

IN THE HIGH COURT OF AUSTRALIA

DEVELOPMENT UNDERWRITING LIMITED

v.

THE COMMISSIONER OF TAXATION OF
THE COMMONWEALTH OF AUSTRALIA

REASONS FOR JUDGMENT

Judgment delivered at Sydney
on Friday, 30th July 1971

DEVELOPMENT UNDERWRITING LIMITED

v.

THE COMMISSIONER OF TAXATION
FOR THE COMMONWEALTH OF AUSTRALIA

ORDER

1
Appeal allowed with costs. Usual order as to
exhibits.

DEVELOPMENT UNDERWRITING LIMITED

v.

THE COMMISSIONER OF TAXATION
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JUDGMENT

MENZIES J.

DEVELOPMENT UNDERWRITING LIMITED

v.

THE COMMISSIONER OF TAXATION
FOR THE COMMONWEALTH OF AUSTRALIA

By its appeal the appellant taxpayer set out to convince the Court that the sum of \$100,000, received by it from the National Mutual Life Association of Australasia Limited during the year ended 30th June 1967, was not part of its assessable income of that year.

The Commissioner included the receipt as part of the assessable income of the taxpayer on the footing that it was the proceeds of a policy of insurance effected upon an employee - one Ignaz Abeles - so that, upon his death on the 2nd October 1966, the company should receive the money to take the place of the benefits it would otherwise have derived from the continuance of his services as the managing director of Metro Shirts (Industries) Pty. Limited and its subsidiaries; Commissioners of Inland Revenue v. William's Executors (1944) 26 Tax Cas. 23, and Carapark Holdings Limited v. The Commissioner of Taxation for the Commonwealth of Australia (1965-66) 115 C.L.R. 653. The taxpayer contests this and contends that the court should find that the policy in question was taken out by the taxpayer so that it would be in a position, in the event of the death of Mr. Abeles, to pay to his estate large sums deposited with the taxpayer upon terms that they would be repaid upon three months notice in writing.

The policy for £50,000 was issued on the 12th April 1965 to commence on the 8th October 1964 - Mr. Abeles' birthday - upon a proposal made by the taxpayer on the 3rd November 1964. The annual premiums of £1152.10.0. were paid by the taxpayer. The assurance was arranged for the taxpayer by one George Gombos.

On the 27th November 1964 Mr. Gombos received from the assurance company a memorandum as follows:

"In view of the large amount of assurance involved we require the following to assist us with our assessment of the risk:-

- (i) The examination by Dr. Armati,
- (ii) The medical examination and ECG by Dr. G. McDonald,
- (iii) A large film X-ray of the chest,
- (iv) An up-to-date report from Dr. Pollack, and
- (v) A statement from the assurers, Development Underwriting Limited, stating the reason for this large amount of assurance, together with various financial reports.

So far we have received numbers i, ii and iv of the above but as yet we have not received the chest x-ray report or statement regarding the reasons for the assurance and the financial reports. We shall be pleased if you will give the above matters your early attention."

To this he replied on the 4th December 1964 in these terms:

"The Manager,
National Mutual Life P/L,
350 George Street,
SYDNEY, N.S.W.

Dear Sir:

I. Abeles - £50,000. Key-Man Assurance.

Mr. Abeles, Managing Director of Metro Shirts Pty. Ltd., will be insured for £50,000 (Table III CT -- 10 years) by Development and Underwriting Co. Ltd. -- a

Public Investment Company, which took up a 51% interest in Metro Shirts Pty. Ltd.

Development and Underwriting believes that, if Mr. Abeles died in the initial stage of their association, and before proper replacements were trained, his death would represent at least a £50,000 loss by the investors.

Mr. Abeles is the founder and Managing Director of Metro Shirts P/L, and his name is closely associated and identified with that of Metro Shirts in the shirt manufacturing industry.

Yours sincerely,

G. GOMBOS."

I admitted these documents subject to objection in order that I might consider what had been Mr. Gombos' role in the events leading to the issue of the policy. He carried on a general insurance agency. His evidence is that about six months before November 1964 he had become a field representative of the National Mutual Life Association of Australasia Limited and that he was obliged to place all life assurance with that company. A witness, Mr. Varga, who had known him for many years, said that he knew that his occupation was an insurance broker. I find that, whatever his position vis-a-vis the National Mutual Life Association of Australasia Limited, he was instructed by the taxpayer to obtain a policy for £50,000 upon the life of Mr. Abeles for a period of ten years and that he accepted that instruction. I do not find that he was instructed that the policy was to be a so-called "Key-Man Assurance" and I do not find that he had authority from the taxpayer to write as he did on the 4th December. His own evidence was that what he wrote

in the letter was his own construction of the position. I have decided that, in these circumstances, I should determine this appeal without relying upon the statement in the second paragraph of the letter in question.

The assurance arose out of a transaction in 1964 whereby the taxpayer acquired an interest in a group of companies, which may be called the Metro group, which was controlled by Mr. Abeles and his wife. As it eventuated the deal was constituted by four agreements made on the 23rd August 1964. Two of these were service agreements. The principal agreement, to which Metro (Holdings) Pty. Limited - an Abeles company - and the taxpayer were parties, provided inter alia for the incorporation of Metro Shirts (Industries) Pty. Limited, in which Metro (Holdings) Pty. Limited held A shares and the taxpayer B shares in equal numbers, one hundred each in the first place. Each agreed to lend to the new company "the sum of NINETY THOUSAND POUNDS (£90,000) by way of loan under the following terms and conditions:

- (a) the said loans shall be free of interest;
- (b) none of the lenders shall have the right to demand repayment of the said loans as long as it is a member of the company;
- (c) the Company may repay the said loans or any part thereof to the lenders at any time PROVIDED THAT the same be repaid to each of the lenders in equal proportions".

The agreement also provided for Mr. and Mrs. Abeles to enter into service agreements with Metro Shirts (Industries) Pty. Limited and its subsidiaries, he as managing director and she as manageress respectively. The term of Mr. Abeles' service was a period of five years with provision for renewal.

The second agreement was an agreement by Mr. and Mrs. Abeles and Metro (Holdings) Pty. Limited to sell their shares in three operating companies to the new company Metro Shirts (Industries) Pty. Limited for £194,630. The third and fourth agreements, as I have said, were service agreements.

In the course of the negotiations leading to the making of the foregoing agreements, a matter for bargaining was the way in which the taxpayer should provide its share of the moneys which the new company would require to carry out its purchase of shares in the operating companies. The negotiations had been commenced in about May 1964 between Mr. Paul Strasser, a director of the taxpayer, and Mr. Abeles at the instance of a Mr. Varga who was a friend of both. At the first meeting Mr. Strasser made it clear to Mr. Abeles that the taxpayer would not provide cash in full and asked that 75% of any money provided by the taxpayer should be returned to it on deposit at interest for a period of five years. To this Mr. Abeles agreed in substance but later, Mr. Strasser says, he raised an objection. Mr. Strasser's evidence about this is as follows:

"Originally he did not have any objection whatever; he was prepared to put in part of the contract. But later on he told us that his wife objected to putting in the contract and his solicitor, who was a very cautious man, objected to putting it into the contract but I should know that he was master of his own affairs so he would finally leave the money with us. He asked me to believe that he was a gentleman and that he would keep the agreement between us that he would leave the money there and that it was to be part of the contract."

Mr. Strasser then handed negotiations over to his co-director, Mr. Robert Strauss.

Mr. Strauss began his negotiations by telling Mr. Abeles "that one of the principal conditions of Development Underwriting proceeding with the acquisition of his business was that we come to a satisfactory arrangement as to the manner of payment, as Development Underwriting Limited would not be interested in a straight out cash purchase. We would have to agree to either extended term payment or alternatively, and he indicated he would like to get the cash, he agreed to deposit the proceeds of the sale with Development Underwriting Limited for a period of five years as an interest-bearing deposit". To this Mr. Abeles then agreed but, according to the evidence, that agreement was of a provisional character for the matter was further discussed on later occasions. Mr. Strauss' evidence of what happened on one such occasion was as follows:

"Well, Mr. Abeles indicated to me that he has quite a lot of trouble with his wife, who is 50% owner of the business, and she objects that any of her funds which would come to her from the sale be with Development Underwriting Limited, she wanted to invest it in something else. Mr. Abeles also raised the question of, apart from wanting to invest somewhere else, she was also concerned that something would happen to him and

she would have difficulty if all the funds are tied down with Development Underwriting Limited and with Metro.

What did you say to that? --- I told him one way to overcome that is to take out an insurance policy if they are worried. I cannot help him as far as investment is concerned, but as far as concern to having access to funds in the case of death, I told him one way we can overcome this problem would be to take out an insurance policy. Under the terms of the arrangement Metro Industries would be a debtor of Mr. Abeles' family and the holding company, it would be somewhere in the vicinity of \$150,000 to \$200,000. I told him Metro Industries could take out an insurance policy 'and if anything happened to you, a certain cash amount, we can repay your loan account, the indebtedness to you and your family.'

Later, according to the evidence of Mr. Strauss:

"Mr. Abeles told me that it does not seem he can proceed with this arrangement, mainly because his wife is pressing him very much, and it probably should be appreciated they were both working in the business, and Mr. Abeles said 'I do not want to discuss business at home' - it was during the day - 'and my wife is very much against this long term investment, and also my solicitor is against it.' His solicitor was Mr. Winter. Mr. Winter advised him he should not deposit the funds in Development Underwriting for such a long period.

I advised him then that if he cannot see his way clear to agree with that, I do not think we can proceed with the purchase because Development Underwriting Limited would not be interested to acquire his business on straight out cash basis. He then told me could we come to a gentlemen's agreement - 'What I would be prepared to do is to give you my word that I will leave the money with Development Underwriting Limited for five years, but Development Underwriting should issue a certificate that I deposited the money in such a manner so as I can withdraw it by giving three months notice at any time.'

I told him that if he gives his word I am quite happy to a gentlemen's agreement, I would accept he would keep it, but then I turned around and told him 'What will happen to Development Underwriting if something happens to you?' - as it was his argument until then. He said 'Rather than Metro taking out insurance,

Development Underwriting can take out an insurance and should anything happen to me and my family will ask for the money on 3 months notice, you can cover yourself by taking out this life assurance'".

It would seem that it was at about this time that Mr. Strauss brought a proposal that the taxpayer should insure the life of Mr. Abeles to the executive committee of the company consisting of Sir Jack Stevens, Mr. Strasser, Mr. Strauss and the managing director, Mr. R.C. Williams. Mr. Williams said that, in accordance with his practice, he made a record of what occurred in a minute book. That minute book cannot now be found. I find that the proposal that Mr. Strauss made to the committee was that the taxpayer should insure the life of Mr. Abeles for £100,000 but that the executive committee agreed to take out a policy in the sum of £50,000 rather than £100,000 because it considered that the premium on the larger sum was too high.

On the 17th August the proposed transaction relating to the Metro group was brought before the board of directors of the taxpayer. The minute dealing with the matter is as follows:

"Mr. Strauss tabled a memorandum in respect of the proposed purchase of a majority interest in the Metro Shirts Group which was discussed at length. It was unanimously agreed that the purchase should be proceeded with on the basis of Mr. Strauss' memorandum."

The memorandum referred to in this minute is missing.

It was later, but at a time that I cannot determine, that Mr. Strauss instructed Mr. Gombos to obtain for the taxpayer a policy upon the life of Mr. Abeles for £50,000 for ten years.

When Mr. Strauss was asked why was it that the policy was taken out for ten years rather than five years, at a higher rate of premium than was necessary, he said, in effect, that, although he thought five years was the correct period, he agreed to ten years and the higher premiums under pressure from Mr. Gombos.

Upon the execution of the four agreements cheques were exchanged and £65,000 was deposited by Metro (Holdings) Pty. Limited with the taxpayer and £15,000 was deposited by Mr. and Mrs. Abeles with the taxpayer. Deposit notes, it seems, were issued, but in the taxpayer's register there is on each card the following notation:

"Advised by J. Varga that as a result of a burglary it appears that this D.N. has been stolen. K.J.S.
5/8/65."

The initials K.J.S. are those of Mr. K.J. Stanton, the secretary of the taxpayer. On each card there is also a notation as follows:

"K.J.S. refer any repayment request to R.C.W."

R.C.W. are the initials of Mr. R.C. Williams, the managing director of the taxpayer. The cards indicate that the moneys deposited were repayable upon three months notice in writing. Interest was originally at 8% and subsequently at 9%. Evidence was given that these rates were current rates for interest on long term deposits.

When Mr. Abeles died in 1966 the deposits were not then repaid. There were partial refunds commencing on the 3rd

April 1967. There were also further deposits by Metro (Holdings) Pty. Limited. The deposits of Metro (Holdings) Pty. Limited which stood at \$125,000 in January 1969 were repaid in full by December 1969.

So much for the matter of fact. The question now to be considered is whether the taxpayer effected the insurance in question to put itself in a position to repay the deposits were they to be called up upon the death of Mr. Abeles within five years from the making of the deposits. That is the taxpayer's case.

The evidence of Mr. Strasser, Mr. Strauss and Mr. Williams is that this was the only reason for the taxpayer insuring the life of Mr. Abeles, and this evidence received some support from the evidence of Mr. Varga in that he says when Mr. Strauss asked Mr. Abeles how could the taxpayer repay if, upon his death, a demand was to be made by the estate of Mr. Abeles, he suggested that the taxpayer should take out life insurance to enable it to do so.

It is clear, I think, that the decision to take out life insurance was made before the making of the agreements to give effect to the proposed transaction.

Upon the oral evidence, therefore, the taxpayer has made out a strong case. There are, however, some matters that have made me hesitate to accept that evidence.

It is not reassuring that every contemporary document of the taxpayer, which might have thrown some light upon the matter, has disappeared, particularly the minutes of the executive committee and the memorandum referred to in the minutes of the board of directors. Furthermore, in its income tax return for the year 1965, there is a claim for a deduction of the part of the premium paid during that year, justified as follows:

"Policy of Life on I. Abeles

10 year policy in favour of Development Underwriting Limited for an amount of £50,000. If Mr. Abeles dies during currency of policy.

Mr. Abeles is full time Managing Director and key man of the Metro Shirts Group of Companies, which are in turn subsidiaries of Development Underwriting Limited."

This return was made up by the taxpayer's auditors and was signed by Mr. Stanton as the taxpayer's public officer. No explanation was forthcoming regarding the making of the claim for the deduction or the justification for it that was put forward in the return.

It is odd too that, when it was apparent that the deposits to be made would be in the order of £70,000, Mr. Strauss proposed an insurance of £100,000 and the executive committee decided upon an insurance of £50,000. Mr. Strauss' proposal was too high for the purpose asserted. The assurance actually effected would not have afforded the full protection that the witnesses said that the taxpayer both wanted and needed.

Moreover, if the insurance was to protect the taxpayer for the period within five years from the making of the deposits - as was claimed - it was an unnecessary expense to insure at a higher rate of premium for ten years. This was not satisfactorily explained, and in particular I do not accept Mr. Strauss' statement that he was talked into this by Mr. Gombos. That would have been out of character.

Finally, although one would not expect evidence of what happened seven years ago given by various witnesses to be entirely consistent, I do find that the evidence of Mr. Williams that Mrs. Abeles was present when it was made clear that Mr. Abeles had promised to leave the deposits with the taxpayer for from three to five years, and made no demur at this, is hardly consistent with the professed reason for making the deposit repayable at three months notice and for Mr. Abeles to supplement this by a gentlemen's agreement, not put in writing, not to call up the deposit for a period of five years. What was undoubtedly suggested by the evidence is, that the course which was followed, was followed, as a way of concealing from Mrs. Abeles that the loans were really to be for a period of five years. There could have been no reason for concealing from her what, according to the evidence of Mr. Williams, she knew, i.e. that the loans were not really at call but were for a term. Indeed, the reasons proffered for leaving an important term out of the executed agreements leaves me unconvinced that I have heard the full truth of the matter.

The foregoing matters would have shaken my confidence in the oral evidence, to an extent which would have lead me to say that the taxpayer had not discharged the onus of proof resting upon it, were it not that, nevertheless, I do regard two of the witnesses, Mr. Strasser and Mr. Varga, as truthful and reliable witnesses. In the course of his evidence, Mr. Strasser said:

"MR. MAHONEY: Was it discussed at the executive meeting the policy to be taken out on his life was for an amount of \$100,000? --- If I remember not only the executive committee meeting but even the board meeting of DUL it was discussed. I think originally Mr. Strauss proposed \$200,000, only we wanted to save money and we thought the premium was too high and we reduced it to half, \$100,000.

What was that policy taken out for? --- Against life.

What was the reason why DUL took it out? --- The reason was in the case I mentioned before, in case he would die we would be faced by an estate and we did not have the word of the estate that the estate leaves there the money for five years, so we might be facing a sudden pay out of \$150,000 or \$160,000 and we were trying to get as much liquidity of DUL as possible. At this time \$160,000 was still a considerably high amount in the affairs of DUL."

I have, therefore, although not without doubt, come to the conclusion that I should accept the taxpayer's case.

Accordingly, as I have been satisfied that the Commissioner was wrong in bringing the \$100,000 into assessable income on the footing that the proceeds of the policy should be received to take the place of the benefits the taxpayer would otherwise have derived from the services of Mr. Abeles as managing director of Metro Shirts (Industries) Pty. Limited

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and its subsidiaries, and it has not been suggested that it is assessable income on any other basis, I have decided to allow this appeal.