*Mann* C.J. and *Macfarlan* J., *Martin* J. dissenting) that the respondent company, Tariff Reinsurances Ltd., was liable to pay income tax upon certain profits derived by the company in the years ended 30th April 1931 and 30th April 1932.

Tariff Reinsurances Ltd. is a company incorporated in England, and it carries on the business of reinsurer of insurance risks accepted by other persons. The Automobile Fire and General Insurance Co. of Australia Ltd. is a company incorporated in Victoria and

(1) (1921) 29 C.L.R. 225.
(2) (1928) 28 S.R. (N.S.W.), at pp. 461, 468.
(3) (1936) 4 A.T.D. 32.
(4) (1811) 3 Camp. 158; 170 E.R. 1340.

carries on the business of insurance, principally insurance of motor vehicles against damage and other risks. On 22nd August 1928 the two companies made an agreement in writing for the reinsurance by the English company of certain motor-insurance risks accepted and to be accepted from time to time by the Victorian company. The contract was made in London, the manager of the Victorian company having travelled to England for the purpose of making an arrangement for reinsurance. The English company is not registered in Victoria as a foreign company. It does not carry on business in Victoria and has no agent or representative in Victoria, unless the facts stated in the case stated show the contrary.

The contract between the parties was of the type known as a treaty of reinsurance (See *Welford and Otter-Barry's Fire Insurance*, 3rd ed. (1932), p. 383). Under the contract the English company reinsures the Victorian company in respect of two-thirds of the risks to which the contract applies. The consideration for the English company undertaking this liability is constituted by monthly payments made by the Victorian company. These payments are calculated by taking two-thirds of the gross premiums in respect of the relevant risks and deducting therefrom an amount varying with the loss ratio from thirty-five per cent (when the loss ratio is relatively low) to twenty-seven and a half per cent (when the loss ratio is relatively high). Thus, the better the selection of risks by the Victorian company, the smaller the payment made by it to the English company. A further deduction is made of ten per cent on the profits of the Victorian company calculated in the manner set forth in the contract. It is quite possible under the contract for the English company to make a profit out of the agreement in any year though the Victorian company in that year should make no profit at all. It is clear that the agreement is not an agreement for the sharing of profits made by the Victorian company.

The contract provides that moneys payable to the English company shall be paid into its account at the Bank of New South Wales in Melbourne. If the English company had to make any payment on account of losses to the Victorian company which could not be satisfied by deductions from the moneys payable to the credit of the English company, it would be necessary under the terms of the

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contract for these payments to be made by the English company to the Victorian company in Victoria.

The contract provides that the Victorian company may accept such insurance risks and pay such claims as it thinks proper. It is provided that the English company shall be deemed to have reinsured the risks insured by the company upon the same conditions as may for the time being be subsisting with regard to the policies of insurance issued by the Victorian company, "the intention being that the reinsurer shall follow the fortunes of the company in regard to the policies of insurance of which the reinsurer by virtue of this agreement takes part." It is thus clear that the English company takes no part in the business conducted by the Victorian company, and that it is not entitled to exercise any control over that business.

The English company in fact made profits in the years mentioned out of the reinsurance business which came to it under the contract. The question is whether these profits are taxable under the *Income Tax Act* 1928 of Victoria.

Sec. 42 of that Act provides, subject to an exception which is not material in the present case, that "so far as regards any company liable to pay tax the income thereof chargeable with tax shall . . . be the profits earned in or derived in or from Victoria by such company" during the relevant year. It is not disputed that the English company has made profits during the years in question. The controversy is as to whether those profits were earned in or derived in or from Victoria. It has not been argued that the profits were earned in Victoria by the English company, but it has been contended that they were derived in or from Victoria.

The terms of the contract are set forth fully in the special case, but the references which I have made to them are sufficient to show that the remuneration of the English company depended upon the amount of the business and the character of the business done by the Victorian company. But, as already stated, the English company did not share in the profits of the Victorian company, and its remuneration was not dependent upon the earning of profits by the latter company. There is nothing in the contract which can be relied upon as creating anything like a "partnership" between the companies in the sense of carrying on business in common or as a

joint venture. Nor is the Victorian company in any sense an agent of the English company—the Victorian company has no authority by virtue of the contract to engage the English company in any liability to any third person.

It has been argued for the Commissioner of Taxes that the profits of the English company which are in question are really derived from the insurances of motor cars arranged in Victoria, and that the English company has therefore derived those profits in or from Victoria. The Victorian insurances are said to be the business operations which are the real source of the profits of the English company. On the other hand it is argued that the profits of the English company are derived from the contract of reinsurance which was made in London, and that therefore they are not derived in or from Victoria.

It is a question of fact whether income (or profits) is derived from a particular country. In *Federal Commissioner of Taxation* v. *W. Angliss & Co. Pty. Ltd.* (1) my brother *Starke* sets out and examines a number of cases which have dealt with this subject. It is there shown that the question which arises is really a question of fact and that no absolute rule of law can be stated the application of which will make it possible to determine all cases.

The English company derives its profits from its own business and not from the business carried on by the Victorian company. The business which "yields the profits" (to use the phrase of *Lovell & Christmas Ltd.* v. *Commissioner of Taxes* (2)) to the English company is the business of reinsurance. In order to determine whether the profits are derived in or from Victoria it is necessary to ascertain what the taxpayer does in order to obtain the profits in question (*Premier Automatic Ticket Issuers Ltd.* v. *Federal Commissioner of Taxation* (3), per *Dixon* J.). It is not relevant to consider what another person, who is not an agent in any sense of the taxpayer, does in order to obtain the moneys which he uses for the purposes of making payments to the taxpayer. In this case the English company carried on no operations or transactions in Victoria at all (See *Smidth & Co. Ltd.* v. *Greenwood* (4)). The English company made profits, but

(1) (1931) 46 C.L.R. 417, at pp. 421 et seq.; see especially at p. 423.
(2) (1908) A.C., at p. 52.
(3) (1933) 50 C.L.R., at p. 294.
(4) (1921) 3 K.B. 583, at pp. 593 et seq.

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those profits were not made by reason of anything done in Victoria by the English company.

The place where a contract is made is an element in determining whether profits made by that company are made in that particular place. This element may be decisive in determining the answer to the question whether a trade which consists in the making of contracts is exercised in that place (*Grainger & Son* v. *Gough* (1)). But, as *Starke* J. emphasized in *Angliss' Case* (2), the place where the contract is made is not a decisive element in determining the place from or in which profits are derived. I venture to refer to what I have already said on this subject in *Commissioner of Taxation (N.S.W.)* v. *Hillsdon Watts Ltd.* (3).

The payment of moneys to or by the company in Victoria is a banking transaction and cannot be said to amount to business operations in Victoria from which the profits in question are derived.

In this case the contract for reinsurance was made in England, and that fact is an important element in the determination of the question which arises. Further, the profits were derived from that contract and were not derived from the insurance operations of the Victorian company in Victoria. These operations doubtless provided the moneys with which the Victorian company paid its debts to the English company, but that fact does not bring about the result that profits are derived by the English company from Victoria. If the contrary view were taken income would be derived from Victoria by every person in other countries who sold goods to persons who paid for the goods with moneys earned in or derived from Victoria (Cf. *Ferguson* J. in *Sixsmith* v. *Commissioner of Taxation* (4)).

It is not necessary in this case to determine whether or not the profits of the company were derived in or from England. Doubtless the English company carried on the business of reinsurance in England, but there is no statement to that effect in the special case. It is sufficient for the appellant to show that the profits were not derived in or from Victoria. In my opinion it has shown that they

(1) (1896) A.C., at pp. 335, 340.
(2) (1931) 46 C.L.R. 417.
(3) (1937) 57 C.L.R., at pp. 42, 43.
(4) (1928) 28 S.R. (N.S.W.), at p. 468.

were not so derived. To the fact that the contract was made in England I add the facts that the English company conducted no transactions or operations of a profit-making kind in Victoria, that it in fact did nothing in Victoria, that the Victorian company was not, in carrying on its business, the agent or representative or employee of the English company, and that there is no evidence to show that it was engaged in any form of joint venture in Victoria with the Victorian company.

In my opinion the appeal should be allowed and the question in the special case should be answered in the negative.

RICH J. This is an appeal from a decision of the Full Court of Victoria which by a majority, *Mann* C.J. and *Macfarlan* J., *Martin* J. dissenting, held that the income or profit obtained by a London reinsurance company under a reinsurance treaty, there made with a Victorian company for the reinsurance of risks on motor cars, was "profits earned in or derived in or from Victoria" (sec. 42, *Income Tax Act* 1928 (Vict.)). The London company is the appellant. The Victorian company is incorporated in that State and there carries on insurance business, the chief part of which is the insurance of motor cars against damage and other risks. It does not appear whether the risks are confined to motor cars whose owners reside in Victoria, but in the ordinary course of affairs it seems probable that the company effects insurances in Melbourne irrespective of any State boundary, although naturally the greater number of the cars will be used for the most part in Victoria. The reinsurance treaty was made in London by a representative of the Victorian company who journeyed thither seeking reinsurances or some general reinsurance arrangement. No doubt the treaty follows common practice. Its effect is to hold during its currency the Victorian company reinsured in respect of two-thirds of every risk accepted by the Victorian company. The reinsurance premiums, or consideration for the reinsurance, are calculated by reference to the premiums payable by the insured under the original insurance. There is some complication in the calculation owing to allowances, deductions or rebates the quite apparent object of which is to provide incentives

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to the reinsured to be careful in the choice of risks and in the settlement of claims. The primary proportion of premiums ceded to the reinsurer by the reinsured is the same as that of the risk, viz., two-thirds. From this the allowances are to be deducted. We listened to an elaborate discussion of the basis and true inwardness of the calculation of the deductions, the object of which was to show that the reinsurance treaty resulted in "pooling" or profit-sharing. I do not quite see what virtue there is in these expressions one way or the other. It is quite clear that under the treaty the payments to the reinsurer, whether they are called premiums or by whatever name they are described, are calculated upon a proportion to the original premiums, and it does not seem to me to matter whether it is a simple proportion or a more complicated one based upon a number of variables. The material facts of the case are simply that a company carrying on business in London and not in Victoria makes a reinsurance treaty with a company carrying on business in Victoria in the insurance of risks more or less identified with Victoria, that the London company's remuneration is equivalent to a portion of the premiums and that the payment of the remuneration, less the London company's proportion of losses, is to be made to a bank account in Melbourne. I do not think that any amount of discussion of the facts will make more of them than this. On these facts we have to decide whether the London company derives its profit in or from Victoria. We are frequently told, on the authority of judgments of this court, that such a question is "a hard, practical matter of fact." This means, I suppose, that every case must be decided on its own circumstances, and that screens, pretexts, devices and other unrealities, however fair may be the legal appearance which on first sight they bear, are not to stand in the way of the court charged with the duty of deciding these questions. But it does not mean that the question is one for a jury or that it is one for economists set free to disregard every legal relation and penetrate into the recesses of the causation of financial results, nor does it mean that the court is to treat contracts, agreements and other acts, matters and things existing in the law as having no significance. In the present case it seems to me that the London company is

engaged in a business the profits from which arise from transactions exclusively financial in their nature. The first consideration in that business must be the company's financial capacity to shoulder the risk involved in the reinsurance, the next must be the business ability of its managers in the selection, acceptance and rejection of the various reinsurance risks proposed to it and the last must be the matters which make it ready to include the proposed reinsurance treaty under the risks accepted. In considering the source of the profit of such a business or of any transaction arising in it I do not think that the place where the event or events may or do happen upon which the company's liability depends can matter at all. The source of the income of a marine insurer carrying on business in London may be in London, wherever the ships or cargoes he insures may happen to be from moment to moment. In the case of reinsurance I fail to see why the place where the reinsured operates is any more to the point. The idea that a reinsurer is engaged in a joint operation with the reinsured does not strike me as an ordinary conception of reinsurance. They are independent contracts (*Nelson* v. *Empress Assurance Corporation* (1)), although the obligations arising under them may arise upon the same contingencies. To identify the reinsurer's premiums or other remuneration with the original premiums and to treat them as part of the insurer's source of income seems to me to overlook the entirely separate character of the two businesses out of which the transactions arise. As well might it be said that a butcher who supplies a restaurant with meat and is paid by the restaurant proprietor out of the gross returns the latter receives derives his income from the carrying on of the restaurant. If this method of reasoning were allowable the income of the first producer of any article should be traced through to the ultimate consumer who pays for it. And I do not attach any importance to the fact that the place of payment is Melbourne. This is only a question of banking convenience and possibly exchange. To my mind the source of the reinsurer's income is a contract constituting a reinsurance treaty made in London in the ordinary course of a business carried on in London.

In my opinion the appeal should be allowed.

(1) (1905) 2 K.B. 281, at p. 285.

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STARKE J. Appeal from a judgment of the Supreme Court of Victoria upon a special case stated for its opinion.

The facts are set forth in detail in the case. The Automobile Insurance Co. of Australia Ltd. carried on business in Victoria and effected insurance upon motor vehicles against damage and other risks. It made an agreement dated 22nd August 1928 with Tariff Reinsurances Ltd. to reinsure these risks. The reinsurance agreement was not a contract to reinsure against liability on particular policies, but to reinsure against liabilities on policies generally. It was a contract quite independent of the original contract of insurance effected by the Automobile Co.: there was no privity of contract between the reinsurers and the original insured. The contract did not between the parties to it pool the premiums received under the original contracts; nor did it amalgamate the business of the two companies nor constitute them partners nor agents as between themselves. It is what is known in the insurance world as treaty reinsurance, and the form and effect of such contracts is explained in *Welford and Otter-Barry's Fire Insurance*, 3rd ed. (1932), pp. 382 et seq., and in an article by Dr. *Golding* in the *Encyclopædia Brittanica*, 14th ed. vol. 19, "Reinsurance." In this case the reinsurance contract provides that when the Automobile Co. effected an insurance covered by the contract Tariff Reinsurances Ltd. reinsured the company in respect of such insurance in the proportion of two-thirds of the risk so accepted and that the Automobile Co. should pay to the credit of the reinsurers at Melbourne the equivalent of $66\frac{2}{3}$ per cent of the Automobile Co.'s gross motor premiums pertaining to the contract in respect of each month, less certain deductions which in the contract are referred to as commission and profit commission, which are also explained in the article mentioned.

Tariff Reinsurances Ltd. made considerable profits in respect of the reinsurance effected under the contract already mentioned. For the year 1931-1932 the commissioner assessed it to income tax in the sum of £6,700, and for the year 1932-1933 in the sum of £9,381.

The following question was stated for the opinion of the Supreme Court: Was the commissioner right in disallowing the said objections to the said assessments for the years 1931-1932 and 1932-1933 respectively upon the ground that Tariff Reinsurances Ltd. did not

derive any income in Victoria from premiums on reinsurance received from Automobile Insurance Co. of Australia Ltd., such income being derived ex Australia? A majority of the learned judges of the Supreme Court resolved this question in the affirmative, and an appeal is now brought to this court.

The question depends upon the provisions of sec. 42 of the *Income Tax Act* 1928 of Victoria: "So far as regards any company liable to pay tax the income thereof chargeable with tax shall . . . be the profits earned in or derived from Victoria by such company during the year immediately preceding the year of assessment."

Tariff Reinsurances Ltd. is a company incorporated in England and apparently carries on business there as a reinsurer of business risks. Every operation of business in connection with the negotiation and conclusion of the reinsurance contract took place in England and as part of the business of the reinsurer there. The contract provides that regular statements of the risks taken by the Automobile Co. shall be forwarded to the reinsurer, which may by its representatives examine the books of the company. But the company is to pay into a banking account at Melbourne to the credit of the reinsurer the equivalent of $66\frac{2}{3}$ per cent of the company's gross motor premiums pertaining to the reinsurance contract, less deductions already mentioned. But, apart from keeping this banking account in its name, the reinsurer has no office nor place of business and does not engage in any business operation in Victoria.

The reinsurance contract involved, as already observed, no transaction or privity between the reinsurer and the original insured. Where, then, do the operations take place from which the income or profit of the reinsurer in fact arises? Did they take place in England or Victoria? The question resolves itself in the last resort into a question of fact. Every detail of the transaction must be considered: no one fact is conclusive. In my opinion in this case the real connection of the business operations is with England. It is where the substance and essence of the operations were transacted. They had no connection with Victoria except that the risks reinsured existed in Victoria. But the making of reinsurance in England in respect of risks arising in Victoria is not a business operation carried

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on in Victoria (*Lovell & Christmas Ltd.* v. *Commissioner of Taxes* (1); *Greenwood* v. *F. L. Smidth & Co.* (2); *Studebaker Corporation of Australasia Ltd.* v. *Commissioner of Taxation (N.S.W.)* (3); *Federal Commissioner of Taxation* v. *W. Angliss & Co. Pty. Ltd.* (4)).

Consequently, in my opinion, the appeal should be allowed and the question stated answered in the negative.

DIXON J. The appellant is a company incorporated in Great Britain. Its business is that of reinsuring risks undertaken by other insurers. In the year 1928 it entered into a reinsurance treaty with a Victorian company carrying on in Victoria the business of motor car insurance. The treaty was made in London, whither the Victorian company had sent its manager to obtain reinsurance cover. Under the terms of the treaty it remained in force until terminated by notice, and no such notice was given, at all events at any time material to the question we are called upon to determine. That question is whether any part of the moneys received by the appellant under the treaty is taxable in Victoria as profits earned in or derived in or from that State by the appellant company.

The *Income Tax Act* 1928 (Vict.) applies to the financial years concerned, and sec. 42 of that Act in prescribing what income of a company is to be chargeable with income tax provides that it shall be the profits earned in or derived in or from Victoria by such company during the year immediately preceding the year of assessment.

Except for the treaty of reinsurance the appellant company appears to have carried on no activities in and to have had no connection with Victoria. The question depends altogether on the effect of the treaty and what was done under it. It is an open treaty of reinsurance or, as it is sometimes called, a quota-share treaty. It covers all risks in relation to motor vehicles insured by the ceding company during its currency. The ceding company as reassured is bound to cede and the appellant as reinsurer to accept the stipulated proportion of every risk, which is two-thirds. That one should not retain the better risks and that the other should not refuse the worse is a fundamental principle of a quota-share treaty.

(1) (1908) A.C. 46.
(2) (1922) 1 A.C. 417.
(3) (1921) 29 C.L.R. 235.
(4) (1930) 46 C.L.R., at pp. 421-423.

As is usual in such contracts, the consideration payable to the reinsurer by the reassured is calculated by taking as a base the same proportion of the original premium as the proportion of risk transferred and by making deductions therefrom. The ceding company has all the expense of obtaining the premiums and conducting an insurance business and accordingly could not afford to cede to the reinsurer a proportion of the premium equal to that of the risk accepted. The first deduction therefore is a percentage of the premium income, regarded no doubt as sufficient to recoup such expenses. It is a percentage varying between twenty-seven and a half and thirty-five per cent of the earned premiums according to the loss ratio of the year of account. The variation obviously tends to make it more profitable for the reassured to keep down the ratio of losses to premium income by exercising care either in the selection of risks or in the adjustment of claims or in both. The second deduction allowed from the reinsurer's proportion of the premium is a percentage of the reinsurer's "profit" from the treaty during the year of account. The "profit" is calculated according to a prescribed method based on a simple comparison between premiums and losses and between the premium reserve and estimated liability for losses at the beginning and end of the year respectively. It is an artificial "profit." The rate allowed is ten per cent. This deduction of a percentage of the profit and the variation with loss ratio in the percentage deducted under the first head together operate to give the ceding company improved terms of reinsurance during the currency of the treaty as the risk reinsured improves. It thus puts the reassured in a position of obtaining better rates for better risks, as he might have done under the older practice of facultative reinsurance. Both the percentages are called commissions in accordance with the usual terminology of reinsurance treaties. A third deduction provided for by the present treaty is a fixed annual sum allowed on account of the costs of employing a motor engineer or engineers. The contract contains the ordinary provisions by which the reinsurance of a risk is to be upon the same terms and conditions as the original insurance and the reinsurer is bound to follow the fortunes of the reassured; it authorizes the latter to settle all claims and requires the reinsurer

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to bear, as its proportion of the loss, a due part of the aggregate amount of the settlement and costs incurred. *Bordereaux* and lists of losses are to be forwarded to the reinsurer by the reassured. Payments of the amounts due to the reinsurer are to be made monthly to a bank account opened by the reinsurer in Melbourne. The treaty contains a number of subsidiary provisions, but none of them appears material to the question whether the returns to the reinsurer from the transaction constitute income derived in or from Victoria.

In assessing the appellant, the commissioner treated as taxable income the net yearly balance credited to the appellant by the ceding company, consisting in the difference between the two-thirds proportion of the premiums and the aggregate of the deductions for "commissions" &c. under the treaty together with the reassured's proportion of losses.

It appears incidentally that the appellant had in its turn made reinsurance contracts with other companies, but no claim is made on its behalf to reduce the assessment on account of the cost of reinsuring the risks undertaken in pursuance of the treaty. The circumstance is, however, not unimportant; for it illustrates the real nature of the profit or income arising from reinsurance business. It does not consist in the net receipts from a particular treaty, but in a favourable balance arising from the business as an interconnected whole; and this may, perhaps, be said to depend as much upon the retention as upon the acceptance of risks. This consideration is material to the ground upon which the majority of the learned udges in the Supreme Court decided that the appellant's net receipts under the treaty were liable to Victorian income tax. The ground was that the treaty conferred upon the appellant a title to share in profits earned by the reinsured in Victoria. *Mann* C.J. said: "In point of pure fact the reinsurance company shares the profits of the Victorian business and has no other profits relevant to this case" (1). *Macfarlan* J. said that an examination of the contract and of the relations between the companies and of the manner in which it was carried out pointed to one of two conclusions, "either the Victorian company was really the agent here of the English

(1) (1938) V.L.R., at p. 22.

company or else it was engaged with it in a joint adventure " (1). This view of the matter may be said to treat the insurance of motor-car risks in Victoria as a source of profit which is earned by the companies in combination or, if earned by the ceding company alone, is divided by it with the reinsurer. It is based, no doubt, upon the fact that the consideration for the reinsurance is calculated by reference to the original premiums and that a portion of the losses is necessarily borne by the reinsurer. It is a view too which may, perhaps, claim support from the terminology of reinsurance, which speaks of ceding premiums and deducting commissions on premiums and on profits. Further, to regard the reassured under a treaty as an agent of the reinsurer is not entirely without judicial authority. For, in *In re Norwich Equitable Fire Assurance Society* (2), *Kay* J. described a treaty as an agreement of agency. He did so in the course of rejecting an argument that a partnership, or something like a partnership, had been established by a treaty for the reinsurance of risks which the reassured should accept in the course of a fire-insurance business conducted through a foreign agency. Counsel had said that it was not merely an agency agreement, and *Kay* J. said it was. But it seems probable that some confusion occurred through clauses dealing with the reassured's foreign agency and a percentage allowance on account of the expenses thereof (3).

Notwithstanding these considerations, I am unable to adopt the view that the appellant shared in the profits of the reassured, or was engaged with it in a joint adventure, or employed it as an agent in Victoria, and I do not think that on those or on any other grounds the appellant should be considered to have earned or derived profits under the agreement in or from Victoria.

Though, unlike facultative reinsurance, a treaty does not insure an existing risk in which the reassured has an insurable interest as the original insurer, it is nevertheless a contract of reinsurance, an antecedent contract for the reinsurance of a defined portion of risks of a specified kind to be undertaken in the future by the reassured. The original insured is a stranger to the reinsurer. He is unaffected by the reinsurance and obtains no legal advantage from it. It

(1) (1938) V.L.R., at p. 24. (2) (1887) 3 T.L.R. 781 ; 57 L.T. 241.
(3) (1887) 3 T.L.R., at p. 782.

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establishes no relations except with the reassured, and it does not authorize the reassured to bring about any relations between third persons and the reinsurer. The treaty does not in any way constitute the reassured a representative of the reinsurer nor empower the latter to perform any act on its behalf.

The notion that, because the risks reinsured are risks to property in a given place, therefore the reinsurer carries on in that place the business of insurance has been rejected as without foundation by the Supreme Court of the United States (*Morris & Co.* v. *Skandinavia Insurance Co.* (1)). No doubt it is true, as *Romer* J., as he then was, said in *First Russian Insurance Co.* v. *London and Lancashire Insurance Co.* (2), that "a reinsurance business does not consist" scil., exclusively, "in executing reinsurance treaties. It consists in the performance of the manifold acts for which the treaties provide, the passing to and fro of the bordereaux and the accounts, the intimation, agreement and payment of losses, the correspondence and interviews which such matters demand." But a transaction of reinsurance is essentially a matter of finance. Its basis is indemnification. The reinsurer furnishes his obligation, which stands upon his credit, and it is from this that his title to the recompense springs. The nature and extent of the recompense from the given transaction depend on the exercise of judgment and the use of knowledge and information in negotiating and accepting the contract or treaty. The profit from the business of which the given transaction is an incident depends on the interrelation of all such transactions, their bearing upon one another and the arrangements made for retaining and ceding risk.

Although the reward contracted for under a quota-share treaty is based as a matter of calculation upon the premiums received by the reassured on the original insurances, it is not a share either in the gross or the net profits of the reassured. The gross receipts of the reassured, no doubt, include its gross premium income. But there is, in my opinion, no more reason to regard the sums due to the reinsurer as part of the gross receipts or the premium income than to identify any other part of the reassured's expenditure with those receipts or that income, because, as will almost always be the case,

(1) (1929) 279 U.S. 405; 73 Law. Ed. 762. (2) (1928) Ch. 922, at p. 937.

the expenditure is defrayed thereout. Commissions to canvassers and agents based on premiums might just as well be considered in that light for taxation purposes. No one doubts that, in ascertaining the income or profits of the reassured from its insurance business, the amount paid by it for reinsurance must be deducted, just as the commissions to its agents; and it cannot matter whether it obtains its reinsurance under a treaty nor whether the treaty is a quota-share treaty, a surplus treaty or an excess of loss treaty. That the reinsurer takes no share in the net profits or income of the reassured admits, I think, of no doubt. The amount of the profits of the reassured is dependent upon a multitude of elements of which the reinsurance treaty is only one. Too high an expenditure on efforts to obtain new business might, for instance, conceivably leave it with a loss although the reinsurer's net receipts under the treaty were left undiminished, or were actually increased.

Nothing in the present case was done in Victoria by the appellant and nothing was done there on its behalf except the receipt by the bank of money paid to its account. The transaction out of which the receipts taxed as income arose was the acceptance in London of a reinsurance treaty negotiated in London as an ordinary incident of a reinsurance business there carried on. Upon the question where the profit was derived or earned, the place of actual payment has in this case but a very slender bearing. It is a matter only of banking and business convenience. All the other matters mentioned by *Romer* J. as making up reinsurance business were carried out or done in London. There the *bordereaux*, the accounts and lists of losses were received, the correspondence was written and the negotiations and interviews leading to the treaty took place. The contention which traces the profits to the activities of the reassured as a Victorian source is analogous to the contentions rejected in the *Premier Automatic Ticket Issuers Ltd. Cases* (1) and in *Studebaker Corporation of Australasia Ltd.* v. *Commissioner of Taxation (N.S.W.)* (2). Indeed, once the view is adopted that the treaty is an independent transaction involving neither the division of net earnings nor agency or representation, it is not easy to distinguish these cases.

(1) (1933) 50 C.L.R. 268, 304. (2) (1921) 29 C.L.R. 225.

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In my opinion the dissenting judgment of *Martin* J. is right and the appeal should be allowed.

The order of the Supreme Court should be discharged and the question in the special case should be answered: No, and the special case remitted to the County Court. The respondent should pay the costs in this court and in the Supreme Court.

McTIERNAN J. I agree that the appeal should be allowed.

The appellant is not taxable under sec. 42 of the Victorian *Income Tax Act* 1928 unless the facts show that the profits which the respondent seeks to tax under that section were "earned in or derived in or from Victoria" by the appellant company. The intention of these words is not satisfied merely by showing that profits have been received in Victoria. It must be shown that they are made out of a business or some operation carried on in Victoria by their recipient or represent the fruit of some investment made in Victoria. In my opinion the acts in the present case do not support the conclusion either that the profits in question, even though received in Victoria, are attributable to any operation or activity of the appellant in Victoria or that it employed the reinsurance company as its agent or acquired an interest in that company's business. The profits are attributable to the treaty of reinsurance, the making of which was an operation carried out by the appellant in the course of its business in London, and it did not carry out any activity or conduct any business whatsoever in Victoria pursuant to the treaty or otherwise whereby it earned or derived any part of the profits sought to be taxed.

Appeal allowed with costs. Order of Supreme Court discharged. Question in special case answered: No. Respondent to pay costs of and incidental to special case. Matter remitted to County Court at Melbourne to proceed therein in conformity with this judgment.

Solicitors for the appellant, *Mills & Oakley*.

Solicitor for the respondent, *F. G. Menzies*, Crown Solicitor for Victoria.

H. D. W.