Foll *RAC Insurance Pty Ltd v FCT* 20 ATR 1089

Appl *Memorex Pty Ltd v FCT* 19 ATR 553

Appl *RAC Insurance Pty Ltd v FCT* 21 ATR 709

Appl *CMI Services Pty Ltd v FCT* 94 ALR 153

Appl *CMI Services Pty Ltd v FCT* 21 ATR 445

Expl/Appl *Chamber of Mfrs Insurance Ltd v FCT* 74 FLR 42

Appl *FCT v Employers Mutual Indemnity Assoc Ltd* 21 ATR 741

Appl *Unitraders Investments Pty Ltd v FCT* (1991) 22 ATR 83

Appl *Chamber of Mfrs Insurance Ltd v FCT* (1984) 2 FCR 455

Appl *Australasian Catholic Assurance Co Ltd v FCT* (1959) 100 CLR 502

Dist *Piers v Commissioner of Inland Revenue* [1995] 3 NZLR 456

Dist *A A T Case 50/96; No 11,189* (1996) 33 ATR 1196

Dist *A G C (Investments) Ltd v FCT* (1992) 23 ATR 287

[HIGH COURT OF AUSTRALIA.]

COLONIAL MUTUAL LIFE ASSURANCE SOCIETY LIMITED . . . . . APPELLANT;

AND

FEDERAL COMMISSIONER OF TAXATION . RESPONDENT.

H. C. OF A. 1946. MELBOURNE, *June* 11-14; *July* 10. Starke J. *Oct.* 10, 11, 14, 15. SYDNEY, *Nov.* 25. Latham C.J., Dixon and Williams JJ.

Income Tax (Cth.)—Assessment—Income or capital—Mutual life-assurance society—Variation of investments to increase effective interest yield—Profit-making scheme—Business—Income Tax Assessment Act 1936-1941 (*No.* 27 *of* 1936—*No.* 69 *of* 1941), *ss.* 6, 17, 25, 26 (*a*).

The appellant was a mutual life-assurance company limited by guarantee, the members of which were its policy holders, and the main object of which was to carry on life-assurance and other insurance business. Its operations included the issue of policies of assurance of various kinds and the investment of its funds. It was guided in its investments by actuarial calculations which indicated that, to meet its liabilities under insurance policies, it must obtain a certain effective interest yield on its investments. With a view to maintaining, and, where possible, increasing, the interest yield, it either held until maturity securities to which it had subscribed or which it had purchased in the market or sold securities and purchased others with the proceeds, whichever seemed best calculated to effect the purpose. The interest yield was the governing consideration, the appellant's general policy being to hold its securities as investments, not to traffic in or make a profit from realizing them. In its income year 1940 the total amount realized from the sale of securities and the redemption of such as it had chosen to hold until maturity exceeded the average cost to it of the securities.

Held that the amount of the excess was assessable income of the appellant for the purposes of the *Income Tax Assessment Act* 1936-1941, either as a "profit arising . . . from the carrying on or carrying out of" a "profit-making undertaking or scheme," within the meaning of s. 26 (*a*) of the Act, or as a profit according to ordinary usages and concepts.

Decision of *Starke* J. affirmed.

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Colonial Mutual Life Assurance Society Ltd. v. Federal Commissioner of Taxation.

July 10.

Appeal under the *Income Tax Assessment Act*.

This was an appeal by the Colonial Mutual Life Assurance Society Ltd. from an assessment to Federal income tax. The facts appear in the judgments hereunder.

Phillips K.C., *Spicer* and *H. U. Best*, for the appellant.

Hudson K.C. and *Adam*, for the respondent.

Cur. adv. vult.

Starke J. delivered the following written judgment:—

This is an appeal on the part of the Colonial Mutual Life Assurance Society Ltd. pursuant to the provisions of the *Income Tax Assessment Act* 1936-1941 from a decision of the Commissioner of Taxation including a sum of £27,713 in its assessment to income tax for the financial year 1941-1942.

The same sum appears also to have been included in an assessment to further tax on undistributed income of the Society but that assessment is not the subject of this appeal.

The Society is incorporated as a company limited by guarantee under the law of the State of Victoria: See *The Colonial Mutual Life Assurance Society Act* 1912. It is a mutual society and its members are its policy holders.

The objects of the Society are the assurance of lives, the granting of annuities and endowments and all other cognate business and to do all such other things as are incidental or conducive to the attainment of the above objects. The operations of the Society include the issue of policies of assurance of various descriptions, the grant of annuities and endowments and the investment of its funds which it derives from premiums paid to it and returns from its investments.

Article 42 of the articles of association of the Society provides that a board of directors shall lay out and invest the funds of the Society in the mode authorized by the articles and that the board or local boards having authority in that behalf may from time to time vary or transpose any investments made for or into others of any nature authorized at their discretion.

In the year which ended on 31st December 1940 it appears that various stocks and debentures, investments of the society, matured, and that it also sold various stock and debentures, investments of the Society. But the gains or losses thus accruing are not entered in the accounts of the Society as capital gains or losses. The sums realized were reinvested in various securities of the same kind.

The difference between the average cost of the securities and the amount realized disclosed a surplus of £27,713. The documents,

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forwarded by the Commissioner to the Court "Profit on sale or realization of investments," contain a summary of the figures constituting this sum of £27,713 and the statement forwarded by the Commissioner to the Court showing the particulars of sales and maturities of stocks and debentures during the year ended 31st December 1940 contains the detailed items which make up this sum.

The general manager of the Society said, in his evidence, that the general policy of the Society was to hold its securities as investments and not to traffic in or to make a profit from realizing them and that the governing consideration in purchasing stocks or debentures or varying or "switching," as it is called, its investments in such securities was to increase its effective interest yield. I see no reason to doubt the accuracy of this statement. But the gains or losses already mentioned were taken into account in calculating the effective interest yield to the Society. The effective yield is not the rate of interest contracted to be paid but the yield that the Society requires from year to year until the prescribed maturity of the security. That yield may or may not be greater than the nominal or contracted yield. Incidental receipts and expenses such as brokerage and commission are taken into account in calculating the yield. The Society writes the securities from year to year up or down to par according as their cost is above or below par until at the prescribed maturity date the securities will appear at par in the accounts of the Society. Thus the security is entered in the books at its cost price. If this price exceeds face value the book value is written down gradually in each year so that at maturity the security appears at par in the accounts of the Society and the effective interest yield is maintained at the rate required by the Society when it purchased the same. If the cost price is below par then the security is written up gradually to par at maturity. These adjustments are effected through the Society's "Written off Securities" account but it is not necessary that I should enter upon any detailed explanation of the process for it has been fully stated and illustrated in a written statement by an actuary of the Society which is in evidence. By this process the true or effective yields of the securities to the Society during their currency are ascertained and ensured.

The question is whether the Society is assessable to income tax in respect of the sum of £27,713 for the financial year 1941-1942.

The *Income Tax Assessment Act* 1936-1941 in Part III., Division 8 makes some special provision touching the assessment of life-assurance companies to income tax but they do not affect this case and otherwise the assessable income of such a company is governed by the general provisions of the Act. By those provisions a taxpayer

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is assessable to income tax in respect of the proceeds of any business carried on by the taxpayer and in respect of any profit arising from the carrying on or carrying out of any profit-making undertaking or scheme: See *Income Tax Assessment Act*, ss. 6, 17, 25, and 26.

A taxpayer means a person deriving income and includes a company. It was said however that the case of the *New York Life Insurance Co.* v. *Styles* (1) suggests that mutual societies do not trade or carry on a business or carry on or carry out any profit-making undertaking or scheme. But that proposition was finally negatived in the case of the *Commissioners of Inland Revenue* v. *Cornish Mutual Assurance Co. Ltd.* (2), where it was said that the real question in the *New York Case* (1) was whether there were any taxable profits within the *Income Tax Act* (16 & 17 Vict. c. 34) (See (3)). It was held that no part of premium income received under participating policies was liable to be assessed to income tax as profits or gains under Schedule D of the English Act, 16 & 17 Vict. c. 34, an Act imposing duties on profits arising from property, professions, trades and offices. By the *Income Tax Assessment Act* 1936-1944 it is expressly enacted in s. 111 that "the assessable income of a life assurance company shall not include premiums received in respect of policies of life assurance, or considerations received in respect of annuities granted . . ."

Next it was said, that the *Income Tax Assessment Act* charges income and not capital, which no doubt is true. And that where the owner of an investment chooses to realize it and obtain a greater price for it than that at which he originally acquired it, the enhanced price is not income for the purposes of the *Income Tax Assessment Act*. But that where what is done is not merely a realization or change of investment but an act done in what is truly the carrying on or carry-out of a business then the enhanced value so obtained is assessable.

The test to be applied is whether the amount in dispute is a gain made in an operation of business in carrying out a scheme of profit making. This principle is well settled and has been frequently applied (*Californian Copper Syndicate* v. *Harris* (4); *Ducker* v. *Rees Roturbo Development Syndicate* (5); *Ruhamah Property Co. Ltd.* v. *Federal Commissioner of Taxation* (6); *Commissioner of Taxes* v. *British Australian Wool Realization Association Ltd.* (7); *Punjab Co-operative Bank Ltd., Amritsar* v. *Commissioner of Income Tax, Lahore* (8), decided under the Indian *Income Tax Act* the terms of which are

(1) (1889) 14 App. Cas. 381.
(2) (1926) 12 Tax Cas. 841.
(3) (1926) 12 Tax Cas., at pp. 853, 854, 867.
(4) (1904) 5 Tax Cas. 159.
(5) (1928) A.C. 132, at p. 140.
(6) (1928) 41 C.L.R. 148.
(7) (1931) A.C. 224, at p. 231.
(8) (1940) A.C. 1055, at p. 1072.

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stated in *Commissioner of Income-Tax, Bombay Presidency and Aden* v. *Sarangpur Cotton Manufacturing Co. Ltd. of Ahmedabad* (1)). In some cases the line may be difficult to draw but the question is one of fact (*Wilcock* v. *Pinto & Co.* (2) ; *Blockey* v. *Federal Commissioner of Taxation* (3)).

The intention of a taxpayer cannot be considered as determining what it is that his acts amount to ; and the real thing that has to be decided is what were the acts that were done in connection with the business and whether they amount to a trading which would cause the profits that accrued to be profits arising from a trade or business (*J. & R. O'Kane & Co.* v. *Commissioners of Inland Revenue* (4)).

Now in the present case the business of the Society was the assurance of lives, the granting of annuities and other cognate business and the investment of its funds. Some of its investments were varied or switched from time to time in order to increase the effective interest yield to the Society. It was a normal operation or step in the carrying on of its business. It is true that these operations were small in comparison with the aggregate value of the securities which the society held as investments but that does not make its acts in varying or switching its investments in order to increase its interest yield any the less an operation of business or establish the variation or switching as a mere realization or change of investment (*Punjab Co-operative Bank Ltd., Amritsar* v. *Commissioner of Income-Tax, Lahore* (5) ; *Westminster Bank Ltd.* v. *Osler* (6) ; *Inland Revenue Commissioners* v. *Westleigh Estates Co. Ltd.* (7)). And the manner in which the Society dealt with its gains or losses does not affect the assessable nature of the surplus resulting from its operations (cf. *Mersey Docks and Harbour Board* v. *Lucas* (8)).

The Society did not contend that any part of the sum of £27,713 was not derived or realized during the year of income upon which its assessment was based (cf. *Brown* v. *National Provident Institution* (9)), but confined itself to the question of principle whether the transactions in question here were taxable transactions at all.

In my judgment the Commissioner rightly assessed the Society to income tax in respect of the surplus realized by those transactions, namely £27,713, and this appeal must therefore be dismissed with costs.

From this decision the appellant appealed to the Full Court.

(1) (1937) 65 Ind. App. 1, at p. 2.
(2) (1925) 1 K.B. 30, at pp. 44, 45.
(3) (1923) 31 C.L.R. 503, at p. 511.
(4) (1922) 12 Tax Cas. 303, at p. 347.
(5) (1940) A.C. 1055.
(6) (1933) A.C. 139, at pp. 140, 146.
(7) (1924) 1 K.B. 390, at p. 490.
(8) (1883) 8 App. Cas. 891.
(9) (1921) 2 A.C. 222, at pp. 253-256.

Coppel K.C. (with him *Phillips* K.C. and *Spicer*), for the appellant. The *Income Tax Assessment Act* contains no definition of "income." The definitions in s. 6 of income from personal exertion and income from property are merely a division, and "income" itself is left to be determined on general principles except to such extent as may be provided otherwise in the Act. The question here depends mainly, if not entirely, on s. 26 (*a*) of the Act, which, it is submitted, is an exhaustive statement of the cases in which income may be derived from the realization of investments; there is no room for any further or additional test. Alternatively, even if s. 26 (*a*) is not exhaustive, still the moneys here in question are not income according to any test provided either by the section or by the general law. On the facts as found by *Starke* J. the moneys were not profits arising from the sale of property acquired for the purpose of "profit-making by sale" within s. 26 (*a*) (*Premier Automatic Ticket Issuers Ltd.* v. *Federal Commissioner of Taxation* (1), per *Dixon* J.); nor did they arise from the carrying on of any "profit-making undertaking or scheme." What the section contemplates is an undertaking or scheme which is designed to produce the profit in question; it may be that the section does not require that to be the sole object, but it must at least be the dominant object. The words "undertaking or scheme" require the assumption of some plan from which the profits arise. An accidental profit is not a profit arising *from the scheme*; it is a profit arising from the business operation in which the scheme is applied but beyond the ambit of the scheme. It follows that intention is an important element for the purposes of the second branch of s. 26 (*a*), and the appellant had no such intention as would bring it within the provision. The sole purpose of "switching" investments was to increase the effective interest yield on the appellant's investments quite regardless of whether there was any capital accretion; sometimes there was no capital accretion. If the appellant had made a business of trading in securities it would be within the section; but that is not what it was doing. When it bought below par it took the difference into the effective yield over a period of years, but that does not make the amount of the difference "income" unless it is the result of trading in securities. Any admittedly capital increase would be dealt with in the same way. Principal moneys lent on mortgage, when repaid, would go into the same surplus sum. That the switching of investments was, as *Starke* J. expressed it, a "normal operation" in the carrying on of the appellant's business is not conclusive that the amount gained was income; dealings in capital are no less "normal" in business

(1) (1933) 50 C.L.R. 268, at p. 298.

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than the gaining of income. " Profit " involves a comparison of purchase and sale prices. The receipt of the face value of a bond on maturity, whether it is greater or less than what was paid for the bond, is merely the result of the performance of the obligation of the bond.

[Dixon J. That is only another way of saying that the profit, if any, was made at the time of purchase, not at maturity.]

According to the English authorities, the difference between issue price and redemption price, where the latter is greater, is capital, not income, in the hands of a recipient who has held the security from issue to maturity (*Lomax* v. *Peter Dixon & Son Ltd.* (1)); it remains so no matter how many subscriptions the recipient makes, or to how many issues; if he does not sell, he is not trading in the securities and there is no income gain. The mere fact that, in addition to subscribing to securities and holding them to maturity, the investor carries on a business of selling securities to which he has subscribed on issue or purchased on the market, and thereby gains income, does not alter the nature of the return he receives from the securities he holds to maturity. Sale, however, is not always the criterion; the mere sale of something not bought for resale cannot produce a " profit." The finding that the securities here were not purchased for resale is conclusive in the appellant's favour. [He referred to *Smith Barry* v. *Cordy* (2); *Punjab Co-operative Bank Ltd., Amritsar* v. *Commissioner of Income-Tax, Lahore* (3); *Liverpool and London and Globe Insurance Co.* v. *Bennett* (4); *Northern Assurance Co.* v. *Russell* (5); *Inland Revenue Commissioners* v. *Scottish Automobile and General Insurance Co. Ltd.* (6).]

[Williams J. referred to *Royal Insurance Co. Ltd.* v. *Stephen* (7); *Australian Mutual Provident Society* v. *Inland Revenue Commissioners* (8).]

In the present case the realization of investments is no part of the ordinary activity of the appellant, which is a purely mutual company. Even if the true view of the English authorities is that a life-insurance company conducts a business which consists in part in the making of profits by the realization of investments, that view cannot be applied to a *mutual* life-insurance company. The nature of the company is shown in *The Colonial Mutual Life Assurance Society Act* 1912 (Vict.): The company is declared to be purely a mutual company; it is

(1) (1943) K.B. 671.
(2) (1945) 1 All E.R. 695.
(3) (1940) A.C. 1055, at pp. 1070 et seq.
(4) (1912) 2 K.B. 41; (1913) A.C. 610.
(5) (1889) 2 Tax Cas. 551.
(6) (1931) 16 Tax Cas. 381.
(7) (1928) 14 Tax Cas. 22.
(8) (1946) 174 L.T. 316.

a company limited by guarantee ; it has no shareholders ; only policy holders share in any surplus. *Cornish Mutual Assurance Co. Ltd.* v. *Inland Revenue Commissioners* (1) was decided on the *Finance Act* 1920 (Imp.), s. 53 (2) (*h*) of which contained a special definition of " profit " in relation to mutual trading concerns ; the inquiry was whether the company was a mutual trading concern, not what was profit. *New York Life Assurance Co.* v. *Styles* (2) at least negatives the idea that *all* gains of a mutual life-assurance company are gains from a business : See also *Jones* v. *South-West Lancashire Coal Owners' Association Ltd.* (3). It follows that *Starke* J. was wrong in deciding that the money here in question was income because the appellant carried on a business. If the English authorities do not establish any more than that, they at least go as far. The varying of investments is merely something done for the benefit of the members. It is not trading.

Hudson K.C. (with him *Adam*), for the respondent. The question here is one of fact ; the finding of *Starke* J. should not be disturbed. Section 26 (*a*) does not narrow the field of income ; it is not intended as a definition. [He referred to *Hannan, Principles of Income Taxation* (1946), pp. 27, 28.] The appellant was carrying on a business ; none of the cases which have been cited is an authority to the contrary. The only significance of the nature of the business is that premium receipts are not taxable. In *Municipal Mutual Insurance Ltd.* v. *Hills* (4) the question was whether certain moneys were profits derived from the business ; there was no question of the nature of the company's activities in general. The appellant's business consists of entering into insurance contracts creating future obligations, to meet which it invests the moneys received by way of premiums in the most effective and profitable manner consistent with security. The investment of its funds is of the essence of its insurance business, and is a profit-making undertaking or scheme within the meaning of s. 26 (*a*). It is not to the point to say that the profit is " accidental " ; it arises from the undertaking whether or not it was the kind of profit looked for. Even if the amount in question is not within s. 26 (*a*), it is income according to general principle and is, therefore, taxable. The respondent's view is supported by the *Cornish Mutual Assurance Co. Ltd.'s Case* (5) (which, despite the appellant's comment on it, is in point here),

(1) (1926) A.C. 281 : See pp. 285, 286.
(2) (1889) 14 App. Cas. 381.
(3) (1927) A.C. 827, particularly at p. 832.
(4) (1931) 16 Tax Cas. 430 : See pp. 440, 447.
(5) (1926) A.C. 281.

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Liverpool and London and Globe Insurance Co. v. *Bennett* (1) and the *Punjab Co-operative Bank Case* (2). In the *Scottish Automobile and General Insurance Co. Ltd.'s Case* (3) the main question seems to have been one of fact, whether a particular finding was supported by evidence, but it contains dicta which are favourable to the respondent here. [He referred to *Westminster Bank Ltd.* v. *Osler* (4); *Californian Copper Syndicate* v. *Harris* (5); *Ducker* v. *Rees Roturbo Development Syndicate* (6); *Lomax' Case* (7); *Hannan, Principles of Income Taxation* (1946), pp. 104, 490; *Davies* v. *Premier Investment Co. Ltd.* (8).]

Phillips K.C., in reply. The question is whether the process under consideration is one of investment; if so, it does not matter whether it is called a part of the appellant's business or not. [He referred to *Danmark Pty. Ltd* v. *Federal Commissioner of Taxation* (9); *Western Gold Mines* v. *Commissioner of Taxation (W.A.)* (10).]

Cur. adv. vult.

Nov. 25.

The Court delivered the following written judgment:—

These reasons for judgment were prepared by *Williams* J. The origin of this appeal was an objection to an assessment of the appellant Society disallowed by the respondent Commissioner in respect of its assessable income derived during the twelve months ending 31st December 1940, this period having been accepted by the respondent in lieu of the ordinary accounting period of twelve months ending 30th June 1940. The Society appealed to this Court under s. 197 of the *Income Tax Assessment Act* 1936-1941. The appeal came on for hearing before *Starke* J. and was dismissed with costs.

The Society is a mutual life-assurance company limited by guarantee. Its profits are divisible only amongst its policy-holders. Every person effecting a policy for a life or other assurance annuity or endowment with the Society with participation in profits becomes a member of the Society. The Society carries on as its principal business that of life assurance, either full life policies, or endowment policies and annuities, and also carries on the business of accident insurance. The Society has been in business since 1873 and has been very successful, the life assurance fund at the end of the year

(1) (1911) 2 K.B. 577: See p. 589; (1912) 2 K.B. 41: (1913) A.C. 610: See pp. 616, 617.
(2) (1940) A.C. 1055, particularly at p. 1072.
(3) (1931) 16 Tax Cas. 381: See p. 389.
(4) (1933) A.C. 139, at pp. 140, 147.
(5) (1904) 5 Tax Cas. 159.
(6) (1928) A.C. 132.
(7) (1943) K.B., at pp. 673, 675.
(8) (1945) 2 All E.R. 681.
(9) (1943) 7 A.T.D. 191.
(10) (1938) 59 C.L.R. 729.

1940 in the ordinary department of life assurance (excluding the life assurance fund in the industrial department and the accident insurance fund) standing at over £21,000,000. A number of grounds of objection were made to the assessment but the only ground which was argued before *Starke* J. and raised on this appeal is whether the net profit of £27,713 made on the sale and maturity of certain investments in Australia, New Zealand, Great Britain and South Africa during the year of income is a capital profit and not taxable as the Society contends, or an income profit and therefore part of the assessable income of the Society as the Commissioner contends.

From the evidence tendered on behalf of the Society it appears that the solvency of a life-assurance company depends upon its accumulated funds being at any time sufficient to meet its estimated liabilities under its policies. The Society makes an annual actuarial investigation in order to ascertain its position in this respect. Any net surplus in the fund over these liabilities, after allowing for the expenses of the business and other contingencies, is available for distribution amongst the policy-holders in the form of a bonus or in such other manner as the directors may decide. An actuarial liability has to be provided for a policy immediately upon its issue, which is in effect that portion which must be set aside from each premium to provide for the payment of the policy at its maturity, assuming that the portion set aside earns a certain rate of interest. In the case of the Society the assumed rate is three per cent per annum. Estimates are made of certain expenses and liabilities which must be deducted from the balance of each premium, and the residue after such deductions, together with the other income earned by the assets of the Society after deducting therefrom such amounts as are required to be retained for various purposes, represents the net surplus.

The fundamental policy of the Society in investing its funds is based on buying sound securities in order to hold them until maturity.

The predominant if not the sole consideration in acquiring securities is to obtain the most effective interest yield during the period between the date of acquisition and that of maturity. The greater the effective interest yield from the investment of the premiums over the assumed rate of three per cent, the greater the net surplus available for distribution among the policy-holders and the more attractive the policies of the Society become to the public in comparison with those of its competitors. In the year ending 31st December 1940 the effective interest yield was £4 8s. 1d. per cent. In order to maintain and increase the effective interest yield securities are "switched" from time to time, that is to say some are realized

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Latham C.J. Dixon J. Williams J.

and the proceeds of sale immediately re-invested in other securities; but the percentage of funds so switched is small in comparison with the total holdings. In the accounting period it was higher than usual, due to the disturbance of interest rates and conditions of investment generally on account of the war, but even then the sales were only eight point seven per cent of the total stocks and debentures. The important factor in this investment process is that in calculating the effective interest yield from a security the Society takes into account not only the annual interest payable on the security, but also the price below or above par at which the security is acquired. Two illustrations are given in the evidence—one of £100 four and one-half per cent stock purchased at £102 13s. six years before maturity which would give an effective annual yield of four per cent over the intervening period, and the other of £100 three and one-half per cent stock purchased at £97 7s. 3d. six years before maturity which would also give the same effective annual yield, in the first instance after apportioning and charging the depreciation in the capital value of the security between the date of purchase and that of maturity against the annual interest, and in the second instance apportioning and adding the accretion in the capital value of the security to the annual interest. Although this depreciation or accretion in capital value is thus apportioned and taken into account in arriving at the annual net surplus, the Society claims that the only amount which should be returned as assessable income of the Society is the actual annual interest received from the securities.

Prima facie the depreciation in or accretion to the capital value of a security between the date of purchase and that of realization is a loss of or accretion to capital and is therefore a capital loss or gain and does not form part of the assessable income: *Lomax* v. *Peter Dixon & Son Ltd.* (1). But in the words of the Lord Justice Clerk in *Californian Copper Syndicate* v. *Harris* (2) which have been so often quoted, "it is equally well established that enhanced values obtained from realization or conversion of securities may be so assessable, where what is done is not merely a realization or change of investment, but an act done in what is truly the carrying on, or carrying out, of a business."

The *Income Tax Assessment Act* defines "income from personal exertion" to mean income consisting of *inter alia* the proceeds of any business carried on by the taxpayer. Section 26 (*a*) provides:—"The assessable income of a taxpayer shall include—(*a*) profit arising from the sale by the taxpayer of any property acquired by him for the purpose of profit-making by sale, or from the carrying on

(1) (1943) K.B. 671.

(2) (1904) 5 Tax Cas. 159, at p. 166.

or carrying out of any profit-making undertaking or scheme." Such profits are included in the definition of income from personal exertion. It is not contended that the inclusion of the proceeds of any business carried on by the taxpayer in the definition of income from personal exertion makes all the proceeds of a business income for the purposes of the Act; and it is common ground that, as *Jordan* C.J. held in *Scott* v. *Commissioner of Taxation* (1) in relation to a similar provision in the *Income Tax* (*Management*) *Act* 1934 (N.S.W.), the definition only refers to proceeds which would be held to be income in accordance with the ordinary usages and concepts of mankind, except in so far as the Act states or indicates an intention that receipts which are not income in ordinary parlance are to be treated as income.

The appellant contends that the maxim *expressio unius exclusio alterius* applies, and that receipts which are of a capital nature are only made income for the purposes of the *Income Tax Assessment Act* so far as they are caught by the express provisions of s. 26 (*a*). But we cannot see why such receipts should not be income where they would be income according to ordinary usages and concepts. *Starke* J. found, and this finding has not been attacked, that the purpose of the appellant in varying or switching its securities from time to time was to increase the effective interest yield irrespective of whether the variation was or was not likely to produce an accretion to capital. The new investments were not therefore acquired for the purpose of profit-making by sale. In view of this finding the respondent cannot bring the case within the first limb of s. 26 (*a*). As *Rowlatt* J. pointed out in *Devon Mutual Steamship Insurance Association* v. *Ogg* (2), " There must be the finding that the purchase was made with the intention of selling at a profit, in other words, of initiating a trade. Here that is negatived. It seems to me that Mr. Latter [in this case Mr. *Hudson*] cannot get the case on its legs without a finding in the affirmative on that point."

The crucial question is whether the net profit of £27,713 is a profit arising from the carrying on or carrying out of a profit-making scheme, and if it is not whether this net profit is income according to ordinary usages and concepts. As Lord *Parker* said in *Liverpool and London and Globe Insurance Co.* v. *Bennett* (3), " This question ought, in my opinion, to be determined on ordinary business principles, having regard to the circumstances under which, and the purposes for which, the investments were made and are held by the appellant company."

Since the future interest to be earned by the investment of the premiums is taken into account in determining what portion of the

(1) (1935) 35 S.R. (N.S.W.) 215; 52 W.N. 44.
(2) (1927) 13 Tax Cas. 184, at p. 201.
(3) (1913) A.C. 610, at p. 622.

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premium must be set aside to pay the policy at its maturity, and the expenses and other contingencies of the business must be met by the investment of the balance, it is clear that the investing of its funds is part of the business of the Society. It was held in *Northern Assurance Co.* v. *Russell* (1) that the profits or gains of a company carrying on the business of life assurance can only be ascertained by actuarial calculation, and that the profits and gains are not, as in the case of contracts of insurance like fire insurance which are for one year only, the amount of the net premiums and other income received during the year less the amounts required to meet claims and the expenses and other outgoings of the business, but the net surplus after provision has been made for the liabilities of the company on certain assumptions as to the rate of mortality, the rate of interest, and the amount of expenses likely to be experienced in the future. The Lord President of the Court of Exchequer, Scotland, laid down in that case five propositions as useful guides to the Income Tax Commissioners dealing with cases of this description. Of these propositions we need quote only 2 and 5: " (2) that the interest of investments which has not suffered deduction of Income Tax at its source must be taken into account in ascertaining the assessable amount of profits and gains of the company . . . (5) Where the gain is made by the company (within the year of assessment . . .) . . . by realizing an investment at a larger price than was paid for it, the difference is to be reckoned among the profits and gains of the company " (2). In *Clerical, Medical, and General Life Assurance Society* v. *Carter* (3) it was held that a life assurance company could be made liable to income tax on the interest of investments made by the company for the purposes of its business, although the income tax on interest from such investments which had been deducted at the source exceeded the amount of the profits of the company for the year of assessment. It appears from this and other cases that under the English *Income Tax Acts* the Commissioners have the choice of bringing interest from investments into account in determining the annual profits or gains of the company from a trade exercised in the United Kingdom under Case 1 of Schedule " D," or of separately assessing the interest as income from property under other cases. If it is brought into account in determining the annual profits or gains the amount of tax on the interest deducted at the source must be credited against the amount of tax on the annual profits or gains. In *Last* v. *London Assurance Corporation* (4) the company was assessed on the annual profits or gains. The form of

(1) (1889) 2 Tax Cas. 571.
(2) (1889) 2 Tax Cas., at pp. 577, 578.
(3) (1889) 22 Q.B.D. 444.
(4) (1885) 10 App. Cas. 438.

final assessment made after the decision of the House of Lords appears in the footnote to the *Clerical, Medical, and General Life Assurance Society* v. *Carter* (1), in the court below, the final item being for the amount remaining to be assessed or the amount of which tax had been overpaid, as the case might be. But the result of assessing the tax on interest from investments separately was that interest on investments made and retained abroad escaped tax : *Gresham Life Assurance Society Ltd.* v. *Bishop* (2). This led to the case of the *Liverpool and London and Globe Insurance Co.* v. *Bennett* (3), where a fire and life insurance company had interest-producing investments abroad and at home, the interest from the investments abroad being received abroad and not remitted to the United Kingdom. It was held that the income of the foreign investments formed part of the profits and gains of the company's business and was properly taxed under Case 1. Lord *Shaw* said : " The series of propositions in *Northern Assurance Co.* v. *Russell* (4) and *Scottish Union and National Insurance Co.* v. *Smiles* (5), which were formulated as instructions to the Commissioners, cover the present case, and have never been judicially controverted as a convenient guide " (6). It also appears from the form of final assessment in *Last's Case* (7) and from *Royal Insurance Co. Ltd.* v. *Stephen* (8) that profits and losses made upon a realization of investments are, in accordance with the fifth proposition in *Northern Insurance Co.* v. *Russell* (4), usually taken into account in assessing the profits and gains taxed under Case 1. On the other hand, in *Brice* v. *Northern Assurance Co.* (9), (one of the three cases before *Hamilton* J. which led to the appeal to the House of Lords in *Liverpool and London and Globe Insurance Co.* v. *Bennett* (10)) it was proved to the satisfaction of the Commissioners that it was not part of the business or trade of the company to deal in investments or to vary its investments or to make profits by so doing ; that investments were not made or sold with the intention of earning profits and were rarely realized and then only for special reasons, and that any sums realized in excess of the cost of such investments were treated as and were capital and carried to Capital Investment Reserve Fund or used in writing off depreciation on other securities and were not in any way used or dealt with as profits or gains or taken into account for dividend purposes. Accordingly, the Commissioners held that a sum of £6,690, the net proceeds

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(1) (1888) 21 Q.B.D. 339, at p. 345.
(2) (1902) A.C. 287.
(3) (1911) 2 K.B. 577 ; (1912) 2 K.B. 41 ; (1913) A.C. 610.
(4) (1886) 2 Tax Cas. 571.
(5) (1889) 2 Tax Cas. 551.
(6) (1913) A.C., at p. 617.
(7) (1885) 10 App. Cas. 438.
(8) (1928) 14 Tax Cas. 22.
(9) (1911) 6 Tax Cas. 327, at p. 345.
(10) (1913) A.C. 610.

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of sale of investments, was not profit or gain derived or arising from the company's trade or business and that it was capital and not subject to be assessed to income tax. There was an appeal to *Hamilton* J. on this point but in view of this finding it was abandoned. His Lordship, however, appears to have agreed with the finding and said: "I take it that throughout the object of these investments it is not to do what I venture to call a stock-jobbing business, it is not to invest money with the object of getting in and getting out of rapidly moving investments, but is, as is stated expressly in the *Liverpool and London and Globe Case* (1) in order to have a fund created out of accumulated profits in past years and not distributed, and which may be easily realizable if required" (2). The same view that a profit on the sale of investments was not on the facts of that case a profit made by trading by a company carrying on an insurance business other than life assurance but was a profit made on a change of investments for the purpose of securing a higher rate of interest was taken by the Commissioners and upheld on appeal by a majority of the Court of Session, Scotland, in *Commissioners of Inland Revenue* v. *Scottish Automobile & General Insurance Co. Ltd.* (3). But the insistence by Lord *Shaw* upon the correctness of the whole of the series of propositions enunciated in *Northern Assurance Co.* v. *Russell* (4) after he had presumably read the remarks of *Hamilton* J. in the court below, and the criticism by the Privy Council of some dicta in *Commissioners of Inland Revenue* v. *Scottish Automobile & General Insurance Co. Ltd.* (5) in *Punjab Co-operative Bank Ltd., Amritsar* v. *Commissioner of Income-Tax, Lahore* (6), coupled with the willingness of the Inspector of Taxes in *Royal Insurance Co. Ltd.* v. *Stephen* (7) to allow a loss on realization amounting to £754,000 as a deduction in computing its profits assessable under Case 1, tends to show that the sounder view is that profits and losses on the realization of investments of the funds of an insurance company should usually be taken into account in the determination of the profits and gains of the business.

There is in England an additional complication where the taxpayer is a mutual insurance company. Apart from statute, surpluses arising out of the transactions of purely mutual insurances between an association as insurer and its members as the insured are not assessable to income tax as profits and gains of a trade because the common fund is composed of sums provided by the contributors out of their own moneys, and any surplus after satisfying claims whether

(1) (1911) 6 Tax Cas. 327.
(2) (1913) 6 Tax Cas., at p. 355.
(3) (1931) 16 Tax Cas. 382.
(4) (1886) 2 Tax Cas. 571.
(5) (1931) 16 Tax Cas. 381.
(6) (1940) A.C. 1055, at p. 1072.
(7) (1928) 14 Tax Cas. 22.

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it goes back to the contributors in reduction of their premiums or in enhancement of the sum insured, is in essence a return of their own moneys which they have overpaid and is not a profit : *New York Life Insurance Co.* v. *Styles* (1) ; *Jones* v. *South-West Lancashire Coal Owners' Association* (2) ; *Municipal Mutual Insurance Ltd.* v. *Hills* (3) ; *Inland Revenue Commissioners* v. *Ayrshire Employers Mutual Insurance Association Ltd.* (4). In *Hills' Case* (5) Lord *Warrington of Clyffe* said : " It is now settled by the decisions above referred to, and is not disputed, that the mere carrying on of such a business is not a trade, nor are the surpluses profits, for the purposes of Income Tax."

But the position is different under the *Income Tax Assessment Act*. Under Part III., Div. 8, of this Act, all companies carrying on the business of life assurance are assessed for ordinary income tax on the same basis, whether they are companies which carry on business with a view to making profits for their shareholders or are mutual assurance companies. The definition of a mutual life assurance company was introduced into s. 110, which is one of the sections in Part III., Div. 8, and into s. 160c (1a) by the *Income Tax Assessment Act* 1942. But these amendments do not affect the assessment under appeal and in any event the amendment of s. 110 has no operative effect in Part III., Div. 8, and appears to have been introduced for the purposes of Part IIIa, which deals with further tax on the undistributed income of a company. Part III., Div. 8, includes ss. 110-116. Section 111 provides that " the assessable income of a life assurance company shall not include premiums received in respect of policies of life assurance, or considerations received in respect of annuities granted." Section 115 provides, that four per cent (reduced to three per cent by Act No. 22 of 1942) of the " calculated liabilities " of a life assurance company shall be an allowable deduction. The assessable income of a life assurance company, whether it is a mutual assurance company or not, is therefore all the income of the company except its premiums, and from that income there can be deducted the ordinary deductions authorized by the Act as modified by Part III., Div. 8, and the special deduction allowed by s. 115.

But an insurance company, whether a mutual insurance company or not, is undoubtedly carrying on an insurance business and the investment of its funds is as much a part of that business as the collection of the premiums. The purpose of investing the funds of the appellant is to obtain the most effective yield of income. The

(1) (1889) 14 App. Cas. 381.
(2) (1927) A.C. 827.
(3) (1931) 16 Tax Cas. 430.
(4) (1946) 175 L.T. 22.
(5) (1931) 16 Tax Cas., at p. 442.

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diminution or increase in the capital value of the investment between the date of purchase and that of maturity, and the apportionment and deduction or addition over the intervening period of that diminution from or increase to the interest actually payable on the investment is a material ingredient in the ascertainment of this yield. In *Konstam, Law of Income Tax*, 8th ed. (1940), p. 126, it is stated that "the buying and selling of investments is a necessity of insurance business ; and where an insurance company in the course of its trade realizes an investment at a larger price than was paid for it, the difference is to be reckoned among its profits ; conversely any loss is to be deducted." This view is in line with that of the Privy Council in the case of a bank in *Punjab Co-operative Bank Ltd., Amritsar* v. *Commissioner of Income-Tax, Lahore* (1). In our opinion there is no substantial distinction between the business of an insurance company and that of a bank in this respect. The acquisition of an investment with a view to producing the most effective interest yield is an acquisition with a view to producing a yield of a composite character, the effective yield comprising the actual interest less any diminution or plus any increase in the capital value of the securities. Such an acquisition and subsequent realization is a normal step in carrying on the insurance business, or in other words an act done in what is truly the carrying on of the business of the society.

The society employs an expert staff whose business it is continuously to supervise and plan the investment and, if necessary, the realization and re-investment of its funds as they exist and are augmented from time to time by fresh premiums with a view to obtaining the most effective interest yield. The accretion in capital value is used for the purpose of increasing the effective interest yield from the investment and therefore for an income purpose : *Cunard's Trustees* v. *Inland Revenue Commissioners* (2). It is as much a source of income as the interest payable on the investment : *Inland Revenue Commissioners* v. *Desoutter Bros. Ltd.* (3). We can see no distinction in substance between the profit or loss made when an investment is subsequently converted into cash by sale and when it subsequently matures and is paid off. As *Rowlatt* J. said in *Royal Insurance Co. Ltd.* v. *Stephen* (4) : "At the bottom of this principle of waiting for a realisation, I think there is this idea : while an investment is going up or down for Income Tax purposes the Company cannot take any notice of fluctuations, but it has to take notice of them when all that state of affairs comes to an end,

(1) (1940) A.C. 1055, at pp. 1072, 1073.
(2) (1945) 174 L T. 133, at p. 135.
(3) (1945) 174 L.T. 162.
(4) (1928) 14 Tax Cas., at p. 28.

. . . when an investment ceases to figure in the Company's affairs, when it is known exactly what the holding of that investment has meant, plus or minus to the Company, and then the Company starts so far as that portion of its resources is concerned with a new investment. Then one knows where one is and it is no longer a question of paper, it is a question of fact and that is a realisation." It is not necessary to show a regular business of buying and selling to bring a source of profit within the meaning of the word "trade" in Case 1 of Schedule D of the English Act: *Cordy* v. *Barry* (1). The profit of £27,713 was as much a profit from the carrying out of a profit-making scheme as the interest payable on the investments from which this profit was derived. It was therefore a profit within the meaning of the second limb in s. 26 (*a*). Alternatively it was a profit according to the ordinary usages and concepts of mankind.

Appeal dismissed with costs.

Solicitors for the appellant: *Moule, Hamilton & Derham.*

Solicitor for the respondent: *G. A. Watson*, Acting Crown Solicitor for the Commonwealth.

E. F. H.

(1) (1946) W.N. (Eng.) 170.