[HIGH COURT OF AUSTRALIA.]

MAGRATH . . . . . PLAINTIFF;

AND

THE COMMONWEALTH . . . . . DEFENDANT.

H. C. OF A. 1944.

SYDNEY, *April* 14.

MELBOURNE, *May* 29.

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

Income Tax (Cth.)—Assessable income—External loan—Gold dollar bonds—Principal and interest payable "without deduction for any taxes" present or future, imposed by Commonwealth or State—Bondholder resident in Commonwealth—Whether promise not to impose tax—Income Tax Assessment Act 1922-1934 (*No.* 37 *of* 1922—*No.* 18 *of* 1934), *s.* 13—*Income Tax Assessment Act* 1936-1941 (*No.* 27 *of* 1936—*No.* 69 *of* 1941), *s.* 25—*Loans Securities Act* 1919 (*No.* 25 *of* 1919), *s.* 3.

The plaintiff, who was at all material times a resident of the Commonwealth, had since December 1929 been the holder of some bonds issued in New York in 1927 by the Commonwealth of Australia as part of an external loan. The bonds provided that principal and interest were payable "to bearer" in New York in gold coin of the United States of America "without deduction for any taxes" then or at any time thereafter imposed by the Commonwealth or by any taxing authority thereof or therein, and the interest coupons attached to the bonds provided that interest was similarly payable "without deduction for any Australian taxes present or future."

Held, by *Rich*, *McTiernan* and *Williams* JJ. (*Latham* C.J. and *Starke* J. dissenting), that by the bonds the Commonwealth promised the plaintiff as holder that the interest, after having been paid to him in full, would not form part of his assessable income for the purpose of Federal income tax within the meaning of the *Income Tax Assessment Act* 1922, and the *Income Tax Assessment Act* 1936, as respectively amended, or any other *Income Tax Assessment Act* thereafter to be enacted although he was a resident of Australia and liable as a taxpayer within the meaning of those Acts.

Perpetual Trustee Co. (Ltd.) v. *Federal Commissioner of Taxation*, (1932) 47 C.L.R. 402, and *Ervin* v. *Federal Commissioner of Taxation*, (1935) 53 C.L.R. 235, referred to.

CASE STATED.

An action was brought in the High Court by William George Magrath against the Commonwealth of Australia for the recovery

of additional amounts of income tax which Magrath alleged he had become liable to pay or had paid by reason of the inclusion as part of his assessable income derived during the years ended 30th June 1932 to 30th June 1942 inclusive, of interest paid to him by the Commonwealth in respect of certain bonds owned by him.

Upon the action coming on to be tried before *Williams* J. his Honour, at the request of both parties and pursuant to s. 18 of the *Judiciary Act* 1903-1940, stated a case, which was substantially as follows, for the consideration of the Full Court.

1. On 24th December 1929 the plaintiff was and has been ever since a resident of New South Wales, and, as such, has been liable as a taxpayer to pay Federal income tax under the provisions of the *Income Tax Assessment Acts* 1922 and 1936 as amended from time to time.

2. On 24th December 1929 the plaintiff purchased in the United States of America from the previous holder or holders thereof forty-six bonds of the defendant, each bond having a face value of one thousand dollars and having interest coupons attached thereto.

3. The bonds are gold bonds payable to bearer and are part of an external loan of forty million dollars five per cent gold bonds floated by the defendant in the United States of America in the year 1927. The bonds are dated 1st September 1927 and are due 1st September 1957 but are subject to redemption at the option of the defendant not earlier than 1st September 1947 as therein mentioned.

4. The bonds are definitive bonds which were sold and issued to the plaintiff's predecessor or predecessors in title in the United States of America in accordance with the provisions of a contract in writing (hereinafter called the loan contract) dated 22nd August 1927 duly made between the defendant by its agent, its Commissioner in the United States of America, and two American corporations, namely, J. P. Morgan & Co. and National City Co.

5. The loan contract provided, *inter alia*, that the defendant agreed to sell to the said corporations, subject to the conditions therein stated, and the said corporations agreed to purchase from the defendant, all of the forty million dollars principal amount of the bonds at a price referred to in the contract; that on such date as should be fixed by the corporations not later than 16th September 1927 the defendant would deliver in the City of New York, State of New York, United States of America, to the corporations or their nominee or nominees temporary or provisional bonds of the issue for the aggregate principal amount of forty million dollars and that thereupon the corporations would make payment therefor of the

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purchase price specified in the contract; that the defendant would deliver or cause to be delivered prior to 1st June 1928 to the holders of the temporary or provisional bonds in exchange therefor either at the office of J. P. Morgan & Co. or at the principal office of the National City Bank of New York, in the State of New York, definitive bonds of the denomination of $1,000; and that the corporations proposed, on or after 23rd August 1927, to make a public offering of the bonds in the United States of America at a price referred to in the contract.

6. The loan contract further provided that the text of the definitive bonds and of the coupons for interest thereon should be substantially as set forth in a schedule attached to the loan contract and the text of the bonds purchased by the plaintiff and of the interest coupons attached thereto is in fact substantially as set out in the schedule.

7. The loan contract further provided that "all payments in respect of the bonds and the coupons shall be made without deductions for any taxes, imposts, stamp dues and assessments now or at any time hereafter imposed or levied by the Commonwealth of Australia or any of its States or municipalities or other taxing authorities thereof or therein." A true copy of the loan contract, which is sufficiently set forth above, was annexed as part of the case.

8. Such bonds were duly issued upon the terms and conditions set forth therein by authority of the Governor-General of the Commonwealth acting with the advice of the Executive Council pursuant to the power conferred upon him by s. 3 of the *Loans Securities Act* 1919.

9. By the bonds the defendant, for value received, promises "to pay to the bearer, on the first day of September 1957, the principal sum of one thousand dollars . . . , and to pay interest on such principal sum at the rate of five per cent . . . per annum, semi-annually on the first day of March and the first day of September in each year after the date hereof until such principal sum shall have been paid, but only upon presentation and surrender of the coupons for such interest thereto attached, as severally they mature. Such principal sum and interest instalments, when due respectively, will be paid in the borough of Manhattan, City of New York, State of New York, United States of America, either at the office therein of J. P. Morgan & Co. or at the principal office of The National City Bank of New York, as the holder hereof shall elect, in gold coin of the United States of America of the standard of weight and fineness existing on September 1, 1927, without deduction for any taxes now or at any time hereafter imposed by the Commonwealth of Australia or by any taxing authority thereof or therein."

10. By each interest coupon the defendant promises to " pay to bearer " on a date stated in the coupon " in the Borough of Manhattan, City of New York, United States of America, either at the office of J. P. Morgan & Co. or at the principal office of The National City Bank of New York, twenty-five dollars, gold coin of the United States of America of the standard existing on September 1, 1927, without deduction for any Australian taxes present or future."

11. Each bond is stated to be one of the external loan of 1927, thirty-year five per cent gold bonds dated 1st September 1927 for an aggregate principal amount of $40,000,000 issued by the defendant in accordance with the loan contract dated 22nd August 1927 entered into by the defendant with J. P. Morgan & Co. and the National City Co. as bankers.

12. The bonds contain a provision that they shall not be negotiable until countersigned for authentication by the National City Bank of New York or its successor duly appointed by the defendant for such purpose. At the time the plaintiff purchased the bonds this condition had been complied with.

13. A true specimen copy of one of the bonds and of the interest coupons attached was annexed as part of the case. Particulars are sufficiently set forth above.

14. The plaintiff, since he became the owner of the bonds, has caused the interest coupons to be duly presented and the interest which has become due from time to time to be duly collected on his behalf in New York and transmitted to him in Australia. The defendant has always paid the interest to the plaintiff as it has become due from time to time without any deduction and in accordance in all respects with the provisions of the bonds and the interest coupons attached thereto.

15. Pursuant to the provisions of the Federal *Income Tax Assessment Acts* 1922 and 1936 as amended the Federal Commissioner of Taxation has included the interest received by the plaintiff from time to time on the bonds at its value in Australian currency as part of his assessable income derived during the years ended 30th June 1932 to 30th June 1942 inclusive, and the plaintiff has become liable to pay, and has paid part of, the taxes assessed on that basis.

Upon these facts the following questions of law were stated for the consideration of the Full Court :—

1. Whether by the bonds the defendant promised the plaintiff as holder that the interest, after having been paid to him in full, would not form part of his assessable income for the purpose of Federal income tax within the meaning of the *Income Tax Assessment Act* 1922, and the *Income Tax Assessment Act* 1936, as respectively

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amended, or any other *Income Tax Assessment Act* thereafter to be enacted although he was a resident of Australia and liable as a taxpayer within the meaning of those Acts.

2. In the event of the first question being answered in the affirmative, whether the plaintiff is entitled to recover from the defendant by way of indemnity or as damages the additional amounts of income tax which the plaintiff has become liable to pay or has paid by virtue of the inclusion of such interest as part of his assessable income derived during the years ended 30th June 1932 to 30th June 1942 inclusive under the provisions of the *Income Tax Assessment Acts* 1922 and 1936 as amended.

Teece K.C. (with him *Smyth*), for the plaintiff. Upon the true construction of the contract the Commonwealth promised that the interest received by the bondholder in respect of the bonds would not be liable for income tax. The Parliament, by imposing income tax on that interest, committed a breach of that contractual obligation and the Commonwealth thereupon became liable in damages. Although the interest was in fact paid to the plaintiff without deduction there was, afterwards, tax payable, with the result that the plaintiff received less than he otherwise would have done. The collection of the tax is a breach of the promise made. The only *obiter dictum* relevant to the matter mentioned in *Ervin* v. *Federal Commissioner of Taxation* (1) appears in the judgment of *Starke* J. (2), but *obiter dicta* pertinent to this case were made in *Perpetual Trustee Co. (Ltd.)* v. *Federal Commissioner of Taxation* (3). Although the contract is expressed to be by the Commonwealth, it is really by the Crown in right of the Commonwealth. The Crown is liable in damages for breach of contract because it has, in effect, warranted that the Commonwealth Parliament would not exercise its power of taxation in respect of the bonds. The bonds were offered to investors generally. In those circumstances the test is: How would the ordinary investor or business man interpret the conditions under which the bonds were offered (*The Commonwealth* v. *Queensland* (4))? The promise to pay without deduction would be understood in a general way by the ordinary person as meaning that the moneys so paid would be free of taxation. The clause appearing in the bonds and coupons is equivalent to s. 52B of the *Commonwealth Inscribed Stock Act* 1911-1940. It is important to bear in mind that at the time the bonds were issued there was no provision whatever

(1) (1935) 53 C.L.R. 235.
(2) (1935) 53 C.L.R., at p. 249.
(3) (1932) 47 C.L.R. 402, at pp. 408, 412, 416.
(4) (1920) 29 C.L.R. 1, at pp. 9, 14, 15.

for any deduction therefrom. The Commonwealth is liable in damages to the extent of the amount of the tax paid in respect of the interest received. The provision in the *Income Tax Assessment Act* 1930 was not a case of retrospectively justifying payments which were not properly paid as in *Werrin* v. *The Commonwealth* (1).

Sugerman K.C. (with him *Dignam*), for the defendant. There has not been any breach of the contract on the part of the Commonwealth. The Commonwealth did not make any promise in the terms alleged by the plaintiff. The prospectus in respect of the bonds was addressed not to investors at large but to American investors. The promise made by the Commonwealth was that the bonds would be paid without deduction by it at the source. The words " without deduction " apply only to the moment of payment. They cannot be interpreted in accordance with a supposed business meaning. The whole obligation is satisfied when the interest has been paid in full. The obligation has then been performed and there cannot be a subsequent breach. The decision in *Perpetual Trustee Co. (Ltd.)* v. *Federal Commissioner of Taxation* (2), that the value of the bonds was properly included in the estate for purposes of estate duty, applies *a fortiori* to the inclusion in assessable income of interest from the bonds for purpose of income tax. *The Commonwealth* v. *Queensland* (3) is distinguishable because (*a*) of the difference in the words used, namely, " shall not be liable to income tax," and (*b*) the bonds were issued to American investors and were addressed in the first instance to them. The general principles of tax exemption practice in the United States of America, including the principle that tax exemptions should be construed strictly, are shown in *Tucker* v. *Ferguson* (4) ; *Seton Hall College* v. *South Orange* (5)—See also *Digest of the United States Supreme Court Reports*, (1929), vol. 8, pp. 5954-5956. The very long-settled course of authority in America shows that this is not the sort of contract into which would be read an implication. The words should be given their ordinary natural meaning, that is, that the amount is to be paid in full without deduction. A distinction is drawn in the English cases between the gift of an annuity payable without deduction of tax and the gift of an annuity payable free of tax. Where the words used are " without deduction of tax " or " without deduction of income tax," super-tax, not being deductible, is not included, that is, the gift is not free of super-tax or sur-tax.

(1) (1938) 59 C.L.R. 150.
(2) (1932) 47 C.L.R. 402.
(3) (1920) 29 C.L.R. 1.
(4) (1875) 89 U.S. 406, at pp. 574, 575 [22 Law. Ed. 805, at p. 816].
(5) (1916) 242 U.S. 100, at p. 106 [61 Law. Ed. 170, at p. 174].

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When the gift is free of income tax as in *In re Reckitt* (1) then the words " income tax " are construed as including non-deductible super-tax : See also *In re Hooper* ; *Phillips* v. *Steel* (2). The tendency of the courts in England is to read the words quite literally. A promise to pay free of tax is just as much a promise relating only to payment as a promise to pay without deduction. The promise is transferred with the bonds. There is no continuing promise to persons in respect of bonds transferred by them ; the only real *nexus* is between the Commonwealth and the holder for the time being. That promise is that the Commonwealth will pay without deduction for tax. The meaning of the words is indicated upon a realization that it cannot be said that a person who, having received payment of interest, subsequently sells his bonds, retains the benefit of the promise. The bonds are negotiable instruments payable to bearer. The particular contractual duty sought to be enforced by the plaintiff is so inconsistent with the nature of a negotiable instrument that he could not get the right to have that duty performed in the capacity of bearer of a negotiable instrument. The promise was not made to the world at large. The promise is that upon due date the specified amount, neither more nor less, shall be paid to the bearer. The promise does not extend beyond that. A promise which did so extend cannot subsist in a negotiable instrument. One does not find in instruments which are negotiable a promise which not only sounds in damages but which sounds differently in the hands of various persons into whose hands interest may come. Upon the plain meaning of the document the promise relates entirely to payment and is satisfied and fully performed once payment has been made. The element " without deduction " is simply one of a number of elements in the matter of payment. The Commonwealth has no power by a term in a contract to prevent a State or a local governing authority from imposing a tax. *Perpetual Trustee Co. (Ltd.)* v. *Federal Commissioner of Taxation* (3) concludes the matter in favour of the defendant.

Teece K.C., in reply. The law, as revealed in the decisions of the courts of the United States of America cited on behalf of the defendant, that in the event of anticipatory conditions in a charter which give exemption from liability the exemption must be read most strictly against the person claiming exemption, is not the law here. Neither in this Court nor in England has it been laid down that a different rule has to be applied to a contract which provides exemption

(1) (1932) 2 Ch. 144.
(2) (1943) 60 T.L.R. 161.
(3) (1932) 47 C.L.R. 402.

from tax from the rule applicable to any other contracts. What is now being construed is not a taxing Act but a contract prepared by the Commonwealth Government under the authority of an Act of the Commonwealth legislature ; therefore the ordinary rule of interpretation applies. The document was drawn by the Commonwealth ; therefore any ambiguities therein should be resolved in favour of the taxpayer. Cases in which the courts, upon the interpretation of wills, have drawn a distinction between a legacy and an annuity without income tax and free of income tax, are no guide to the construction of the contract : See *In re Reckitt* (1). These cases are quite irrelevant and merely deal with what was in the mind of the testator. The measure of damages is the additional tax the plaintiff has had to pay by reason of the inclusion of the interest in his assessable income.

Cur. adv. vult.

May 29.

The following written judgments were delivered :—

LATHAM C.J. Case stated under *Judiciary Act* 1903-1940, s. 18. The plaintiff is and at all material times has been a resident of New South Wales. Since the amendment of the *Income Tax Assessment Act* 1922 effected by the *Income Tax Assessment Act* 1930, s. 4, he has been liable as a resident of Australia to pay Federal income tax upon taxable income derived from all sources, whether in Australia or elsewhere : See *Income Tax Assessment Act* 1922-1930, s. 13, and *Income Tax Assessment Act* 1936, s. 25. Before the amending Act of 1930 he was liable to pay Federal income tax only in respect of income derived from sources within Australia : *Income Tax Assessment Act* 1922, s. 13.

Since 24th December 1929 the plaintiff has been the holder of gold dollar bonds issued on behalf of the Commonwealth of Australia in the United States of America. By the bonds the Commonwealth promised to pay the bearer the principal sum on a fixed date with interest—" such principal sum and interest instalments . . . will be paid . . . in gold coin of the United States of America of the standard of weight and fineness existing on September 1, 1927, without deduction for any taxes now or at any time hereafter imposed by the Commonwealth of Australia or by any taxing authority thereof or therein." By each interest coupon the Commonwealth promised to pay to bearer on a date stated in the coupon in gold coin of the fineness of the standard specified amounts of interest " without deduction for any Australian taxes present or future."

The case states that the Commonwealth has always paid the interest to the plaintiff as it has become due from time to time

(1) (1932) 2 Ch. 144.

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without any deduction and in accordance in all respects with the provisions of the bonds and the interest coupons attached thereto. Under the *Income Tax Assessment Acts* 1922 and 1936 as amended the Commissioner of Taxation has included the interest received by the plaintiff on the bonds as part of his assessable income derived during the relevant years, and the plaintiff has become liable to pay, and has paid, taxes so assessed.

The plaintiff does not dispute that he is bound to pay income tax upon income including the interest derived from the bonds. The defendant does not dispute that the income derived from the bonds is income derived from a source outside Australia, so that if the plaintiff were not a resident of Australia he would not be liable to be assessed to income tax in respect of such income : See *Income Tax Assessment Act* 1930, s. 4 (*a*), (*b*), and *Income Tax Assessment Act* 1936, s. 25 (1) (*b*).

It is contended on behalf of the plaintiff that the demand for payment of income tax, though authorized by the *Income Tax Assessment Act*, is nevertheless made in breach of the contract contained in the bonds and coupons and that the Commonwealth is liable for damages for breach of contract, the amount of damages recoverable being the additional amounts of income tax which have become payable by reason of the inclusion of the interest as part of the assessable income of the plaintiff.

The first question asked in the case is as follows :—

" Whether by the bonds the defendant promised the plaintiff as holder that the interest, after having been paid to him in full, would not form part of his assessable income for the purpose of Federal income tax within the meaning of the Federal *Income Tax Assessment Act* 1922, and the Federal *Income Tax Assessment Act* 1936, as respectively amended, or any other *Income Tax Assessment Act* thereafter to be enacted although he was a resident of Australia and liable as a taxpayer within the meaning of those Acts."

The second question in the case relates to damages and arises only if the first question is answered in the affirmative.

The plaintiff contends that, upon the true construction of the promises made in the bonds and the coupons, so far as interest is concerned, the Commonwealth promised that the interest should not be liable to income tax as part of his income—that in an ordinary business sense it should be free of income (and other) taxes. The difficulty in the way of this construction is that the promises in question are promises to pay fixed sums on fixed dates without deduction for any Australian taxes, whether those taxes exist at the time when the bond is issued or are subsequently created and

imposed. Such a promise is either performed or is not performed at the time when payment is made. It relates only to payment and not to any facts or events subsequent to payment. If the payment of the contractual amount is actually made without deduction the promise is performed according to its terms.

In *Perpetual Trustee Co. (Ltd.)* v. *Federal Commissioner of Taxation* (1) the Court considered a promise in the same terms as in the case of the present bonds. In that case the value of the bonds was included in an assessment for estate duty. It was contended for the executors of the deceased person that the imposition of estate duty was a breach of the contract to pay without deduction for taxes, and that the inclusion of the bonds in the assessment was for that reason unlawful. The time for payment of the principal had not arrived, and, accordingly, it could not be said, as is contended for the Commonwealth in the present case, that the relevant contract had been performed by the Commonwealth. The argument presented to the Court was to the effect that the terms of the contract prevented the imposition of any tax upon or in relation to the principal sum payable in pursuance of the bonds. As to this argument *Gavan Duffy* C.J., *Starke* J. and *Evatt* J. said that there was nothing in the bonds which excluded or rendered inoperative the power of the Parliament with respect to taxation, " though if a tax were imposed contrary to the terms of the bonds, a breach of the contractual obligation would arise which would sound in damages equivalent to the amount of tax " (2). Their Honours then went on to consider whether, even if estate duty could, under the statute, be lawfully imposed on the value of the estate of the deceased including therein the value of the bonds, such imposition would infringe the obligation of the bonds. It was pointed out that the obligation was to pay in New York in gold coin an amount of dollars without deduction, and it was said " if that amount is paid there without deduction, then the obligation of the bonds is performed according to its tenor and effect " (3). *Dixon* J., with whose reasons for judgment *McTiernan* J. agreed, expressed the same opinion (4). *Rich* J. dissented. The case did not require a decision upon the question whether there was or was not a breach of the contractual obligation. The actual decision was that the contract did not limit the taxing power of the Commonwealth Parliament. But I agree with the views expressed by the majority of the Court as to the meaning of the particular contract—namely, that the obligation then and now in question is fully performed if the contractual amount is paid

(1) (1932) 47 C.L.R. 402.
(2) (1932) 47 C.L.R., at p. 409.
(3) (1932) 47 C.L.R., at p. 409.
(4) (1932) 47 C.L.R., at p. 416.

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without deduction at the time of payment, and that the subsequent imposition of a tax upon an amount which is determined by including the amount of money so paid or payable is not a breach of the obligation. This opinion is based upon the precise words of this particular promise—a promise to pay a fixed sum of money at a fixed date without deduction. I construe this promise as excluding any deduction at the time of payment—the amount must be paid in full. In the case of non-residents who derive no income from and have no property in Australia, the actual result of such payment in full is that the amount payable cannot be diminished by subsequent taxation. But this particular promise is not, in my opinion, a promise of immunity from such taxation. The question of the propriety of the imposition of taxation in cases which the taxing power can legally reach is one of policy, not of law.

It is said that the promise is illusory if it is construed in the manner above stated. But the condemnation of this construction as illusory rather assumes than proves that the competing construction (full immunity from all Australian taxation) is right. It cannot be said that the promise, upon the above-stated construction, has no effect. It is a promise of payment in full without deduction for any tax. The promise would be broken if before payment any tax deduction was made. Such a promise cannot be regarded as meaningless. Further, the performance of the promise in fact brings about the result of securing immunity from all taxation in respect of either principal or interest in the case of all non-resident holders of bonds who derive no income from and have no assets in Australia. This is an attribute of the bonds which must, in the case of any holder, increase the market value abroad of the bonds. Finally, I call attention to the fact that the same promise is made with respect to both principal and interest—"to be paid without deduction for any taxes imposed by the Commonwealth of Australia or by any taxing authority thereof or therein." How can this promise, which prima facie has the same meaning in both cases, be construed as a promise that neither principal nor interest shall be taxed in any way at any time? So far as the principal is concerned, there appears to me to be no escape from the conclusion (as decided in *Perpetual Trustee Co. (Ltd.)* v. *Federal Commissioner of Taxation* (1)), that the inclusion in the estate of a deceased person for purposes of estate duty of the value of a bond not yet matured cannot be a breach of the obligation to pay the principal without deduction when the bond matures. But, further, it is difficult to see how, upon the payment of the bond at maturity, any construction can

(1) (1932) 47 C.L.R. 402.

be given to the promise other than that it is then to be paid in full without deduction. If a person receives 100 dollars as principal under a bond, it could hardly be contended that an amount of 100 dollars of his assets is thereafter at all times to be free from taxation. If such a view is rejected, can it be held that as long as the sum of 100 dollars is in some manner identifiable (e.g., not being paid into a bank account but preserved *in specie*), and is in the hands of the bondholder (or possibly of his representatives after his death), it is non-taxable ? It seems to me to be impossible to get this meaning out of the words of the promise. Thus in the case of the principal it is very difficult to give any other meaning to the promise than that the money shall be paid in full without any deduction being made at the time of payment in respect of any tax. The same construction should be given to the same promise in the case of interest payments.

In my opinion the first question asked should be answered in the negative, and therefore the second question does not arise.

Rich J. In the year 1927, the Commonwealth of Australia was desirous of borrowing money. On 22nd August of that year, through the medium of a Commissioner, it entered into a contract in the United States of America with two American corporations, by which it agreed to sell and the corporations to buy gold bonds, of the denomination of 1,000 dollars, to the amount of forty million dollars, in the terms set forth in a schedule. The contract provided, by article 1, clause 5, that all payments in respect of the bonds and coupons should be made without deduction for any taxes, imposts, stamp dues and assessments now or at any time thereafter imposed or levied by the Commonwealth of Australia or any of its States or municipalities or other taxing authorities thereof or therein.

Bonds were issued accordingly, by each of which the Commonwealth promised to pay to the bearer on 1st September 1957 the principal sum of 1,000 dollars, and to pay in the meantime interest at the rate of five per cent per annum semi-annually on surrender of interest coupons, the principal and interest to be paid in gold in New York " without deduction for any taxes now or at any time hereafter imposed by the Commonwealth of Australia or by any taxing authority thereof or therein," the bond not to be negotiable until countersigned for authentication by the National City Bank of New York or its successor. Each interest coupon contained a promise to pay to bearer in New York " without deduction for any Australian taxes present or future."

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In 1929, the plaintiff, who is a resident of New South Wales, purchased in the United States of America forty-six of these bonds. The Commonwealth has always paid him the interest without any deduction ; but the Federal Commissioner of Taxation has included the interest at its value in Australian currency as part of his assessable income derived during the years 30th June 1932 to 30th June 1942, so that, according to the tenor of the general provisions of the *Income Tax Assessment Act*, the plaintiff has become liable to pay, and has been compelled to pay part of, the taxes assessed on that basis. The question is whether he is entitled to obtain a refund from the Commonwealth of the income tax which has been exacted from him in respect of this interest.

There can be no doubt that the provision in the bonds that principal and interest are to be paid in gold in New York, without deduction for any taxes at any time imposed by the Commonwealth of Australia or by any taxing authority thereof or therein, was held out as one of the inducements to purchase these bonds. Read by the card, all that it promises is that the payment in New York will be without *deduction* for taxes. I do not think, however, that this is the way in which any ordinary purchaser would read it. The bonds were being offered to the general public in the United States of America, and I think that any layman would regard himself as being promised that his principal and interest would not be subject to Australian taxation. It would not occur to him that what was in this way promised was intended to be avoided or evaded by laying stress on the word " deduction," that it was really intended to give him exemption only from such forms of exaction as the Commonwealth could achieve by the machinery of deduction, and that he was left exposed, in respect of the payments, to every form of taxation that ingenuity could devise, so long as it was not carried out by what was technically a " deduction." In a particular context, " without deduction," according to its natural construction, means simply " free of " (*In re Williams* ; *Williams* v. *Templeton* (1)), and, in my opinion, this is such a context. It would, in my opinion, be a repudiation of legal liability if, when a citizen of the United States who had acquired some of these bonds also acquired some income-producing property in Australia, the Commonwealth insisted on including the bond interest in his assessment to Australian income tax, and exacted payment out of his Australian property on this footing, because it was achieving the result otherwise than by a " deduction " from the interest.

(1) (1936) Ch. 509, at p. 514.

It was held by the Supreme Court of the United States in *Evans* v. *Gore* (1), that a provision of the Constitution of the United States that the compensation of judges " shall not be diminished during their continuance in office " could not be evaded by subjecting judges to income tax on their remuneration after it had reached their hands. What could not be done directly could not be done indirectly or evasively. Only by subordinating substance to mere form could it be held that compensation was not in this way diminished. It is true that in *O'Malley* v. *Woodrough* (2) the Supreme Court, by a majority, receded from this position (Cf. *Cooper* v. *Commissioner of Income Tax* (*Q.*) (3)), but, assuming the latter cases to have been correctly decided, which is open to doubt, the holders of bonds such as these stand in a much stronger position. No question of constitutional policy is here involved. The transaction was purely a commercial one, and should be determined by considerations of a commercial character.

In my opinion, it is a breach of contract with a bondholder for the Commonwealth to exact income tax in respect of the interest payable to him ; and, since the bonds are to bearer, I am of opinion that the Commonwealth binds itself to all the terms of the bond to any bearer wherever he may be, whether in the United States of America or in Australia.

There is, in my opinion, nothing in the decisions of this Court in *Perpetual Trustee Co.* (*Ltd.*) v. *Federal Commissioner of Taxation* (4), *Ervin* v. *Federal Commissioner of Taxation* (5), or *West* v. *Commissioner of Taxation* (*N.S.W.*) (6), which is inconsistent with this.

For these reasons, I am of opinion that the first question submitted should be answered in the affirmative.

In so answering it, I think it desirable to add a word of warning. The case was argued before us on the assumption that all that is involved is a question of construction, and that the plaintiff is entitled to succeed if that question is resolved in his favour. But the fact that the bonds contain, as in my opinion they do, an absolute warranty by the Executive Government that payments made under them shall be free from all forms of Federal taxation does not necessarily conclude the matter. The Executive Government has no more dispensing power in relation to Commonwealth legislation than had James II. in relation to English legislation. It cannot, without legislative authority, exempt a bondholder, or anybody else, from obligations imposed by existing legislation, much less can it

(1) (1920) 253 U.S. 245, at p. 254 [64 Law. Ed. 887, at p. 892].
(2) (1939) 307 U.S. 277 [83 Law. Ed. 1289].
(3) (1907) 4 C.L.R. 1304.
(4) (1932) 47 C.L.R. 402.
(5) (1935) 53 C.L.R. 235.
(6) (1937) 56 C.L.R. 657.

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tie the hands of future Parliaments. Any attempt to do so is necessarily void, and can create no legal rights. If, therefore, an Act is passed imposing a tax on bond interest notwithstanding the warranty, a legal obligation to pay is created, and from this obligation no promise of the Executive, past, present or future, can absolve the bondholder, although it may not be possible to enforce it if the bondholder is not within the reach of the Commonwealth. The Commonwealth, by its legislature, can, without any breach of the law, repudiate promises given by its Executive Government. It follows that an action brought in Australia against the Commonwealth to recover tax lawfully imposed but operating in derogation of an executive warranty must fail, because the warranty could not lawfully be given. To allow such an action would be enabling the Executive to fetter the legislative power of Parliament. Further, unless Parliament authorized or granted an exemption in order to give effect to such a warranty, it would be the legal duty of the Executive for the time being to enforce payment, whether it be the Executive which gave the warranty or some subsequent Executive. And it would be the duty of the Auditor-General to draw the attention of Parliament to any failure on the part of the Executive to do so. No argument has been addressed to us as to whether there is anything in the *Income Tax Assessment Act*, or in any other Act, which exempts the payments from income tax, and I therefore express no opinion on the point.

It follows that, in my opinion, the second question should not be answered in the present state of the case.

STARKE J. Case stated pursuant to the *Judiciary Act* 1903-1940 raising the question whether upon the true construction of certain gold bonds and coupons for interest attached thereto the Commonwealth agreed that the plaintiff should not be liable to pay any income tax in respect of the interest collected by him on presentation of the coupons. The gold bonds and the coupons were issued by the Commonwealth in the United States of America.

The plaintiff, who at material times was resident in Australia, purchased bonds and coupons for interest attached thereto in America and interest was there collected on his account upon the presentation of the coupons. It was a term of the bonds that the principal and interest when due should be paid in America in gold coin of the United States of America of the standard of weight and fineness existing on 1st September 1927 without deduction for any taxes now or at any time hereafter imposed by the Commonwealth of Australia or by any taxing authority thereof or therein. And

it was also a term of the coupons that the interest mentioned in each coupon should be paid in America in the gold coin of the United States of America existing on 1st September 1927 " without deduction for any Australian taxes present or future." The case states that the Commonwealth has always paid interest to the plaintiff as it became due without any deduction and in accordance with all the provisions of the bonds and interest coupons attached thereto.

No question is raised in this case by reason of the provisions of s. 52A and s. 52B of the *Commonwealth Inscribed Stock Act* 1911-1933 (*Perpetual Trustee Co. (Ltd.)* v. *Federal Commissioner of Taxation* (1) ; *Ervin* v. *Federal Commissioner of Taxation* (2)).

The obligation of the bonds and the coupons for interest is to pay in America in gold coin of the United States of America without deduction for any Australian taxes. And in fact interest has been paid in America in gold coin in precise accordance with those words. But it is argued that the true meaning of the stipulations in the bonds and the coupons is that the interest payable thereunder should be free from Australian taxes in order to give business efficacy to the transaction. However it is with Federal income tax alone that we are concerned in this case. And that tax is levied by the Federal *Income Tax Assessment Acts* 1922 and 1936 as amended upon taxable income derived directly or indirectly by every resident from all sources, whether in Australia or elsewhere, and by every absentee from sources in Australia. Doubtless the interest income in the present case does not arise from any source in Australia : See *Federal Commissioner of Taxation* v. *United Aircraft Corporation* (3). And therefore the interest payable under the bonds and coupons could not be brought to charge under the *Income Tax Assessment Acts* unless the recipient were a resident of Australia. The stipulations in the bonds and coupons give, however, complete protection to non-residents if the interest be paid in gold coin in the United States of America without any deduction whatever and therefore full business efficacy to the transaction in such cases. But in the case of residents in Australia the explicit words of the Acts bring to charge income from whatever source derived and wherever paid or received. It seems probable that such legislation was not contemplated when the bonds and coupons were issued. But that is no reason for departing from the explicit words of the bonds and the coupons and implying a term which in truth is only necessary in the case of residents of Australia. And unless the stipulations of the bonds and coupons explicitly free the principal

(1) (1932) 47 C.L.R. 402. (2) (1935) 53 C.L.R. 235.
(3) (1943) 68 C.L.R. 525.

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sum and interest secured by the bonds from Australian taxes there is no reason for implying a term exempting residents from income tax or relieving them of burdens which fall upon other citizens.

The first question stated should be answered in the negative.

McTIERNAN J. *Question* 1. This question is in these terms: "Whether by the bonds the defendant promised the plaintiff as holder that the interest, after having been paid to him in full, would not form part of his assessable income for the purpose of Federal income tax within the meaning of the Federal *Income Tax Assessment Act* 1922 and the Federal *Income Tax Assessment Act* 1936 as respectively amended or any other *Income Tax Assessment Act* thereafter to be enacted, although he was a resident of Australia and liable as a taxpayer within the meaning of those Acts."

In the first place, it is necessary to notice the terms of the relevant promise in the bonds to which the question relates. It is stated in each bond that the Commonwealth for value received promises to pay on 1st September 1957 to the bearer of the bond the principal sum and to pay interest on such sum at the rate of 5 per cent per annum semi-annually until the principal sum shall have been paid. It is also stated in each bond, and this is the relevant promise, that such principal sum and interest instalments will be paid in New York in gold coin of the United States of the standard weight and fineness existing on 1st September 1927, that is, the date of the issue of the bond, "without deduction for any taxes now or at any time hereafter imposed by the Commonwealth of Australia or by any taxing authority thereof or therein." By each interest coupon the Commonwealth also promised to pay the interest "without deduction for any Australian taxes present or future." The promise in the bond is not in the terms set out in the question. We are asked, as I understand the question, to determine whether the meaning of the words used in the bond is that the Commonwealth promised the bearer that pursuant to the provisions of any then existing Act, or any Act that the Commonwealth might thereafter pass, it would not levy income tax on the interest paid to any bearer of the bond and charge him with such tax.

In 1927, when the loan contract was made and the bonds were issued, there was no Commonwealth Act in force which imposed any income tax on the income derived by a taxpayer who was a resident of Australia from sources outside the country. The *Income Tax Assessment Act* 1922 as amended, which was then in force, provided by s. 13 that income tax should be levied and paid only upon the taxable income derived by a taxpayer from sources in Australia.

The possibility of conflict between the promise in the bond regarding deductions for taxation arises because s. 13 of that Act, as amended by s. 4 of the *Income Tax Assessment Act* 1930 (which came into force on 18th August 1930) and s. 25 of the *Income Tax Assessment Act* 1936, which replaced the former principal Act, both provide that Commonwealth income tax shall be levied and paid upon the income derived by a taxpayer, who is a resident of Australia, from all sources, whether in the country or elsewhere, and there is nothing in either Act to exclude the interest which would be paid to any Australian resident holding any of those bonds. It is, of course, within the territorial limits of Commonwealth legislative power with respect to taxation to impose income tax on the income which a resident derives directly or indirectly from sources outside Australia. Compare *Commissioner of Stamp Duties (N.S.W.)* v. *Millar* (1); *Trustees Executors and Agency Co. Ltd.* v. *Federal Commissioner of Taxation* (2); *Colonial Gas Association Ltd.* v. *Federal Commissioner of Taxation* (3).

It appears that the plaintiff, an Australian resident, purchased forty-six of the bonds in the United States of America on 24th December 1929, and that the Commonwealth levied income tax on the interest paid to him under the bonds, during the five successive years beginning on 1st July 1931, by applying the provisions of the *Income Tax Assessment Act* 1922 as amended when it was in force and afterwards the provisions of the *Income Tax Assessment Act* 1936 as amended.

Nothing was deducted for tax from the interest payable to the plaintiff before actual payment. It was paid in full according to the measure stipulated by the bonds and the coupons which he held. The tax was imposed on the interest after it was paid to him. The interest was treated as part of the income, not exempt from taxation, which he derived from all sources. The decision of the question whether by taking this course the Commonwealth departed from its promise depends upon the meaning of the words " without deduction for any taxes now or at any time hereafter imposed by the Commonwealth of Australia or by any taxing authority thereof or therein." It made the promise both as the obligor of the bond and as an authority having the power of taxation.

It would be within the Commonwealth's legislative power with respect to taxation to levy tax on the interest and provide that the tax should be paid by deduction from the interest before payment. The loan was an external one and a tax on the interest payable to

(1) (1932) 48 C.L.R. 618. (2) (1933) 49 C.L.R. 220.
(3) (1934) 51 C.L.R. 172.

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subscribers or other bondholders who are non-residents and have no assets in Australia, could not be recovered except by deducting the tax from the interest before payment. If the intention of the bond is that the Commonwealth promised merely that it would not collect in this manner any tax which it might impose on the interest, then the promise would afford protection against taxation of the interest only to subscribers or bondholders in the above-mentioned class, but would afford no protection to subscribers or bondholders who are residents of Australia or non-resident subscribers or bondholders with assets in this country. It should not be presumed, I think, that the Commonwealth did not contemplate that persons and corporations who were abroad and had no assets in Australia, would not take up the bonds. The promise should, I think, be construed to give as effective protection to the non-resident bondholders with assets in Australia as to the non-resident bondholders without assets in the country. Indeed, the promise would be illusory in the case of non-resident bondholders with assets in Australia if it were a promise merely to refrain from deducting tax imposed on the interest before paying the interest but not a promise to refrain from imposing any tax on the interest. In my opinion it is in accordance with the fair or natural meaning of the words of the promise, to pay without deduction for tax, to hold that the effect of the promise is not exhausted when the interest is paid to the bondholders. If the promise is not exhausted after the payment of interest, it follows that it is a promise not to impose tax on the interest at all, not merely a promise not to employ a particular manner of collecting the tax, that is, deduction before payment to the bondholders. The result is that the promise extends to protect the bond interest from taxation whether it is paid to bondholders resident or non-resident in Australia with or without assets in the country. By imposing income tax on the plaintiff's bond interest under s. 13 and the other provisions of the *Income Tax Assessment Act* 1922-1930 as amended in the years to which they applied, and under s. 25 and the other provisions of the *Income Tax Assessment Act* 1936 as amended in each of the remaining years, the Commonwealth subjected the interest to a deduction for tax just as really as if the amount of the tax thus levied and paid by the plaintiff on the interest had been deducted from it before the interest was paid to the plaintiff.

In my opinion the answer to the first question should be " Yes."

Question 2. This question is in these terms : " In the event of the first question being answered in the affirmative, whether the plaintiff is entitled to recover from the defendant by way of indemnity

or as damages the additional amounts of income tax which the plaintiff has become liable to pay or has paid by virtue of the inclusion of such interest as part of his assessable income derived during the years ended 30th June 1932 to 30th June 1942 inclusive under the provisions of the Federal *Income Tax Assessment Acts* 1922 and 1936 as amended."

The promise in the bonds has not, of course, the force of a constitutional guarantee: it is not capable of binding the Parliament not to impose tax upon the bond interest if it should think fit to do so. But it has become unnecessary to pursue this matter. The attitude of the Commonwealth, as I understand it, is that if it is literally inconsistent with the terms of the promise to impose taxation on the interest otherwise than by deducting the tax before payment, it would not contend that on technical grounds the plaintiff has no right to recover the taxation which he has paid in respect of the bond interest under the provisions of the Acts referred to in the second question.

In my opinion I am not precluded by the *ratio decidendi* of any of the cases in this Court, which were cited in argument, from reaching these conclusions.

WILLIAMS J. The facts and questions are set out in the case stated and I need not repeat them.

The bonds, which are dated 1st September 1927, are for the principal sum of $1,000, and have a currency of thirty years, but are subject to redemption by the Commonwealth on or after 1st September 1947. They carry interest at the rate of five per cent per annum payable half-yearly on 1st March and 1st September in each year, and contain a promise by the Commonwealth to pay the principal sum and interest when due in New York in gold coin of the weight and fineness existing on 1st September 1927, without deduction for any taxes now or at any time hereafter imposed by the Commonwealth of Australia or by any taxing authority thereof or therein. Each interest coupon contains a promise by the Commonwealth to pay to the bearer in New York on the due date $25 gold coin of the United States of America of the standard existing on 1st September 1927 without any deduction for any Australian taxes present or future.

The plaintiff, as the holder of several of the bonds, has been paid his interest in full in New York from time to time, but the Commonwealth, in accordance with the provisions of the Federal *Income Tax Assessment Acts* 1922 and 1936, has included the interest in his assessable income because he is a resident of Australia and liable as

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a taxpayer within the meaning of those Acts. The answer to the questions asked in the case depends upon whether the promise by the Commonwealth that interest should be paid without deduction of, *inter alia,* Federal income tax is limited to a promise not to impose a tax which is deductible prior to payment (often referred to as taxation at the source), or whether it is a promise not to tax the interest at all.

It was contended that this Court had already decided this question in favour of the Commonwealth in *Perpetual Trustee Co. (Ltd.)* v. *Federal Commissioner of Taxation* (1). In that case H. R. W. R. Haege, the holder of similar bonds, died domiciled in Australia, and the question arose whether the bonds formed part of his estate for the purposes of Federal estate duty within the meaning of the *Estate Duty Assessment Act* 1914-1928. This Court held that the bonds formed part of the estate for the purposes of duty within the meaning of the Act and were not exempted by s. 52A of the *Commonwealth Inscribed Stock Act* 1911-1927. This was all that it was necessary for the Court to decide in order to dispose of the appeal, but four out of the five Justices who sat discussed the question whether to impose the tax was a breach of the promise contained in the bonds to pay the principal sum at maturity without deduction of any Commonwealth tax. In their joint judgment *Gavan Duffy* C.J., *Starke* and *Evatt* JJ. said :—" Further, as the matter was argued at length, we think it right to say that the levy of an estate duty on the value of the estate of the deceased, including the value of the gold bonds, would not infringe the obligation of the bonds ; that obligation is to pay in New York in gold coin of the United States of America the dollars and interest mentioned, and if that amount is paid there without deduction, then the obligation of the bonds is performed according to its tenor and effect. The imposition of an estate duty upon the estate of a domiciled Australian lessens the amount of that estate which is distributable, but his executor is still entitled to and will receive, under such bonds as these, the precise number of dollars, in gold coin of the United States, therein stipulated " (2). *Dixon* J. said :—" I think it is not inconsistent with the obligation expressed by this clause to include the value of such bonds in ascertaining the estate of a person dying domiciled in Australia for the purpose of assessing estate duty. The primary purpose of the provision is to confer upon the bondholder a right to repayment in full and in cash. The provision may well carry with it an implication that the Commonwealth shall by no use of its taxing power impair the obligation of the bond but, in my opinion,

(1) (1932) 47 C.L.R. 402. (2) (1932) 47 C.L.R., at p. 409.

no such impairment is involved in including the bonds or the debt secured by them among the assets which upon the death of the deceased go to make up the estate liable to estate duty " (1).

As these statements are only *obiter dicta* they do not bind me, although they are entitled to the highest respect, but, accepting them as binding, the facts of that case are, in my opinion, distinguishable, because the promise is to pay the principal sum at maturity and the interest which accrues due every six months without deduction for taxation to the bearer of the bonds or of the interest coupon for the time being as the case may be. To include the capital value of bonds upon which the principal sum becomes payable *in futuro* (and I might add to a bearer whose identity is still unknown) in the value of the estate of a deceased person who is the holder for the time being may not be a breach of such a promise.

But the questions asked in the present case, which relate to the imposition of Federal income tax upon the interest in fact paid to the plaintiff as the bearer of coupons which have matured, raise the different question whether it is a breach of contract to tax this interest after it has been paid in full by reason of the bearer being resident in Australia. This point was not adverted to in the joint judgment of *Rich*, *Dixon*, *Evatt* and *McTiernan* JJ. in the later case of *Ervin* v. *Federal Commissioner of Taxation* (2), but *Starke* J. evidently thought that it was not covered by what had been said in *Perpetual Trustee Co. (Ltd.)* v. *Federal Commissioner of Taxation* (3), because he said: " The bonds constitute a contract between the Commonwealth and the bondholders. And for any breach of that contract the Commonwealth will be responsible. The case stated does not raise the question whether the collection of income tax in respect of income arising from the bonds will constitute a breach of the contractual provisions of the bonds. The Commonwealth should not assume too readily, however, that such cases as *Perpetual Trustee Co. (Ltd.)* v. *Federal Commissioner of Taxation* (3) and *Murdock* v. *Ward* (4) settle the matter in its favour " (5).

For these reasons I am of opinion that the Court is not precluded from deciding the questions stated without reconsidering the reasons in *Perpetual Trustee Co. (Ltd.)* v. *Federal Commissioner of Taxation* (3) or *Ervin's Case* (6).

Speaking generally, in a transaction of a private nature, a provision that a payment in the nature of income, say an annuity, should be made without deduction would not amount to a direction to make

(1) (1932) 47 C.L.R., at p. 416.
(2) (1935) 53 C.L.R., at pp. 242-246.
(3) (1932) 47 C.L.R. 402.
(4) (1900) 178 U.S. 139, at p. 148 [44 Law. Ed. 1009, at p. 1013].
(5) (1935) 53 C.L.R., at p. 249.
(6) (1935) 53 C.L.R. 235.

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the payment without deducting income tax. In *Gleadow* v. *Leetham* (1) *Kay* J., in discussing the question whether a provision in a will that annuities should be paid free from all deductions and abatements whatsoever included income tax, said :—" Income tax, as it seems to have been stated over and over again, is not properly speaking a deduction, and there must be something else besides the word ' deduction ' to make the gift of an annuity free of income tax. It was only where the word ' deduction ' was coupled with the word ' taxes,' or there was some other indication that it was meant to include income tax, that it was so construed " (2). He also said : —" It was contended that this case is distinguishable . . . for the reason that the annuity was given by the testator to his wife ' to pay to his wife the clear yearly sum of.' If, however, income tax be not a deduction but a payment which she has to make herself, not out of the annuity, but because she receives the annuity, I do not consider that the word ' clear ' carries the matter any further " (3).

This case was approved in *In re Shrewsbury Estate Acts* ; *Shrewsbury* v. *Shrewsbury* (4). There a private Act provided for the payment of jointures " clear of all deductions whatsoever for taxes or otherwise," and it was held by the Court of Appeal that, having regard to the provisions of the *Income Tax Acts* and on the construction of the private Act, the appellant was entitled to have her jointures paid in full free from deduction of income tax. *Warrington* L.J. said :—" But another principle which I think emerges from those authorities is that the question is one purely of construction of the particular document in the case, and that if there appears on the face of that document an intention that income tax shall be included in the expression ' deductions ' for the purpose of the instrument which has to be interpreted, then it will be so interpreted ; and I think if there is a reference to taxes in connection with the expression ' deductions,' it may be and in some cases has been held to be enough to indicate the intention to which I have referred—namely, that although income tax is not usually included in the expression ' deductions ' unqualified, yet where there is that connection it may be so included. Instances to which the principle just referred to has been applied are found in *In re Bannerman's Estate* ; *Bannerman* v. *Young* (5), in *Turner* v. *Mullineux* (6) and in *Peareth* v. *Marriott* (7), as decided by *Bacon* V.-C. In my opinion, therefore, *Kay* J. in *Gleadow* v. *Leetham* (1) was expressing a correct

(1) (1882) 22 Ch. D. 269.
(2) (1882) 22 Ch. D., at p. 272.
(3) (1882) 22 Ch. D., at p. 273.
(4) (1924) 1 Ch. 315.
(5) (1882) 21 Ch. D. 105.
(6) (1861) 1 J. & H. 334 [70 E.R. 775].
(7) (1882) 22 Ch. D. 182.

conclusion where he divided the cases into two classes, one in which there is nothing but the expression 'clear annuity' or 'clear of all deductions,' and the other where the expression 'deductions' is so connected with the word 'taxes' as to indicate that the author of the instrument intended to include income tax amongst the things from which the annuitant in question was to be free" (1). And *Sargant* L.J. said :—"Now to deal more closely with the phrase in question. Had it been 'clear of all deductions for income tax or otherwise' there could be no question, the annuity would be relieved from its liability to undergo the process of deduction, though this may have only been a method, and though income tax was not strictly a deduction" (2).

In the latest case, *In re Hooper* (3) *Uthwatt* J. said :—"The effect of the cases, which begin with *Lethbridge* v. *Thurlow* (4) and continue in a stream to the present day, is that income tax is not to be regarded as included in a direction to pay an annuity 'free from deductions' unless there is shown in the will an intention that income-tax is to be treated as a deduction."

The *Shrewsbury Case* (5) only deals with income tax deducted at the source and payable by the trustees prior to the payment by them of the amount of the annuity to the annuitant. But in 1909 there was imposed in England a tax, at first called a super-tax and later a sur-tax, which was payable upon assessment by all persons whose total income exceeded a certain amount, and further questions then arose as to whether various provisions relating to the payment of income tax on annuities were sufficiently wide to include the proportion of sur-tax attributable to the amount of the annuity. In *In re Reckitt* (6) the will provided for the payment to the widow of an annuity "free of income tax," and the Court of Appeal held that the wife was entitled to payment of the annuity free of sur-tax. Lord *Hanworth* M.R. pointed out (7) that where a reference is made to a deduction, indicating that the freedom which is to be allowed is in regard to a deduction in a case to which the system of deduction applies, the court may come to the conclusion that super-tax is not included; and *Romer* L.J. pointed out (8) that there could be a difference between the cases where the freedom clause was confined to the position between the trustee who had to pay the annuity and the annuitant and where it referred to the position between the annuitant and the Crown. The words in that case, "to pay free of income tax," referred to the relationship between the annuitant

(1) (1924) 1 Ch., at p. 337.
(2) (1924) 1 Ch., at p. 340.
(3) (1943) 60 T.L.R., at p. 162.
(4) (1851) 15 Beav. 334 [51 E.R. 567].
(5) (1924) 1 Ch. 315.
(6) (1932) 2 Ch. 144.
(7) (1932) 2 Ch., at p. 149.
(8) (1932) 2 Ch., at p. 154.

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and the Crown, and it was held that the annuitant was entitled to have the whole of the income tax for which she was liable in respect of the annuity whether payable by way of deduction or subsequently assessed defrayed out of the trust fund.

These cases are not, of course, particularly in point in the solution of the present problem, but they do, to my mind, afford assistance in that in *In re Shrewsbury Estate Acts* ; *Shrewsbury* v. *Shrewsbury* (1) the court linked up the provisions to which I have referred with the cases cited in the judgments relating to statutes providing that the proprietors of certain species of property should not be rated or assessed for the payment of taxes which were held to include income tax in respect of their property ; and in *In re Reckitt* (2), where as here the question arose between the Crown and the subject, it was held that a provision that an annuity should be paid by trustees to an annuitant " free of income tax " was sufficient to make the payment, as I have said, free of all tax, whether deducted at the source or not.

The relevant provisions in the bonds and interest coupons in the present case relate to the position that arises between the Commonwealth in its dual position of debtor and taxing authority, and the bearers of the bonds or coupons as creditors. It seems clear that if the bonds and coupons had provided that the payments were to be made free of Commonwealth taxation, the Commonwealth would have contracted not to impose any tax on the interest either at the source or by a subsequent assessment (*Duke of Argyll* v. *Inland Revenue Commissioners* (3)) ; and I am unable to discover any difference in substance between the particular expressions used in the bonds and coupons and such expressions as to pay the interest free of tax or to pay the interest free from deduction of tax. As *Knox* C.J. pointed out in *The Commonwealth* v. *Queensland* (4), the proper meaning to attribute to the words should be that which would naturally and reasonably be attributed to them by persons who might be expected to buy the bonds on the faith of the promise which they contained.

When dealing with statutes relating to taxation (and agreements with a taxing authority made under statutory authority as in the present case are in the same position) the court should place upon such expressions, read in their immediate context and in their general setting in the revenue system, a meaning which will achieve a practical and reasonable result (per Lord *Wright* in *Income Tax Commissioners for the City of London* v. *Gibbs* (5)). At the time the bonds were issued the Commonwealth only taxed income derived from a source in Australia ;

(1) (1924) 1 Ch. 315.
(2) (1932) 2 Ch. 144.
(3) (1913) 109 L.T. 893.
(4) (1920) 29 C.L.R., at p. 10.
(5) (1942) A.C. 402, at p. 431.

it did not deduct tax prior to payment and taxation rates were not on a flat but on an ascending scale. Therefore, since the contract was made and was to be performed in the United States of America, so that, on the authorities, the source of the payment of the capital and interest was outside Australia, no tax would have been payable at the date of the contract whether the interest was paid to a person resident abroad or in Australia. But, since the Commonwealth was the debtor, a buyer of the bonds might well have believed that the source of the payment was in Australia, and that, in the absence of some provision relating to taxes in existence in 1927, the interest might be liable to Australian taxation. The States could only tax income derived from a source in the State or received by a person resident in the State or by some person who, though not resident, came into the State or had assets there. Under Federal and at least some State systems of taxation, the tax in each year was measured by the amount of assessable income derived by the taxpayer during the previous year.

The promise contained in the bonds and coupons is to pay the interest without deduction of Commonwealth or State taxation, present or future. The interest is payable to the bearer of the coupon. The identity of the bearer would not be disclosed until the moment at which the coupon was presented. It would not be known at the time of presentation, therefore, whether the bearer was liable to Federal or State taxation, and, even if he were, what his rate of tax would be. Even if the method of paying tax on current income was contemplated, the rate of tax would still be unknown, so that, in relation to the existing Federal system and that of at least some of the States, the expression, if confined to deductions prior to payment of interest, would have been meaningless and ineffective.

The only tax that could be deducted in a practical sense prior to payment would be a flat rate upon the 25 dollars payable upon the presentment of a coupon. Even if it was contemplated that a State might impose a tax at a flat rate upon the income from Commonwealth bonds, the power to impose such a tax would be subject to the constitutional limits already mentioned, so that, since, as I have said, the identity of the bearer of a coupon would not be known in advance, it would be impossible in practice to deduct State taxation, even with the assistance of the Commonwealth, prior to the payment of the interest.

All these considerations show that to construe the expression as confined to the deduction of taxes prior to payment would make the exemption of small value with respect to Commonwealth taxation, and in a practical sense illusory with respect to State taxation.

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It would mean construing a somewhat elaborate expression as equivalent to a simple promise to pay the interest in full.

The expression is wide enough to cover taxation imposed by any taxing authority in Australia, such as a municipality, but, assuming that such taxation on a Commonwealth debt could be conceived, the remarks which I have made with respect to the illusory nature of the relief from State taxation sought to be collected by a deduction prior to payment would apply *a fortiori* to taxation by such an authority.

Further, each interest coupon, which bears a date corresponding to that on which the interest payable on the presentation of that coupon will become payable, contains a promise that the interest will be paid without deduction for any Australian taxes, present or future. The present taxes would be the taxes existing at the date of the presentation of the coupon. But future taxes are not to be deducted, so that, unless the expression amounts to a promise that the payment is to be free of tax, any levying of tax on the interest by the Commonwealth as a debtor being regarded, as I am satisfied that it should be regarded in any reasonable commercial sense, as a deduction from the amount which the Commonwealth has contracted to pay in full, the bearer might be assessed upon the payment by a tax imposed by an Act passed after the date of payment.

A deduction of a tax at the source is mere machinery for the collection of the tax (*Forbes* v. *Attorney-General for Manitoba* (1); *Tasmanian Steamers Pty. Ltd.* v. *Lang* (2)), so that, if the expression only means that tax must not be deducted from the interest at the source, it leaves it open to the Commonwealth to impose any tax it likes on the interest so long as it does not attempt to collect it in one particular manner. It was no doubt contemplated that the bonds would be purchased by citizens of the United States of America, who, if the Commonwealth is right, would be able to avoid payment of the tax so long as they were careful not to enter Australia or to acquire any property here. It is plain enough that the parties contemplated that, in the absence of some exemption, it would be open to the Commonwealth to tax the interest, but it is inconceivable that they could have contemplated, and even more inconceivable that, if they did, the Commonwealth could have agreed, that while reserving to itself the right to impose any tax it liked on the interest, it would not attempt to collect it in a particular, and what would be under the circumstances the most effective, manner.

(1) (1937) A.C. 260.

(2) (1938) 60 C.L.R. 111.

For all these reasons I am of opinion that the expression means that the capital and interest when payable in respect of the bonds is to be free of all Australian taxation, present and future.

The position which arises is analogous to that contemplated by *Scrutton* J. (as he then was) where, in the *Duke of Argyll's Case* (1), he said :—" I think that I must hold that the Act of 1871 prevents the annuitant or her husband from being assessed to income tax or super-tax whereby she would not in my opinion be free of all taxes as the statute provides. I am not at all sure that if the Attorney-General's contention is right, the thing would not work out in the same way, because I am rather inclined to think that when the Commissioners of the Treasury with one hand had got from the annuitant or her husband income tax, the annuitant would say to the Commissioners of the Treasury, ' now pay me the amount free of all taxes,' and they would have had to pay it back."

No separate argument was addressed to us that, although the first question was answered in the affirmative, the second question should be answered in the negative, counsel for the Commonwealth adopting the attitude, very rightly if I might say so, that if the Court considered that the first question should be answered in the affirmative the Commonwealth desired to honour its contractual obligations to the full. The bonds were issued in accordance with s. 3 of the *Loans Securities Act* 1919 which empowers the Governor-General, that is, the Federal Executive Council, to authorize the Treasurer to borrow moneys on such terms and conditions and issue such securities in such form as the Governor-General approves, while s. 6 provides that whenever, by the final judgment of any court of competent jurisdiction in the United Kingdom, any sum of money is adjudged to be payable by the Commonwealth in respect of any stock or securities, the Treasurer shall forthwith pay the sum out of the Consolidated Revenue Fund, which is thereby appropriated accordingly. The Act therefore enabled the Governor-General to authorize the Treasurer to issue the bonds free of present and future taxation. But the Parliament in 1919 could not fetter a future Parliament, if the latter Parliament thought fit to do so, from repudiating the promise that the bonds should be free of taxation ; so that if, upon the true construction of the *Income Tax Assessment Acts* of 1922 and 1936, this exemption has been abolished in the case of bondholders who are resident in Australia, then the Commonwealth would be able to set up that the subsequent statute had made it impossible for the Commonwealth to continue to honour its promise to the plaintiff (*Reilly* v. *The King* (2)). But the *Income Tax*

(1) (1913) 109 L.T., at p. 895. (2) (1934) A.C. 176

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Assessment Acts of 1922 and 1936 deal with the subject matter of income tax generally, while the promise in the bonds relates to the exemption from taxation of particular property, so that, applying the maxim *generalia specialibus non derogant*, it may well be that the Acts of 1922 and 1936 do not operate to destroy the particular exemption. Acts creating some special exemption from taxation in the case of particular property followed by subsequent general Acts wide enough in terms to include that property have been construed in this way in England (*Pole-Carew* v. *Craddock* (1); *Cadbury Bros. Ltd.* v. *Sinclair* (2); *United Towns Electric Co. Ltd.* v. *Attorney-General for Newfoundland* (3)). As at present advised, this appears to me to be the position, but if it is not, then the Commonwealth will have to legislate in order to give effect to its avowed intention of honouring the promise to the full. But the parties may desire to address further arguments to the Court on the second question, so that I agree that it is not advisable to answer it at present.

For these reasons I am of opinion that the first question asked in the case stated should be answered in the affirmative.

Question 1 *answered in the affirmative. Liberty to the parties to apply to the trial judge with respect to further proceedings relating to the second question. Costs of the case stated up to and inclusive of this order to be costs in the action. Case remitted to the trial judge.*

Solicitors for the plaintiff, *C. Lightoller & Co.*

Solicitor for the defendant, *H. F. E. Whitlam*, Crown Solicitor for the Commonwealth.

J. B.

(1) (1920) 3 K.B. 109.

(2) (1933) 149 L.T. 412.

(3) (1939) 1 All E.R. 423.