[HIGH COURT OF AUSTRALIA.]

COMMERCIAL BANKING COMPANY OF SYDNEY LIMITED . . . . . } APPELLANT;

AND

FEDERAL COMMISSIONER OF TAXATION . RESPONDENT.

FEDERAL COMMISSIONER OF TAXATION . APPELLANT;

AND

COMMERCIAL BANKING COMPANY OF SYDNEY LIMITED . . . . . } RESPONDENT.

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SYDNEY, *April* 13, 14, 17.

MELBOURNE, *June* 6.

Latham C.J., Dixon, McTiernan, Williams, Webb and Fullagar JJ.

Income Tax (Cth.)—Assessment—Super tax—Company—Further tax on undistributed profits—Assessable income—Deductions—Permissibility—Debt conversion—Commonwealth Government securities—Freedom from future increases of income tax—Interest—Reduced by apportionment of deduction representing expenditure incurred in gaining income, including interest from Commonwealth Government securities—Rebates—New securities—Banking company—"Principal business"—"Lending of money"—Interest on Commonwealth Government securities bought in market—"Income from personal exertion"—"Included in the taxable income"—Income Tax Assessment Act 1936-1944 (*No.* 27 *of* 1936—*No.* 3 *of* 1944), *ss.* 3, 6, 160, 160A, 160B, 160C, 160AA, 160AB, 160AD (*a*)—*Commonwealth Debt Conversion Act* 1931 (*No.* 18 *of* 1931), *s.* 20—*Commonwealth Inscribed Stock Act* 1911-1940 (*No.* 20 *of* 1911—*No.* 25 *of* 1940), *s.* 52B (2)—*Income Tax Acts* 1930 (*Nos.* 51 *and* 61 *of* 1930)—*Income Tax Act* 1944 (*No.* 36 *of* 1944), *ss.* 5 (7), 6.

In the year of income the amount of interest received by a bank on overdrafts, treasury bills, special war-time deposit and Commonwealth Government securities for which the bank had subscribed was more than £1,700,000. The total income of the bank as returned, including these items and also exchange, commission, fees on current accounts, rents and some other small items, was £2,458,864. Thus about seventy-five per cent of the bank's income was derived from the lending of money.

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Held, that the bank's principal business consisted of the lending of money, therefore the interest so received was "income from personal exertion" within the meaning of those words as defined in s. 6 of the *Income Tax Assessment Act* 1936-1944.

Held, further, that interest paid upon Commonwealth Government securities purchased in the market was not derived from the "lending of money," but was, if the proceeds of a business, "income from personal exertion."

The commissioner assessed a bank upon the basis that the amount of such interest which, apart from s. 20 of the *Commonwealth Debt Conversion Act* 1931, would be taxable in respect of the income year was the amount of interest received but was reduced by an apportionment of deductions representing expenditure made in gaining the bank's income, including the interest to which s. 20 applied.

Held, further, that under the terms of s. 20 no such deductions were permissible.

The commissioner had no authority to attribute any of the deductions made under s. 160C of the *Income Tax Assessment Act* 1936-1944 to the interest received from the new securities, but should have assessed the bank upon the basis that the whole amount of £151,371 was free from further tax.

So *held* by the whole Court.

For the purpose of ascertaining the rebate under s. 160AB of the *Income Tax Assessment Act* 1936-1944 upon the amount of interest to which that section applied derived by the taxpayer during the year of income, the whole of the interest was to be taken to be included in its taxable income.

So *held* by *Dixon*, *McTiernan*, *Williams*, *Webb* and *Fullagar* JJ. (*Latham* C.J. dissenting).

REFERENCE by *Latham* C.J.

The Commercial Banking Co. of Sydney Ltd. was, on 7th February 1945, assessed under the *Income Tax Assessment Act* 1936-1944 for income tax payable by it for the financial year ended 30th June 1944 as follows :—

	Taxable income £	Rate of tax (pence per £)	Tax payable £
Interest other than Government loan interest subject to 1930-1931 rate ..	567,902	72d.	
Government loan interest subject to 1930-1931 rate	122,415	16d.	
Total ..	690,317		178,531 12 0
Deduct rebates of tax—S. 160AB on £297,458 @ 2s.			29,745 16 0
			148,785 16 0

Super tax on £562,902		28,145 2 0	
Rebate s. 46 (2A)			
		176,930 18 0	
Cr. by transfer from other assessments		34,326 5 5	
Total amount of tax payable		£142,604 12 7	

The explanatory statement issued with the notice of assessment showed, *inter alia* :—

	£	£
Commonwealth loan interest taxable at 1930 rate, gross interest		151,371
Deduct estimated expenses at ½%	757	
Proportion of interest paid 20,179,473/84,472,435 x £586,537 =	28,199	28,956
		122,415
Rebateable s. 160AB gross interest		439,774
Deduct estimated expenses at ½%	2,199	
Proportion of interest paid 20,179,473/84,472,435 x £586,537 =	140,117	142,316
		297,458

The company was also assessed under Part IIIA of the Act for further tax on its undistributed income based on income derived during the year ended 30th June 1944, as follows :—

		£
Taxable income as assessed		690,317
Less taxes (s. 160C)		171,662
Amount remaining		518,655
Less dividends paid out of taxable income		355,426
Taxable income which had not been distributed		163,229
Less Commonwealth Consolidated Loan interest (s. 20, *Commonwealth Debt Conversion Act* 1931)		44,990
Taxable income subject to further tax ..		118,239
Rate of tax (pence in £)	24	
Further tax payable		11,823.18
Credit by transfer from 1940/1941	£2,558 2 0	
and from 1941/1942	9,265 16 0	11,823.18
Balance		Nil

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The explanatory statement issued with the notice of assessment for further tax was as follows :—

	Taxable C.L.I.	Income other	Exempt Ex-Aust.	Total
	£	£	£	£
Net income as per assessment	122,415	567,902	loss 8,715	681,602
Deduct Ex-Australia loss	1,545	7,170	8,715	—
	120,870	560,732	—	681,602
,, Federal income tax	9,224	153,723	—	162,947
	111,646	407,009	—	518,655
Add Adjustments other than appropriation ..	—	76,667	—	76,667
	111,646	483,676	—	595,322
Appropriation apportioned	40,415	175,085	—	215,500
Net profit as per a/s ..	71,231	308,591	—	379,822
Dividends paid	66,656	288,770	—	355,426

	C.L.I.	Other income	Total
	£	£	£
Taxable income assessed	122,415	567,902	690,317
Deduct—Ex-Aust. loss	1,545	7,170	8,715
	120,870	560,732	681,602
,, Federal income tax paid ..	9,224	153,723	162,947
	111,646	407,009	518,655
,, Dividends paid as above	66,656	288,770	355,426
	44,990	118,239	163,229
	Deduct C.L.I.		44,990
Income subject to further tax			£118,239

The company formally objected to (A) the assessment of income tax on the following grounds :—(i) that the assessment was excessive as regards the rate of tax and as regards the amount on which super tax had been levied ; (ii) that the amount of £151,371 should be chargeable at 1s. 4d. in the pound in lieu of the amount of £122,415 shown in the notice of assessment, and that the amount

upon which the rate of 6s. in the pound had been charged should be reduced by £28,956; (iii) that the amount upon which super tax had been charged should be reduced by £28,956; (iv) that the commissioner was in error in attributing deductions relating to interest paid £28,199, and administrative expenses £757 (totalling £28,956) to the Commonwealth loan interest, as such amounts were not part of the deductions attributable to the income of the taxpayer derived from property as provided in s. 20 of the *Commonwealth Debt Conversion Act* 1931, and further that the opinion of the commissioner had not been properly formed and should be set aside; (v) alternatively, that the commissioner was in error in attributing the deductions amounting to £28,956 to the Commonwealth loan interest, and that if any amount of the deductions should have been attributed to such interest, a much lesser sum should have been so attributed; (vi) that the whole amount of the Commonwealth loan interest, £439,774, should have been treated as included in the taxable income and subject to rebate under s. 160AB of the *Income Tax Assessment Act* 1936-1944; (vii) alternatively, that the amount rebateable under s. 160AB of that Act was greater than £297,458; and (B) the assessment for further tax on the following grounds:—(*a*) that the Commonwealth loan interest excluded from the assessment should have been £151,371 and not £44,990 as shown in the assessment, or, alternatively, a greater amount than £44,990 should have been excluded; (*b*) that s. 160 did not authorize any part of the dividend paid out of the taxable income to be attributed to the Commonwealth loan interest, nor did s. 20 of the *Commonwealth Debt Conversion Act* 1931; (*c*) that an amount of £1,545 deemed to be ex-Australian loss attributable to the Commonwealth loan interest was not a deduction attributable to the income of the taxpayer derived from property within the meaning of that expression in s. 20 of the *Commonwealth Debt Conversion Act* 1931; and (*d*) that Federal income tax, £9,224, was not a deduction attributable to the income of the taxpayer derived from property within the meaning of that expression in s. 20 of the *Commonwealth Debt Conversion Act* 1931, and that deductions amounting to £28,956 for interest paid and administrative expenses, were also not deductions attributable to the income of the taxpayer derived from property within the meaning of that expression in s. 20. Further, the opinion of the commissioner had not been properly formed and should be set aside.

The objections were disallowed by the commissioner whereupon the company requested him to treat the objections to the assessments as appeals and to refer them to the Board of Review.

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The questions raised before the Board of Review were concerned with the determination of:—(i) the amount, if any, which should have been deducted from assessable income consisting of interest to which s. 20 of the *Commonwealth Debt Conversion Act* 1931 applied (referred to as " s. 20 interest ") for the purpose of ascertaining the extent to which the interest was, by virtue of that section, free from the ordinary income tax, the super tax and the further tax under Part IIIA of the *Income Tax Assessment Act* 1936-1944, and (ii) the amount, if any, which should have been deducted from assessable income consisting of interest to which s. 160AB of the *Income Tax Assessment Act* 1936-1944 applied (referred to as " rebateable interest ") for the purpose of ascertaining the extent to which the interest was, within the meaning of that section, included in the taxable income and was therefore the subject of the rebate of two shillings in the pound which was allowable under the section.

The company's balance sheet as at the close of business on 30th June 1944 (including the figures of the London Branch by cable) showed liabilities as follows:—

	£
Total shareholders' funds	9,338,959 0 7
Deposits, Bills payable and other liabilities, including provisions for contingencies	81,489,994 11 7
Notes in circulation	13,531 10 0
Balance due to other banks	213,034 11 0
	£91,055,519 13 2

Assets included the following:—

	£
Coin, bullion, notes and cash at banks	4,565,439 15 8
Cheques and bills of other banks	1,280,146 16 7
Balances with and due from other banks	205,619 18 9
Money at short call in London	531,250 0 0
Treasury Bills—Australian Government	10,220,000 0 0
Public securities (including Treasury bills) at or below market value (including £4,000 lodged with Public Authorities)— Australian Government securities	14,496,224 12 9
Special war-time deposit with account Commonwealth Bank of Australia	23,399,000 0 0
Bills receivable and remittances in transit	3,403,316 2 7
	£58,100,997 6 4
Loans advanced and bills discounted, after deducting for debts considered bad or doubtful	£31,413,371 1 9

Dealing with s. 20 interest, particulars of the assessment of the company's taxable income for purposes of ordinary tax and super tax were as follows :—

	£	£
Assessable income :		
Section 20 interest		151,371
Rebateable interest (s. 160AB)—		
(*a*) interest on Commonwealth securities	298,461	
(*b*) discount on Commonwealth Treasury bills	141,313	439,774
Interest—		
(i) on overdrafts, &c.		1,291,880
(ii) on special war-time deposit account with the Commonwealth Bank		128,874
(iii) recovered		105,821
(iv) other		67
Discount on bills		681
Exchange, commission, fees on current accounts		243,637
Bad debts recovered		69,122
Rents received		27,637
Total ..		£2,458,864
Allowable deductions :		
Expenses	£1,107,276	
Interest paid	586,537	
Grants to provident funds ..	74,734	1,768,547
Taxable income ..		£690,317

The assessment was confined to income derived by the company from sources in Australia, its other income (which was relatively very small) not being exempt from tax in England where it was derived (s. 23 (*q*)).

In view of the provisions of s. 20 of the *Commonwealth Debt Conversion Act* 1931, the company's liability in respect of s. 20 interest was limited to tax at the 1930-1931 rate of 1s. 4d. in the pound on the whole of the amount of £151,371 without any deduction except as might be allowed by the commissioner under the provisions of s. 20 (2) as being properly attributable to the interest. In purporting to apply those provisions for the purpose of assessing the company's ordinary tax and super tax the commissioner deducted £28,956 from £151,371 and charged tax at the rate of 1s. 4d. in the pound on the amount of £122,415 which remained, with the result that the latter amount was treated as free of the ordinary tax to the extent of 4s. 8d. (6s. less 1s. 4d.) in the pound and as wholly free of the super tax of 1s. 0d. in the pound (on the excess of the

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taxable income over £5,000). The deduction of £28,956 was made up of estimated expenses, £757 (being one-half per cent of £151,371, the s. 20 interest), and portion of the amount of £586,537 which was allowed as "interest paid," £28,199. The amount last-mentioned bore the same proportion to the interest paid (£586,537) as the average amount for the year of the assets from which the s. 20 interest was derived (£4,061,249) bore to the average amount for the year of the whole of the company's Australian assets (£84,472,435). Thus $\frac{£4,061,249}{£84,472,435} \times £586,537 = £28,199$. The amount of £586,537 was paid on deposits bearing interest and consisting substantially of fixed deposits.

The company claimed, in effect, that the whole of the amount of the s. 20 interest (£151,371) should be taxed at 1s. 4d. in the pound and therefore be free of (*a*) the ordinary tax to the extent of 4s. 8d. in the pound, and (*b*) the whole of the super tax, on the ground that the company's only income from property consisted of rents and that, as none of the deductions was properly attributable to the s. 20 interest the extent to which that interest was taxable and free of tax, respectively, was required by s. 20 (2) to be determined by applying the respective rates to the whole of that interest without any deduction. It involved the question, *inter alia*, of whether the company's principal business consisted of the lending of money.

The company put in evidence a statement (and explanatory notes thereon) of particulars of the whole bank averages for the year under review, of the amount of its assets and liabilities as follows :—

ASSETS :

	£	% of Total
A. Loans, advances and bills discounted ..	32,563,904	37.96
B. Commonwealth Government inscribed stock and treasury bills	24,240,722	28.25
C. Special war-time deposit with Commonwealth Bank	17,129,519	19.96
D. Coin, bullion, notes and cash	5,203,854	6.07
E. Balances due from other banks (except Commonwealth) and cheques, notes and bills of other banks	1,832,490	2.14
F. Items (remittances) in transit, &c. ..	1,963,317	2.29
G. Landed and house property	1,727,141 1,130,233	3.33
	£85,791,180	100%

LIABILITIES :	£	% of Total
H. Shareholders' funds	15,534,963	18.11
I. Deposits bearing interest	31,789,319	37.05
J. Deposits not bearing interest	36,856,083	42.96
K. Bills in circulation	1,428,259	1.66
L. Notes in circulation	13,537	.02
M. Balances due to other banks	170,019	.20
	£85,791,180	100%

Item A. : The interest produced by these loans, &c., included the amount of £1,291,880 which appeared in the particulars of the assessable income, that amount being only £2,758 less than the total interest so produced. Item B. : The amounts which made up this item and the income derived during the year from the respective securities were as follows :—

	Amount	Interest
	£	£
Commonwealth Treasury bills from which rebateable interest was derived ..	10,452,000	141,313
Commonwealth inscribed stock :—		
(*a*) from which rebateable interest was derived	9,727,000	298,461
(*b*) from which s. 20 interest was derived	4,061,000	151,371

Particulars of the company's Commonwealth Inscribed Stock were as follows :—

	Subscribed or converted	Purchased	Total
	£	£	£
As at 30th June 1943 ..	4,555,550	8,285,000	12,840,550
Converted or purchased during the year ended 30th June 1944	1,068,900	8,011,940	9,080,840
	5,624,450	16,296,900	21,921,390
Sold or converted during the year ended 30th June 1944	1,341,500	6,189,340	7,530,840
	£4,282,950	£10,107,600	£14,390,550

The average for the year ended 30th June 1944, of securities "subscribed or converted", was £4,476,488—face value.

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Item C. : Consisted of funds deposited by the company with the Commonwealth Bank pursuant to the *National Security* (*Wartime Banking Control*) *Regulations* which, by reg. 9, required every trading bank (including by specification the company), to lodge in a special account with the Commonwealth Bank such part of its surplus funds as was directed by that bank in accordance with a plan approved by the Treasurer. Interest on the deposit was at the rate of three-fourths of one per cent per annum and amounted to £141,313 for the year.

A schedule of certain figures was as follows:—

	Balance Sheet as at 30th June		Average for the year ended 30th June		Interest or Discount paid or received year ended 30th June 1944
	1943	1944	1943	1944	
Deposits Bearing Interest—					
Whole Bank	31,848,941	33,821,355	29,559,508	31,789,319	591,949
Australia	31,672,231	33,635,842	29,456,235	31,607,217	589,251
Interest attributed to Australia by the Commissioner of Taxation	—	—	—	—	586,537
Treasury Bills—All in Australia—Interest subject to Rebate under Section 160AB	8,165,000	10,220,000	11,002,211	10,452,019	141,313
Commonwealth Inscribed Stock—					
All in Australia—					
Interest subject to Rebate under Section 160AB	8,347,783	12,391,956	4,773,878	9,727,454	298,461
Interest subject to Section 20 of the Debt Conversion Act	4,589,389	2,104,268	5,216,892	4,061,249	151,371
War Time Deposit A/c—All in Australia ..	11,982,000	23,399,000	7,541,038	17,129,519	128,874
Loans Advances and Bills Discounted—Whole Bank	33,603,347	31,413,371	34,810,650	32,563,904	1,294,639
Australia	33,531,275	31,343,228	34,549,321	32,241,669	1,291,881
Current Accounts (Deposits on call)—					
Whole Bank	31,299,068	40,564,125	28,827,530	36,856,083	—
Australia	30,969,991	40,186,504	28,434,554	36,501,290	—

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Assets regarded as moneys lent, the amounts of their averages, and of the interest derived therefrom, for the year were set out in a statement as follows :—

	Average amount	Interest
	£	£
Loans, advances and bills discounted	32,563,904	1,294,639
Treasury bills	10,452,019	141,313
War-time special deposit account ..	17,129,519	128,874
" Subscribed or converted " inscribed stock	4,476,488	approx. 150,000
	£64,621,930	£1,714,826

These totals (taken to the nearest thousand) were, respectively, about seventy-five per cent of the average of the company's total assets and about seventy per cent of the company's total (gross) income. To the extent that the same assets were held in Australia their averages amounted to £63,823,207 and the (assessable) interest derived therefrom amounted to £1,712,068 ; and the percentages of those amounts amounted to, respectively, (*a*) the average of the total Australian assets, and (*b*) the total assessable income, were practically the same as those stated in respect of the figures for the whole bank.

Dealing with the assessment under Part IIIA of the Act for further tax, the " portion " of the company's taxable income referred to in s. 160B was, pursuant to s. 160C, ascertained by deducting from the taxable income of £690,317, the sum of £527,088, being Federal income tax £162,947, ex-Australian loss £8,715, and dividends £355,426, leaving a balance of £163,229 as the undistributed portion. In purporting to apply s. 20 of the *Commonwealth Debt Conversion Act* 1931, the commissioner deducted, in respect of s. 20 interest, the amount of £44,990, leaving an amount of £118,239, upon which the further tax of two shillings in the pound was charged which amounted to £11,823 18s. 0d. The amount of £44,990 was claimed by the commissioner to be that part of the s. 20 interest which was included in the undistributed portion, £163,229. The taxable income was taken by the commissioner to include s. 20 interest to the extent of £122,415 which was the amount calculated by him under s. 20 (2) and treated by him as free of the ordinary tax in excess of 1s. 4d. in the pound and of the super tax. In arriving at the amount of £44,990 the commissioner made deductions from the amount of £122,415 (*a*) upon the theory that each of the deductions from the taxable income which were made under s. 160C in respect

of the Federal income tax, the ex-Australian loss and the dividends necessarily had the effect of excluding from the undistributed portion some part of the s. 20 interest (£122,415) which was included in the taxable income, and (*b*) upon the further theory that in the absence of anything in the Act to indicate the manner in which the deductions under s. 160C were to be attributed to the components of the taxable income they must be deemed to have been deducted ratably from the several components of that income. The three deductions under s. 160C were dealt with separately. The Federal income tax (which was paid during the year of income upon the income of the previous year) was deducted from s. 20 interest and the other taxable income in the respective proportions of the tax paid on the similar incomes of the previous year, and the ratable apportionment of the dividends was based on what remained of the s. 20 interest and the rest of the taxable income after the two other deductions were made.

The company's general ground of objection was that the amount of s. 20 interest which should have been excluded from the assessment was £151,371 (the whole of that interest) and not £44,990, or, alternatively, that a greater amount than £44,990 should have been excluded. The other grounds of objection were based on the assumption that the deductions which resulted in the amount of £44,990 being treated as the only part of the s. 20 interest included in the undistributed portion (£163,227) were made by way of an attempt to determine under s. 20 (2) of the *Commonwealth Debt Conversion Act* 1931 " such part of the deductions allowable from the income of the taxpayer as, in the opinion of the commissioner, is properly attributable to the (s. 20) interest."

As regards rebateable interest and the assessment of ordinary tax, the company claimed that the whole of the interest (£439,774) derived from the Commonwealth Treasury bills and Inscribed Stock to which s. 160AB applied, was, within the meaning of that section, included in the company's taxable income. The assessment was an expression of the commissioner's opinion that the interest was included only to the extent of the amount of £297,458. An alternative claim by the company was that the amount included was greater than £297,458. In arriving at the latter amount the commissioner made certain deductions, amounting to £142,316, from the gross amount of the interest. These deductions, which were part of the deductions admittedly allowable (from the total assessable income) in the calculation of the taxable income, were considered by the commissioner to be properly attributable to the interest and were arrived at by the application of the method employed in

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determining the deduction which he made from the s. 20 interest (purportedly under sub-s. (2) of that section). The amount of £142,316 was made up as follows :—

	£
Estimated expenses (½% of £439,774—the gross amount of the s. 160AB interest	2,199
Proportion of interest paid on deposits bearing interest, the proportion being 20,179,473/84,472,435 x £586,537	140,117
Total ..	£142,316

The numerator and the denominator in the latter calculation were, respectively, the average amounts (in pounds) for the year of (*a*) the Treasury bills and inscribed stock to which s. 160AB applied, and (*b*) the total Australian assets of the company. The amount of £586,537 was the interest paid by the company on interest bearing deposits, and which consisted substantially of fixed deposits. The amount of £2,199 was the estimated cost of administering the funds invested in the relevant securities. The amount of £140,117 was attributed as a deduction to the interest on those investments on the ground that the interest paid by the company on interest bearing deposits was expenditure incurred in order to hold and retain those investments. It was not claimed by the commissioner that the actual source of the funds so invested was either the fixed deposits upon which the company paid that interest or any previous fixed deposits. The evidence of the accountant to the company's general manager was that it was impossible to say what funds were utilized to acquire the investments.

The Board of Review held :—(1) That the whole of the s. 20 interest (£151,371) was free of the ordinary tax and super tax to a total extent of 5s. 8d. in the pound ; (2) that the company's claim in respect of the assessment for further tax under Part IIIA of the *Income Tax Assessment Act* 1936-1944 should be wholly upheld and consequently that the amount of the further tax chargeable to the company under Part IIIA was £185 16s. 0d., being tax at 2s. in the pound on the amount of £11,858 which was the excess of the undistributed portion over £151,371 ; (3) that in respect of the rebate under s. 160AB the assessment was not excessive ; and (4) that the company's principal business consisted of the lending of money.

The company appealed to the High Court against that part of the decision relating to rebateable interest under s. 160AB, on the following grounds :—(1) That the Board was in error :—(i) in

holding that the commissioner was justified in deducting the sum of £142,316 from the amount of £439,774 interest derived by the company from securities mentioned in s. 160AB for the purpose of ascertaining the amount of such interest included in the company's taxable income for the purposes of the rebate provided in that section; (ii) in holding that the commissioner was authorized by the Act to make that deduction or any part thereof; (iii) in not holding that the whole amount of that interest so derived was included in the company's taxable income; (iv) in not holding that an amount greater than £297,458 of that interest was included in the company's taxable income; and (v) in holding that the commissioner was justified in attributing a proportionate part (£140,117) of the total interest paid by the company to its depositors in respect of fixed deposits to the interest derived by the company from those securities and deducting such sum from the total amount of the interest so derived for the purpose of ascertaining the amount of interest included in the company's taxable income and entitled to rebate under s. 160AB; and (2) that the Board should have held:—(*a*) that the amount of £140,117 deducted by the commissioner was and ought to have been in the company's taxable income for the purposes of s. 160AB; and (*b*) that the commissioner was not authorized by the *Income Tax Assessment Act* 1936-1944 to make any deductions from the amount of Commonwealth loan interest (£439,774) and should not have confirmed the assessment in respect of the amount of rebate allowed under s. 160AB.

The Federal Commissioner of Taxation appealed to the High Court against so much of the Board's decision as decided that the company's claim to freedom from income tax, super tax and further tax upon the undistributed income to the extent claimed in the company's two relevant objections be upheld, such decision being a decision involving a question of law, upon, *inter alia*, the following grounds:—(1) that the Board was in error in deciding that the whole of the company's assessable income to which s. 20 of the *Commonwealth Debt Conversion Act* 1931 applied (£151,371) was free of ordinary tax to a total extent of 5s. 8d. in the pound, and should have decided that the sum of £122,415 only was free of ordinary tax to a total extent of 5s. 8d. in the pound; (2) that the Board was in error in deciding that the whole of the company's assessable income to which s. 20 applied (£151,371) was free of super tax, and should have decided that the sum of £122,415 only was free of super tax; (3) that the Board was in error in deciding that the amount of the company's taxable income subject to further tax upon undistributed income was £11,858, and should have

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decided that the amount so subject was £118,239; (4) that the Board was in error in deciding that for the purposes of the *Income Tax Assessment Act* 1936-1944, the company's principal business consisted of the lending of money; and (5) that the Board's decision was wrong in law.

Williams J., by consent, ordered that the appeals be heard together and that in lieu of preparing and filing separate appeal books for each appeal respectively, the appellants in both the appeals be at liberty to file a joint appeal book containing all the documents which would be required to be included in separate appeal books.

The appeals came on for hearing before *Latham* C.J. The accountant to the general manager of the company gave certain explanatory evidence relating to matters arising in the transcript and record of the proceedings before the Board of Review, other than the decision and reasons of the Board.

Latham C.J. referred the appeals to the Full Court of the High Court.

C. A. Weston K.C. and *G. E. Barwick* K.C. (with them *A. B. Kerrigan*), for the Commercial Banking Co. of Sydney Ltd.

C. A. Weston K.C. On the question of rebateability the company was entitled to the benefit of s. 160AB of the *Income Tax Assessment Act* 1936-1944, except as regards securities which came within the scope and operation of s. 20 of the *Commonwealth Debt Conversion Act* 1931. The position as regards interest derived from sources other than "s. 20 securities" is completely covered by *Douglass* v. *Federal Commissioner of Taxation* (1) and *Carpenters Investment Trading Co. Ltd.* v. *Federal Commissioner of Taxation* (2). The whole of a rebateable class of interest should be treated as included in the taxable income to the extent of the taxable income. The observations relating to the treatment of the word "included" in *Douglass* v. *Federal Commissioner of Taxation* (3) were applied by the four Justices in *Carpenters Investment Trading Co. Ltd.* v. *Federal Commissioner of Taxation* (4). Prima facie, when there is what might be termed an exemption, the whole of what was exempt could be included, and must be treated as included, in the taxable income, so far as that taxable income extends (*Carpenters Investment Trading Co. Ltd.* v. *Federal Commissioner of Taxation* (2)). The view put forward on this point by the commissioner was rejected in *Hughes* v. *Bank of New Zealand* (5). The policy of the Act is

(1) (1931) 45 C.L.R. 95.
(2) (1949) 79 C.L.R. 341.
(3) (1931) 45 C.L.R., at p. 106.
(4) (1949) 79 C.L.R., at p. 351.
(5) (1938) A.C. 366, at p. 378.

quite obvious. Section 160AB was intended to induce people to take up that particular class of security.

G. E. Barwick K.C. The words in s. 160AB are " of interest," not " of income from interest." The reference is to the words " of interest " as included in the taxable income. The fundamental object of the section is to induce people to invest money in securities, the inducement being that for every pound received by the investor as interest he will get a rebate from tax. That to which the rebate is to be granted is every pound of interest which is included in the taxable income. " Every pound of interest " means every pound of interest and does not mean every pound of benefit derived from the interest. That view should be accepted in preference to the commissioner's view that the rebate was not upon every pound of interest but upon the residuum of every pound of interest after there has been applied to it the cost worked out upon some spreading or apportionment basis of obtaining it. The whole amount of the interest is equally included in the taxable income. In *Hughes* v. *Bank of New Zealand* (1) the exemption was given to the interest as a receipt; a thing received, and it was held to be nothing to the point to say that it was a constituent item in the resultant profit. The entire item must be excluded although it was only a component of the profit. The question in *Hughes* v. *Bank of New Zealand* (2) was the application of a provision for exemption to arise from certain stipulated sources; and in *Inland Revenue Commissioners* v. *Australian Mutual Provident Society* (3) the provision was to create a notional set of profits for the purpose of tax. In the last-mentioned case, in a real sense, none of the items which went to make up the conventional sum was itself being taxed. Every pound of interest received is included in the taxable income if it is used as part of the computation of the taxable income. The expression " which is included in his taxable income " calls attention for the need for there to be a taxable income before the section would operate at all, and the words " in his assessment " contemplate that there must be an assessable amount. The section is directed to the original pounds of interest. Even if the amount of interest received were greater than the taxable income the taxpayer would be entitled to a rebate of two shillings in respect of each pound of that amount of interest. The *Commonwealth Inscribed Stock Act* 1911-1940, s. 52B (3), the *Taxation of Loans Act* 1923, s. 3, and the *Commonwealth Debt Conversion Act* 1931, s. 14, provide examples

(1) (1938) A.C., at p. 374.
(2) (1938) A.C. 366.
(3) (1947) A.C. 605, at p. 627.

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of interest which is not included in the taxable income of any taxpayer.

F. W. Kitto K.C. (with him *G. P. Donovan*), for the Commissioner of Taxation. In *Douglass* v. *Federal Commissioner of Taxation* (1) the Court did not decide that the words " included in " prima facie had one of two possible meanings, but it acknowledged that two meanings were open and proceeded to adopt the second of the reasons stated for reasons associated with what was felt to be the compelling policy of the Act. Section 160AB should be construed on its own language. The word " included " is at least capable of referring to a conclusion consisting of the containing of a portion of the ingredient in question in the original. The prima-facie meaning of the language used is that there is found the taxable income, recognizing that it is a remainder which is obtained after carrying out a subtraction sum, that the interest has been a component of the sum from the subtraction so made and that there will be found some part of that component—but not the whole of it —still remaining when consideration be given to the constituent elements in the remainder. The construction contended for on behalf of the company would be to exclude from the section the words " which is excluded from his taxable income and which is." The definition of the word " assessment " should be read into the section.

[DIXON J. referred to *Jolly* v. *Federal Commissioner of Taxation* (2) and *Richardson* v. *Federal Commissioner of Taxation* (3).

McTIERNAN J. referred to *Shell Co. of Australia Ltd.* v. *Federal Commissioner of Taxation* (4).]

In this section the legislature spoke of the process by which the tax payable was ascertained in the first instance and the rebate was itself a step in the process. There was not any context which required a different view. Unlike *Douglass* v. *Federal Commissioner of Taxation* (1) this was not a case where a rebate was allowed on a lump sum ; it was a rebate on a rate. When the section provides that the taxpayer is to get a rebate ascertained by applying another rate to a portion of the taxable income it means that regard should be had to the taxable income and the reduced component parts that comprise it, for the purpose of the main tax, and in determining rebate regard should again be had to taxable income and one of the reduced components in that taxable income. The evidence

(1) (1931) 45 C.L.R. 95.
(2) (1933) 2 A.T.D. 362; noted 7 A.L.J. 285; (1934) 2 A.T.D. 434; noted 7 A.L.J. 427.
(3) (1932) 48 C.L.R. 192.
(4) (1949) 78 C.L.R. 439.

shows that the commissioner did not simply spread all allowable deductions over all the assessable income; he did not take all the items. The taxable income consists of a certain number of pounds, and the question arises: how many pounds of that sum consists of interest? The expression "every pound of interest" is an appropriate expression upon any construction of the section. The word "included" may in a different context have a different meaning, but this is dependent upon there being some indication in the context or policy (*Douglass* v. *Federal Commissioner of Taxation* (1) and *Carpenters Investment Trading Co. Ltd.* v. *Federal Commissioner of Taxation* (2)). Section 160AB is not directed to the original pounds of interest. It does not require to be determined how much of the original pound of interest is still left in the taxable income. It deals with the interest which is included in the taxable income. The section refers to the interest which is included in the taxable income and it directs one to apply the rate to every pound of so much of the interest in the assessable income as is found in the taxable income. The word "pound" is directed to so much of the interest as is found in the taxable income. Sections 159 and 160 show that when the legislature was minded to give a rebate on a sum included in the taxable income it adopted the form found in s. 160AB, and it showed in s. 160AA that it knew very well how to provide for the contrary result. It is significant that the words used are "included in his taxable income" and not "included in his assessable income." The expression "pound of interest" is not apt either to "assessable income" or to "taxable income." The requirement in s. 160AB is to ascertain how much of a certain part of assessable income remains in taxable income. Taxable income is a remainder comprised of all kinds of receipts from which a total amount of deductions has been made: nothing can be identified.

[DIXON J. referred to *Douglass* v. *Federal Commmissioner of Taxation* (3).]

The whole of the proposition there stated is now submitted to the Court.

[DIXON J. referred to *British Imperial Oil Co. Ltd.* v. *Federal Commissioner of Taxation* (4).]

The problem of construction in s. 160AB is whether that does not require the commissioner to make an attribution. Section 160AB is directed to a consideration of the amount of taxable income which would not be there if the interest had not been derived and

(1) (1931) 45 C.L.R. 95.
(2) (1949) 79 C.L.R. 341.
(3) (1931) 45 C.L.R., at p. 105.
(4) (1926) 38 C.L.R. 153, at p. 171.

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the expenditure in support of it had not been incurred. *Douglass* v. *Federal Commissioner of Taxation* (1) had three differentiating features from this case. The choice in that case was between a construction which served the policy of the Act and one which defeated the policy. No such construction applies in this case. In *Carpenters Investment Trading Co. Ltd.* v. *Federal Commissioner of Taxation* (2) the Court adopted the view it did, not because of a policy to avoid double taxation, but because of the plain scheme in the Act to which effect had to be given.

The words " unless the taxpayer's principal business consists of the lending of money " in exception (*a*) in the definition of " income from personal exertion " in s. 6, contemplate a case where there is an entire business which consists of the lending of money. It is that business and nothing else. Inapt as it may be, the word " principal " means that there must be a business of lending money, which is either the chief amongst several, or is the sole business. Lending money is an important feature of banking, but it is not the principal feature or element or activity in the carrying on of that business. The actual position is stated in *Bank of New South Wales* v. *The Commonwealth* (3). The interest arising from money lending does not arise principally from the actual lending of it ; it arises from the entire business because it is an inseparable part of the business.

[WILLIAMS J. referred to *In re Shields' Estate* (4) and *Commissioners of the State Savings Bank of Victoria* v. *Permewan Wright & Co. Ltd.* (5).]

The greater part of the Commonwealth Government securities held by the company was bought and therefore did not represent money lent. The question of what is principal and what is secondary is not a question that is subjective to the banker, it is a matter for objective determination by looking at all that was done and determining on a construction of all the facts relating to each thing which should be regarded as principal and which as merely secondary. The Board misdirected itself when it said that the only thing necessary to look at was what directly brought in most of the income. It failed to give effect to the fact that the interest did not all arise from money lent, a considerable proportion of it arose from securities purchased. There is a real distinction between subscribing to a Commonwealth Government loan and buying Commonwealth Government stock in the market. The question is not whether the particular sum is interest, but whether the principal

(1) (1931) 45 C.L.R. 95.
(2) (1949) 79 C.L.R. 341.
(3) (1948) 76 C.L.R. 1, at p. 194.
(4) (1901) 1 I.R. 172, at p. 198.
(5) (1914) 19 C.L.R. 457, at p. 471.

business of the taxpayer consists of lending money. Then it is necessary to find transactions of loan in order to determine whether those transactions of loan were the principal business of the taxpayer. Transactions of purchase in the market are not loan. The principal activity, the one that occupies not only the most time, but most of the staff and premises, and gets the position of prominence because of its nature in going to the essence of banking, is the borrowing. In the case where a principal business consists of lending money, the interest that arises from that business is said to be regarded as still in the category of personal exertion income. The above submissions and the reasoning of the Board were all based on the assumption that sub-s. (2) of s. 20 of the *Commonwealth Debt Conversion Act* 1931 requires regard to be had to the allowability of deductions of property income according to the *Income Tax Assessment Act* in force for the time being. Section 20 (2) is not similar to any provision in the *Income Tax Assessment Act*, nor has it to be construed by reference to that Act, although it is conceded that the word " allowable " necessitates a consideration of that Act to ascertain what deductions are allowable. It is inherently improbable that s. 20 (2) was really intended to vary the amount of the allowable deductions that could be subtracted from the interest according as different schemes of taxation in force from time to time might throw different deductions against artificial classes branded as income from property and income from personal exertion. The words " income from property " should be construed in their ordinary sense. Section 20 (2) authorizes the deduction from s. 20 interest of any allowable deductions under the current Assessment Act, which in fact are in respect of the income of the taxpayer derived from property, including this interest, and which the commissioner is of opinion are properly attributable to the interest. The freedom from tax over and above the year 1931 was intended to apply to the whole of this type of interest, with the exception of such deductions as really related to it and were allowable under the current Assessment Act. The expression " allowable from the income " does not mean that one is required to find whether they are allowable from the income of the taxpayer derived from property as defined in the current Assessment Act, but whether they are allowable from the income of the taxpayer properly and ordinarily described as income from property. There was not any ground upon which the Board could hold that these particular deductions are properly attributable to s. 20 interest. The Board found that the deductions were not allowable from income derived

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from property and therefore, and for that reason only, the commissioner could not form an opinion as to their attributability. No further tax could be charged in respect of s. 20 income. The whole question was: By making those deductions under s. 160c was part of the s. 20 interest excluded, or, in other words, did each deduction made reduce the amount of s. 20 interest contained in the taxable income? This was quite a different proposition from the proposition in *Symon* v. *Federal Commissioner of Taxation* (1) and was not a case where a doctrine as in that case could be relied upon. One did not prima facie treat each payment out of a sum containing various ingredients as ratable, reducing each of the ingredients: see *Resch* v. *Federal Commissioner of Taxation* (2). If s. 160c be complied with then there has already been excluded from the taxable income some of each ingredient in it, so that the injunction contained in s. 20 of the *Commonwealth Debt Conversion Act* 1931 is obeyed by refraining from taxing so much of the s. 20 interest as would remain in the final sum after those steps had been carried out. Section 160c had nothing whatever to do with any question as to how the company applied its funds and what fund it made in all the payments which are enumerated in s. 160c. That section only sets an exercise in subtraction, that is, that from taxable incomes certain sums should be deducted. There was in the ultimate remainder the whole of the s. 20 interest which had been included in taxable income.

C. A. Weston K.C., in reply on the appeal by the company and in chief on the appeal by the commissioner. Eight justices of the Court have said in *Douglass* v. *Federal Commissioner of Taxation* (3) and *Carpenters Investment Trading Co. Ltd.* v. *Federal Commissioner of Taxation* (4) that apart from some overriding context the words "included in taxable income" have a certain meaning. The Court has not been asked to reconsider those decisions and should not do so, but should, in the absence of any argument to the contrary, treat them as having been correctly decided. Those cases are not distinguishable from this case. The policy was to induce persons to subscribe to certain types of Commonwealth Government securities. It was clear that s. 20 of the *Commonwealth Debt Conversion Act* looked to the *Income Tax Assessment Act*. Deductions which were allowable were deductions allowable under the law and did not refer to deductions which, as a principle of accountancy, were proper to be set off.

(1) (1932) 47 C.L.R. 538.
(2) (1942) 66 C.L.R. 198, at p. 230.
(3) (1931) 45 C.L.R. 95.
(4) (1949) 79 C.L.R. 341.

[WILLIAMS J. referred to *Stevenson* v. *Federal Commissioner of Taxation* (1).]

The meaning of s. 20 of the *Commonwealth Debt Conversion Act* was not any different from what it would have been if it were an amendment of the *Income Tax Assessment Act*. It was an inducement to people to invest money in the securities upon the footing that their net return would remain constant. Section 3 of the *Income Tax Assessment Act*, coupled with the *Commonwealth Debt Conversion Act*, was intended to maintain the status quo in all respects. By amendments made to s. 46 (3) in 1932 the legislature displaced the decision in *Douglass* v. *Federal Commissioner of Taxation* (2). It was amended from a lawyer's point of view, but hardly from a financial point of view. The fact that s. 46 (3) was amended but s. 160AB or its prototype was enacted in the original terms was a very clear indication of the intention of the legislature. When s. 160AB was introduced there was not any corresponding provision. It did not appear on the evidence that any expenditure or deduction in *Douglass* v. *Federal Commissioner of Taxation* (2) and in *Carpenters Investment Trading Co. Ltd.* v. *Federal Commissioner of Taxation* (3) was attributable to the dividends in question, and in neither case was the decision of the Court rested on that supposition. The circumstances under which s. 159 of the *Income Tax Assessment Act* operates are different from those under which s. 160AB operates. Those sections are entirely immaterial. Section 159 does not assist the company in any degree whatever. Section 20 (1) of the *Commonwealth Debt Conversion Act* limits the imposition of income tax and of nothing else, and sub-s. (2) carries on the idea of sub-s. (1). "Included in his taxable income" was discussed in *Douglass* v. *Federal Commissioner of Taxation* (4).

Section 50 of the *Income Tax Assessment Act* has no application to the case by virtue of s. 3 of that Act. By virtue of that Act there is a complete code to be found in the *Commonwealth Debt Conversion Act* 1931. If, however, the Board was right in concluding that s. 50 had an application to the case, then the Board was right in arriving at the conclusion which it did. Section 3 drives one irresistibly to consider the relevant parts of the *Income Tax Assessment Act* but only to find the extent of the immunity and for no other reason. Section 20 of the *Commonwealth Debt Conversion Act* deals with the provisions of the *Income Tax Acts* 1930, not in the future. The company was formed to lend money as a bank.

(1) (1942) A.L.R. 346; 7 A.T.D. 154; noted 16 A.L.J. 319.
(2) (1931) 45 C.L.R. 95.
(3) (1949) 79 C.L.R. 341.
(4) (1931) 45 C.L.R., at pp. 102-106.

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The major part of its assets is money lent, and the major part of its income is interest on moneys lent, that is, in the ordinary way, by way of overdraft. The very large amounts which, under the regulations, are deposited with the Commonwealth Bank are loans notwithstanding that they were deposited with that bank under compulsion, or supposed compulsion. A principal part of the business is lending money which has been obtained in the recognized method, therefore the matter comes completely within the definition of money obtained from personal exertion (*Commissioner of Taxation* v. *Commercial Banking Co. of Sydney* (1)). Section 160AB was misquoted by a member of the Board with a very serious result. That section overrides everything in the *Income Tax Acts*. Section 20 of the *Commonwealth Debt Conversion Act* and s. 160AB are special sections dealing with a particular matter and in so far as there be any inconsistency they override everything in the Act.

G. E. Barwick K.C., in reply on the appeal by the company and in chief on the appeal by the commissioner. The inquiry relating to what is the principal business might be expressed : What is the principal profit-making or profit-intending enterprise ? Section 160C does not require that there should be ascertained how much of the various items which are deducted from the taxable income under s. 160C were paid out of s. 20 interest. Section 160C ignores s. 20 altogether ; it has not any relation to it. The simple reconciliation between s. 160C and s. 20 is that whatever tax is allowed to be charged by reason of the s. 20 interest has already been dealt with ; therefore not a single penny further tax can be laid upon the taxpayer by reason of the receipt of it, and that must result in the deduction of the whole sum from the ultimate figure which is arrived at by working out the sum dictated by s. 160C. Those sections are reconciled by deducting the gross amount of the s. 20 interest. As an argument of last resort, the commissioner should not have directed his attention to the question of how much of the dividend was paid out of the s. 20 interest, and having done so he should apply *Symon* v. *Federal Commissioner of Taxation* (2) and *Sterling Trust Ltd.* v. *Inland Revenue Commissioners* (3). Section 20 (2) of the *Commonwealth Debt Conversion Act* does not make any reference to deductions allowable in the abstract at all. The expression " income of the taxpayer derived from property " is an expression which only has significance in an Income Tax *Act*.

(1) (1927) 27 S.R. (N.S.W.) 231 ; 44 W.N. 65.
(2) (1932) 47 C.L.R. 538.
(3) (1925) 12 Tax Cas. 868.

F. W. Kitto K.C., in reply on the appeal by the commissioner. The commissioner did not take the view required by *Symon* v. *Federal Commissioner of Taxation* (1) and *Sterling Trust Ltd.* v. *Inland Revenue Commissioners* (2), therefore it is agreed by the parties that those cases are not applicable. It was, by common concession, the fact that the dividends were paid out of taxable income. The only requirement then is to do a mere process of arithmetic, and, automatically, on the principles laid down in *Resch* v. *Federal Commissioner of Taxation* (3), make deductions ratably from every component in the principal sum.

Cur. adv. vult.

June 8.

The following written judgments were delivered :—

LATHAM C.J. These are two appeals from decisions of a Board of Review upon assessments to income tax under the *Income Tax Assessment Act* 1936-1944 of the Commercial Banking Co. of Sydney Ltd. in respect of the income year ended on 30th June 1944. I propose to deal, in the first place, with the appeal by the commissioner.

1. The *Commonwealth Debt Conversion Act* 1931 provided for the conversion of certain existing securities issued by the Commonwealth into " new securities." Section 20, in terms which require close examination, provided that the interest derived from such securities should be free from any future increases of income tax, and s. 3 of the *Income Tax Assessment Act* 1936-1944 provides that nothing in that Act shall affect the operation of the said *Commonwealth Debt Conversion Act* 1931.

The Board of Review has held that, in respect of the whole amount of interest to which s. 20 applies, the taxpayer is entitled to be free of ordinary tax (6s. in the pound), super tax (1s.) and further tax (2s.) (see *Income Tax Act* 1944, s. 5 (7) and s. 6) to the extent to which the total of those taxes, namely 9s., exceeds the tax payable (1s. 4d.) which would have been payable if income tax had been imposed upon the taxable income of the taxpayer in accordance with the provisions of the *Income Tax Acts* 1930. The commissioner has assessed the bank upon the basis that the amount of such interest which (apart from s. 20) would be taxable in respect of the income year 1943-1944 is the amount of interest received, but reduced by an apportionment of deductions representing expenditure made in gaining the income of the company, including the interest to which s. 20 applies. The company contends that

(1) (1932) 47 C.L.R. 538.
(2) (1925) 12 Tax Cas. 868.
(3) (1942) 66 C.L.R. 198.

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the Board has rightly held that under the terms of s. 20 no such deductions are permissible.

Section 20 of the *Commonwealth Debt Conversion Act* 1931 is in the following terms:—"(1) Notwithstanding anything contained in the *Taxation of Loans Act* 1923 or in any other Act or State Act, the interest derived by any person in any financial year from new securities exchanged for existing securities (other than interest which in accordance with the provisions of section fourteen of this Act is free from Commonwealth and State Income Tax) shall be free—(*a*) from any income tax payable under a law of the Commonwealth to the extent by which the total amount of income tax which but for this section would be payable in respect of that interest exceeds the amount of income tax which would have been payable in respect of that interest if income tax had been imposed upon the taxable income of the person in that year in accordance with the provisions of the *Income Tax Acts* 1930 (other than section 7A of that Act); and (*b*) from all income tax under the law of a State. (2) In determining, for the purposes of this section, the amount of income tax which would be payable in respect of interest to which this section applies, the rate of tax shall be applied to the whole amount of that interest included in the income of the taxpayer without any deduction except such part (if any) of the deductions allowable from the income of the taxpayer derived from property as, in the opinion of the Commissioner of Taxation, is properly attributable to the interest. (3) In this section 'income tax' includes any tax imposed in respect of income."

In the relevant year the bank held securities which were new securities within the meaning of s. 20 amounting to £4,061,249, this amount representing the monthly average of the relevant stock held during the income year. The total amount of interest received upon such stock in that year was £151,371. The commissioner apportioned expenditure of the company between that interest and other receipts of the company from interest-bearing securities. In the first place, he made a deduction of estimated expenses of managing &c. the s. 20 securities at one-half per cent—£757. Secondly, in that year the bank paid in interest on deposits an amount of £586,537. These deposits provided moneys which the bank invested in, *inter alia*, "new securities." Accordingly the commissioner treated a proportion of the interest paid on deposits as expenditure incurred in gaining the interest on the "new securities." The Australian assets of the bank, averaged over the year, amounted to £84,472,435. The commissioner ascertained the part of £586,537 attributable to the new securities by taking the same proportion

of that amount as the proportion represented by the new securities to the total Australian assets, thus reaching a sum of £28,199. The total of £757 and £28,199 is £28,956. The commissioner treated this amount of the expenditure as incurred in the gaining of the interest on the new securities, with the result that only the balance of £122,415 (i.e. £151,371 less £28,956) was taken as the amount of interest which, apart from s. 20, would be taxed in respect of the income year 1943-1944. This (and not £151,371) was the amount which the commissioner treated as interest which was subject only to the 1930-1931 rate, that is to a tax only of 1s. 4d. in the pound.

2. Various difficulties arise when it is necessary to ascertain how much of the residual amount calculated by deducting one or more amounts from a gross amount, representing the addition of several amounts, is constituted by one of the items which enters into the calculation of the gross amount or, to put the same question in another form, how much of a particular component item is included in the residue left after making deductions from the gross amount. Such questions have arisen upon particular statutory provisions in *Douglass* v. *Federal Commissioner of Taxation* (1) and *Carpenters Investment Trading Co. Ltd.* v. *Federal Commissioner of Taxation* (2). No general principle can be laid down which can be applied in all cases. It is necessary to consider the precise statutory provisions under which the question arises.

In the first place, s. 20 (1) provides that "interest derived by any person" from certain "new securities" is to be free from a certain amount of income tax. Sub-section (3) provides that "income tax" includes any tax imposed in respect of income. Prima facie such a provision applies to the whole amount of such interest.

In the second place, the application of the section requires the comparison of two amounts of income tax payable in respect of that interest. The interest is to be free from any income tax so payable to the extent by which the total amount of income tax which, apart from s. 20, would be payable in respect of that interest exceeds the amount of income tax which would have been payable in respect thereof if income tax had been imposed in accordance with the *Income Tax Acts* 1930. In order to apply the section, therefore, it is necessary to ascertain what tax was payable upon the interest under the 1930 Act, and then to ascertain what tax would be payable in respect of the interest under the income-tax legislation applying to the relevant financial year. The ascertainment of the amount of tax which would be payable apart from

(1) (1931) 45 C.L.R. 95.

(2) (1949) 79 C.L.R. 341.

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s. 20 in 1930 requires merely the application of the relevant rate (1s. 4d. in the pound) to the amount of interest. It would not be possible to ascertain the amount of tax payable at the 1930 rate in respect of that interest by looking at the assessments of any particular taxpayers who happened to hold securities of this class at the time when the *Commonwealth Debt Conversion Act* 1931 was passed. One taxpayer might have had an income consisting solely of interest derived from those securities. Another taxpayer might have had an income of the same amount derived from those securities but have incurred deductible losses in a business which he carried on which reduced his taxable income to an amount much less than the amount of such interest. Thus the taxable incomes of holders of these securities would vary very greatly. The ascertainment of the tax that would be payable in respect of the interest if income tax had been imposed upon the taxable income in accordance with the *Income Tax Acts* 1930 must therefore be construed as requiring an ascertainment of the income tax which would have been payable in respect of the whole of that interest apart altogether from any considerations affecting the assessment of an individual taxpayer.

In the next place, it is necessary, in order to apply the section, to ascertain the amount which would be payable apart from s. 20 in respect of the interest in respect of the financial year as to which the question arises. The ascertainment of this amount necessarily involves the application of the provisions of a current *Income Tax Assessment Act*, such Acts varying, as we know, from year to year. This was disputed in argument, but for the purpose of determining what tax would be payable apart from s. 20 in respect of the interest it is in my opinion plainly necessary to apply the provisions of the *Income Tax Assessment Act* and *Income Tax Act* applying to the relevant year. Otherwise it would be quite impossible to ascertain the amount of tax which "would be payable." It is true that s. 3 of the *Income Tax Assessment Act* 1936-1944 provides that nothing in that Act shall affect the operation of the *Commonwealth Debt Conversion Act* 1931. This provision, however, is in my opinion plainly intended to secure the full operation of the 1931 Act, notwithstanding provisions contained in the 1936-1944 Act for increased tax. Section 3 cannot be interpreted as meaning that the provisions of the 1936-1944 Act are to be disregarded in applying s. 20 of the 1931 Act for the simple reason that s. 20 cannot possibly be applied except upon the basis of a comparison of the amount of tax which would have been payable at 1930 rates with the amount of tax which would be payable under the applicable statutes in

respect of the year 1943-1944 or of any other year in respect of which the application of s. 20 arises.

So far the section is dealing with the whole amount of interest. The calculation of the amount of tax payable in respect of the interest in accordance with the 1930 rates is plainly made by calculating tax at 1s. 4d. in the pound on the whole amount of that interest. There is no provision in the introductory words of s. 20 which makes it possible to apply that rate to some part only of that interest which is regarded as being included in the ultimate taxable income (that is assessable income less allowable deductions —*Income Tax Assessment Act* 1936-1944, s. 6) of a taxpayer who happened to hold in 1930 or 1931 the existing securities for which the new securities were substituted. So also the other element of the comparison, in this case the tax payable in respect of the interest received in the income year 1943-1944, is prima facie to be calculated by applying the relevant increased rate to the whole amount of interest derived by the taxpayer and not to some part thereof (which might be little or nothing) which is regarded as represented by portion of the taxable income of the taxpayer who then happens to hold the securities.

3. But this prima-facie construction of s. 20 is modified, but only to a certain carefully specified extent, by sub-s. (2). This sub-section confirms the prima-facie interpretation of the earlier provisions of the section by providing in the first place that in determining for the purposes of the section the amount of income tax which would be payable in respect of the interest to which the section applies " the rate of tax shall be applied to the whole amount of that interest included in the income of the taxpayer without any deduction." But a modification or limitation is introduced by the words following—" except such part (if any) of the deductions allowable from the income of the taxpayer derived from property as, in the opinion of the Commissioner of Taxation, is properly attributable to the interest." Therefore in applying the section no deduction from the whole amount of interest is to be made unless it is a deduction allowable from the income of the taxpayer derived from property, and then only if such deduction is in the opinion of the commissioner properly attributable to the interest.

The bank derived income by way of interest from various sources —interest on overdrafts, interest on " new securities," interest on other Commonwealth securities for which the bank subscribed or which it purchased, and interest on a special deposit with the Commonwealth Bank. The bank derived income from property in the form of rents. Any deductions which were allowable from the

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income derived from rents obviously could not be regarded as properly attributable to the interest. The commissioner contends, however, that the interest was income derived from property. The bank contends that it was interest derived from personal exertion.

The choice between these propositions depends upon the interpretation to be given to the definition of "income from property" contained in s. 6 of the *Income Tax Assessment Act* 1936-1944. "Income from property" is defined as meaning "all income not being income from personal exertion." "Income from personal exertion" is defined as meaning income consisting of earnings, salaries, wages and various other forms of income including "the proceeds of any business carried on by the taxpayer either alone or as a partner with any other person." This is the only category mentioned in the principal part of the definition of "income from personal exertion" which would include interest. The definition however, continues by providing that income from personal exertion "does not include—(*a*) interest, unless the taxpayer's principal business consists of the lending of money, or unless the interest is received in respect of a debt due to the taxpayer for goods supplied or services rendered by him in the course of his business." The bank asserts and the commissioner denies that the bank's principal business consists of the lending of money. If the contention of the bank is sound, then the interest received by the bank on the "new securities" was income from personal exertion, so that no deduction of expenditure attributable to the gaining of that interest can properly be made in applying s. 20.

4. In the inquiry whether the principal business of the bank consisted of the lending of money it is in my opinion proper to exclude from consideration interest paid by the Commonwealth Government upon stocks purchased in the market because such interest is not derived from "the lending of money." The purchase of stock on the market is not a money-lending transaction. A person who buys Commonwealth stock on the market does not lend money to the vendor or to the Commonwealth. The interest received on the part of the Commonwealth stock so purchased should therefore not be regarded as interest derived from the lending of money. It does not necessarily follow, however, for reasons to be stated, that this amount of interest should not nevertheless be regarded as income from personal exertion. It may be that, when the principal business of a taxpayer consists of the lending of money, all the interest received by him as the proceeds of his business will be income from personal exertion, even though

some of that interest may itself not be derived from the lending of money.

The income of the bank consisted principally of interest, even if interest received on purchased stocks is excluded. In the year 1943-1944 the amount of interest received on overdrafts, treasury bills, special war-time deposit and Commonwealth stock for which the bank had subscribed was over £1,700,000. The total income of the bank as returned, including these items and also exchange, commission, fees on current accounts, rents and some other small items, was £2,458,864. Thus about seventy-five per cent of the income of the bank was derived from the lending of money.

It is advantageous to a taxpayer to be taxed at the lower personal exertion rates rather than at the higher property rates. The inclusion of certain interest in the definition of income from personal exertion is therefore intended to bring within a lower rate of tax income consisting of interest where the taxpayer's principal business consists of the lending of money. It has been argued for the commissioner that this provision can apply in favour of a taxpayer only when the taxpayer carries on several businesses, one of which can be identified as his principal business. A bank carries on, it is said, only one business, the business of banking and activities incidental thereto, and therefore the exception cannot operate in favour of a bank. But such an interpretation produces strange results. A person who conducted a large money-lending business and who combined with it some other negligible small business would receive the benefit of tax at personal exertion rates upon the interest received. On the other hand, a person who carried on a money-lending business of the same dimensions but no other business would be taxed at the property rate on the same amount of interest. A construction which produces such a result should not be adopted unless the words are compelling.

I agree with the Board of Review that it is proper to regard the principal income-producing activity of the taxpayer as the relevant matter in determining whether the taxpayer's principal business consists of the lending of money. The exception introduced into the exclusion of interest from personal exertion does not mean that all interest received by a taxpayer having such a principal business is to be treated as income from personal exertion. It has the effect only of bringing back into the definition interest which would otherwise be excluded by the words " but does not include interest." Therefore in order that any interest should be included within the words of exception from the exclusion of interest generally, it must be interest which qualifies under the definition, that is as being

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income which is the proceeds of a business, there being no other heading in the definition which can apply to it. Two observations, therefore, can be made upon this provision. The words excluding interest in general, taken by themselves, exclude all interest, but the words of the exception from the exclusion bringing interest within the definition of income from personal exertion where the taxpayer's principal business consists of the lending of money only result in leaving within the definition such interest as is interest which, apart from the exception, would be income from personal exertion, that is, if it is the proceeds of a business. Interest which is not the proceeds of a business cannot be income from personal exertion even though it is derived by a taxpayer whose principal business consists of the lending of money. But interest which is the proceeds of a business, even though not derived from the lending of money (e.g. interest received upon purchased securities) is income from personal exertion.

In determining whether the lending of money is the principal business of a taxpayer it is proper to look at the business of the taxpayer in relation to its proceeds, that is the income which it produces. In the present case seventy-five per cent of the income is interest derived from the lending of money and the activity of gaining that income is, from the point of view of proceeds of the business of the taxpayer, the principal business activity of the taxpayer. In my opinion, therefore, the Board of Review properly held that the principal business of the bank was the lending of money and therefore that the interest derived by the bank from the lending of money was income from personal exertion.

5. The commissioner, in applying s. 20, has made a deduction from the amount of £151,371 of certain expenses and a proportion of the interest paid on the money which was invested in the securities which brought in the interest. These deductions may be properly attributable to the interest in question, but they are not allowable as deductions from income from property because that interest is not income from property. Accordingly I agree with the Board of Review that the deductions made by the commissioner were wrongly made.

6. What has been said deals with the decision of the Board of Review in relation to income tax and super tax but leaves outstanding the question of further tax under Part IIIA of the *Income Tax Assessment Act* 1936-1944. Part IIIA provides in s. 160B that further tax at the rate declared by the Parliament shall be levied and paid on that portion of the taxable income of a company which has not been distributed as dividends or applied in paying certain

taxes or meeting certain losses. The rate declared by the Parliament in the *Income Tax Act* 1944 upon such portion of the income of a company was 2s. in the pound. Section 160c provides for the ascertainment of the portion of the taxable income of the company which has not been so distributed or applied. It provides (so far as material) that for the purpose of the further tax such portion shall be ascertained by deducting from the taxable income of the company (1) certain taxes; (2) losses incurred in carrying on business out of Australia, except losses of a capital nature; (3) the amount of dividends paid out of the taxable income of the year of income within a specified time. The following table shows the manner in which the commissioner applied these provisions in the present case in respect of the income derived from new securities to which s. 20 of the *Commonwealth Debt Conversion Act* 1931 was applicable. (The commencing figure of £122,415 should, for reasons already stated, in my opinion be £151,371, but it is convenient to use the commissioner's figure for the purpose of explaining the method which was applied in the assessment.)

	Commonwealth Loan Interest	Other Income	Total
	£	£	£
Taxable income assessed	122,415	567,902	690,317
Deduct—Ex-Aust. loss	1,545	7,170	8,715
	120,870	560,732	681,602
,, Fed. inc. tax paid	9,224	153,723	162,947
	111,646	407,009	518,655
,, Divs. paid as above	66,656	288,770	355,426
	44,990	118,239	163,229
		Deduct C.L.I.	44,990
		Income subject to further tax	£118,239

The commissioner therefore charged tax of 2s. in the pound upon £118,239.

Section 160c requires certain deductions to be made for the purpose of ascertaining the undistributed income of a company for the purposes of the tax. The above table shows that the commissioner distributed these deductions as between, on the one hand, the amount of Commonwealth loan interest which he regarded as

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entitled to the freedom from tax provided for by s. 20 of the 1931 Act and, on the other hand, the rest of the taxable income of the company. It is not necessary in my opinion to consider the particular method of distribution of these three items of deduction from the Commonwealth loan interest and other income. The result of the calculations of the commissioner was that the amount of s. 20 income included in the taxable income was taken as £44,990 and it was exempted from further tax, but that the balance of £118,239 was treated as income subject to further tax.

In relation to further tax, what the commissioner has done is to deduct from the s. 20 interest amounts representing a proportion of taxes, losses and dividends and to treat only the remainder of the interest as interest which would have been taxed apart from s. 20.

In my opinion the statute gives no authority for these deductions because the only deductions which can be made under s. 20 from the whole amount of interest are deductions which are allowable from income from property. The deductions to be made under s. 160c have nothing to do with deductions from income from property. Section 160c is concerned simply with the ascertainment of a portion of taxable income irrespective of whether or not it is income from property. The balance, after the due subtractions have been made, is to be treated as undistributed income for the purpose of the imposition of further tax. No question arises in the application of s. 160c as to whether the taxpayer paid taxes or dividends or met losses out of any particular fund. If such a question had arisen it would have been necessary to consider the applicability of the principle stated in *Symon* v. *Federal Commissioner of Taxation* (1). This is the principle that when, if a taxpayer makes a payment out of a particular fund, he obtains a benefit, and he in fact makes a payment out of a mixed fund, the payment should be regarded as made out of that part of the fund which would be most beneficial to the taxpayer. But in the present case for the purpose of making the three subtractions for which s. 160c provides no question arises as to the fund out of which the taxpayer made any payment. It is true that in the case of the third deduction, namely "the amount of dividends paid out of the taxable income of the year of income" within a certain period, it is necessary to ascertain the fund from which the payment was made, and in determining this question the principle of *Symon's Case* (1) may well be applicable. But, when the amount of such dividends has been ascertained, that amount simply becomes one of the items in the process of subtraction prescribed by s. 160c, and that provision,

(1) (1932) 47 C.L.R. 538.

as already stated, does not involve any appropriation by the taxpayer company to any particular portion of the income. Thus the principle of *Symon's Case* (1) is irrelevant in the application of s. 160c to the present case.

For the reasons which I have stated, in my opinion the commissioner had no authority to attribute any of the s. 160c deductions to the interest received from the new securities but should have assessed the taxpayer upon the basis that the whole amount of £151,371 was free from further tax. Accordingly, in my opinion the appeal of the commissioner should be dismissed.

7. I now come to the appeal of the bank. This appeal relates to the application of the provisions of s. 160AB of the *Income Tax Assessment Act* 1936-1944. So far as relevant, s. 160AB is in the following terms :—" A taxpayer shall be entitled to a rebate in his assessment for an amount of two shillings for every pound of interest which is included in his taxable income and which is derived from bonds, debentures, stock or other securities issued by —(*a*) the Government of the Commonwealth, except securities to which section twenty of the *Commonwealth Debt Conversion Act* 1931 or sub-section (2) of section fifty-two B of the *Commonwealth Inscribed Stock Act* 1911-1940 applies."

When deductions are made from assessable income in order to determine taxable income the deductions are made from the whole of the assessable income and the balance is the taxable income. If it becomes necessary for some particular purpose to assign deductions to particular items of gross income, prima facie each item in that income must be considered as ratably reduced by all expenditure incurred in gaining it which is not definitely attributable to some particular component thereof and in the latter case that component should be considered as reduced by the amount so attributable. Where the general expenditure of a profit-making business is met out of all the receipts of the business, constituting a mixed fund, and no method of appropriation of expenditure to particular items is prescribed by law or lawfully applied by those in control of the business, each item of the mixed fund may properly be considered as proportionately reduced in order to arrive at that which must be deemed to be the part of each item which is left in the residue : see *Resch* v. *Federal Commissioner of Taxation* (2).

8. There is no dispute as to the amount of the securities held by the bank from which interest was derived which were included in the relevant year in the description contained in quoted par. (*a*) in s. 160AB. The amount of interest derived therefrom in the year was

(1) (1932) 47 C.L.R. 538.

(2) (1942) 66 C.L.R. 198.

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£439,774. The commissioner applied s. 160AB in the following manner. He made a deduction at a rate of one-half per cent as representing a proportion of general management expenses—£2,199. He then took the amount of interest paid by the bank upon deposits —£586,537. He distributed this proportionately according to values between what may be called the rebatable stock in respect of which the rebate under s. 160A was allowable (£20,179,473) and the total value of Australian assets of the bank (£84,472,435), thus arriving at an amount of £140,117. This amount was taken as representing a fair proportion of the interest upon the deposits which provided moneys out of which the investments in interest-bearing securities were made. These two sums, making £142,316, were deducted from £439,744, leaving a balance of £297,458. This sum was treated by the commissioner as the sum in respect of each pound in which a 2s. rebate was allowable. The contention of the bank is that a 2s. rebate should be allowed upon each pound in the amount of £439,774.

It was pointed out that the commissioner had used for the purpose of this calculation the value of all Australian assets irrespective of whether or not they produced income and that this basis was more favourable to the taxpayer than what might be regarded as a more justifiable basis, namely, taking the proportion of the value of the rebatable stock to the income-producing assets, or possibly taking the proportion of interest derived from the rebatable stock to the whole income of the bank.

9. The question is whether the commissioner was right in making a deduction from rebatable interest of amounts representing expenditure incurred in earning that interest. The answer to this question depends upon the interpretation of the words which introduce s. 160AB—" A taxpayer shall be entitled to a rebate in his assessment of an amount of two shillings for every pound of interest which is included in his taxable income and which is derived from " certain securities. It is argued for the taxpayer that the section applies in respect of every pound of interest, that is, in the present case, each and every pound included in the amount of £439,774. It is argued that this whole amount is " included in the taxable income " if it enters into the calculation of the taxable income. It was not explained how this interpretation could be adopted if, as might be the case, e.g. a taxpayer incurred large deductible losses, with the result that the taxable income was less than the amount of interest. But perhaps a sufficiently practical reply to this objection is provided by s. 160AD (*a*), which provides that " Notwithstanding anything contained in this or any other Act—(*a*) the sum

of the rebates allowable under this Act shall not exceed the amount of tax which would otherwise be payable by the taxpayer."

The argument for the taxpayer is that the whole of the amount of £439,774 is included in the taxable income because it is taken into account in calculating that income and it is contended that *Douglass* v. *Federal Commissioner of Taxation* (1) established a general rule to this effect. But the decision in *Douglass' Case* (1) was a decision upon particular words which were difficult to construe and it was largely influenced by consideration of the policy of the Act, namely the avoidance of double taxation. It may further be observed in relation to *Douglass' Case* (1) that the deductions sought to be made in determining what part of certain dividends was included in the taxable income were in that case deductions which had no relation to the acquisition of that income. In the present case the Court is called upon to consider the precise words of s. 160AB and the deductions which the commissioner seeks to make are deductions which represent expenditure incurred in gaining the relevant income so that they may well be regarded as deductions properly made before the amount of that income which is included in taxable income can be ascertained. In my opinion *Douglass' Case* (1) should not be regarded as conclusive of the present case.

10. The taxable income of the company was £690,309. As already stated, the interest derived from rebatable stock was £439,774. The whole of this amount, it was said, was included in the taxable income of £690,309. An amount of £151,371 was interest on other securities not rebatable. But reasoning identical with that submitted on behalf of the taxpayer would reach the conclusion that the whole of this amount of £151,371 also was included in the taxable income. Accordingly upon that reasoning the sum of these amounts would be included in the taxable income of £690,309. The sum of those amounts (£439,774 plus £151,371) is £591,145. The balance of the taxable income was therefore £99,172. The assessable income was £2,458,864. If £591,145 is subtracted from this amount of assessable income, the remainder is £1,867,719. The result, therefore, of the reasoning of the taxpayer is that of the amount of £1,867,719 only £99,172 was included in the taxable income, whereas, of the taxable income consisting of £591,145 derived from Commonwealth interest, the whole amount was included in the taxable income. Such a result does not incline the mind towards accepting the reasoning which produces it.

In my opinion this reasoning on behalf of the taxpayer in effect strikes out of s. 160AB the words " which is included in his taxable

(1) (1931) 45 C.L.R. 95.

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income" and treats the section as if it read "A taxpayer shall be entitled in his assessment to a rebate of 2s. for every pound of interest . . . which is derived from" certain securities. In other words the argument treats the section as applying to the amount of interest *simpliciter* without inquiring how much of the interest is included in the taxable income. No effect whatever is given by the argument to the words "which is included in his taxable income."

When it is intended to give a rebate upon a specific amount of money received by a taxpayer the legislature made definite provision to that effect. I refer for an example in the first place to s. 160, which refers to concessional rebates. That section contains this provision—"A taxpayer shall be entitled to a rebate in his assessment of tax equal to an amount ascertained by applying—(*a*) to each of the amounts set forth" the rate of tax appropriate to taxable incomes from personal exertion or to a company, as the case may be. There can be no doubt as to the interpretation of this provision. The amounts specified are taken and then a rebate is ascertained by applying a rate of tax to that amount. Similarly, in s. 160AA provision is made that a taxpayer shall be entitled to "a rebate" in his assessment of the amount obtained by applying to the amount of certain calls a particular rate of tax. Here again it is clear that the rebate is applied to the whole of a particular amount. But s. 160AB is quite different in character. It does not provide that a taxpayer shall be entitled to a rebate of 2s. for every pound of interest derived by him from certain securities. The rebate is allowed only upon every pound of such interest which is included in his taxable income. In my opinion the only way in which effect can be given to these words in the process of ascertaining for the purposes of s. 160AB how much of the interest to which the section relates is included in the taxable income of a taxpayer is to make some apportionment of deductions from assessable income between that interest and other income. It is not denied that if any apportionment is permissible the particular method adopted by the commissioner is not unfair to the company.

Accordingly I am of opinion that the appeal of the bank should be dismissed.

DIXON J. These are cross appeals from a decision of a Board of Review given by the Board upon an appeal by a taxpayer from an assessment. The taxpayer is the Commercial Banking Co. of Sydney Ltd. and the assessment is upon the income derived by the banking company during the year ended 30th June 1944. Section

20 of the *Commonwealth Debt Conversion Act* 1931 (No. 18) provided a protection from taxation for the interest upon " new securities " exchanged under the Commonwealth debt conversion plan for existing securities as defined in that Act : see s. 3. The banking company held a large amount of such securities during the financial year in question and the interest from those securities is included in its income. The protection from Federal income tax is not absolute. It is a protection to the extent by which the total amount of income tax which, but for s. 20, would be payable in respect of that interest exceeds the amount of income tax which would have been payable in respect of that interest if income tax had been imposed upon the taxable income of the person in the year of tax in accordance with the provisions of the *Income Tax Acts* 1930. The provision directs that, notwithstanding anything contained in any other Act, the interest derived by any person in any financial year from " new securities " exchanged for existing securities shall be free from any income tax payable under a law of the Commonwealth to that extent. It will be seen that to give effect to the provision it is necessary to ascertain the amount of income tax which would have been payable in respect of the interest if income tax had been imposed upon the taxable income in accordance with the provisions of the *Income Tax Acts* 1930. That having been done it becomes the limit, beyond which the interest upon the " new securities " is free of any income tax payable under a law of the Commonwealth. The expression " income tax " includes any tax imposed in respect of income. The limit having been fixed, therefore, it is to the advantage of the holder of the securities to bring as much as possible of the tax which, except for the operation of s. 20, he would pay as a result of his assessment under the words of exclusion or immunity, namely the words " free of any income tax . . . to the extent by which the total amount of income tax which but for this section would be payable in respect of that interest exceeds " the limit.

But these words do not operate according to their natural meaning. They are subject to a special provision contained in sub-s. (2) of s. 20. That sub-section provides that in determining for the purposes of the section the amount of income tax which would be payable in respect of interest to which the section applies, the rate of tax shall be applied to the whole amount of the interest from " new securities " included in the income of the taxpayer without any deduction except such part, if any, of the deductions allowable from the income of the taxpayer derived from property as in the opinion of the Commissioner of Taxation is properly attributable to

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the interest. This provision deals explicitly, though artificially, with the problem necessarily involved in ascertaining how much of the taxable income represents interest included in the assessable income. Such a problem is inherent in a system which ascertains taxable income by massing all gross income on one side and all deductions on the other side and treating the taxable income as the excess of the former over the latter. Sub-section (2) deals with it simply. It takes the amount of interest included in " the income," that is, gross income, of the taxpayer and it forbids any deduction from that interest except deductions of the character the sub-section describes. It being to the advantage of the taxpayer to apply the limited immunity to as large a part of the taxable income as possible, it follows that his interests are best served by showing that there are no such deductions and the whole of the interest therefore obtains the qualified immunity.

Two of the questions in these cases arise from a contention of the commissioner that in ascertaining the extent of the freedom conferred deductions should be thrown against the interest upon " new securities " held by the bank. One contention concerns the assessment for the purposes of ordinary tax; the other for the purposes of the assessment of the further tax provided for by Part IIIA, that is ss. 160A to 160E. The deductions which sub-s. (2) of s. 20 authorizes by way of exception are such part of the deductions allowable from the income of the taxpayer derived from property as in the opinion of the Commissioner of Taxation is properly attributable to the interest.

The commissioner says that deductions of this character should be made falling under two heads. He says, first, that the general management expenses should be apportioned so that a small part should be attributed to the receipt of the interest. He fixes this at one-half per cent of the interest received. In the next place he says that as the bank obtains at interest a great part of the funds which are laid out in the securities in question as well as in the various investments and other employments of money by which the bank gains interest, a proper proportion of the interest paid by the bank should be thrown against the interest received by the bank on " new securities " as a deduction. The commissioner arrives at what he considers a proper ratio by taking that proportion which the amount of the " new securities " bore to the amount of the total Australian assets of the banking company. It, of course, produced a large deduction.

The question for consideration is whether this can be justified as a deduction allowable from the income derived from property.

The meaning of the expression " income . . . derived from property " in s. 20 (2) is perhaps not beyond dispute, but I think it must be taken to refer to the distinction made by the *Income Tax Assessment Act* applicable to any given year with reference to which an assessment must be made between income from property and income from personal exertion. It is true that that distinction is not relevant to the taxation of a company except during the times when a further tax was payable upon the taxable income derived by any person from property. It is also true that in one sense ultimately all deductions are allowable from the income of a taxpayer derived from property in the same sense as all deductions are ultimately allowable from his income derived from personal exertion. The distinction, however, must be made for the purposes of rate in the case of an individual. Obviously sub-s. (2) refers to a distinction existing for the purposes of administering the *Income Tax Assessment Acts*. The purpose of the distinction is immaterial. It is therefore necessary to turn to the definition of " income from property " contained in the *Income Tax Assessment Act*.

The definition is, of course, " all income not being income from personal exertion." That throws one back on the definition of " income from personal exertion." It includes the proceeds of any business carried on by the taxpayer. But there is a special exclusion of interest unless the taxpayer's principal business consists of the lending of money or unless the interest is received in respect of a debt due to the taxpayer for goods supplied or services rendered by him in the course of his business. I think that if a taxpayer is brought within what I may call the " unless " clause, that is the exception to the exclusion of interest, the result is simply that his case is not governed by the peremptory exclusion of interest from income from personal exertion. In other words, it is not an absolutely necessary consequence that the interest is derived from personal exertion. It just becomes a question to be decided by a proper application of the rest of the definition of " income from personal exertion."

In the present cases the bank claims that it does come within the " unless " clause because it is a taxpayer whose principal business consists of the lending of money. This the commissioner denies. The matter must in some degree depend on an analysis of the business of banking or of the business of this particular bank but in the end it depends less on this than upon a proper understanding of the meaning of the provision. It is, of course, true that the lending of money is a most important part of the general business of banking. It is also true that the business of banking considered

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as a separate business and not as forming simply one example of the business of lending money is not easily capable of definition. But the plain object of this particular provision of the definition is to allow a taxpayer the benefit of the rate for personal exertion where in truth the obtaining of interest is the substantial purpose of his business, if the interest is obtained by the lending of money. When, in ordinary understanding, what in point of law is interest is in substance a profit dependent upon the pursuit of organized business activities it is income from personal exertion. The word "principal" is introduced in order to exclude incidental and subsidiary activities in a business, but if the chief part of the business from which the profit is obtained consists of the lending of money that is enough. A banker's business may be said to be that of dealing in money. A great part of organized banking consists in the performance of services for customers which result in the banker having at his command large funds. But, extensive and important as those services are, and indispensable as they are to the acquisition of funds, if it stopped at that the banker would make no profit. The profit-making side of his activities is in putting out the money so as to increase it, and that substantially means to obtain interest. If attention is riveted upon the relations of the banker to his customer and the amount of work done in that respect it might be thought that to say that the principal business consists of the lending of money is to ignore all the business done with customers whose accounts are in credit as well as much else besides. But if attention is riveted on the activities of banking in which the money is used or laid out it would seem correct to say that the decisively profit-making side of the business is concerned with the lending of money. Doubtless the distinction is not irrelevant between advances on overdraft, the deposits with the Commonwealth Bank pursuant to the *National Security Regulations* and, after the period with which we are concerned, the *Banking Act* 1945, the discount of treasury bills, the taking up of Australian Government securities on issue and the purchase of them in the market. But of these various kinds of outlay to obtain interest I think the only one which does not amount to the lending of money in point of law is the purchase of Australian Government securities in the market. There a security representing money lent is purchased. But I do not think that because a business seeking its profit in interest does not stop at lending but also includes the taking over, so to speak, of a loan already made at interest, it can for that reason be said to be a business which does not principally consist of the lending of money. On the whole I think the Board of Review was right

in holding that the taxpayer's principal business consisted of the lending of money.

I am therefore of opinion that the deductions made by the commissioner do not come within the exception expressed in sub-s. (2) of s. 20 of the *Commonwealth Debt Conversion Act* 1931 and do come within the prohibition contained in the words " without any deduction."

The problem of the application of s. 20 to the further tax under Part IIIA is affected by the conclusion I have stated, but it is not the same problem. Part IIIA levies a further tax at the rate declared by the Parliament on that portion of the taxable income of a company which has not been distributed as dividends : s. 160B. But again that is an artificially defined conception. The taxable income of a company not distributed as dividends is ascertained under s. 160C. It is done by taking the taxable income of a company and making from it prescribed deductions. The relevant deductions are (1) taxes paid in the year of income ; (2) the net loss incurred in carrying on the taxpayer's business out of Australia ; and (3) the amount of dividends paid out of the taxable income of the year of income before the expiration of six months after the close of that year. The further tax is paid upon the balance, that is to say the excess of the taxable income over these deductions. Clearly enough s. 20 gives an immunity from further tax so far as it relates to an amount of interest included in the income of the taxpayer and, having regard to what I have already decided, that must be without any deduction.

But it is not easy to apply the conception of s. 20 to a further tax on a part only of the taxable income. In terms s. 20 (2) forbids the making of deductions. It seems an easy solution to say that in applying the immunity given by s. 20 the deductions directed by s. 160C must therefore be ignored and in the end I have come to the conclusion that it is the right solution. But the view of the commissioner has been that it is necessary to trace into the taxable fund the interest which is entitled to the protection and that that is the first step. He accordingly places what he considers a due proportion of the loss incurred in overseas trading against the interest, a due proportion (somewhat differently ascertained) of the taxes paid in a previous year and an aliquot or proportionate part of the amount distributed in dividend. The rest of the interest, he says, is reflected in or represented in the taxable fund and is alone entitled to the limited tax immunity. In the case of the proportion of tax he takes that amount of tax which became payable in the previous year by reason of the possession of the same or like

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securities. The other two deductions are proportioned upon the basis that when deductions are made from a total fund a proportionate part is made from each pound in that fund. In my opinion this reasoning cannot be justified. There is, I think, a distinction between the dividend and the other two deductions. The dividend is a payment made by the company in whose choice it was to declare it out of any available source. In declaring it out of the taxable income from the year, as appears to have been done, an intention to declare it ratably out of each and every part of the taxable income may perhaps be presumed or imputed. The other two deductions are made by statute. That is s. 160c seems to have no intention except to prescribe an arithmetical sum consisting of the aggregation of a number of deductions and a subtraction thereof from a prescribed total, namely the taxable income. There is in my opinion no foothold for the commissioner's assertion that these deductions are to be imputed ratably to the interest as well as the other ingredients in the assessable income. The effect is to detract from both the policy of s. 20 (2) and the provision in which it is expressed by diminishing the amount of interest which is to obtain the advantage. There is more to be said for the commissioner's view in the case of the dividend for the reason I have given. As against it the taxpayer resorts to the alleged presumption that a taxpayer allocates payments in such a way as will not expose him to tax. I have expressed my views upon this presumption in *Symon's Case* (1) and *Resch's Case* (2), and I see no reason to depart from the views I then expressed. But the presumption that the taxpayer intended to distribute the dividend ratably out of each and every part of the fund depends upon a legal principle which I do not think is applicable to the question that we have to decide. That question is not how much of the interest is contained in the taxable subject resulting from the application of s. 160c. It is how far the provisions of s. 160c are overreached by the provisions of s. 20 (2) of the *Commonwealth Debt Conversion Act*. On the whole I think that s. 20 (2) must be construed and applied according to its terms and therefore as forbidding the making of any deduction from the interest including the deduction of a ratable part of the dividend.

I now turn to a third question covered by the appeals. Included in the assessable income is a large sum of interest upon securities which do not fall within s. 20 of the *Commonwealth Debt Conversion Act* 1931. It is therefore interest which is entitled to the benefit

(1) (1932) 47 C.L.R., at pp. 549 et seq.

(2) (1942) 66 C.L.R., at pp. 229, 230.

of a rebate under s. 160AB. That provision directs that a taxpayer shall be entitled to a rebate in his assessment of an amount of 2s. for every pound of interest which is included in his taxable income and which is derived from bonds, debentures, stock or other securities issued by the Commonwealth Government, except securities to which s. 20 of the *Commonwealth Debt Conversion Act* 1931 or s. 52B (2) of the *Commonwealth Inscribed Stock Act* 1911-1940 applies, or by the Government of a State or by certain other public bodies. In ascertaining the amount of interest included in the taxable income the commissioner has thrown against the interest deductions which he considers appropriate to it. Again he has taken an amount of the administration expenses and adopted one-half per cent of the amount received as a proper proportion. He has, however, made a very large deduction consisting of what he considers an appropriate proportion of the interest paid by the banking company on deposits bearing interest. He has arrived at this by taking the proportion which the total of the securities held by the bank to which s. 160AB applies bears to the total of the Australian assets. This proportion is applied to the interest paid on interest-bearing deposits. The theory is that some expenditure upon interest is a necessary result of the holding of the securities which produce the interest on which the rebate is claimed. The commissioner says that how much of the interest is included in the taxable income within the meaning of s. 160AB can only be ascertained by taking the interest contained in the assessable income and throwing against it deductions which are attributable to the interest. Only the residue of the interest is contained in the taxable income.

When it is asked how much of an item forming an ingredient in a gross sum from which deductions are made is " included " in the net sum the question must immediately be provoked—What do you mean by included ? In *Douglass' Case* (1) I pointed out that there appeared to be two methods of answering a question how much of the item is included in the net residue and that it was a question of interpretation, dependent largely upon the subject matter and the context, which of the two methods was intended. One way is to treat the question as meaning by how much is the net residue increased by reason of the presence of the item in the gross sum. If that is the meaning of the question the deductions must be divided into two contrasted classes. There may be deductions which would not be allowable but for the inclusion of the item of

(1) (1931) 45 C.L.R., at p. 105.

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assessable income in the assessable income. In other words they may be expenses which would not be allowable deductions were it not for the fact that the income is included. It is not easy to imagine any important expenses of that character in relation to interest. But let it be supposed that for some exceptional reason the taxpayer had employed an agent to collect interest on his Government securities. The commission or remuneration of the agent for so doing would not be allowable except by reason of the inclusion of the interest in the assessable income and, accordingly, would be indissolubly associated with it. That is one class of deductions. The other class of deductions would be all those that would be allowable against the assessable income independently of the presence in the assessable income of the given item (in this case interest). If the meaning of " included in the taxable income " is that stated, viz. a reference to the amount by which the net balance is increased by reason of the presence of the item in the gross sum, then the second class of deductions must be ignored. No part of them can be thrown against the item. The first class of deductions should be made from the item because the net balance is only increased by the inclusion of the net amount of the item.

The other possible interpretation to be attached to the word " included " is that it means the proportion of the given item of the assessable income which remains in the taxable income after all the deductions have been made. In arriving at that proportion the same division of deductions into two parts must be made, but for a different purpose. The first class of the deductions would be thrown altogether against the particular item. The remaining deductions would be dealt with as follows. They would be examined to see if any particular one of them was in like manner indissolubly associated with some other particular item of revenue included in the assessable income. If so, it would be thrown against that item. That process having been gone through, the deductions which were, so to speak, common to the whole would then be ratably apportioned.

It will be seen that the commissioner has not done exactly either of these things. He has not chosen one or other of the rival interpretations and applied it inflexibly. For myself I do not see a logical justification for the exact thing that he has done. I suspect that he has pursued a line of reasoning which is more in accordance with the first of the above-suggested interpretations, but in carrying it out has attempted to find a proportionate part of expenditure by the bank which he thinks the bank could not have avoided while

at the same time retaining the interest-bearing securities. It is necessary to decide which of the possible interpretations is to be attached to s. 160AB when it uses the expression " which is included in the taxable income."

I think the decision must be reached on broad lines of statutory interpretation. The purpose of s. 160AB is to ensure to a taxpayer who invests in particular loans a definite rebate. The assurance is held out to him in order to induce him so to invest, because it is to the public advantage that investments of that character should be made. The purpose is in effect to say—If you make this interest from those securities a form of your income, from the tax upon that income you will obtain a rebate. The point of view both of the legislature and of the taxpayer who acted upon the assurance would more naturally be that he was to be assured of a rebate on the amount by which his income is increased by the inclusion of interest upon the specified securities. I construe s. 160AB as in effect meaning that a taxpayer is to be entitled to a rebate in his assessment of an amount of 2s. for every pound of interest by reason of the inclusion of which in his assessable income his taxable income has been increased. It will be seen that upon this meaning the rebate cannot be upon more than the taxable income which, of course, is obvious enough, and, further, that if there are any special deductions which, but for the inclusion of the interest in the assessable income, would not be allowable, they are to be thrown against it. None of the deductions, however, in the present cases are of this character. The result of the views I have expressed is that in my opinion two declarations should be made. The first is a declaration that for the purposes of s. 20 (2) of the *Commonwealth Debt Conversion Act* 1931, both in its application to the ascertainment of ordinary tax and of further tax, no deduction should be made from the amount of interest to which s. 20 applies. The second declaration is that for the purpose of ascertaining the rebate under s. 160AB upon the amount of interest to which s. 160AB applies derived by the taxpayer during the year of income the whole of the interest is to be taken to be included in its taxable income. I think that the taxpayer's appeal should be allowed with costs and the commissioner's appeal should be dismissed with costs.

McTIERNAN J. In my opinion the taxpayer's appeal should be allowed with costs and the commissioner's appeal should be dismissed with costs.

I agree with the reasons of *Dixon* J.

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WILLIAMS J. On both these appeals I am in substantial agreement with the reasons of *Dixon* J. I also agree with the declarations which he proposes. In my opinion the appeal of the bank should be allowed and the appeal of the Commissioner of Taxation dismissed.

WEBB J. The bank's appeal: I am unable to distinguish this case from *Douglass* v. *Federal Commissioner of Taxation* (1) or *Carpenters Investment Trading Co. Ltd.* v. *Federal Commissioner of Taxation* (2). As counsel for the appellant bank pointed out, the exemption in s. 160AB, is of interest, and not of income from interest, and to give effect to the exemption in those words it is necessary to treat the word "included" in s. 160AB as referring to the amount by which the taxable income is increased by reason of the presence of the interest in the assessable income. The choice is between regarding the expression "included in the taxable income" as elliptical, that is as meaning "included in the calculation of the taxable income," and attributing to the legislature the use of an expression that conveys that the items included in the aggregate sum from which the deductions are made continue to be identifiable in the remainder. But even if each pound of interest could be viewed as truncated or shrunken—to employ expressions used by the Chief Justice and counsel for the bank in the course of the argument—so as to be identifiable in the remainder I think the exemption would still be in respect of every pound of interest in its reduced form. However, I think that, even if there were no deductions from the interest, or other item of assessable income, it would not be identifiable in the single figure that represents the taxable income; you must go back further in the calculation for that. The interest then is included in the taxable income in the sense that it is to be taken into the calculation in arriving at the taxable income. But it is a rebate from the taxable income that is granted, and, of course, it is limited by the taxable income.

In *Douglass' Case* (1) and *Carpenters Case* (2) the Court gave the words their ordinary meaning: there was no straining of language to avoid double taxation. The words of exemption given their natural meaning secured that result.

I would allow the bank's appeal.

The commissioner's appeal: I think the decision of the Board of Review was right, and I have nothing to add to the reasons for sustaining it given by the Chief Justice and *Dixon* J.

I would dismiss the commissioner's appeal.

(1) (1931) 45 C.L.R. 95. (2) (1949) 79 C.L.R. 341.

FULLAGAR J. I have read the judgment of my brother *Dixon* in this case, and, as to all three of the questions involved in the two appeals, I agree with it. On two of those questions I do not wish to add anything. On the question arising under s. 160AB I wish to add two observations.

In the first place, the argument of the taxpayer did not, as I understood it, invite us to ignore the words "included in the taxable income" in s. 160AB, or to read the words "taxable income" as if they were "assessable income." I took it to concede that, for the purpose of calculating the rebate on the interest under s. 160AB, it would be proper to subtract from the gross amount of interest any amount which only became an allowable deduction from assessable income because of the inclusion of the interest in the assessable income. The average investor probably simply collects his interest or has it paid into his bank, and incurs no deductible expenditure in so doing. But there must be many cases in which an agent or trustee collects interest for a client or beneficiary and charges a commission for so doing. I should suppose that the commission so charged would be deductible both for the purpose of calculating the taxable income of the client or beneficiary and for the purpose of calculating his rebate under s. 160AB. Where, but only where, no expenditure can be actually attributed to the receipt of the interest so as to be deductible because of the receipt of the interest, the rebate is to be calculated on the gross amount of the interest.

The second observation I would make is this. Under our system taxable income is arrived at by subtracting allowable deductions from assessable income. In the "difference" which results from the subtraction the items which went to make up the assessable income have commonly lost their identity. There is, therefore, a degree of inaccuracy in speaking of an amount which entered into the assessable income as being "included in the taxable income": cf. the example given by *Dixon* J. in *Douglass* v. *Federal Commissioner of Taxation* (1). But, as *Starke* J. said in that case (2) it has been "included in account," and it seems to me to be the natural and proper way of reading the critical expression in s. 160AB to read it as referring to the amount by which the taxable income is increased through the inclusion of the interest in the calculation. Any other paraphrase of words which cannot be applied with absolute strictness seems to me to depart from the meaning really conveyed by those words.

(1) (1931) 45 C.L.R., at p. 105. (2) (1931) 45 C.L.R., at p. 103.

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In my opinion, the appeal of the taxpayer should be allowed, and the appeal of the commissioner dismissed, and I agree that the declarations proposed by *Dixon* J. should be made.

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Appeal allowed with costs. Declare (1) *that for the purpose of s.* 20 (2) *of the Commonwealth Debt Conversion Act* 1931, *in its application to the ascertainment of ordinary tax and of further tax, no deduction should be made from the amount of interest to which s.* 20 *applies*; (2) *that for the purpose of ascertaining the rebate under s.* 160AB *of the Income Tax Assessment Act* 1936-1944 *upon the amount of interest to which s.* 160AB *applies derived by the taxpayer during the year of income the whole of the interest is to be taken to be included in its taxable income. Assessment remitted to the commissioner for amendment in accordance with these declarations.*

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Appeal dismissed with costs.

Solicitors for the Commercial Banking Co. of Sydney Ltd., *Dibbs, Crowther & Osborne.*

Solicitor for the Federal Commissioner of Taxation, *K. C. Waugh*, Crown Solicitor for the Commonwealth.

J. B.