[HIGH COURT OF AUSTRALIA.]

MUTUAL LIFE AND CITIZENS' ASSURANCE COMPANY LIMITED . . . APPELLANT;

AND

COMMISSIONER OF TAXATION . . RESPONDENT.

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SYDNEY, 1958, Dec. 4, 5, 8;

1959, April 27.

Dixon C.J., McTiernan, Fullagar, Taylor and Menzies JJ.

Income Tax (Cth.)—Assessable income—Exempt income—Income from sources outside Australia—Not exempt from tax in country where derived—Exempt from tax under local legislation—Life assurance company—Branch in United Kingdom—Investments in securities—Income therefrom not chargeable to tax in United Kingdom—Company liable to pay tax in United Kingdom—Calculated on formula which disregards exempt income for purpose of ascertaining statutory proportion—Whether income from securities exempt in United Kingdom—Income Tax Act 1918 (*Imp.*), *s.* 46 (1), *schedule C. and* 2 (*d*), *schedule D, Case III, r.* 3—*Income Tax Assessment Act* 1936 (*Cth.*), *s.* 23 (*q*).

Section 23 of the *Income Tax Assessment Act* 1936 (Cth.) provides :—" The following income shall be exempt from income tax :— . . . (*q*) income derived by a resident from sources out of Australia, where that income is not exempt from income tax in the country where it is derived . . . ".

A life assurance company resident in Australia and maintaining a branch in the United Kingdom held as part of its life assurance fund investments in certain United Kingdom war loan securities and securities of British possessions the income from which was payable and paid in the United Kingdom. This income was exempted from United Kingdom income tax under s. 46 (1) and r. 2 (*d*) of the Rules applicable to schedule C of the *Income Tax Act* 1918. The company, however, was required by the revenue authorities in the United Kingdom to pay, and did in fact pay, income tax, computed under r. 3 of the rules applicable to Case III of schedule D, on that " portion " of the total income of the investments of the life assurance fund which bore the same proportion to that total income as the amount of premiums received from policy holders resident in the United Kingdom and certain other policy holders bore to the total amount of premiums received by the company.

Held :—(1) By *Dixon* C.J., *McTiernan*, *Fullagar* and *Taylor* JJ., that the whole of the company's income from the United Kingdom war loan securities and securities of British possessions was " not exempt from income tax " in the United Kingdom within the meaning of s. 23 (*q*) ;

(2) By *Menzies* J., that so much, but only so much, of the company's total income from the said securities was " not exempt from income tax "

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in the United Kingdom within the meaning of s. 23 (*q*) as bore to the total income of the life assurance fund the proportion mentioned in r. 3 of the Rules applicable to Case III of schedule D of the *Income Tax Act* 1918.

Hughes v. *Bank of New Zealand* (1937) 1 K.B. 419; (1938) A.C. 366 and *Inland Revenue Commissioners* v. *Australian Mutual Provident Society* (1946) 1 All E.R. 236, 528; (1947) A.C. 605 considered.

CASE STATED.

Upon an appeal by The Mutual Life and Citizens' Assurance Company Limited against an amended assessment of income tax on income derived by it in the accounting period ended 31st December 1935, the parties being in agreement as to the relevant facts, *Menzies* J. stated a case for the opinion of a Full Court of the High Court pursuant to s. 18 of the *Judiciary Act* 1930-1955 as follows :—

1. The Mutual Life and Citizens' Assurance Company Limited (hereinafter called the company) is a company duly incorporated under the *Companies Act* 1936 (N.S.W.) and is a resident within the meaning of that expression in s. 6 of the *Income Tax Assessment Act* 1936 (hereinafter called the said Act).

2. The company pursuant to s. 18 of the said Act adopted the period of twelve months ending 31st December in each year as its accounting period.

3. The company is a "life assurance company" within the meaning of the said Act.

4. On 14th September 1936 the company lodged two returns of income in respect of income derived during the period of twelve months ended 31st December 1935. One of the returns related to the company's life assurance business and the other to its general business. Certain financial statements and other documents accompanied the said returns.

5. One of the documents forwarded with the return of income in respect of the company's life assurance business included the following particulars :—

Interest as per Published Accounts—			
Ordinary Branch	£824,336	1	6
Sinking Fund	65	0	0
Industrial Branch	212,498	1	0
Transfer and Office Fees as per Published Accounts	498	12	2
INCREASE by conversion to Australian Currency	54,799	18	9
	£1,092,197	13	5

Less			
Interest Income outside the Commonwealth exclusive of Interest on tax-free State Government Securities outside the Commonwealth		£329,923 15 5	
Less			
Interest on New Zealand Gov. Stock exempt from Income Tax in New Zealand		650 2 6	
		£329,273 12 11	
The Company has paid income tax outside Australia on this Interest Income. Exemption claimed under s. 23 (*q*).			
Tax-free Interest on State Government Securities issued prior to 1st January 1924 as per attached list—			
In Commonwealth—	£5,466 17 0		
Outside Commonwealth—	25,237 9 8	30,704 6 8	
Interest on Overdue Premiums		34,922 15 5	394,900 15 0
Assessable Income *			£697,296 18 5

* (Of this amount £333,862 16s. 10d. is interest derived from Australian Consolidated Stock)

Less Deductions			
Income Tax paid to State Governments and Land Tax paid to Commonwealth and State Governments in 1935 as per attached list—		32,913 5 4	

Management Expenses— Deduction as per attached sheet	45,018 0 0	
Amt. paid to Staff Superannuation Fund (deduction claimed under ss. 66 and 78 (*b*) and (*c*)	5,017 17 10	
Deduction re 4% of Valuation of Liabilities ss. 114 and 115	546,721 0 0	
		£629,670 3 2
		£67,626 15 3

6. The Company claimed exemption from tax under s. 23 (*q*) of the said Act in respect of the said amount of £329,273 12s. 11d. Included in the said sum of £329,273 12s. 11d. were the following items of income received in the United Kingdom being interest received in respect of the following securities situate in the United Kingdom.

Interest	*Securities*	*Book Values as at* 31/12/1935
£1,520 6s. 3d.	N.S.W. Inscribed Stock 3½% 1/7/50	£18,750 0s. 0d.
62,425 0s. 0d.	Government of New Zealand 5½% 1/2/51	885,919 1s. 5d.
3,339 7s. 6d.	Alberta & Gt. Waterways Stk. 5% 1/1/59	50,000 0s. 0d.
4,142 11s. 2d.	U.K. War Loan Stock 3½% 1/12/52	51,394 7s. 6d.
£71,427 4s. 11d.		
6,246 5s. 0d.	Maisoneuve Debentures City of Regina Bonds, City of Sydney Bonds	90,832 10s. 0d.
3,802 10s. 0d.	Loans to Melbourne Metropolitan Board of Works	57,256 17s. 6d.
1,968 14s. 11d.	Queensland National Bank Stock	25,000 0s. 0d.
3,517 7s. 11d.	Loans on policies granted in the United Kingdom and other unidentifiable interest	27,579 6s. 9d.
£15,534 17s. 10d.		

7. The Deputy Commissioner of Taxation assessed the company to tax in respect of the financial year 1936-1937, and gave notice thereof to the company by a notice of assessment dated 23rd April 1937. This assessment was based upon a taxable income of £103,621, the amount of tax being assessed at £5,181 1s. 0d. The company paid the tax so assessed on 23rd June 1937. The said taxable income of £103,621 did not include any part of the amounts of £71,427 4s. 11d. or £15,534 17s. 10d., referred to in par. 6 above.

8. A notice of amended assessment, based on income derived during the year ended 31st December 1935, was forwarded to the company on 14th June 1940. The said amended assessment was based upon a taxable income of £265,031, the tax payable thereon being £13,251 11s. 0d. An adjustment sheet forwarded with the notice of amended assessment disclosed that the taxable income has been increased by the inclusion in the assessable income *inter alia* of the said sum of £71,427 4s. 11d., referred to in par. 6 above. The adjustment sheet also disclosed that the said sum of £15,534 17s. 10d. had been treated as exempt income. On 13th August 1940 the company paid the additional tax so assessed.

9. The United Kingdom war loan stock referred to in par. 6 above was in the year in question a security issued by the United Kingdom Treasury with a condition that the interest thereon should not be liable to tax or super-tax, and this security was shown in the manner directed by the United Kingdom Treasury to be in the beneficial ownership of a person who was not ordinarily resident in the United Kingdom, that is to say, the company, and accordingly the said interest of £4,142 11s. 2d. received by the company in the United Kingdom from this security fell within the class of interest referred to in s. 46 (1) of the *Income Tax Act* 1918 (Imp.).

10. The New South Wales stock, New Zealand stock and Alberta and Great Waterways stock referred to in par. 6 above were in the relevant year securities of a British Possession and each of them was payable in the United Kingdom, and it was proved to the satisfaction of the Commissioners of Inland Revenue of the United Kingdom that in the relevant year the company owned the said securities and was entitled to the interest thereon, and that it was not at the relevant time resident in the United Kingdom, and accordingly the several amounts of interest, namely £1,520 6s. 3d., £62,425 0s. 0d. and £3,339 7s. 6d., referred to in the said paragraph and received by the company in the United Kingdom from these securities fell within the class of interest referred to in r. 2 (*d*) of schedule C of the *Income Tax Act* 1918 (Imp.).

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11. The several amounts of interest referred to in par. 6 above and received by the company in the United Kingdom from Queensland National Bank stock, Maisoneuve debentures, City of Regina bonds, City of Sydney bonds from loans to Melbourne Metropolitan Board of Works, loans on policies granted in the United Kingdom and other now unidentifiable interest did not fall within the classes of interest referred to in s. 46 (1) of the *Income Tax Act* 1918 (Imp.) or r. 2 (*d*) of schedule C of the *Income Tax Act* 1918 (Imp.).

12. The company objected to the amended assessment referred to in par. 8 hereof by notice of objection dated 5th August 1940. So far as material for present purposes the objection contained the following paragraph : " (3) That the amount of £71,427 interest derived from government securities in the United Kingdom is incorrectly included in the assessment. We claim that this interest is exempt from Commonwealth income tax under s. 23 (*q*) of the *Income Tax Assessment Act* 1936 by reason of the fact that such interest has been included in the company's British assessment and has thus been charged with income tax in the United Kingdom ".

13. On 11th October 1940 the Deputy Commissioner of Taxation forwarded to the company a notice informing the company that the objection dated 5th August 1940 had been allowed to the extent indicated in a notice of amended assessment and explanatory statement forwarded therewith. The said amended assessment was based upon a taxable income of £264,871 which figure was determined after treating the abovementioned amount of £71,427 4s. 11d. as not exempt from taxation under s. 23 (*q*) of the said Act.

14. By letter dated 17th October 1940 the company requested that the objection be treated as an appeal and be forwarded to the High Court for determination.

15. By letter dated 10th March 1941 the Deputy Commissioner of Taxation informed the company that it had been decided to allow a further ground of its objection dated 5th August 1940, and a further notice of amended assessment was forwarded to the company. This assessment was based upon a taxable income of £263,447, which figure was determined after treating the abovementioned amount of £71,427 4s. 11d. as not exempt from taxation under s. 23 (*q*) of the said Act.

16. United Kingdom tax was assessed on the company for the tax year under r. 3 Case III of Schedule D of the *Income Tax Act* 1918 (Imp.) and was computed as follows :—

The Mutual Life & Citizens' Association Co. Ltd.
(of Australia)

Accounts for the year ended 31*st December* 1935

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Ordinary Branch	
Interest per accounts	£824,336
Less Interest on Annuity Fund £83,572 at £4 19s. 5d.%	4,154
	£820,182
Proportion of U.K. Premiums to World Premiums ..	2.888%

Liability under Rule 3 *of Case III Schedule 'D'*

Income Tax Act 1918

2.888% x 820,182 = ...	23,687
Total expenses of management (year to 31/12/35) 330,137	
Proportion attributable to U.K. 2.888 % =	9,534
	14,153
Add Sinking Fund profit	59
	14,212

Tax chargeable at 4s. 9d.	£3,375	7	0
Add Tax deducted from annuities paid	215	19	7
	£3,591	6	7
Less Tax deducted from taxed income	230	3	5
1936-37 Net U.K. tax assessed and paid.. ..	£3,361	3	2

17. The sums of £71,427 4s. 11d. and £15,534 17s. 10d. were included in the sum of £824,336 shown in pars. 5 and 16 hereof.

18. The United Kingdom tax so levied was paid by the company.

19. The said appeal coming on to be heard before me and the facts hereinbefore stated being agreed between the parties I state the following question of law for the opinion of the High Court of Australia namely :—Whether the said amount of £71,427 4s. 11d. or any part thereof was exempt from income tax under the provisions of s. 23 (*q*) of the *Income Tax Assessment Act* 1936.

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Sir *Garfield Barwick* Q.C. (with him *R. J. Ellicott*), for the appellant. Basically the question here is one of construction of the words " not exempt " in the Australian Act. Section 23 (*q*) requires the exclusion from the computation of the assessable income of income which qualifies within in its terms. Bearing in mind that as a matter of strictness tax is imposed on persons, not income, the opening words of s. 23 should be read as " The following income shall not be included in the computation of income tax in respect of the recipient of that income." It might be paraphrased shortly by expressions such as " exempt from income tax ", " not liable to tax " or " not subject to tax " and each of such expressions requires one or other of the following to be reserved :— (i) that the income is not to be brought to account in any way in the process of assessing liability to tax ; (ii) that the income or its receipt is not to be used as a factor for the purpose of determining the tax payable, either as to quantum or rate ; or (iii) that liability to tax is not to be increased by reason of his having received the income. The converse of these ways of expressing the idea may be used in explication of the words " not exempt ". Support for this submission is to be found in *The Commonwealth* v. *State of Queensland* (1). [He referred to *Australian Machinery and Investment Co. Ltd.* v. *Deputy Federal Commissioner of Taxation* (2) ; *Texas Co.* (*Australasia*) *Ltd.* v. *Federal Commissioner of Taxation* (3).] *The Commonwealth* v. *State of Queensland* (4) is, in one sense, an extreme illustration of how the income can be used in the process of assessment although that specific income is not visited with tax and thus the result can be arrived at that such income is not exempt from tax. Here when Case III, r. 3 (1), is found to be appropriate and applicable the investment income in question was included in the assessment to tax in England. It was used as a factor in arriving at the assessable sum under the system of law in the place where the income was derived and is accordingly within s. 23 (*q*) " not exempt ". Case III, r. 3, schedule D was inserted into the Imperial Act after s. 46 (1) and schedule C, r. 2 (*d*) because it was found impracticable to attempt to assess non-resident assurance companies under the other cases. [He referred to *Equitable Life Insurance Society of U.S.A.* v. *Hills* (5) ; *Inland Revenue Commissioners* v. *Australian Mutual Provident Society* (6), *per* Viscount *Simon* (7), *per* Lord *Wright* (8), *per* Lord *Porter* (9).] This case emphasises that Case III, r. 3, is not qualified

(1) (1920) 29 C.L.R. 1, at pp. 9-11, 16, 17, 20.
(2) (1946) 8 A.T.D. 81, at pp. 100, 101.
(3) (1940) 63 C.L.R. 382, at pp. 431, 432, 452, 471, 472.
(4) (1920) 29 C.L.R. 1.
(5) (1924) 8 Tax Cas. 657, at p. 660.
(6) (1947) A.C. 605.
(7) (1947) A.C., at p. 616.
(8) (1947) A.C., at p. 623.
(9) (1947) A.C., at p. 625.

by s. 46 or r. 2 schedule C and therefore if it be right to say that the use of r. 3 subjects all the investment income, to which the section is applied, to tax in some respects then it is still true notwithstanding the presence of s. 46. Let it be assumed that there had been no s. 46 or no r. 2 (*d*) schedule C but only Case III, r. 3, in the Imperial Act then, the facts being as they are here, it could not be said that the income here was exempt from the viewpoint of s. 23 (*q*), because its receipt and the amount itself have been used for the purpose of determining the assessable income and therefore the amount of tax. So, if one came to the conclusion that on its true construction the Imperial Act gave paramountcy to r. 3 over the other provisions then a similar result must follow and the *Australian Mutual Provident Society Case* (1) decides that r. 3 operates without qualification by the other provisions. On the reasoning of that case there is no cause for the operation of s. 46 (1) and the other provisions whilst the assessment is under Case III r. 3. [He referred to *Australian Mutual Provident Society Case* (2) ; *Ostime* (*Inspector of Taxes*) v. *Australian Mutual Provident Society* (3), per *Jenkins* L.J. (4), per *Parker* L.J. (5).] Once the investment income is used as a factor in the computation of the assessable income so as to create or increase a liability, then one cannot say of such income that it is not exempt. Thus the amount included in the computation under r. 3 cannot be said to have been not exempt from tax within the meaning of s. 23 (*q*) and accordingly the question in the case should be answered favourably to the appellant.

K. W. Asprey Q.C. (with him *L. W. Street*), for the respondent. The Inland Revenue Commissioners have an option whether to tax on Case I which is profits or gains, or on Case III which sets up an artificial method of ascertaining what the tax liability of a foreign assurance company is : see *Konstam, The Law of Income Tax* 6th ed. (1933), pp. 215, 216 and *Equitable Life Insurance Society of U.S.A.* v. *Hills* (6). Looking at the introductory part of schedule D, Cases I, II and III all levy taxes in respect of profits, even though some amounts are artificially deemed profits for the purposes of the Act, and it is not until Case IV is reached that one finds any tax in respect of investments. Under Case III, r. 3 (1), the prerequisite is not the receipt of income from securities but the carrying on of a life assurance business. The appropriate calculations having been

(1) (1947) A.C. 605.
(2) (1947) A.C., at pp. 617-619, 621-623, 625, 626, 627.
(3) (1958) 3 W.L.R. 354.
(4) (1958) 3 W.L.R., at pp. 358-361, 362, 363.
(5) (1958) 3 W.L.R., at pp. 364, 365.
(6) (1924) 8 Tax Cas. 657, at p. 661.

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made under Case III, r. 3, the result obtained is deemed to be profit from the carrying on of a life assurance business. [He referred to *Inland Revenue Commissioners* v. *Australian Mutual Provident Society* (1), *per* Viscount *Simon* (2).] Leaving out of account income from investments, which are exempt from tax under s. 46 and schedule C, r. 2 (*d*), all other income from investments received by the assurance companies in England is exposed to liability for tax. The words " exempt from income tax " in the opening sentence of s. 23 of the *Income Tax Assessment Act* mean " not to be taken into account in any way in arriving at the liabilities of the tax payer to pay tax assessable under the Act ", but in s. 23 (*q*) the words " not exempt from income tax " are to be read as " chargeable to taxation in the sense that the specific income derived outside Australia is of such a quality as might attract it into the category of assessable income in the country in which it was derived." These words in s. 23 (*q*) are a practical concept and do not involve the idea that merely because the income has been used as a referential factor in a computation to determine tax liability in the country of origin such income is not there exempt from tax. [He referred to *Texas Co. (Australasia) Ltd.* v. *Federal Commissioner of Taxation* (3).] The passage in the speech of Viscount *Simon* in the *Australian Mutual Provident Society Case* (4) negatives any suggestion that the criterion for liability to tax under Case III is receipt of investment income. In the instant case the whole of the investment income was exempt from tax under s. 46 and schedule C, r. 2 (*d*). Prior to the introduction into the Act of Case III the Inland Revenue Commissioners had to ascertain the true profit figure under the other provisions of the Act in order to levy tax, but under this case they may resort to the artificial or conventional figure ascertained in accordance therewith. There is, however, in that case nothing to suggest that the introduction thereof was intended to bring to tax income otherwise exempt. An assessment made under Case III, r. 3, does not expose to liability for tax any part of the specific investment income exempted by s. 46 and schedule C, r. 2 (*d*). [He referred to the *Australian Mutual Provident Society Case* (1), *per* Viscount *Simon* (5), *per* Lord *Wright* (6).] Accordingly such investment income does not fall within s. 23 (*q*). To fall within that paragraph one must find the specific income, for which exemption is claimed, exposed to liability to tax in the country in which it is derived; whether tax was in fact attracted is beside the question.

(1) (1947) A.C. 605.
(2) (1947) A.C., at pp. 612, 617.
(3) (1940) 63 C.L.R. 382.
(4) (1947) A.C., at pp. 617, 618.
(5) (1947) A.C., at p. 620.
(6) (1947) A.C., at pp. 621, 622.

The situation in *The Commonwealth* v. *State of Queensland* (1) presented an entirely different problem from that with which the Court is here faced ; see *per Knox* C.J. (2), *per Isaacs* and *Rich* JJ. (3). The question should be answered favourably to the respondent.

R. J. Ellicott, in reply.

Cur. adv. vult.

The following written judgments were delivered :—

DIXON C.J. I have had the advantage of reading the judgment prepared by *Fullagar* J. and I agree in it.

McTIERNAN J. I am of opinion that the decision of this case is governed by the decision in *Inland Revenue Commissioners* v. *Australian Mutual Provident Society* (4). In my opinion, therefore, the question asked by the stated case should be answered " Yes ".

FULLAGAR J. This is a case stated by *Menzies* J. in an appeal by the Mutual Life and Citizens' Assurance Company Limited against an amended assessment of income tax on income derived by it in the accounting period ended 31st December 1935. The company is incorporated in New South Wales, and is a resident of Australia within the meaning of the *Income Tax Assessment Act* 1936 (Cth.). It carries on the business of life assurance in Australia, and also in the United Kingdom, where it maintains a branch. During the accounting period the investments of its life assurance fund included certain United Kingdom war loan stock, New South Wales Government inscribed stock, New Zealand Government inscribed stock, and Alberta and Great Waterways stock. The interest on these securities, which amounted to a total sum of £71,427 4s. 11d., was payable and paid in the United Kingdom. The question raised by the stated case is whether the whole or any part of this sum is exempt from Commonwealth income tax under s. 23 (*q*) of the *Assessment Act*. Section 23 provides that " The following income shall be exempt from income tax :— . . . (*q*) income derived by a resident from sources out of Australia, where that income is not exempt from income tax in the country where it is derived . . .".

The commissioner does not dispute that the company was a resident of Australia, and he does not dispute that the income in question was derived from sources out of Australia. But he maintains that the case does not fall within s. 23 (*q*) because that income

(1) (1920) 29 C.L.R. 1.
(2) (1920) 29 C.L.R., at p. 10.
(3) (1920) 29 C.L.R., at pp. 13, 15.
(4) (1947) A.C. 605.

was exempt from income tax in the country where it was derived, viz. the United Kingdom. So far as the United Kingdom war loan stock is concerned, that stock was issued with a condition that the interest thereon should not be liable to tax or super-tax and the commissioner refers to s. 46 (1) of the *Income Tax Act* 1918 (Imp.). That sub-section provides :—" Where the Treasury have before the commencement of this Act issued or may thereafter issue any securities which they have power to issue for the purpose of raising any money or any loan, with a condition that the interest thereon shall not be liable to tax or super-tax, so long as it is shown, in manner directed by the Treasury, that the securities are in the beneficial ownership of persons who are not ordinarily resident in the United Kingdom, the interest of securities issued with such a condition shall be exempt accordingly." Paragraph 9 of the case states :—" . . . this security was shown in manner directed by the United Kingdom Treasury to be in the beneficial ownership of a person who was not ordinarily resident in the United Kingdom, that is to say, the company. . . .".

So far as the New South Wales, Canadian and New Zealand stocks are concerned, the commissioner refers to r. 2 (*d*) of the Rules Applicable to Schedule C of the First Schedule in the *Income Tax Act* 1918. Schedule C provides :—" Tax under Schedule C shall be charged in respect of all profits arising from interest, annuities, dividends, and shares of annuities payable out of any public revenue, for every twenty shillings of the annual amount thereof." Rule 2 provides :—" No tax shall be chargeable in respect of— . . . (*d*) The interest or dividends on any securities of a foreign State or a British possession which are payable in the United Kingdom, where it is proved to the satisfaction of the Commissioners of Inland Revenue that the person owning the securities and entitled to the interest or dividends is not resident in the United Kingdom. . . .". Paragraph 10 of the case states that the New South Wales, Canadian and New Zealand stocks were securities of a British Possession and were payable in the United Kingdom, and it proceeds :—" . . . it was proved to the satisfaction of the Commissioners of Inland Revenue of the United Kingdom that in the relevant year the company owned the said securities and was entitled to the interest thereon, and that it was not at the relevant time resident in the United Kingdom . . .".

If no more appeared than has so far appeared, it would seem plain enough that the commissioner was right, that all the interest in question was exempt from income tax in the United Kingdom, and that the company could not therefore claim the benefit of s. 23 (*q*) of the *Assessment Act* (Cth). It is necessary now, however, to refer to certain other provisions of the *Income Tax Act* 1918, and to certain further facts. Schedule D of that Act provides that tax under that schedule shall be charged in respect of a considerable variety of profits or gains, which it is unnecessary to set out, and that the tax shall be charged " under the following cases ". Then follow six " cases ". Case III is " Tax in respect of profits of an uncertain value and of other income described in the rules applicable to this Case ". Rule 3 of the rules applicable to Case III (so far as material) provides :—" 3. (1) Where an assurance company not having its head office in the United Kingdom carries on life assurance business through any branch or agency in the United Kingdom, any income of the company from the investments of its life assurance fund (excluding the annuity fund, if any), wherever received, shall, to the extent provided in this rule, be deemed to be profits comprised in this Schedule and shall be charged under this Case. (2) Such portion only of the income from the investments of the life assurance fund for the year preceding the year of assessment shall be so charged as bears the same proportion to the total income from those investments as the amount of premiums received in that year from policy holders resident in the United Kingdom and from policy holders resident abroad whose proposals were made to the company at or through its office or agency in the United Kingdom bears to the total amount of the premiums received by the company : Provided that in the case of an assurance company having its head office in any British possession, the Commissioners of Inland Revenue may, by regulation, substitute some basis other than that herein prescribed for the purpose of ascertaining the portion of the income from investments to be so charged as being income derived from business carried on in the United Kingdom. . . . (4) Where a company has already been charged to tax, by deduction or otherwise, in respect of its life assurance business, to an amount equal to or exceeding the charge under this rule, no further charge shall be made under this rule, and where a company has already been so charged, but to a less amount, the charge shall be proportionately reduced."

The company was required by the revenue authorities in the United Kingdom to pay, and did in fact pay, income tax computed under r. 3 of the rules applicable to Case III of schedule D. The computation took the figure of £820,182 as representing the total interest on the investments of the company's life assurance fund, and the proportion of what may be shortly called United Kingdom premiums to total premiums as 2.888 per cent. By applying that percentage to the total interest, a sum of £23,687 was arrived at.

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From this sum a deduction was allowed of the due proportion of "expenses of management" under s. 33 (4) which provides:— "Where an assurance company, not having its head office in the United Kingdom, is charged under Case III of schedule D, on a proportion of the income from the investments of its life assurance fund, or on a basis substituted therefor, the relief in respect of expenses of management shall be calculated by reference to a like proportion of its total expenses of management for the year, estimated according to the provisions of this Act." This left a sum of £14,212, and the tax was calculated on this sum at the rate of 4s. 9d. in the £. After the making of certain immaterial adjustments, the amount of tax payable was shown as £3,361 3s. 2d. The important fact to be noted is, of course, that the commencing figure of £820,182 included the interest received by the company on the United Kingdom war loan stock and on the New South Wales, Canadian and New Zealand stocks.

If the matter had been free from English authority, one could have had little hesitation in saying that the assessment of the company on the above basis had the effect of imposing United Kingdom income tax on the interest on the four stocks in question. If you impose tax on a proportion $\frac{a}{b}$ of x, you are taxing x, and, if x includes y, you are taxing y. In other words, as my brother *Menzies* put it during argument, if you impose a tax on 10 per cent of an amount which includes several items, then you are imposing a tax on every item which is included in that amount. But one would also have had little hesitation in saying that the assessment of the company on the above basis could not, as a matter of law, be justified. Rule 3 of the rules applicable to Case III of schedule D is a general provision, which must, according to the accepted rule of statutory interpretation, be read subject to the special provisions of the Act which unequivocally exempt from all tax the interest on the four stocks in question. That interest should accordingly have been excluded from the computation of the tax payable by the company. It would appear that before 1937 the revenue authorities had not acted on this view. But that exempt income should be excluded from the computation in such a case was clearly decided by the Court of Appeal in *Hughes* v. *Bank of New Zealand* (1). In that case the assessment was made under Case I of schedule D. Lord *Wright* M.R. referring to s. 46, said: ". . . The section was put in in 1915, when it was undoubtedly desired to attract subscriptions to loans which were being put forward, as we well remember in those critical years of the War. It seems to me that it would

(1) (1937) 1 K.B. 419.

be rather deplorable if, notwithstanding what I regard as the clear language of s. 46, the owner, not being ordinarily resident in the United Kingdom, was still taxed as part of his trading profits, and in my view that is not the true construction of the section. It is not introduced in respect of any particular schedule ; it is quite general, . . . I see no ground at all consistent with ordinary principles of construction for cutting down its meaning and treating it as only applicable to Case III of schedule D, . . . If they are not taxable at all, then obviously they can neither be charged under Case III of schedule D nor under any Case of schedule D at all " (1).

When *Hughes* v. *Bank of New Zealand* (2) reached the House of Lords (3), the only question argued (apart from a point which has no relation to the present case) was whether the special provisions of the Act, on which the bank relied, did, as a matter of construction, confer on the receipts in question complete immunity from tax. The House of Lords held, as the Court of Appeal had held, that they did. So far as certain interest on war loan stock was concerned, the Crown abandoned in the House of Lords its contention that s. 46 did not confer such an immunity on that interest.

If, then, one could stop at this point, one would say that the interest on the four stocks now in question *was* exempt from income tax in the United Kingdom, where it was derived, and that the commissioner should succeed on this appeal. If the company in fact paid tax which it was not liable to pay, that would be a misfortune which this Court cannot cure. It is now necessary, however, to consider a later decision of the House of Lords, which reversed a decision of the Court of Appeal and restored a decision of *Macnaghten* J. The case is *Inland Revenue Commissioners* v. *Australian Mutual Provident Society* (4).

This case (so far as here material) was concerned only with the method of giving effect, in an assessment under r. 3 of Case III of schedule D, to exemptions from tax to which it was assumed that effect must be given. There were two theoretically possible ways of doing this, which are made plain in the table which appears in the report of the case in the House of Lords (5). The first excludes the exempt income from the commencing figure of the total income of the investments of the life assurance fund, and then applies the prescribed ratio to the balance remaining. The second includes the exempt income in the commencing figure of total income, applies the prescribed ratio to that total, and then deducts the exempt income

(1) (1937) 1 K.B., at pp. 430, 431.
(2) (1937) 1 K.B. 419.
(3) (1938) A.C. 366.
(4) (1946) 1 All E.R. 236 ; (1946) 1 All E.R. 528, ; (1947) A.C. 605.
(5) (1947) A.C., at p. 608.

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from the resultant figure. A similar choice of alternatives is, of course, presented when (as in *Hughes* v. *Bank of New Zealand* (1)) it is a matter of calculating a profit for the purposes of an assessment under Case I of schedule D. The first alternative would appear to provide the correct way of giving effect to the exemption, though the second is more favourable to the taxpayer. In the *Australian Mutual Provident Society Case* (2), *Macnaghten* J. held that the first alternative should be adopted (3), but his decision was reversed by the Court of Appeal (4).

On an appeal by the Crown to the House of Lords, Lord *Porter* (5) intimated that, if the Act required a deduction of exempt income to be made at all in the course of the calculation, it should be made in the manner approved by *Macnaghten* J. (3). But Lord *Porter*, like the rest of their Lordships, really decided the appeal in favour of the Crown on the ground that the proportion sum required by r. 3 of Case III of schedule D should be worked out and applied without taking into account in any way whatever the fact that some of the investments of the company assessed were exempted from income tax by other express provisions of the Act. One result of this view would seem to be that a company of the class mentioned in r. 3, which invests the whole of its assurance fund in securities which s. 46 purports to exempt from income tax, is in precisely the same position, as regards income tax, as a company which invests the whole of its assurance fund in securities to which the Act gives no exemption.

In order to indicate the reason for their Lordships' adoption of this view, it will be sufficient to quote two short passages. Viscount *Simon* said :—" Once it is accepted that r. 3 of Case III is not one which taxes income from investments, whether exempted or not, but one which taxes a conventional sum calculated as the rule directs, it becomes reasonably clear that the sum to be taxed is not varied by inquiring whether one of the elements in the calculation contains income from exempted investments " (6). Lord *Wright* said :—" The charge was a tax on the investment income only as a machinery to tax the general profits of the British business, and as a manner of measuring the charge by an arbitrary figure derived from a percentage of the investment income. In this connection it was not material to distinguish between exempted and unexempted income. All that was needed was a yardstick " (7). The reasons so given were used as an aid in the interpretation of the *Double Taxation*

(1) (1938) A.C., 366.
(2) (1940) 1 All E.R. 236 ; (1946) 1 All E.R. 528 ; (1947) A.C. 605.
(3) (1946) 1 All E.R. 236.
(4) (1946) 1 All E.R. 528.
(5) (1947) A.C., at p. 627.
(6) (1947) A.C., at p. 620.
(7) (1947) A.C., at p. 622.

Relief (*Taxes on Income*) (*Australia*) *Order* 1947 by *Upjohn* J. and the Court of Appeal in *Ostime* (*Inspector of Taxes*) v. *Australian Mutual Provident Society* (1), though *Parker* L.J. (as he then was) felt difficulty in " fully understanding " the decision.

The question then arises—whether the decision of the House of Lords in 1947 compels a different view in this case from that which one would have taken in its absence. In my opinion, it does. In its absence one would have thought, as I have said, that the income of the four securities now in question *was* exempt from income tax in the United Kingdom, with the consequence that the taxpayer was not entitled to the benefit of s. 23 (*q*) of the *Assessment Act* (Cth). But that decision clearly means that a proportion of the company's income from investments, including income from investments of the character described in s. 46 and r. 2 (*d*) of the rules under schedule C, is charged with United Kingdom income tax. If you charge tax on 10 per cent of an identified fund, you cannot be said to leave that fund exempt from tax.

It is important to remember that the ultimate question in this case turns on the meaning of a provision in the *Australian* Act. We have to determine whether the company's income from four specific classes of security is exempt from income tax in the United Kingdom. But the words " exempt from income tax " in this question import " exempt from income tax within the meaning of s. 23 (*q*) of the Australian *Assessment Act*." It is true, of course, that, in order to answer the question, we have to inquire into the law of the United Kingdom relating to income tax, and to examine the statutes of the United Kingdom which impose income tax. But the use, in a statute of the United Kingdom, of the word " exempt " in relation to income of a particular description is not necessarily decisive of the question whether that income is exempt from income tax in the United Kingdom within the meaning of s. 23 (*q*). So it is quite conceivable, if unlikely, that a tax, which was called an income tax in a United Kingdom statute, would not be rightly regarded as an income tax within the meaning of s. 23 (*q*). Here, of course, there is no question but that the United Kingdom tax is such a tax. Everything turns on the word " exempt ".

The general scheme of the Commonwealth legislation is not to impose tax by reference to specific categories of income. It contains, of course, many special provisions as to what does and does not constitute income, but its general plan is to treat as " assessable income "—gross income—whatever is income within the general conception of that term, and to require the " taxable income " to

(1) (1958) Ch. 774 ; (1958) 2 W.L.R. 636 ; (1958) 3 W.L.R. 354.

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be ascertained by subtracting from assessable income what are called "allowable deductions". Consistently with this general plan no income can be regarded as exempt from income tax either if it is required to enter into the calculation directly as itself a part of the assessable income, or even if, though it is excluded from the actual calculation of assessable income, the rate of tax is increased by reference to its existence. See *Reid* v. *Federal Commissioner of Taxation* (1); *The Commonwealth* v. *State of Queensland* (2); cf. *Douglass* v. *Federal Commissioner of Taxation* (3), and *Commercial Banking Company of Sydney Ltd.* v. *Federal Commissioner of Taxation* (4). The United Kingdom income tax legislation adopts, as has often been observed, a different general scheme. It does impose tax by reference to specific categories of income, and these are not completely mutually exclusive. But the calculation required by r. 3 of Case III of schedule D and s. 33 (4) is precisely parallel to the process of ascertaining assessable income and then subtracting allowable deductions in order to arrive at taxable income. The difficulties to which *Dixon* J. adverted in *Australian Machinery and Investment Co. Ltd.* v. *Deputy Federal Commissioner of Taxation* (5) do not exist here. What the Commonwealth Act calls assessable income is obtained by taking a proportion of a total income which includes interest on the four classes of securities mentioned above. It is impossible to say that that process leaves that interest exempt from income tax within the meaning of s. 23 (*q*).

Their Lordships in the *Australian Mutual Provident Society Case* (6) did not expressly deal with the relation between s. 46 and r. 2 (*d*) of schedule C on the one hand and r. 3 of Case III of schedule D on the other hand. In this connection two possible views seem to be open as to the effect of the decision. It may be that the former provisions are to be regarded as qualified or excluded, so far as life assurance companies are concerned, by the latter provision. Or it may be that the former provisions stand unaffected but are to be construed as meaning merely that the interest therein referred to is not to be charged specifically or *eo nomine* with tax. For the purposes of the present case, it does not matter which view be taken. On either view the interest in question is not exempt from income tax in the United Kingdom.

It follows that the whole of the interest, amounting to £71,427 4s. 11d., which is referred to in the case stated is exempt from income tax in Australia, because the whole is not exempt in the United

(1) (1947) 73 C.L.R. 282.
(2) (1920) 29 C.L.R. 1.
(3) (1931) 45 C.L.R. 95.
(4) (1950) 81 C.L.R. 263.
(5) (1946) 8 A.T.D. 81, at pp. 100, 101.
(6) (1947) A.C. 605.

Kingdom. It is true, of course, that r. 3 of Case III of schedule D does not in terms charge with tax the whole of that interest, but only a specified proportion (2.888 per cent) of that whole. But it does not follow that only that percentage of that whole is to be regarded as " not exempt from income tax " for the purposes of s. 23 (*q*). It is not possible to say that any identifiable part of the total sum is taxed, and that an identifiable remainder is " exempt ". It is not possible to attribute or appropriate the United Kingdom tax paid by the company to any specific part or portion of the total interest from the four classes of security in question. The tax was calculated by reference to a percentage of the total sum, but it was not paid on any specific part of that total sum. If it had ever become necessary for any purpose to apportion the amount of tax paid among components of the interest received, the apportionment could only have been made by attributing the tax paid to each pound of that interest rateably. There are many purposes of the law for which it may be necessary to make an apportionment in respect of a payment, and, unless a special appropriation can be made and is made, the rule of the common law is that a payment is attributed rateably to each pound of a debt or fund. In *Ellis* v. *Emmanuel* (1) *Blackburn* J. said :—" It was said that the dividends are by law applied to each part of the debt rateably, which is unquestionably true " (2). And see *Commissioner of Stamp Duties* (*N.S.W.*) v. *Perpetual Trustee Co. Ltd.* (3) ; *W. & A. McArthur Ltd.* v. *Federal Commissioner of Taxation* (4) ; *Resch* v. *Federal Commissioner of Taxation* (5) ; *Re D* (*a Lunatic Patient*) [*No.* 2] (6) and *Blackston Bank* v. *Hill* (7). In the present case it may be said that essentially it is not a matter of distributing a payment but of distributing a burden. But the position is entirely analogous. The burden cannot be distributed in any way which will leave it resting not on the whole, but exclusively on some severable part, of the interest received. The whole, therefore, is " not exempt ".

The question asked by the case stated should be answered—Yes.

TAYLOR J. The question raised by the case stated involves an inquiry whether the sum of £71,427 4s. 11d., being part of the investment income received by the appellant in the United Kingdom, was, within the meaning of s. 23 (*q*) of the *Income Tax Assessment Act* 1936 of the Commonwealth of Australia, " not exempt " from

(1) (1876) 1 Ex. D. 157.
(2) (1876) 1 Ex. D., at p. 163.
(3) (1929) 43 C.L.R. 247, at p. 266.
(4) (1930) 45 C.L.R. 1, at p. 20.
(5) (1942) 66 C.L.R. 198, at p. 230.
(6) (1926) V.L.R. 467, at pp. 485, 486.
(7) (1830) 10 Pick. (Mass.) 128, at p. 133.

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United Kingdom income tax. At first sight the problem may seem simple for some of the components of that amount were declared by s. 46 (1) of the *Income Tax Act* 1918 (Imp.) to be "exempt" from income tax and the remaining components, by virtue of r. 2 of the general rules applicable to schedule C of that Act, were not "chargeable" with tax. But the income tax payable by the appellant pursuant to the latter Act was assessed without reference to these provisions and, in the result, the amount of the assessment was precisely the same as it would have been if the component parts of the income receipts in question had not been declared to be "exempt" from or not "chargeable" with tax.

This anomaly resulted from the fact that in the making of the assessment the formula prescribed by r. 2 of Case III in schedule D to the Act was employed. Pursuant to this rule the tax payable was calculated upon the appropriate proportion (2.888 per cent) of the aggregate income of the company from the investment of its life assurance fund. That proportion was less than the appellant's United Kingdom investment income though a perusal of r. 3 readily reveals that this is an accidental feature and would not be a necessary result in every case.

In disregarding the provisions of s. 46 (1) and r. 2 of the general rules applicable to schedule C the income tax authorities acted in accordance with the principle now established by the decision of the House of Lords in *Inland Revenue Commissioners* v. *Australian Mutual Provident Society* (1). That case decided, in effect, that tax assessed pursuant to r. 3 of Case III to schedule D was not a tax upon the investment income of the assurance company concerned; it was, it was said, a tax upon a "conventional or notional sum . . . 'deemed to be profits' to be charged as such" (per Viscount *Simon* (2)) or "a charge under the case on a notional figure deemed to be a figure of profit" (per Lord *Wright* (3)) and the process employed was said to be "a conventional calculation adopted for the purpose of estimating an otherwise almost incalculable sum" (per Lord *Porter* (4)).

The peculiar difficulties in the way of assessing life assurance companies to income tax was adverted to by several of their Lordships and it is not out of place to repeat the observations of Viscount *Simon* on this point: "The present r. 3 had its origin in s. 15 of the *Finance Act* 1915 (5 & 6 Geo., c. 62). As Mr. *Hills* pointed out to us, before the Act of 1915 there was much difficulty in getting income tax from a life assurance company resident abroad with a

(1) (1947) A.C. 605.
(2) (1947) A.C., at p. 619.
(3) (1947) A.C., at p. 621.
(4) (1947) A.C., at p. 627.

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branch here. Such a company could avoid United Kingdom income tax on its income from investments, even though it had a branch in the United Kingdom, by so arranging its affairs that its investments were foreign investments, the proceeds of which were not caught by United Kingdom income tax. It is true that the company might be regarded as carrying on in this country a trade through its branch, but there was much practical difficulty in arriving at the figure under case I of sch. D of annual profits of such a branch for, in the case of life assurance business, the true profits attributable to the branch could not be ascertained in the normal manner, as is shown by provisions in the *Assurance Companies Act* 1909 for a quinquennial valuation. Section 15 of the *Finance Act* 1915, was, it would seem, aimed at meeting this difficulty, and it did so by providing for a conventional figure, which should be 'deemed to be profits', comprised in schedule D, on which a non-resident life assurance company, with a branch in the United Kingdom, would make a contribution to United Kingdom income tax, however it arranged its investments. The provisions now contained in r. 3 of case III call for the use of certain factors in order to arrive at this conventional figure, upon which such an assurance company as the respondent society is required to pay tax in respect of the annual profit of its life assurance business carried on in this country " (1).

The case is, of course, clear authority for the proposition that in arriving at the " conventional figure " in this case no account could be taken of the fact that part of the appellant's investment income in the United Kingdom was declared by other provisions of the Act to be " exempt " or not " chargeable " to tax. In the result the application of r. 3 produces the anomaly already mentioned for if, as Lord *Porter* said, " a non-resident company should have invested all its life assurance fund in tax-exempt securities, it would pay tax on the conventionally apportioned sum without any reduction and would be no better off than if the statutory proportion were wholly liable to tax " (2) His Lordship agreed that this was a " hardship " but it did not, in his view, entitle their Lordships to disregard the plain meaning of the rule. " So long as the words are in their present form ", he said, " the result must be looked on as the price which non-resident assurance companies have to pay for engaging in business in this country " (2) The sense of this final observation was expressed by Viscount *Simon* in the concluding words of the passage quoted earlier and by Lord *Wright* when he said that the process employed " was merely a convenient mode of imposing

(1) (1947) A.C., at p. 617. (2) (1947) A.C., at p. 626.

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some charge on the assurance company in consideration of the privilege it enjoyed in trading in this country " (1) He added that " The charge was a tax on the investment income only as a machinery to tax the general profits of the British business, and as a manner of measuring the charge by an arbitrary figure derived from a percentage of the investment income " (1) and that " In this connexion it was not material to distinguish between exempted and unexempted income " (1)

The decision in the case disposes, of course, of the notion that the question raised by the case stated can be answered simply by saying that the provisions of s. 46 (1) and r. 2 of the rules applicable to schedule C exempted the income in question from income tax for in the making of the assessment no effect was given to these provisions. But, according to the respondent, the case goes further and decides that no part of those receipts are subjected to tax. That is to say, the tax was charged upon what was merely an " arbitrary " or " conventional " figure which, though arrived at by employing the prescribed formula, did not in reality represent any part of that income. Therefore, it is said, that the income was not chargeable with tax and should therefore be regarded as exempt.

To my mind this contention is fallacious. It may at once be conceded that the tax was calculated by applying the appropriate rate to an amount which was equal to the appropriate proportion of the appellant's aggregate income from the investment of its life assurance fund. It may also be conceded that the proportion when ascertained was a " conventional " or " arbitrary " figure and that, in reality, it did not represent and was not part of the appellant's United Kingdom investment income. But it is another thing to say that, therefore, the company was not subjected to tax in respect of that investment income. Indeed, to assert that it was not would, by parity of reasoning, be to assert that the company was not subjected to tax in the United Kingdom in respect of any part of its income wherever derived. This, to my mind, would be in the face of their Lordships' decision for as already appears the formula contained in r. 3 was prescribed merely as a means of assessing the tax payable " in respect of the annual profit of its life assurance business carried on " in the United Kingdom and the tax, itself, constituted " a charge . . . on a notional figure deemed to be a figure of profit " or upon " notional profits . . . ascertained in a conventional way and then subjected to tax ". The views implicit in these observations, it seems to me, receive the literal support of s. 1 of the *Income Tax Act* and of the classification, contained in r. 2 of

(1) (1947) A.C., at p. 622.

schedule D, of the profits and income with which Case III was designed to deal. In the result the tax payable in the United Kingdom should, in my opinion, be regarded as the tax properly payable in respect of the whole of the appellant's income in the United Kingdom during the relevant period and accordingly no part of the amount in question was exempt from tax.

For these reasons the question in the case stated should be answered by saying that the amount of £71,427 4s. 11d. was wholly exempt from Commonwealth income tax.

Menzies J. The answer to the question whether £71,427 4s. 11d., the interest received by the taxpayer in the United Kingdom from securities situated in the United Kingdom, or any part thereof, is exempt from income tax under the provisions of s. 23 (*q*) of the *Income Tax Assessment Act* 1936, which exempts income not exempt from income tax in the country where it is derived, requires in the first place an examination of the United Kingdom legislation to find out whether the interest or any part of it was exempt from income tax in the United Kingdom. If it was, what was exempt cannot fall within s. 23 (*q*).

The interest in question is expressly declared to be exempt from income tax as to part by s. 46 (1) of the *Income Tax Act* 1918, and as to the rest by r. 2 (*d*) of schedule C of the *Income Tax Act* 1918 so that at first sight these provisions would seem to be conclusive that the income in question is exempt in the United Kingdom ; but the income tax laws of the United Kingdom are not something to be understood at first sight ; indeed, they seem to call for a measure of second sight. In this particular case the provision that creates the difficulty is r. 3 of the rules applicable to Case III of schedule D of the *Income Tax Act* 1918 which I will refer to more shortly as Case III, r. 3. This is a provision that was designed to facilitate the taxation of foreign assurance companies. Prior to its enactment such companies were taxable upon their United Kingdom gains under schedule D, Case I, and under other provisions as well. These provisions were, however, difficult to apply and to facilitate the collection of tax s. 15 of the *Finance Act* 1915 was introduced. Part of that section is now Case III, r. 3. It provides a formula for ascertaining the taxable income of such companies which may be expressed as follows :

$$\frac{\text{United Kingdom Premium Income}}{\text{Total Premium Income}} \times \begin{matrix}\text{Total Investment Income}\\ \text{of Life Assurance Fund}\end{matrix}$$

The figure thus arrived at is deemed to be " profits comprised in this Schedule " and then, apparently because the provisions of s. 1 of

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schedule D to the effect that tax under the schedule shall be charged in respect of the annual profits accruing to a person from any trade exercised within the United Kingdom were thought not to apply, it is provided expressly that the calculated amount "shall be charged under this Case".

In seeking to find out the character of what it is that is charged in the manner described it is necessary to keep in mind that annual profits which may be taxed under Case I of schedule D are ascertained by deducting expenditure from receipts. Such a calculation is not, of course, open in a case where it is provided in terms that a sum calculated without any regard to expenditure shall be deemed to be chargeable profits, and to meet this situation there was a further provision in s. 15 of the *Finance Act* 1915, which is now to be found in s. 33 (4) of the *Income Tax Act* 1918, to the effect that when a company is charged under Case III, r. 3, "the relief in respect of expenses of management shall be calculated by reference to a like proportion of its total expenses of management for the year estimated according to the provisions of this Act". The relief there referred to is that now provided for by s. 33 (1) which says, *inter alia*, that where an assurance company "has not been charged in respect of its profits in accordance with the rules applicable to Case I of Schedule D the company . . . shall be entitled to repayment of so much of the tax paid by it as is equal to the amount of the tax on any sums disbursed as expenses of management (including commissions) for that year". This provision is of general application when an assurance company is charged on a basis other than annual profits; cf. *Sun Life Assurance Society* v. *Davidson*; *Phoenix Assurance Co. Ltd.* v. *Logan* (1).

Case III, r. 3, and s. 33 (4) therefore provide an additional means for taxing an assurance company not having its head office in the United Kingdom which carries on life assurance business there through any branch or agency. The provisions I have referred to, however, do clearly contemplate that the taxation of such a company may still be differently based, e.g. on the basis of annual profits; cf. s. 33 (1) and Case III, r. 3 (4). See too *Equitable Life Insurance Society of U.S.A.* v. *Hills* (2).

It is not a matter for surprise that tax collectors and taxpayers alike have from time to time become lost in this elaborate labyrinth and it is hardly less surprising that the decisions of the Courts have not perfectly illuminated its darkest places. This is perhaps best illustrated by *Inland Revenue Commissioners* v. *Australian Mutual Provident Society* (3). In that case there had been a difference

(1) (1958) A.C. 184.
(2) (1924) 8 Tax. Cas. 657.
(3) (1947) A.C. 605.

between the commissioners and the society about the way in which the exemption provided by s. 46 and r. 2 (*d*) of schedule C should be applied in determining the tax charged under Case III, r. 3. A number of hypothetical examples of the ways in which the provision might be applied were prepared for examination by the courts and of these the Court of Appeal chose an example which adopted the society's method of computation as illustrating the proper operation of the various relevant provisions. Upon appeal by the commissioners the House of Lords, following an observation made by Viscount *Simon* in the course of the argument, decided that the sum to be taxed was not affected at all by the fact that one of the factors in the calculation contained as an element income from exempted investments. The basis of the decision was that the tax charged under Case III, r. 3, was not directly or indirectly a tax upon income from investments but, to use the language of Viscount *Simon*, " the thing to be taxed " is " a conventional or notional sum " (1) deemed to be profits and to be charged as such. Lord *Wright* said : " In truth, as already observed, the charge under r. 3 was not a charge on the specified investments except in form : it was an artificial mode of charging the general profit of the British business. Rule 3 not being qualified except for sub-r. 4, and being a charging section must receive its appropriate effect from the court, notwithstanding an apparent but not real conflict between it and s. 46 of the *Income Tax Act* 1918 " (2). Lord *Porter* stated that exempt investments should not be taxed even indirectly and added that to include tax-free investments in assets the profits from which were to be taxed would be to tax what ought not to be taxed. Following this he said : " But it has no application to a case where the profits or income, the subject of charge, is a notional sum calculated in a conventional way nor do I think it matters whether it is or is not established that the tax-exempt investments are assets of the branch carried on in this country " (3). This case, then, for the reasons indicated by the citations that I have made, decided that interest from tax-exempt investments must be included in the total income from investments of the life assurance fund for the purpose of the calculation of that portion of the income from investments of the fund that is deemed to be profits and is charged with tax. The decision means that for the purpose of the exempting provisions already referred to the tax that is imposed by Case III, r. 3, is not to be regarded as a tax on investment income as such ; it is rather a tax upon a calculated sum given the character of profits

(1) (1947) A.C., at p. 619.
(2) (1947) A.C., at p. 623.
(3) (1947) A.C., at p. 625.

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imposed by a provision which contains no exemption. To use Lord *Porter's* words : " The result must be looked on as the price which non-resident assurance companies have to pay for engaging in business in this country " (1). This seems to me to be the view of the decision that was taken by *Upjohn* J. and by the Court of Appeal in *Ostime* (*Inspector of Taxes*) v. *Australian Mutual Provident Society* (2) where a claim made by the Inland Revenue Commissioners that what was taxed under Case III, r. 3, was not profits was rejected. It was not decided in either case, however, that Case III, r. 3, charges all that goes to make up what are in strictness United Kingdom profits. Nor does the language of the rule require this conclusion ; indeed it points the other way in providing that what is to be charged as profits comprised in the schedule is a portion of the total income from the assurance fund. When Case III, r. 3, provides an additional method for taxing the companies to which it relates there seems to me to be no justification for identifying what is taxed thereunder with what would be taxed if the other methods of taxing were to be adopted. The reason for disregarding the exemption provisions was that Case III, r. 3, makes chargeable a " notional " or " conventional " sum. When Lord *Wright* spoke of Case III, r. 3, as " an artificial mode of charging the general profits of the British business " (3) he was not, I think, identifying what Viscount *Simon* and Lord *Porter* described as a " notional " or " conventional " sum with the net profits of the British business. The existence of s. 33 as I have pointed out indicates that something different from annual profits is taxed under Case III, r. 3.

In the present case the taxpayer was taxed under Case III, r. 3, and in conformity with *Inland Revenue Commissioners* v. *Australian Mutual Provident Society* (4) the £71,427 4s. 11d. in question was included as part of the total investment income for the purpose of the calculation of tax. The fraction—$\dfrac{\text{United Kingdom Premiums}}{\text{Total Premiums}}$— produced a figure of 2.888 per cent and this was applied to £820,182 being the total income of the company from the investments of its life assurance fund and which included the £71,427 4s. 11d. in question, to arrive at a figure of £23,687. At this point in the calculation of tax it would seem correct to say that 2.888 per cent of every £1 of the £71,427 4s. 11d. was deemed to be profit and charged with tax. Section 33 had, however, to be applied which,

(1) (1947) A.C., at p. 626.
(2) (1958) Ch. 774; (1958) 2 W.L.R. 636; (1959) Ch. 427; (1958) 3 W.L.R. 354.
(3) (1947) A.C., at p. 623.
(4) (1947) A.C. 605.

as I have pointed out, did no more than entitle the company to repayment of so much tax paid by it as is equal to the amount of tax on any sum disbursed as expenses of management. This sum in the computation of the taxpayer's United Kingdom tax was calculated to be £9,534. The company therefore had to pay tax on £23,687 at 4s. 9d. in the £1 and was entitled to repayment of 4s. 9d. in the £1 upon £9,534. This relief was given by deduction in the calculation of the tax payable, that is, £9,534 was deducted from £23,687 to produce a figure of £14,153 which was taxed at 4s. 9d. in the £1. In the result the £71,427 4s. 11d. was included in the £820,182 that formed an element in the calculation of United Kingdom tax; and of the £71,427 4s. 11d. so much as was comprised in the sum of £14,153 was charged with tax. This can be ascertained by calculation.

It is now necessary to turn to s. 23 (*q*) of the *Income Tax Assessment Act* 1936 to decide whether upon the basis I have just stated all or any part of the sum of £71,427 4s. 11d. should for the purposes of s. 23 (*q*) be regarded as exempt from United Kingdom tax.

The whole sum was not exempt because, as I see it, an ascertainable portion thereof was charged with tax under Case III, r. 3. What is taxed under any description is not exempt from tax. I think the argument for the commissioner that no part of the £71,427 4s. 11d. was taxed pushes the House of Lords decision too far. That decision, as is perhaps seen most clearly from the speech of Lord *Porter*, really depended upon the view that Case III, r. 3, imposed tax upon an amount without embodying the exemptions provided by s. 46 (1) and r. 2 (d) of schedule C, not that it charged what was brought to tax by Case I, without the appropriate exemptions nor that the amount taxed thereunder must be regarded as entirely separate from the items going to make up the investment income.

It was argued for the taxpayer, however, that not only was the whole sum not exempt but no part of it was exempt because the £71,427 4s. 11d. was brought into the calculation of the tax that became payable and the words " income not exempt from income tax " amount to the same thing as " assessable income ". The argument that " income not exempt from income tax " is equivalent to " assessable income " is, I think, substantially correct if what is meant is income brought to tax. The phrase " income . . . exempt from income tax " in the beginning of s. 23 has been regarded as meaning " not assessable income " : cf. *Texas Co. (Australasia) Ltd.* v. *Federal Commissioner of Taxation* (1), per *Dixon* J. (2) but I

(1) (1940) 63 C.L.R. 382.
(2) (1940) 63 C.L.R., at p. 472.

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cannot think this is conclusive as to like words in s. 23 (*q*) because the phrase in the opening words of s. 23 refers to Australian law which makes " assessable income " the basis of the imposition of tax by imposing tax upon assessable income less allowable deductions, i.e. taxable income, whereas the phrase in s. 23 (*q*) refers to non-Australian systems of taxation which operate differently and may not require any ascertainment of " assessable income ". I have, however, reached the conclusion that s. 23 (*q*) is dealing with income of the character there described upon which the taxpayer in some way or another is liable to be taxed in the country where it is derived : see *Texas Co.* (*Australasia*) *Ltd.* v. *Federal Commissioner of Taxation* (1). How it is brought to tax is not important for the purposes of s. 23 (*q*).

The final matter for determination is then whether the whole of the £71,427 4s. 11d. is brought to tax in the United Kingdom. If United Kingdom tax was levied upon the £820,182 with or without deduction I think that the whole £71,427 4s. 11d. which forms part of the larger sum would have been charged but that is not the case. What is charged, however, is a fraction of the £820,182 and therefore, as it seems to me, a fraction of each and every pound going to make up that sum, and accordingly, a fraction of the £71,427 4s. 11d. To take a comparable case from the *Income Tax Assessment Act* 1936 itself I turn to s. 26 (*d*) which provides that the assessable income of a taxpayer shall include five per cent. of the capital amount of any gratuity paid in a lump sum in consequence of retirement from any employment. I regard that provision as saying in effect that five per cent of the gratuity is brought to tax and ninety-five per cent is not and that is the case notwithstanding that the whole gratuity must be used for the purpose of calculating what is assessable income. I think s. 26 (*d*) denies that the whole gratuity is assessable income by providing expressly that five per cent of the whole is assessable income. In the same way I think that Case III, r. 3, denies that the whole of the income from the investment of the life assurance fund is brought to tax by providing expressly that a specified calculable portion is to be charged with tax. Furthermore for the reasons given earlier I am not prepared to regard Case III, rule 3, as taxing actual British profits (which would include the £71,427 4s. 11d.) without exemption.

My conclusion is that the portion of the £71,427 4s. 11d. that is included in the portion of the income from the investment of the life assurance fund of the taxpayer that is charged under Case III, r. 3, but only that portion of the £71,427 4s. 11d., is brought to tax and

(1) (1940) 63 C.L.R., at pp. 432, 452, 472.

accordingly that is the only portion which is exempt from tax under s. 23 (*q*). That portion is so much of the £71,427 4s. 11d. as is included in the sum of £14,153 which was charged with tax in the United Kingdom. That is exempt from tax under s. 23 (*q*) but the balance of the £71,427 4s. 11d. is not exempt.

Question in the case stated answered: Yes, wholly. Order that the costs of the case stated be reserved for the judge disposing of the appeal.

Solicitors for the appellant, *Laurence & Laurence.*

Solicitor for the respondent, *H. E. Renfree,* Crown Solicitor for the Commonwealth.

R. A. H.