HIGH COURT OF JUSTICE (CHANCERY DIVISION)—11TH, 12TH AND 20TH DECEMBER, 1957

COURT OF APPEAL—3RD AND 4TH JUNE, 1958

HOUSE OF LORDS—4TH, 8TH AND 9TH JUNE AND 16TH JULY, 1959

Ostime (H.M. Inspector of Taxes)
v.
Australian Mutual Provident Society[1]

Income Tax, Schedule D—Double taxation relief—Australian life assurance society with United Kingdom branch—Mutual society—Income of life assurance fund—"Industrial or commercial profits"—Income Tax Act, 1918 (8 & 9 *Geo.* V, *c.* 40), *Schedule D, Case* III, *Rule* 3; *Double Taxation Relief* (*Taxes on Income*) (*Australia*) *Order,* 1947 (*S.R. & O.* 1947 *No.* 806), *Schedule, Articles* II (1) (*i*) *and* (3) *and* III (2) *and* (3).

The Respondent Society was a mutual assurance society resident in Australia; it carried on life assurance business through a branch in the United Kingdom. Assessments to Income Tax in respect of "life fund interest" were made on it for the years 1947–48 *to* 1953–54 *under Rule* 3 *of Case* III *of Schedule D* (*and Section* 430, *Income Tax Act,* 1952). *On appeal to the Special Commissioners the Society contended that these assessments were in respect of "industrial or commercial profits" within the meaning of the Double Taxation Agreement between the United Kingdom and Australia, that the conventional amount chargeable under Rule* 3 *of Case* III *bore no relation to the amount prescribed by the Agreement* (*viz., the profit which the branch might be expected to derive in the United Kingdom if it were an independent enterprise engaged in the same activities and dealing at arm's length with the head office*) *and that as the Society was a mutual society making no profits for United Kingdom tax purposes the latter amount was nil. For the Crown it was contended that the Agreement did not remove the charge under Case* III *but laid down conditions regarding the imposition and extent of such charges, which in the circumstances of the Society were satisfied. The Commissioners held that there was a clear conflict between the provisions of the Agreement and Rule* 3 *of Case* III *and upheld the Society's contentions.*

In the High Court it was contended for the Crown that the Agreement did not apply because a mutual society had no actual "industrial or commercial profits"; alternatively, that that expression referred to profits chargeable under Case I *of Schedule D and not to notional profits taxed under Case* III.

Held, *that the purpose of Rule* 3 *of Case* III *was to attribute to a foreign life assurance company a reasonable sum of profits in respect of business done in the United Kingdom, and the Rule was superseded by the Double Taxation Agreement.*

CASE

Stated under the Income Tax Act, 1952, Section 64, by the Commissioners for the Special Purposes of the Income Tax Acts.

[1] Reported (Ch. D.) [1958] Ch. 774; [1958] 2 W.L.R. 636; [1958] 1 All E.R. 305; 225 L.T.Jo. 60; (C.A.) [1959] Ch. 427; [1958] 3 W.L.R. 354; 102 S.J. 599; [1958] 2 All E.R. 665; 226 L.T.Jo. 36; (H.L.) [1960] A.C. 459; [1959] 3 W.L.R. 410; 103 S.J. 811; [1959] 3 All E.R. 245; 228 L.T.Jo. 12.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 23rd and 24th July, 1956, the Australian Mutual Provident Society (hereinafter called "the Respondent") appealed against assessments to Income Tax as follows:

Year	Amount of assessment
1947–48	£100,000
1948–49	£100,000
1949–50	£100,000
1950–51	£100,000
1951–52	£100,000
1952–53	£100,000
1953–54	£50,000

The assessments were made in respect of "life fund interest" under the provisions of Rule 3 of Case III of Schedule D, Income Tax Act, 1918, so far as they relate to the years of assessment 1947–48 to 1951–52 inclusive, and Section 430, Income Tax Act, 1952, so far as they relate to the years of assessment 1952–53 and 1953–54. The grounds of the appeal were that the said assessments were not competent in law, having regard to the provisions of the Double Taxation Relief (Taxes on Income) (Australia) Order, 1947 (S.R. & O. 1947 No. 806) (hereinafter referred to as "the Australian Double Taxation Agreement").

2. The following documents were produced and admitted at the hearing of the appeal:

(i) A bundle of correspondence between the Respondent and H.M. Inspector of Taxes, City 5th District.

(ii) A copy of the Australian Mutual Provident Society's Act, 1910–1941, and by-laws.

(iii) Alternative computations for Income Tax purposes for 1953–54 enclosed with a letter dated 27th September, 1954, from the Respondent's United Kingdom manager to H.M. Inspector of Taxes, City 5th District.

(iv) Returns of the Respondent to the Board of Trade and published accounts for the years to 31st December, 1952, and 31st December, 1953.

The above documents are not attached to and do not form part of this Case, but are available for the use of the High Court if required.

3. We found the following facts admitted or proved on the evidence adduced at the hearing of the appeal:

(1) The Respondent was established in New South Wales, Australia, in the year 1849, and was first incorporated in 1857 by an Act of the Legislature of the then Colony of New South Wales intituled "an Act to incorporate the Australian Mutual Provident Society". This Act was repealed by the Australian Mutual Provident Society's Act, 1910–1941, which now governs the Respondent (hereinafter called the "Governing Act").

(2) The Governing Act recited:

> "Whereas by an Act of the Legislature of the State (formerly Colony) of New South Wales, passed in the seventh year of the reign of her late Majesty Queen Victoria, and numbered ten, after reciting, amongst other things, that it was desirable to encourage the foundation of friendly societies for the purposes therein mentioned, it was enacted that it should be lawful for any number of persons to form themselves into and to establish a society for the purposes of raising, from time to time, by subscription of the several members of every such society, or by voluntary contributions or donations, funds for the mutual relief or maintenance of the members thereof, their wives, children,

relations, or nominees, in sickness, infancy, advanced age, widowhood, or any other natural state or contingency, whereof the occurrence is susceptible of calculation by way of average, or for any other purpose which is not illegal: And whereas, under and in pursuance of the said Act, a certain Society was established, and is still subsisting in the City of Sydney, in the said State, called the Australian Mutual Provident Society, for the purpose of raising funds by the mutual contributions of the members thereof, or otherwise, for assurances on their own lives, or on the lives of other persons; for the assurance of joint lives and survivorships; for the purchasing, granting and sale of annuities certain or on lives, present, deferred, or reversionary; for the purchasing and granting of endowments, and for the transacting and carrying on of all business dependent on the contingencies of human life: And whereas various other Acts were from time to time passed for the encouragement and regulation of such friendly societies: And whereas one of such Acts, that is to say, an Act of Council passed in the seventeenth year of the reign of her late Majesty Queen Victoria and numbered twenty-six, repealed the said first-mentioned Act, subject however to its provisions continuing in force as to any such society then established, till it should register its rules in conformity with the Act now in recital: And whereas, by the last-mentioned Act, various privileges were conferred upon any such society not granted by the said first-recited Act, but at the same time so limiting the extent and nature of the business allowed to be carried on by any such society, as to be inconsistent with that then carried on by the said Australian Mutual Provident Society, and which business has since been continually and rapidly increasing, so that the said Society had not complied, and could not comply, with the conditions imposed by the said second Act, so as to obtain the additional privileges thereby conferred: And whereas the members thereof were desirous of having proper and enlarged facilities for carrying on and extending its business and operations: and to effect that purpose, and for the encouragement of frugality and of provident habits, and for promoting the objects of the said Society, it was expedient that the same should be incorporated with, and subject to certain privileges, restrictions, and provisions: And whereas, by an Act of the Legislature of the State (then Colony) of New South Wales, passed in the twentieth year of her late Majesty Queen Victoria, the said Society was incorporated with and subject to certain privileges and restrictions, which Act (hereinafter called the Principal Act) has since been amended by Acts passed in the thirty-seventh and fifty-first years respectively of her late Majesty Queen Victoria, and by an Act passed in the third year of his Majesty King Edward VII: And whereas it is expedient to consolidate the said Principal Act and amending Acts and to amend the same:"

and enacted, *inter alia*,

"1. Such and so many persons as are at the commencement of this Act, or at any time thereafter, may become members of the Society, shall (subject to the regulations and provisions hereinafter contained) be and continue to be one body corporate, by the name and style of the 'Australian Mutual Provident Society'; and by that name may transact, carry on, and continue (subject to the provisions of the by-laws of the Society, hereinafter referred to) in or out of the State of New South Wales, the business for which the Society was established as hereinbefore mentioned and also that which it is hereinafter empowered to carry on, and by that name shall have and continue to have perpetual succession and a common seal, and shall sue and be sued, defend and be defended, in all courts whatsoever, and, except where inconsistent with the provisions of this Act, or of any by-law of the Society, shall have and continue to have power, notwithstanding any statute or law to the contrary, to purchase, take, hold, and enjoy to them and their successors for any estate, term of years, or interest, any houses, buildings, lands, and other hereditaments necessary or expedient for the managing, conducting, and carrying on the concerns, affairs, and business of the Society, with power to build on any such lands buildings for offices in whole or in part for the use of the Society, and to lease, sell, convey, assign, assure, and dispose of such houses, buildings, lands, and other hereditaments as occasion may require.

1A. The Society may carry on in or out of New South Wales any business in furtherance of the following objects:—

(*a*) To grant all such assurances and endowments with or without the right to participate in the surplus or profits of the Society for the payment of money on a future date certain or ascertainable or on the happening

of the contingency of death, survival, marriage, birth, failure of issue, sickness, injury, accident, resignation or retirement or of any other event connected with human life and to grant all such annuities as may by law be granted and as the Society may think fit to grant. . .

. . . . . .

2. (1) Every person who has effected or shall hereafter effect with the Society any policy or contract for an assurance endowment or annuity shall be a member of the Society and, except as hereinafter provided, shall continue to be a member in respect of such policy or contract until such policy or contract be by payment or surrender or otherwise discharged. In the event of the interest of any member in any such policy or contract being assigned (whether by operation of law or otherwise) the assignee may, if the by-laws so provide, and subject to the provisions thereof be the member in respect of such policy or contract in lieu of the assignor or other the person whose interest has been assigned. Minors may (subject to any provisions or restrictions contained in this Act or the by-laws) be members.

(2) In this section the word 'person' includes a corporation."

(3) At all material times the Respondent carried on life assurance business, including the granting of annuities, and was an assurance company to which the Assurance Companies Act, 1909, applied. It was a mutual society resident in Australia, its head office being situated in Sydney, New South Wales, and it carried on business in Australia and New Zealand and also in the United Kingdom through a branch office in King William Street in the City of London.

(4) For years of assessment prior to 1946–47 the Respondent was assessed to Income Tax in the United Kingdom under the provisions of Rule 3 of Case III of Schedule D, and was entitled to Dominion Income Tax relief on that part of its income which fell to be taxed under the said Rule 3 by virtue of the provisions of Section 27, Finance Act, 1920, following the decision in *Commissioners of Inland Revenue* v. *Australian Mutual Provident Society*, 28 T.C. 379. For 1946–47 and subsequent years this relief was not allowed to the Respondent by reason of the provisions of Section 51 (2), Finance (No. 2) Act, 1945, and the Australian Double Taxation Agreement.

(5) The amounts in dispute for 1953–54 are set out below as illustrative of the calculation of the amounts in dispute in other years:

Premiums received in 1952—ordinary department (excluding life annuities, endowments certain and annuities certain)	£	*s.*	*d.*
London branch } see 1952–53 expenses	618,855	0	0
Whole Society } claim (Schedule 2)	20,791,691	0	0

$$\text{Ratio} \quad \frac{618{,}855}{20{,}791{,}691} = \cdot 0297645$$

Interest on assurance fund 1952—ordinary department (see 1952–53 expenses claim—Schedule 3)			
Whole Society	7,313,765	0	0
London branch 7,313,765 × ·0297645 =	217,691	0	0
Tax at 9*s.* in £ =	97,960	19	0

	£	s.	d.	£	s.	d.
Less: 1. Schedule A tax 1953–54 on King William Street premises—paid January 1954	4,500	0	0			
2. Schedule A tax 1953–54 on other freehold property—42, Shortlands Road, Beckenham—paid January, 1954	56	11	9			
3. Schedule D, Case VI—paid January, 1954	2,880	0	0			
*4. Amount of tax paid by deduction in 1953	79,359	17	1			
				86,796	8	10
Tax payable Case III (as paid) ... (i.e., Case III Assessment £24,810 0*s.* 4*d.* at 9*s.*)				11,164	10	2

* Note: The Society also paid tax by deduction on funding loan interest and interest on foreign and colonial securities. This tax, amounting to £37,690 8*s.* 11*d.* has been repaid to the Society under Sections 120 and 195, Income Tax Act, 1952.

4. It was contended on behalf of the Respondent:

(i) that by force of Section 51 of the Finance (No. 2) Act, 1945 (and Section 347 of the Income Tax Act, 1952) the provisions of the Australian Double Taxation Agreement have effect in relation to Income Tax so far as they provide for:

(*a*) charging income arising from sources in the United Kingdom to persons not resident in the United Kingdom;

(*b*) determining the income to be attributed to such persons and their agencies, branches or establishments in the United Kingdom;

and that those provisions have such effect notwithstanding anything in any enactment;

(ii) that, by Article III (2) of the Australian Double Taxation Agreement, where an Australian enterprise is engaged in trade or business in the United Kingdom through a permanent establishment situated therein, as is the case here, United Kingdom Income Tax may be imposed on its profits, but may be imposed only on so much of its profits as is attributable to that permanent establishment, and that by Article III (3) thereof the amount of its profits so to be attributed to such a permanent establishment is defined to be that amount of industrial or commercial profits which such permanent establishment might be expected to derive in the United Kingdom if it were an independent enterprise engaged in the same or similar activities to those in which the Australian enterprise is in fact engaged and if its dealings with the Australian enterprise were at arm's length;

(iii) that, as was made clear by the speeches delivered in the House of Lords in *Australian Mutual Provident Society* v. *Commissioners of Inland Revenue,* 28 T.C. 388, Rule 3 of Case III of Schedule D and Section 430, Income Tax Act, 1952, are charging rules which impose a charge of United Kingdom Income Tax not upon the actual or estimated profits of a branch office through which a non-resident assurance company carries on business in the United Kingdom but upon a purely notional or conventional figure;

(iv) that amounts computed for the purposes of the assessments according to the provisions of Rule 3 of Case III of Schedule D and Section 430, Income Tax Act, 1952, represented purely notional or conventional figures

in accordance with the provisions of those Rules and bore no relation whatever to the amount of industrial or commercial profits which a permanent establishment might be expected to derive in the United Kingdom in the circumstances mentioned in Article III (3) of the Australian Double Taxation Agreement, which latter is, by the combined effect of the Australian Double Taxation Agreement and Section 51 of the Finance (No. 2) Act, 1945 (Section 347 of the Income Tax Act, 1952), the only amount upon which Income Tax may be charged ;

(v) that the Respondent was a mutual society carrying on the trade or business of life assurance exclusively with its members, so that the surplus arising from such trade or business yielded no profit assessable to United Kingdom tax, and that had its permanent establishment in the United Kingdom been an independent enterprise engaged in that same activity of carrying on the trade or business of life assurance exclusively with its members, and dealing at arm's length with the Respondent, the taxable profits which it might have been expected to derive from that mutual trade or business would have been nil ;

(vi) that the assessments under appeal were not competent in law ;

(vii) that the appeal should be allowed and the assessments discharged.

5. It was contended on behalf of the Inspector of Taxes:

(i) that the Australian Double Taxation Agreement did not remove or supersede the charge to United Kingdom Income Tax made by Rule 3 of Case III of Schedule D (and Section 430, Income Tax Act, 1952) ;

(ii) that, at the most, the Australian Double Taxation Agreement laid down a condition which had to be satisfied before any charges on profits provided for by the Income Tax Acts might be imposed and put a limit on the extent to which such charges might be imposed ;

(iii) that the circumstances of the Respondent were such that the condition imposed by Articles III (2) and III (3) of the Australian Double Taxation Agreement was satisfied ;

(iv) that the assessments under appeal were therefore competent in law ;

(v) that the appeal should be dismissed and the assessments adjusted in accordance with the facts.

6. We, the Commissioners who heard the appeal, upon consideration of the evidence adduced and the arguments addressed to us on behalf of the parties at the hearing of the appeal and having taken time to consider our decision, decided as follows :

(1) This is an appeal by the Australian Mutual Provident Society against assessments to Income Tax as follows:

1947–48	£100,000
1948–49	£100,000
1949–50	£100,000
1950–51	£100,000
1951–52	£100,000
1952–53	£100,000
1953–54	£50,000

The assessments purport to be made under Rule 3 of Case III of Schedule D, Income Tax Act, 1918 (with regard to the years 1952–53 and 1953–54, Section 430, Income Tax Act, 1952), and the grounds of the appeal are that the said assessments are not competent in law, having regard to the provisions of the Double Taxation Relief (Taxes on Income) (Australia) Order, 1947 (S.R. & O. 1947, No. 806) (hereinafter referred to as "the Australian Double Taxation Agreement").

(2) The facts are not in dispute. The Respondent is a mutual provident society incorporated in New South Wales, Australia, in 1857, and now governed by the Australian Mutual Provident Society's Act, 1910–1941, and carries on the business of life assurance, including the granting of annuities. Its head office is situated in Australia, and it carries on business in the United Kingdom through a branch office in London. It is agreed by both parties to the appeal that the Society is not resident in the United Kingdom for Income Tax purposes, but its circumstances are exactly covered by the provisions of Rule 3 of Case III of Schedule D, and for the years prior to 1946–47 it has been properly assessed to United Kingdom Income Tax under the provisions of the said Rule 3, i.e., on a proportion of its income from the investments of its life assurance fund (excluding the annuity fund) which by virtue of the said Rule 3 has been deemed to be profits comprised in Schedule D and chargeable under Case III. The Respondent was granted Dominion Income Tax Relief under the provisions of Section 27, Finance Act, 1920. It is also common ground that from 1946–47, by virtue of the provisions of Section 51, Finance (No. 2) Act, 1945, the Respondent was no longer able to claim Dominion Income Tax Relief under the said Section 27, Finance Act, 1920, nor was it entitled to any credit against United Kingdom Income Tax for any of the years in question in the appeal in respect of Australian tax paid by it.

(3) The case for the Respondent is that Rule 3 of Case III of Schedule D is a charging rule which charges, not the actual profits of a branch through which an insurance company carries on business in the United Kingdom though not resident therein, but a notional figure treated as the profits of that branch. The authority cited in support of this proposition is *Australian Mutual Provident Society* v. *Commissioners of Inland Revenue*, 28 T.C. 388. Section 51 (1), Finance (No. 2) Act, 1945, authorises the arrangements comprised in the Australian Double Taxation Agreement, and provides *inter alia* that:

> "subject to the provisions of [Part V of the Finance (No. 2) Act, 1945] the arrangements shall, notwithstanding anything in any enactment, have effect in relation to income tax . . . so far as they provide for relief from tax, or for charging the income arising from sources in the United Kingdom to persons not resident in the United Kingdom, determining the income to be attributed to such persons and their agencies, branches or establishments in the United Kingdom".

It is said that the effect of these provisions, as applied to Rule 3 of Case III, is that, if the Australian Double Taxation Agreement contains provisions which are inconsistent with the said Rule 3, then the provisions of the Australian Double Taxation Agreement are to be preferred. Article III (2) of the Australian Double Taxation Agreement provides, *inter alia*:

> "the industrial or commercial profits of an Australian enterprise shall not be subject to United Kingdom tax unless the enterprise is engaged in trade or business in the United Kingdom through a permanent establishment situated therein. If it is so engaged, tax may be imposed on those profits by the United Kingdom, but only on so much of them as is attributable to that permanent establishment".

Article III (3) provides :

> "Where an enterprise of one of the territories is engaged in trade or business in the other territory through a permanent establishment situated therein, there shall be attributed to that permanent establishment the industrial or commercial profits which it might be expected to derive in that other territory if it were an independent enterprise engaged in the same or similar activities and its dealings with the enterprise of which it is a permanent establishment were dealings at arm's length with that enterprise or an independent enterprise ; and the profits so attributed shall be deemed to be income derived from sources in that other territory. If the information available to the taxation authority concerned is inadequate to determine the profits to be attributed to the permanent establishment, nothing in this paragraph shall affect the application of the law of either territory in relation to the liability of the permanent establishment to pay tax on an amount determined by the exercise of a discretion or the making of an estimate by the taxation authority of that territory: Provided that such discretion shall be exercised or such estimate shall be made, so far as the information available to the taxation authority permits, in accordance with the principle stated in this paragraph."

It is admitted that the Respondent is an Australian enterprise engaged in trade in the United Kingdom through a permanent establishment situated therein. It is said that Rule 3 of Case III does not tax investment income, as such, nor does it provide for the making of an estimate or the exercise of a discretion, and that the sum deemed to be profits of the Respondent's branch in the United Kingdom, by reason of the calculation required by the said Rule 3, bears no relation to the industrial or commercial profits which are attributable to the Respondent's branch office in the United Kingdom within the meaning of Article III (2) and (3) of the Australian Double Taxation Agreement, and therefore the assessments are not competent. The Respondent further contends that, since the business it carries on is a mutual business only, it is not assessable to Income Tax in respect of any surplus arising from business done with its members. *Ayrshire Employers Mutual Insurance Association, Ltd.* v. *Commissioners of Inland Revenue*, 27 T.C. 331, and *Faulconbridge* v. *National Employers' Mutual General Insurance Association, Ltd.*, 33 T.C. 103, are cited in support of this proposition. Consequently the industrial or commercial profits attributable, within the meaning of the said Article 3 of the Australian Double Taxation Agreement, to the Respondent's branch in the United Kingdom would be nil in any event.

(4) The case for the Crown is that the charge to Income Tax which is imposed by Rule 3 of Case III of Schedule D is not removed or superseded by the provisions of the Australian Double Taxation Agreement, which does not of itself provide for any charge of tax, but only imposes conditions which must be satisfied before Income Tax may be charged in the United Kingdom on the profits of an Australian life assurance business. Those conditions are (*a*) that the enterprise is engaged in trade or business through a permanent establishment situated in the United Kingdom, (*b*) that if it is so engaged a charge may (but not must) be imposed on the profits of the enterprise, but (*c*) only on so much of them as is attributable to that permanent establishment. If the conditions are satisfied, the Australian Double Taxation Agreement does not provide for any new measure or yardstick by which such profits as fall to be assessed to Income Tax in the United Kingdom are to be compiled. The measure or yardstick provided in Rule 3 of Case III remains in force, so that the only effect of Article III (3) of the Australian Double Taxation Agreement is to limit the charge under Rule 3 to the investment income which the London branch of the Respondent might be expected to derive if it were an independent enterprise engaged

in life assurance business and dealing with its Australian headquarters at arm's length.

(5) The Respondent, being a mutual society, is *prima facie* not liable to Income Tax on the surplus arising from business done with its members. It has no profits or gains which fall to be assessed under Case I of Schedule D: *Ayrshire Employers Mutual Insurance Association, Ltd.* v. *Commissioners of Inland Revenue*(1) and *Faulconbridge* v. *National Employers' Mutual General Insurance Association, Ltd.*(2). Rule 3 of Case III is a charging rule (*Australian Mutual Provident Society* v. *Commissioners of Inland Revenue*(3)) which seeks to charge an insurance company not having its head office in the United Kingdom which carries on life assurance business, mutual or otherwise, through a branch or agency in the United Kingdom, a condition which it is admitted exactly fits the Respondent's present case. The charge is based, not upon the actual profits or the commercial or industrial profits, if any, of the insurance company or its branch, but upon a notional sum deemed to be "profits", comprised in Schedule D and chargeable under Case III, arrived at by reference to a proportion of the income of the company from the investments of its life assurance fund (excluding the annuities fund, if any), wherever received. It is upon this basis that the Respondent has been assessed to United Kingdom Income Tax for years prior to 1946–47. Section 51, Finance (No. 2) Act, 1945, authorises the arrangements comprised in the Australian Double Taxation Agreement in these terms:

> "the arrangements shall, notwithstanding anything in any enactment, have effect".

The Australian Double Taxation Agreement, which is effective for 1946–47, although the first year of assessment before us is 1947–48, provides, in Article III (2), as quoted in paragraph (3) above. Here again the conditions exactly fit the Respondent's case. We have, therefore, to find so much of the industrial or commercial profits of the Respondent as are attributable to its London branch, and Article III (3) also quoted in paragraph (3) above prescribes how this is to be done. In our opinion there is a clear conflict between the provisions of the Australian Double Taxation Agreement and the provisions of Rule 3 of Case III, which does not purport to deal with the industrial or commercial profits of the Respondent within the meaning of the said Article III (2) and (3), nor does it provide for the exercise of a discretion or the making of an estimate in accordance with the principles cited in the said Article III (3). The provisions of the Australian Double Taxation Agreement must therefore prevail, and the assessments having been made under the provisions of Rule 3 of Case III, and not under the provisions of the said Article III, are not competent and must be vacated.

(6) Apart from the foregoing, however, in our opinion the Respondent being a mutual provident society, there are no industrial or commercial profits attributable to its London branch which are assessable to United Kingdom Income Tax, and on this ground also the assessments must be discharged."

7. Immediately after the communication to the Inspector of our determination of the appeal dissatisfaction therewith as being erroneous in point of law was expressed to us on his behalf and in due course we were required to state a Case for the opinion of the High Court pursuant to the Income Tax Act, 1952, Section 64, which Case we have stated and do sign accordingly.

(1) 27 T.C. 331. (2) 33 T.C. 103. (3) 28 T.C. 388.

8. The point of law for the opinion of the High Court is whether on the facts found by us there was evidence upon which we could properly arrive at our decision and whether on the facts so found our determination of the appeal was correct in law.

N. Rowe
R. W. Quayle } Commissioners for the Special Purposes of the Income Tax Acts.

Turnstile House,
94–99, High Holborn,
London, W.C.1.
19th July, 1957.

The case came before Upjohn, J., in the Chancery Division on 11th and 12th December, 1957, when judgment was reserved. On 20th December, 1957, judgment was given against the Crown, with costs.

Mr. J. Pennycuick, Q.C., and Mr. Alan Orr appeared as Counsel for the Crown, and Mr. F. Heyworth Talbot, Q.C., and Mr. G. B. Graham for the Society.

Upjohn, J.—This is an appeal by way of Case Stated from a decision of the Special Commissioners of Income Tax discharging assessments to Income Tax made upon the Respondents, the Australian Mutual Provident Society, for the years 1947–48 to 1953–54 inclusive. For the five earlier years the assessments are made under Rule 3 of Case III of Schedule D of the Income Tax Act, 1918, and for the last two years under Section 430 of the Income Tax Act, 1952. There is no substantial difference between the two Acts for the purposes of this appeal, and the case has been argued before me upon the relevant provisions of the Act of 1918, to which alone I shall refer. The whole question is whether the assessments are correct having regard to the Double Taxation Relief (Taxes on Income) (Australia) Order, 1947 (S.R. & O. 1947 No. 806), which I shall call " the Relief Order ".

The relevant facts can be stated in one sentence. The Respondent Society is a mutual life assurance society, and has for many years carried on that business, *inter alia,* from its head office at Sydney in New South Wales, where it was incorporated, and in other parts of the world, notably in the United Kingdom, where it operates through a branch office in London.

For the purposes of English Income Tax the Respondent Society's life assurance business is treated as a separate business from other classes of insurance business (see Rule 15 of the Rules applicable to Cases I and II of Schedule D), and its income from investments is taxed under Rule 3 of Case III of Schedule D, which I must read:

> " (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 ".

(Upjohn, J.)

Then there is a proviso which I do not think I need read.

> "(3) Every such charge shall be made by the special commissioners as though the company under the provisions of this Act had required the proceedings relating to the charge to be had and taken before those commissioners. (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 necessary calculations have been made pursuant to the provisions of this Rule, and the assessments made accordingly.

Mr. Heyworth Talbot, for the Respondent Society, with his usual admirable candour, has admitted in argument that, apart from authority, there would be much to be said for the view that this Rule is in terms taxing not the life assurance business of the Respondent Society at all but its investment income ; and if that be right it is clear from the Relief Order, which I shall read a little later, that the assessments were rightly made, for the Relief Order expressly excludes from its operation income from investments : see Article II (1) (*i*). However, it is not in dispute that an assessment under Rule 3 is in law an assessment upon profits of the business of life assurance. That was decided by the House of Lords in 1947 in litigation between the Crown and this same Respondent Society, *Australian Mutual Provident Society* v. *Commissioners of Inland Revenue,* 28 T.C. 388 ; [1947] A.C. 605. In that case the question arose as to how income received from tax-exempt securities should be treated in an assessment under Rule 3. It seems that in the lower Courts both parties proceeded upon the footing that tax under Rule 3 was a tax on investment income, but there were differing views as to how the Rule should be applied. In the House of Lords, however, during the argument it was suggested by Lord Simon (see [1947] A.C., at page 611) that the existence of tax-exempt income did not affect the application of Rule 3, and he added

> "Does the mere fact that it is included as an item in the computation of the profits charged under r. 3 amount to charging it with tax? "

Now, it is quite clear from the speeches when judgment was delivered that in the opinion of their Lordships the tax exigible under Rule 3 was not a tax on investment income at all but a tax upon profits of the business, although measured by investment income. It is, of course, a very familiar part of the system of taxation in this country that you may (and, indeed, usually do) tax profits of a particular year of assessment by some yardstick other than the profits of that particular year : for example, as in the old days by reference to an average of three years' profits or as now by reference to a period which may and probably does lie wholly outside the year of assessment. Both parties are agreed that the effect of the speeches in the House of Lords was as I have stated. So I do not propose to refer to them in any detail, but to content myself with one paragraph from the speech of Lord Wright[1]. Speaking of Rule 3 he 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."

This assessment is upon a notional or conventional sum, but nevertheless is an assessment upon the profits of the business.

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(1) 28 T.C., at p. 405; [1947] A.C., at p. 622.

(Upjohn, J.)

The real difficulty that arises in this case, however, is that, as the House of Lords itself decided many years ago in *New York Life Insurance Company* v. *Styles*[1], 14 App. Cas. 381, a mutual society (that is, a society that does business only with its members) does not make profits; its trading surplus accrues to the property of the members but it is not legally correct to look on the trading surplus as profits of the trade for Income Tax purposes. This aspect of the matter does not seem to have been discussed in the House of Lords in 1947. Nevertheless it seems quite plain that apart from the Relief Order a mutual society would be taxable under Rule 3, for the Rule is clear that income from investments is "deemed to be profits comprised in this Schedule", and it is always competent for an Act of Parliament to say that for the purpose of Income Tax a surplus which arises, although not profits, is "deemed to be" so.

I turn then to the Relief Order.

> "Article I. (1) The taxes which are the subject of the present Agreement are . . . (*b*) In the United Kingdom: The income tax (including sur-tax), the excess profits tax, and the national defence contribution (hereinafter referred to as 'United Kingdom tax')."

Then I must read some of the definitions in Article II.

> "(1) In the present Agreement, unless the context otherwise requires— . . . (*h*) The terms 'United Kingdom enterprise' and 'Australian enterprise' mean respectively an industrial or commercial enterprise or undertaking carried on by a United Kingdom resident and an industrial or commercial enterprise or undertaking carried on by an Australian resident; and the terms 'enterprise of one of the territories' and 'enterprise of the other territory' mean a United Kingdom enterprise or an Australian enterprise, as the context requires."

Now this is the important definition:

> "(*i*) The term 'industrial or commercial enterprise or undertaking' includes an enterprise or undertaking engaged in mining, agricultural or pastoral activities, or in the business of banking, insurance, life insurance or dealing in investments, and the term 'industrial or commercial profits' includes profits from such activities or business but does not include income in the form of dividends, interest, rents, royalties, management charges, or remuneration for personal services. (*j*) The term 'permanent establishment', when used with respect to an enterprise of one of the territories, means a branch or other fixed place of business and includes a management, factory, mine, or agricultural or pastoral property, but does not include an agency in the other territory unless the agent has, and habitually exercises, authority to conclude contracts on behalf of such enterprise otherwise than at prices fixed by the enterprise or regularly fills orders on its behalf from a stock of goods or merchandise in that other territory".

I need not read the provisos.

> "(3) In the application of the provisions of the present Agreement by one of the Contracting Governments any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the laws of that Contracting Government relating to the taxes which are the subject of the present Agreement."

Article III:

> "(2) The industrial or commercial profits of an Australian enterprise shall not be subject to United Kingdom tax unless the enterprise is engaged in trade or business in the United Kingdom through a permanent establishment situated therein. If it is so engaged, tax may be imposed on those profits by the United Kingdom, but only on so much of them as is attributable to that permanent establishment: Provided that nothing in this paragraph shall affect any provisions of the law of the United Kingdom regarding the imposition of excess profits tax and national defence contribution in the

(1) 2 T.C. 460.

(Upjohn, J.)

> case of inter-connected companies. (3) Where an enterprise of one of the territories is engaged in trade or business in the other territory through a permanent establishment situated therein, there shall be attributed to that permanent establishment the industrial or commercial profits which it might be expected to derive in that other territory if it were an independent enterprise engaged in the same or similar activities and its dealings with the enterprise of which it is a permanent establishment were dealings at arm's length with that enterprise or an independent enterprise; and the profits so attributed shall be deemed to be income derived from sources in that other territory. . . ."

Before the Commissioners the Crown put forward an argument which proceeded on the footing that the Relief Order was capable of applying to notional profits of a mutual insurance society, but for the reasons which are to be found set out in paragraph 5 of the Case it was said that in fact the Relief Order did not affect tax under Rule 3. That argument did not appeal to the Commissioners, who decided the case in favour of the Respondent Society, and Mr. Pennycuick, for the Crown, has not felt able before me to challenge the correctness of their decision on that footing by any argument. So I have heard no argument at all on the case as presented to the Commissioners, and therefore I do not propose to deal with their decision, except to say that it was plainly reached after very careful and detailed reasoning, and upon the footing stated I am content to accept their unchallenged reasoning and conclusions stated in paragraph 6 (5) of the Case as my own.

Before me Mr. Pennycuick has raised a wholly new point not suggested before the Commissioners, which must now be briefly stated. He submits that the "industrial or commercial profits" referred to in Article II (1) (*i*) is incapable of referring to anything but real profits arising from an actual source of profit, whereas the Respondent Society, being a mutual society, has no actual profit nor any actual source of profit, and so the Relief Order does not apply to it. He says that the Relief Order is not dealing with purely notional or conventional profits which have no existence in law but have only a purely fictional existence for the purposes of Rule 3. It is submitted that "industrial or commercial profits" is defined in Article II (1) (*i*), and therefore Article II (3) has no application, whence it must follow that that phrase must be given its natural and ordinary meaning. That being so, it is said that the phrase cannot include purely notional or fictitious profits but can only refer to real or actual profits, and there being none in law the Relief Order has no application.

Mr. Pennycuick further submitted that Article II is only dealing with profits taxable under Case I of Schedule D, and had no reference to notional profits taxed under Case III. But if it be accepted, as it must in my judgment, in the light of the decision of the House of Lords that tax under Case III is a tax on the profits of the business, I cannot see anything in the Relief Order which distinguishes between taxation under different Cases.

This is a difficult case. In the first place I do not think that "industrial or commercial profits" can really be said to be "otherwise defined" for the purposes of Article II (3) by Article II (1) (*i*). It is a curious definition, if it can be called such, which says "industrial or commercial profits" *includes* (omitting irrelevant words) profits from such business (i.e., the business of life assurance) but does not include, *inter alia*, investment income. I do not think a clause so phrased, as so many Acts of Parliament now are, can properly be said to be a definition clause except in relation to those matters expressly stated to be included or expressly excluded. A large

area not expressly defined is left. "Profits" is nowhere defined, and one is left in the dark as to whether deemed profits are within the inclusion; certainly in terms they are not excluded by the exclusion of investment income.

My approach to the Relief Order is that its whole object is to relieve from double taxation, and that therefore one is looking to those profits or surpluses which by the law of Australia or the United Kingdom, as the case may be, are made the subject of taxation. Article II (3) seems designed to that very end. It seems to me that when considering United Kingdom tax one must look to "profits" which are taxed by the United Kingdom, and if the United Kingdom taxation laws, as interpreted by the House of Lords, tax a trading surplus by deeming it to be a profit although in law it is not, so then that trading surplus is by Article II (3) a profit within Article II (1) (*i*). In other words, if I may respectfully paraphrase the House of Lords' decision, Rule 3 is taxing the trading surplus of the Respondent Society in this country by deeming that surplus to be profits. Those deemed profits are measured by a yardstick which indeed has but little relation to its actual trading surplus in this country, but nevertheless the actual yardstick, as I have already pointed out, matters not. However, the essential fact is that by Statute the Society is deemed to make taxable trading profits of its business. That seems to me to make the Society's taxable surplus "profits" within the intendment of Article II (3) and not to be excluded by any partial definition in Article II (1) (*i*). I therefore reach the conclusion that these taxable surpluses of the Respondent Society are properly described as "industrial or commercial profits" for the purposes of the Relief Order.

When that conclusion is reached then the decision of the Commissioners becomes dead in point, and, as I have already said, the consequence is not seriously challenged by Mr. Pennycuick. The appeal is therefore dismissed, with costs.

Mr. G. B. Graham.—I do not wish to ask for too much, but in the course of the argument your Lordship intimated that, had your Lordship's decision been the other way, there might have been some discussion upon the subject of costs. I only wonder whether your Lordship would wish to say anything about that in order to assist the Court of Appeal in their Order concerning costs, if they should unhappily have to deal with it.

Upjohn, J.—It does not arise. I dismiss the appeal with costs. The point does not arise.

Mr. Graham.—If your Lordship pleases.

The Crown having appealed against the above decision, the case came before the Court of Appeal (Jenkins, Parker and Pearce, L.JJ.) on 3rd and 4th June, 1958, when judgment was given against the Crown, with costs.

Mr. J. Pennycuick, Q.C., and Mr. Alan Orr appeared as Counsel for the Crown, and Mr. F. Heyworth Talbot, Q.C., and Mr. G. B. Graham for the Society.

Jenkins, L.J.—This is an appeal by the Crown from a judgment of Upjohn, J., dated 20th December, 1957, whereby he affirmed a determination of the Special Commissioners in favour of the Respondents, a company called the Australian Mutual Provident Society. The case concerns the effect on the Company's tax liability of the Double Taxation Relief (Taxes on Income) (Australia) Order, 1947.

The Company is a mutual insurance company which was incorporated in New South Wales in 1849 and is now regulated by certain later Australian statutes. The Company has a branch office in London and carries on part of its business here. It is important to observe that, as I have already mentioned, the Company is a mutual insurance society.

I should next refer to some of the Income Tax provisions relating to insurance companies. Rule 15 (1) of the Rules applicable to Cases I and II of Schedule D in the Income Tax Act, 1918, provides as follows:

> "Where an assurance company carries on life assurance business in conjunction with assurance business of any other class, the life assurance business of the company shall for the purposes of this Act be treated as a separate business from any other class of business carried on by the company."

Then there is Rule 3 of the Rules applicable to Case III of Schedule D, which has an important bearing on this case. That Rules provides as follows:

> "(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".

Then there is a proviso under which other methods of calculation can be adopted. I do not think I need refer to that.

> "(3) Every such charge shall be made by the special commissioners as though the company under the provisions of this Act had required the proceedings relating to the charge to be had and taken before those commissioners. (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."

These provisions are those contained in the Income Tax Act, 1918. There are seven years' assessments concerned in the case from 1947–48 to 1953–54. The Act of 1918 applies to the five earlier years and the Act of 1952 applies to the last two years. There is no material difference between the 1918 Act and the 1952 Act for the present purpose, so that I can confine my references to the provisions in the Act of 1918.

The relevance of the fact that the Company is a mutual insurance concern is this: it is well settled that a mutual insurance company is not liable to tax on its mutual insurance business, on the ground that the surpluses arising arise from transactions by the members *inter se* which are not, for Income Tax purposes, regarded as a trade carried on by the company.

Rule 3 of the Rules applicable to Case III of Schedule D was introduced, in fact, in the year 1915 by the Finance Act of that year. As to the provisions of that Rule, it was, I think, for some considerable time understood that the

effect of it was to provide a mode of ascertaining the proportion of the investment income of the company concerned attributable to its business activities in this country, and the method of calculation laid down is of a kind which one can readily understand as a rough and ready method of arriving at a fair proportion of that income. The scheme was to take a sum arrived at by ascertaining the proportion of the premium income received in this country to the premium income received throughout the world. That proportion sum produced a figure which, as I have said, was, I think, long understood as representing simply a proportion of the income from investments corresponding to the proportion of the business done in the United Kingdom to the whole of the business done.

That view, however, was not accepted by the House of Lords in a case concerning this same Company, the case of *Australian Mutual Provident Society* v. *Commissioners of Inland Revenue*(1), which came before the House of Lords early in 1947, judgment having been delivered on 31st March of that year. In that case the dispute was, as I understand it, of this nature. The Company had amongst its investments certain investments which were exempt from Income Tax and the question was at what stage in the calculation prescribed by Rule 3 of Case III of Schedule D allowance ought to be made for these tax-free investments. The Company contended, as I understand it, that the deduction ought to be made from the proportion of income found to be attributable to United Kingdom activities under the provisions of the Rule, for it was said that only thus could the Company be given the full benefit of the exemption ; on the other hand, the Crown's view was that the tax-free investments should be deducted from the totality of investments before applying the calculation to them. The view of the Company on this matter, I understand, prevailed in this Court, but when the matter came before the House of Lords their Lordships took a radically different view.

This new way of looking at the matter was introduced into the case by an observation made by Lord Simon in the course of the argument, [1947] A.C., at page 611. He said this:

> " Why does the existence of exempted income affect the application of r. 3? Does the mere fact that it is included as an item in the computation of profits charged under r. 3 amount to charging it with tax? The real question to be determined is whether, on the true construction of the rule, there has been any error or mistake in the case of this society which holds in its life assurance fund investments exempt from income tax, and, further what is the right decision in view of the fact that the revenue has, in effect, made the concession that the existence of the exempted income makes a difference to the calculation."

At page 617(2), in the course of his speech, Lord Simon said this:

> " Section 15 of the Finance Act, 1915, was, it would seem, aimed at meeting this difficulty,"

—that was the difficulty of taxing insurance companies situate as the Respondent Company in this case was, that is to say, foreign insurance companies with branches in this country—

> " and it did so by providing for a conventional figure, which should be ' deemed to be profits,' comprised in sch. 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) 28 T.C. 388; [1947] A.C. 605. (2) *Ibid.*, at p. 401.

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Then, at page 619(1), he said :

> " In the application of r. 3, the thing to be taxed is not, in whole or in part, exempted receipts, but is a conventional or notional sum—calculated, it is true, by the use of figures which might include the proceeds of exempted investments—but a sum 'deemed to be profits,' to be charged as such, without any deduction save that provided for in sub-r. 4."

Again, on page 620, he says:

> " 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. If variation is required on this ground, it must be provided by legislation."

Then Lord Wright says this, at page 622(2) :

> " 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 connexion it was not material to distinguish between exempted and unexempted income. All that was needed was a yardstick."

There are other observations tending in the same direction elsewhere amongst their Lordships' speeches, but I think those citations will show sufficiently the view they took, which was, in effect, that the sum arrived at by applying the calculation provided for by Rule 3 of Case III of Schedule D was not a figure conventionally arrived at to represent investment income received by the Company and attributed to its activities in this country but was a figure representing the profit derived by the Company from its business in this country. It was conventionally arrived at or notionally arrived at (as it was put in one place by Lord Simon(1)), but, when arrived at, it was an actual figure for tax purposes taken as representing for those purposes the profit arising from the Company's business in this country.

It is noteworthy that their Lordships throughout their speeches made no reference at all to the circumstances that, inasmuch as this was a mutual insurance company, it was not taxable on the profits of its insurance business as distinct from the income of its investments. If the sum so arrived at could be regarded as a figure of investment income conventionally ascertained there would actually be an end of this case, for it will be seen on reference to the Australian Double Taxation Relief Agreement that income from investments is excluded from its scope ; so on that view the position would simply be that the Company would be liable to tax on the figure arrived at by the calculation laid down in Rule 3 as income from investments and would pay tax accordingly, but as their Lordships left the matter there can be no doubt that the figure arrived at under Rule 3 must be regarded for tax purposes as being a figure representing business profits and nothing else. In that state of the law the Order came into operation.

The Agreement was signed on behalf of the Governments of this country and of the Commonwealth of Australia on 29th October, 1946. The necessary steps to bring it into operation and give it statutory effect were taken as regards this country on 23rd April, 1947, and, no doubt, corresponding steps were taken by the Australian authorities at or about the same time. So that in March, 1947, when judgment was delivered by the House of Lords in the case to which I have referred, the Agreement had, in fact, already been signed but had not yet been given statutory effect.

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(1) 28 T.C., at p. 403. (2) *Ibid.*, at p. 405.

(Jenkins, L.J.)

The Agreement (one of many agreements of this character) was made under the provisions of Section 51 of the Finance (No. 2) Act, 1945, and that Section provided as follows:

> "(1) If His Majesty by Order in Council declares that arrangements specified in the Order have been made with the Government of any territory outside the United Kingdom with a view to affording relief from double taxation in relation to income tax, excess profits tax or the national defence contribution and any taxes of a similar character imposed by the laws of that territory, and that it is expedient that those arrangements should have effect, then, subject to the provisions of this Part of this Act the arrangements shall, notwithstanding anything in any enactment, have effect in relation to income tax, excess profits tax and the national defence contribution so far as they provide for relief from tax, or for charging the income arising from sources in the United Kingdom to persons not resident in the United Kingdom, determining the income to be attributed to such persons and their agencies, branches or establishments in the United Kingdom, or determining the income to be attributed to persons resident in the United Kingdom who have special relationships with persons not so resident. (2) On the making of an Order in Council under this section with respect to any arrangements relating to a Dominion as defined for the purposes of section twenty-seven of the Finance Act, 1920 (which provides for relief in respect of Dominion income tax), the said section twenty-seven shall cease to have effect as respects that Dominion except in so far as the arrangements otherwise provide."

Now, the important words to notice in that Section are the words in Subsection (1):

> "then, subject to the provisions of this Part of this Act, the arrangements shall, notwithstanding anything in any enactment, have effect in relation to income tax."

and so forth. It follows that, if and so far as there is any inconsistency between Rule 3 of the Rules applicable to Case III of Schedule D, on the one hand, and the Agreement, on the other hand, then the Agreement, having duly been given statutory effect, must prevail over the Rule.

I should next refer to some of the provisions of the Agreement. It is scheduled to the Double Taxation Relief (Taxes on Income) (Australia) Order, 1947 (S.R. & O. 1947 No. 806). The body of the Order says, by paragraph 1, that it

> "may be cited as the Double Taxation Relief (Taxes on Income) (Australia) Order, 1947",

and, by paragraph 2:

> "It is hereby declared—(*a*) that the arrangements specified in the Agreement set out in the Schedule to this Order have been made with the Government of Australia with a view to affording relief from double taxation in relation to income tax, excess profits tax or the national defence contribution and taxes of a similar character imposed by the laws of Australia; and (*b*) that it is expedient that those arrangements should have effect."

Then the Agreement is set out in the Schedule, and I think I can look first at Article II, which begins with a number of definitions in paragraph (1).

> "In the present Agreement, unless the context otherwise requires— . . . (*f*) The terms 'United Kingdom resident' and 'Australian resident' mean respectively any person who is resident in the United Kingdom for the purposes of United Kingdom tax and is not a resident of Australia"

and the converse case.

> ". . . (*h*) The terms 'United Kingdom enterprise' and 'Australian enterprise' mean respectively an industrial or commercial enterprise or undertaking carried on by a United Kingdom resident and an industrial or commercial enterprise or undertaking carried on by an Australian resident; and the terms 'enterprise of one of the territories' and 'enterprise of the other territory' mean a United Kingdom enterprise or an Australian enterprise, as the context requires. (*i*) The term 'industrial or commercial enterprise or undertaking' includes an

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> enterprise or undertaking engaged in mining, agricultural or pastoral activities, or in the business of banking, insurance, life insurance or dealing in investments, and the term 'industrial or commercial profits' includes profits from such activities or business but does not include income in the form of dividends, interest, rents, royalties, management charges, or remuneration for personal services."

In definition (*i*) it is noteworthy that insurance and life insurance are expressly included and that income in the form of dividends and interest is expressly excluded. I can go now, I think, to paragraph (3) of Article II:

> "In the application of the provisions of the present Agreement by one of the Contracting Governments any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the laws of that Contracting Government relating to the taxes which are the subject of the present Agreement."

Then I can go to Article III:

> "(2) The industrial or commercial profits of an Australian enterprise shall not be subject to United Kingdom tax unless the enterprise is engaged in trade or business in the United Kingdom through a permanent establishment situated therein. If it is so engaged, tax may be imposed on those profits by the United Kingdom, but only on so much of them as is attributable to that permanent establishment: Provided that nothing in this paragraph shall affect any provisions of the law of the United Kingdom regarding the imposition of excess profits tax and national defence contribution in the case of interconnected companies. (3) Where an enterprise of one of the territories is engaged in trade or business in the other territory through a permanent establishment situated therein, there shall be attributed to that permanent establishment the industrial or commercial profits which it might be expected to derive in that other territory if it were an independent enterprise engaged in the same or similar activities and its dealings with the enterprise of which it is a permanent establishment were dealings at arm's length with that enterprise or an independent enterprise; and the profits so attributed shall be deemed to be income derived from sources in that other territory."

I do not think there is anything else I need notice until Article XV, which provides for the commencement of the Agreement. The Agreement is to have effect when all formalities are completed:

> "(*a*) in the United Kingdom, as respects income tax for the year of assessment beginning on the 6th day of April, 1946, and subsequent years",

and other provisions are made in regard to its having effect as to Surtax; and

> "(*b*) in Australia, as respects tax for the year of tax beginning on the first day of July, 1946, and subsequent years."

The question in the case may be expressed as being whether the sum of business profits (as I have termed it) arrived at by the calculation prescribed by Rule 3 of the Rules applicable to Case III of Schedule D is an industrial or commercial profit of an Australian enterprise, namely, the Respondent Company, within the meaning of the Double Taxation Relief Agreement. If it is, then the result would appear to be that the Company can claim to be assessed in accordance with the provisions of paragraphs (2) and (3) of Article III of the Agreement and cannot properly be assessed to tax on the sum arrived at by the calculation prescribed by Rule 3.

On the Crown's side it is contended that, although actual business profits are by definition "industrial or commercial profits" for the purposes of the Double Taxation Relief Agreement, the Rule 3 sum of business profits has nothing whatever to do with the provisions of that Agreement. It is, argues Mr. Pennycuick, a purely notional sum. It has no substratum of fact. It is not a sum arrived at by a conventional calculation but, when so arrived at, representing actual profit. It is a purely notional sum. And he contends

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that the Agreement is concerned with actual profits ; though they may be artificially estimated in accordance with Income Tax principles, actual profits there must be. He says that the true view is that the Company's liability to tax under Rule 3 of Case III on the sum of business profits arrived at by the Rule 3 calculation is wholly outside the Agreement and that the Company remains liable to tax upon it.

In my view that contention should not be accepted. It appears to me that for the present purpose it does not greatly matter whether the sum of profit referred to in Rule 3 is to be regarded as an actual or a notional sum. The purport of the Rule, as I understand the construction placed upon it by the House of Lords, is to impute to an establishment operating here of a foreign insurance company a sum representing the profits arising to that company from its life insurance business in the United Kingdom. That is the object of it, and to carry out that object it applies the proportion formula. On the other hand, the Agreement (which, as I have mentioned, must be taken to override the Act where the two conflict) provides in Article III (3) its own method of estimating and arriving at the profit arising to an Australian company (including an insurance company) from its business (including life insurance business) in the United Kingdom. The system adopted in Rule 3 is a rough and ready method of taking the proportion to which I have referred. The system prescribed by the Agreement is of a far more elaborate and detailed character. But both, in the case here relevant of an Australian company carrying on life insurance business in this country, aim at the same object, which they seek to achieve by different means. It may be that the figures arrived at by applying one or other of the two formulae would be widely different, but, in my view, the Agreement must prevail by the terms of the Act under which it was made.

It follows from that that, for the purpose of assessing this Company to tax for the years in question on the profits of its business in the United Kingdom, one may completely ignore Rule 3 and the figure arrived at by applying the calculation laid down in that Rule. The Company's liability is to be measured in accordance with the Agreement and not otherwise. What the effect of applying the Agreement in substitution for Rule 3 may be it is not for me to say. It may be that it will be found that the fact that this is a mutual society will result in the liability being reduced to nil ; on the other hand, one can see that there might be room for argument to the effect that the various hypotheses postulated by Article III (3) of the Agreement might, when applied, involve the assumption that the Company was not a mutual company. But questions of that kind do not concern us at this stage, and I would prefer to say nothing about them.

The case has been most elaborately argued. I have confined myself, in effect, to one aspect of it which appears to me to be decisive in favour of the Company, but I intend no disrespect to the careful and elaborate argument presented. In the result I see no reason at all to disturb the concurrent views of the Special Commissioners and the learned Judge, and I would dismiss this appeal.

Parker, L.J.—I agree. The short though difficult question in this case is whether the Relief Order—namely, the Double Taxation Relief (Taxes on Income) (Australia) Order, 1947—applies in the circumstances of this case. If it does not, then it is clear—and, indeed, it is conceded—that the seven assessments in this case, five made under Rule 3 of Case III of the Income Tax Act, 1918, and two under Section 430 of the Income Tax Act, 1952, are valid assessments ; if, on the other hand, it does apply, then, by virtue of Section 51

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of the Finance (No. 2) Act, 1945, the measure of liability under the Relief Order prevails and supersedes the liability under Rule 3 of Case III, and accordingly the seven assessments in question must be discharged.

The Relief Order in effect provides that none of the enterprises there referred to shall be taxed in the United Kingdom unless certain conditions are fulfilled. The first is that it must be an enterprise of the type laid down in the Relief Order, and the Relief Order provides that one of the enterprises in question shall be one carrying on the business of life insurance ; accordingly, albeit that the Company in this case is a mutual society, it is clearly an enterprise within the Order. Secondly, that enterprise must have a permanent establishment in the United Kingdom, and there is no doubt that this Company had. The third condition is that what may be taxed are only profits from the activities or business of that enterprise, not including income in the form of dividends, interest, etc. The sole question really in this case is whether the profits on which the Company were assessed to tax are profits within that Relief Order.

I am afraid that for my part I am conscious of inability fully to understand the decision of the House of Lords in *Australian Mutual Provident Society* v. *Commissioners of Inland Revenue*(1) ; but, be that as it may, it is a decision clearly binding upon this Court. As I understand it, their Lordships were there construing Rule 3 of Case III as providing that a certain proportion of the investment income of such a company as this should be deemed to be the business profits of that company—and that, be it observed, whether the company in question was a proprietary company or a mutual society, as, indeed, was the case before the House of Lords. Now, if that be right, then, albeit that they were deemed to be business profits, it seems to me that those profits so deemed come within and come plainly within the words of the Relief Order.

I would add this, that it does seem to me that, in so far as one can look at the surrounding circumstances and the intention of the parties, that must have been their intention. For more than forty years before the Agreement incorporated in the Relief Order was made a foreign enterprise such as this was not taxed under Case I of Schedule D but under Rule 3 of Case III. As Lord Simon put it, in the case to which I have referred, [1947] A.C., at page 617(2) :

> "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 sch. 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."

That being so, it being the case that for some forty years taxation of a life insurance company under Case I of Schedule D was to all intents a dead letter, one arrives at this : that, if the Crown's argument is right, the inclusion in the Relief Order of an enterprise carrying on the business of life insurance would

(1) 28 T.C. 388; [1947] A.C. 605. (2) 28 T.C., at p. 401.

have been there for purely theoretical interest, in that only theoretically and not practically did such a life insurance company earn actual trading profits liable to tax.

For those reasons and the reasons given by my Lord I would dismiss this appeal.

Pearce, L.J.—I agree with what my Lords have said and I have nothing to add.

Mr. F. Heyworth Talbot.—I take it, my Lords, that the appeal is dismissed with costs?

Jenkins, L.J.—That must be so.

Mr. John Pennycuick.—I cannot dispute that. My Lord, this appeal raises a question of considerable general importance in that it affects all Australian insurance companies which carry on business in this country through branches, and also all insurance companies incorporated in other countries which have similar double taxation relief agreements with this country. I ask your Lordships for leave to appeal to the House of Lords in this case.

Jenkins, L.J.—What do you say, Mr. Heyworth Talbot? You do not object, do you?

Mr. Heyworth Talbot.—No, I could not fairly object because I confess that if your Lordships' decision had been otherwise I should have made a like application. The point is undoubtedly of sufficient importance, but there have been circumstances in which this Court has thought fit to impose certain conditions as to costs.

Jenkins, L.J.—That does not generally happen when there is an insurance company involved. I do not think the surplus available for your members would be greatly depleted by a journey to the House of Lords.

Mr. Heyworth Talbot.—I have discharged what I thought to be my duty.

Jenkins, L.J.—Very well, then, we give you your leave, Mr. Pennycuick.

Mr. Pennycuick.—If your Lordship pleases.

The Crown having appealed against the above decision, the case came before the House of Lords (Lords Radcliffe, Tucker, Somervell of Harrow, Birkett, and Denning) on 4th, 8th and 9th June, 1959, when judgment was reserved. On 16th July, 1959, judgment was given against the Crown, with costs (Lord Denning dissenting).

Mr. J. Pennycuick, Q.C., and Mr. Alan Orr appeared as Counsel for the Crown, and Mr. F. Heyworth Talbot, Q.C., and Mr. G. B. Graham for the Society.

Lord Radcliffe.—My Lords, the sole question raised by this appeal is whether the Respondent, an Australian life assurance company, can be lawfully assessed to Income Tax in this country under Rule 3 of the Rules applicable to Case III of Schedule D of the Income Tax Act, 1918, or, as the Rule has become, Section 430 of the Income Tax Act, 1952, having regard to the obligations undertaken by the Government of the United Kingdom in the Double Taxation Relief Agreement entered into with the

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Government of the Commonwealth of Australia on 29th October, 1946. The question itself is said to be a short one, as in one sense it is; but it is not so easy to state it shortly, and since its solution requires a certain amount of introductory matter I must ask leave to take a rather longer time than I should have wished in setting my opinion before your Lordships.

The relevant facts are these. The Respondent is a mutual insurance society incorporated in the State of New South Wales. It has its head office in Sydney and a branch office in London. From these offices it carries on a business of life assurance. It is not in dispute that for the purposes of taxation in this country its life assurance business is to be treated as a business separate from any other class of business carried on by it, and the assessments which are the subject of appeal are confined to the income or profits of that business. These assessments relate to a number of years, beginning with the revenue year 1947–48 and ending with the year 1953–54. Those for the first five years were made under Rule 3 of the Rules applicable to Case III of Schedule D, Income Tax Act, 1918; those for the last two under Section 430 of the Income Tax Act, 1952, which Act replaced the earlier Act in the process of consolidation. As the provisions of the two Acts do not differ in any relevant particular I shall speak throughout of Rule 3 as the governing statutory provision.

The course that the case has taken in the Courts below is that the assessments raised by the Inspector of Taxes were discharged by the Special Commissioners on the Respondent's appeal, and the order of the Special Commissioners has been upheld in the High Court (Upjohn, J.) and in the Court of Appeal (Jenkins, Parker and Pearce, L.JJ.). In all Courts hitherto the same view has prevailed, that there is a conflict between the provisions of Rule 3 and those provisions of the Double Taxation Relief Agreement which deal with the taxation of industrial or commercial profits, and that this conflict precludes for the future an effective assessment under the Rule. I should add at this point that the Agreement became municipal law of this country by virtue of an Order in Council made on 23rd April, 1947, under the authority given by Section 51 (1) of the Finance (No. 2) Act, 1945, which allows the enactment by such Orders of the arrangements contained in double taxation relief agreements, and prescribes further that the arrangements covered by an Order shall have effect in relation to Income Tax notwithstanding anything in any enactment

> "so far as they provide for relief from tax, or for charging the income arising from sources in the United Kingdom to persons not resident in the United Kingdom, determining the income to be attributed to such persons and their agencies, branches or establishments in the United Kingdom . . .".

It is plain therefore that if there is a conflict the unilateral legislation of the United Kingdom must give way.

The decisions in the High Court and the Court of Appeal were dominated by the view taken in those Courts as to the effect of the opinions delivered in this House in an earlier case involving the present Respondent, *Commissioners of Inland Revenue* v. *Australian Mutual Provident Society*(1), [1947] A.C. 605. Both Courts treated that case as deciding that the Rule 3 assessment was an assessment and therefore a tax upon the profits of the business of life assurance and as such was a tax upon commercial profits within the meaning of the Double Taxation Relief Agreement. I do not think that the first part of this proposition has been denied at any stage by

(1) 28 T.C. 388.

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the argument for the Crown, though it challenges the deduction to be drawn from it as to the interpretation of the Agreement. However that may be, I am reluctant that the issue of this appeal should be determined by any exclusive reliance upon what was said by members of this House in the earlier case, since the point that had then to be decided, relating as it did to the applicability of certain provisions about tax-free interest to a Rule 3 assessment, has no direct bearing upon the present dispute, and in any event nothing said by the House in 1947 could amount to an interpretation of the words "industrial or commercial profits" in the Agreement, which was not then before them. I therefore defer until later any further reference to this case.

My Lords, I think that what has to be done is first to ascertain what was the nature of the taxation imposed by Rule 3, so far as that very special enactment admits of any clear categorisation, and then to ask whether or not taxation on that basis can still be imposed consistently with the obligations undertaken by the United Kingdom under the Double Taxation Relief Agreement. I will set out Rule 3 in the form in which it appears in the Income Tax Act, 1918, but before I do so I must make one cautionary remark. The framers of the Rule were concerned to extract what seemed to them a fair quantum of tax from what had hitherto been an unsatisfactory situation. They were not concerned with precise distinctions between commercial and investment income, which in any event do not always admit of such distinction, nor could they be expected to foresee either the contents or the wording of the double taxation relief agreements which have become a feature of post-1946 tax administration.

> "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. (3) Every such charge shall be made by the special commissioners as though the company under the provisions of this Act had required the proceedings relating to the charge to be had and taken before those commissioners. (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."

Rule 3 first became law in 1915, being introduced by Section 15 of the Finance Act of that year. The situation that it was framed to deal with needs to be shortly stated. It arose from a combination of the special difficulties of establishing the true annual profit of life assurance business with the special difficulties of determining the true United Kingdom income of a non-resident life assurance company doing branch business here. If

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that assurance company was organised on the mutual principle a further difficulty was superimposed, but this particular difficulty was due to the quirk of English judicial reasoning which absolved a mutual company from the possibility of making a taxable profit and could have been corrected at any time by appropriate legislation. It had never been easy or convenient to raise an assessment under Case I of Schedule D on a life assurance society in respect of its trading income. To do so involved valuations of liabilities and assets which were not likely to be annually available. On the other hand, life assurance business by its own nature generates the life fund consisting of investments made out of the premium receipts and accumulated income, and the produce of those investments is at least an important part of the annual income of the business. So long therefore as the investments were such as to yield interest or dividends from a source in the United Kingdom, the interest and dividends themselves fell under charge to tax, and, given the allowance to the company of its management expenses, an adequate, though never an accurate, measure of the annual profit accruing to the business could be regarded as obtained. Moreover, since 1914 a company with its head office here had been liable on the income of foreign investments, even if not remitted to this country. A foreign assurance company was however in a different position. If it did business in the United Kingdom through a branch it was not itself a resident, and as a non-resident could not fairly be regarded as taxable in this country in respect either of its world income from investments or more generally its world income from life assurance business. So far as its life fund was represented by United Kingdom securities and no special tax exemption attached to them, it was liable to bear tax on the income from the securities. Theoretically too it was liable to an assessment under Case I of Schedule D in respect of the profits from its business carried on in the United Kingdom. But then a foreign assurance company might well not keep its life fund, or at any rate any substantial part of it, invested in United Kingdom securities, so the tax yield on that ground was only a speculative amount while the problem of raising a valid Case I assessment on the profits of the United Kingdom trade carried on by a branch office which was not even under the obligation of maintaining an independent accounting system was evidently regarded as too vexing for solution.

If it is seen against this background it is fairly clear what Rule 3 was designed to effect. Its purpose was to attribute to a foreign assurance company doing life business here a reasonable sum of income or profits in respect of that business and so to tax that sum as income arising in the United Kingdom. In one sense it charged the income of all the investments of the life fund wherever received and in that sense was a tax on investment income; but the language of the taxing provision, and indeed the whole scheme of it, is so exceptional that I do not think it right to give any determining weight to that consideration. As I have indicated, it was not unusual to regard the income of the life fund as an acceptable alternative to the trading income of the business. In the end it is not the investment income itself that is the subject of tax, but the product of a mathematical calculation represented by the income of the whole life fund multiplied by premiums obtained through United Kingdom business over the company's total premium income. It is the sum produced by this calculation that is deemed to be profits comprised in Schedule D and charged under Case III. This sum, representing an unidentifiable portion of the income from investments, is charged as being income derived from business carried on in the United Kingdom—see the proviso to Rule 3 (2). I regard these last

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words as very important, for to my mind they indicate conclusively the nature of the taxing provision as being designed to attribute to the foreign taxpayer a measure of income to represent the income of his United Kingdom business. It follows that the effect of the charge is not to charge investments as such or any specific investments. Finally, the fact that under Rule 3 (4) the tax charge turns out to be only a supplementary or covering charge, which abates or disappears to the extent that tax is otherwise obtained by deduction from investment income or direct assessment, seems to me to make it very difficult to regard the nature of the taxing provision as being other than that which I have described.

The question we have to determine is how this method of attributing a profit to a life assurance company whose head office is outside the United Kingdom stands up against the provisions of the Double Taxation Relief Agreement. I should find nothing surprising in the conclusion that it had been superseded. Rule 3 was an attempt at a unilateral solution of this particular aspect of double taxation in which the Australian taxing authorities were certainly no less interested than the authorities of the United Kingdom. Bilateral agreements for regulating some of the problems of double taxation began, at any rate so far as the United Kingdom was concerned, in 1946. The form employed, and for obvious reasons similar forms and similar language are employed in all agreements, is derived, I believe, from a set of model clauses proposed by the fiscal commission of the League of Nations. The aim is to provide by treaty for the tax claims of two governments both legitimately interested in taxing a particular source of income either by resigning to one of the two the whole claim or else by prescribing the basis on which the tax claim is to be shared between them. For our purpose it is convenient to note that the language employed in this Agreement is what may be called international tax language and that such categories as " enterprise ", " industrial or commercial profits " and " permanent establishment " have no exact counterpart in the taxing code of the United Kingdom.

Turning then to the Agreement, there is no doubt that the Respondent is an Australian enterprise and therefore comes within the regulation of Article III (2) that its commercial profits are not to be subject to United Kingdom tax at all unless it is engaged in business here through a permanent establishment here. It is conceded that its branch office is such an establishment and therefore the second part of the regulation applies and tax may be imposed on the Respondent's commercial profits by the United Kingdom, but only on so much of them as is attributable to that establishment. It is not left wholly to the will of the United Kingdom taxing authorities to decide the basis on which that attribution of commercial profits is to be made. Article III (3) provides by its terms for a basis which in effect requires the hypothesis that the branch is an independent enterprise dealing as an independent entity at arm's length with the head office. The profits which emerge from a calculation based on this hypothesis are to be deemed to be income derived from sources in the United Kingdom.

I do not think that it is open to us to decide what would be the consequences of taxing the Respondent's commercial profits according to this new formula. It is by no means easy to see what other hypotheses are required or excluded by the central hypothesis. The sole issue under appeal is whether the Respondent can be taxed at all on the Rule 3 basis. In my opinion it cannot be, because the world income from the investments

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of the life fund, which forms the first stage in the Rule 3 calculation of profits, cannot be attributed to the hypothetical independent enterprise without violating the very hypothesis which Article III (3) is designed to lay down as the basis of taxability.

I did not understand the argument for the Crown to maintain that Rule 3 could be applied consistently with an assessment according to Article III (3). What was said was that, having regard to the definition of industrial or commercial profits in Article II (1) (*i*), assessments under Rule 3 were not affected by Article III (3), since the profits they charged were not commercial or industrial profits within the meaning of the Agreement. With all respect to that argument, it seems to me simply a claim to retain the United Kingdom's unilateral basis of attributing United Kingdom business profits to an overseas life assurance company in despite of the new agreed basis of attribution laid down in Article III (3). It is quite true that the definition of industrial or commercial profits declares that it

> " includes profits from such activities or business but does not include income in the form of dividends, interest, rents, royalties . . .".

Accordingly, except so far as Article VI makes certain special stipulations about double taxation of dividends, the respective claims of the taxing authorities upon items of income such as dividends or interest are not regulated on the " permanent establishment " principle of Article III and are left to be taxed according to the local legislation. It would be in accordance with United Kingdom principles to tax all dividends and interest arising from sources in the United Kingdom to whomever accruing, unless specially excepted, but not to tax the foreign income of non-residents. So in this case the Respondent has regularly borne tax on its United Kingdom interest and dividends ; and, for instance, of a total tax claim of £97,961 in respect of the Rule 3 assessment for 1953–54, as much as £86,796 is set off by taxes paid by deduction or otherwise under various Schedules. The tax-deducted portion of that is £79,360. Such income is no doubt income " in the form of " dividends or interest for the purposes of Article II (1) (*i*) : but when I look round for any other comparable income received in the basis year which could be excluded from the provisions of Article III I find none. Certainly I do not find it in the notional sum of profits attributed under Rule 3 to the United Kingdom business, for that sum is not received in the form of dividends or interest and only exists as a measure of profits established by the Legislature for the purpose of the attribution, whereas it is just that question whether such a measure is any longer sustainable in face of the Double Taxation Relief Agreement that is the subject of the present dispute. In other words, as I see it, the Crown's argument can only succeed by assuming in its favour the very hypothesis that the Agreement displaces by a different standard of calculation.

I have left to the end any detailed reference to the opinions of this House in *Commissioners of Inland Revenue* v. *Australian Mutual Provident Society*[1]. The issue in that case was different from this one. It turned on the question how, if at all, a Rule 3 assessment should take account of the circumstance that some of the life fund investments were by Statute free of tax to holders non-resident or not ordinarily resident. When the case began its progress through the Courts the general construction of the nature of the Rule 3 charge seems to have been governed by Rowlatt, J.'s decision in *Equitable Life Assurance Society of the United States* v. *Hills*.

[1] [1947] A.C. 605; 28 T.C. 388.

8 T.C. 657. In that case he had spoken(1) of the charge as a charge on the investment income *simpliciter*:

> "They are taxed on their investments as such, upon a proportion of those investments."

Putting that construction side-by-side with the later decision of the House of Lords in *Hughes* v. *Bank of New Zealand*, 21 T.C. 472, the Court of Appeal had held that the Rule 3 assessment must be adjusted in favour of the taxpayer to reflect the relief on the exempted income. This House was not prepared to accept that conclusion. I think that it is obvious from the opinions of Lords Simon, Wright and Porter that they did not accept Rowlatt, J.'s construction of the Rule 3 charge. For instance, Viscount Simon is found describing the Rule at one point in his speech(2) as one which is made

> "in respect of the annual profit of"

the company's

> "life assurance business",

and at another(3) as

> "not one which taxes income from investments".

Lord Porter in his speech(4) rejects the argument that the charge is imposed on the income from investments and not on profits. The sum charged, he says, does not represent any real income or profit but is merely arrived at by a conventional calculation adopted for the purpose of estimating an otherwise almost incalculable sum. In the view of Lord Wright(5):

> "No specific investments were taxed. . . . The charge was a tax on the investment income only as a machinery to tax the general profits of the British business . . .".

My Lords, I have quoted these extracts at some length, because it is in reliance upon their tenor that the Courts below have decided against the Crown in the present case. It is true, I think, that it would have been sufficient for the decision of the earlier case if the House had merely confined itself to pointing out, as Lord Wright did, that the Rule 3 charge is not in any case a charge upon any specific investments; for, if that is so, it is very hard to see how to carry the relief on particular items of income into the unappropriated proportion. It is true, too, that there is nothing in the earlier case that could amount to an interpretation of the words "industrial or commercial profits" as defined by the Double Taxation Relief Agreement, the point with which we are most immediately concerned. But at the same time I cannot help recognising that the decision was a unanimous decision of the House which was directed to analysing and explaining the true nature of the Rule 3 charge and of what it was that by it was brought under charge, in order to determine the validity of the claim for relief that was under appeal; and I should not think it right to propound in this case any analysis of Rule 3 that was materially different from the explanation then given, unless I was convinced that it was unmaintainable. As it is, I am not faced with this difficulty, since I agree with the observations of the noble Lords that I have quoted and my own reading of the Statute leads me to the same conclusion.

I notice, only to reject, an argument that was presented to but not pressed upon us by the Crown to the effect that, as the date of the making of the Double Taxation Relief Agreement preceded by some months the

(1) at p. 661. (2) 28 T.C., at p. 401. (3) *Ibid.*, at p. 403.
(4) *Ibid.*, at p. 407. (5) *Ibid.*, at pp. 404–5.

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House of Lords' decision in the former case, that Agreement ought to be interpreted in the light of the view of the effect of Rule 3 that had hitherto prevailed and not in the light of the law as laid down by this House. I do not accept that it would make any ultimate difference even if the earlier view were treated as the only relevant one, but perhaps it is sufficient to say that I do not think that such a method of construction as is proposed ought to be applied to a bipartite taxation treaty of this nature. All that can be said in such an Agreement is said by Article II (3), and that is not sufficient to assist the Crown's case.

I would dismiss the appeal.

My Lords, my noble and learned friends **Lord Somervell of Harrow** and **Lord Birkett,** who are not able to be present today, have asked me to say that they agree with the opinion that I have just delivered.

Lord Tucker.—My Lords, I agree.

Lord Denning (read by Lord Keith of Avonholm).—My Lords, your Lordships have to consider today the effect of certain arrangements about taxation which have been made between the Governments of the United Kingdom and of Australia. These arrangements have been made so as to ensure that persons are not taxed twice over, once by the United Kingdom and once by Australia, on the same income. They have been embodied in an Agreement, which I will call the Double Taxation Agreement, and given statutory force in each country. They override any other enactment. Similar agreements in like terms have been made by this country with other countries and by other countries between themselves. The interpretation which your Lordships put upon this Double Taxation Agreement is of more than usual consequence, because if a mistake should be made it may be well-nigh impossible to put it right; for your Lordships' interpretation will govern this country without any likelihood of change by Parliament. At any rate, Parliament itself cannot alter the wording of this Double Taxation Agreement without the consent of both parties to it.

The important thing to notice about the Double Taxation Agreement is that in defining industrial or commercial profits it draws a sharp distinction between profits from a business on the one hand, which I will call business profits, and income in the form of dividends, interest, rents and so forth on the other hand, which I will call investment income. It deals with these quite separately. So far as business profits are concerned, the Double Taxation Agreement says that henceforward, when an Australian company has a permanent establishment in this country, it may be taxed by the United Kingdom on the profits it makes, but only on so much of them as is attributable to its establishment here. The Agreement goes on to say how this amount is to be ascertained. It is by means of a given hypothesis. You are to treat the establishment here as if it were completely independent of the Australian head office and were dealing at arm's length with it, and you are to estimate the profits which such an independent enterprise might be expected to derive on its own, and then tax it on the amount so ascertained.

So far as investment income is concerned, the tax payable in this country is left untouched by the Double Taxation Agreement. For instance, where an Australian company has investments in this country from which it derives dividends, interest, rents and so forth, it has of course to pay tax on that income here by deduction or otherwise. But over in Australia the Australian company, inasmuch as it is an Australian resident, will have to pay Australian tax on all its investment income, wherever derived, including

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its income from investments in the United Kingdom. The Double Taxation Agreement provides that, when paying this Australian tax in Australia, the Australian company will receive credit for the tax it has paid in the United Kingdom.

Such being the general effect of the Double Taxation Agreement, your Lordships are today concerned with its effect on a very special kind of tax which is imposed here under Rule 3 of Case III of Schedule D. It is a tax charged on life assurance companies which have their head office overseas and a branch or agency in the United Kingdom. The critical question is whether it is a tax on profits of the business so as to come within the provisions of the Double Taxation Agreement about business profits, or whether it is rather a tax on investment income so as to come within the relevant provisions about investment income.

My Lords, in order to explain the nature of this special tax, I would first say a little about the business of life insurance itself. First, take a mutual society. It carries on business on a mutual basis, and it is settled law that it makes no trading profits but only a surplus and is not liable to tax upon that surplus: see *New York Life Insurance Company* v. *Styles*[1], 14 App. Cas. 381, *Ayrshire Employers Mutual Insurance Association, Ltd.* v. *Commissioners of Inland Revenue*, 27 T.C. 331. But it is of course liable to tax on its investment income. Secondly, take a proprietary society. It carries on business on a proprietary basis and may in theory make a trading profit, but there is much difficulty in calculating it. It is difficult to say what profit there is when you receive premiums and may have to pay out big sums at some unknown future time. In any case the actuaries seek to calculate the premiums so that they just cover the risk and there is no profit as such. But a proprietary society of course invests its income and receives dividends from it. That is how it makes its money. The result is that in practice a proprietary company is not charged with tax on any trading profit but only on its investment income.

When you are dealing with life insurance companies resident in the United Kingdom, there is no difficulty about applying the Double Taxation Agreement to them. They are resident here and are taxed on their total investment income from the life fund, wheresoever this income is derived, and they are given credit for the tax paid by them in Australia on their Australian investments. But with an Australian society, or any company resident overseas, the position is different. Apart from the special tax which we have to consider, the only tax payable by it in the United Kingdom would be the tax on its investments here ; and it could avoid paying tax in England by reducing its English investments to a minimum. It could make nearly all its investments elsewhere. It was in order to avoid such a situation, so obviously unjust to English taxpayers, that a special tax was introduced. In 1915 it was enacted that life insurance companies with head offices overseas should pay tax on a figure calculated according to a prescribed formula. The formula was this. Take the total income which the company receives from its investments all over the world: then divide this income up, divide it into proportions according to the volume of business done in life insurance in this country compared with the business done overseas. This proportion was usually to be ascertained by comparing the premiums received in this country with those received overseas. By dividing the world investment income in those proportions, you arrive at a fair figure to represent the

(1) 2 T.C. 460.

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proportion applicable to the United Kingdom. The company was to be taxed on the figure so ascertained. These 1915 provisions were afterwards embodied in Rule 3 of Case III of Schedule D, and I will refer to them as the Rule 3 provisions.

The critical question, as I have said, is: What is the nature of this Rule 3 tax? Is it a tax on the investment income of the company, or is it a tax on the profits of the business?—for it needs must, I think, be put in one category or the other if this Double Taxation Agreement is to work on it. And it is to be remembered that the term "profits" must be given the meaning it has under English law, unless the context otherwise requires.

Apart from authority, I should have thought this Rule 3 tax was a tax on investment income. It is not of course a tax on specific investments but it is a tax on a proportion of the world investment income; and that is surely a tax on investment income and not on business profits. In so holding, I should be in good company, for Rowlatt, J., so regarded it in *Equitable Life Assurance Society of United States* v. *Hills*, 8 T.C. 657. So did Dixon, C.J., Fullagar, J., and Menzies, J., in *Mutual Life and Citizens Association* v. *Federal Commission of Taxation*, 33 A.L.J. 54, who all took the view, at page 56, that

> "If you impose a tax on ten per cent. of an amount which includes several items, you are imposing a tax on every item which is included in that amount."

But it is said that there is a decision of this House to the effect that it is not a tax on investment income but is a tax on the profits of the business. That decision is *Commissioners of Inland Revenue* v. *Australian Mutual Provident Society*, [1947] A.C. 605(1). I would draw the attention of your Lordships to the most unusual course which that case took. The question was how the tax under Rule 3 was to be calculated when some of the investments of the Society were in United Kingdom War Loan Stock which was exempted from any tax at all. Both parties—both the Crown and the Society—proceeded on the footing that the tax under Rule 3 was a tax on investment income and that the Society must be given the benefit of this exemption. The parties differed only as to the way in which the benefit should be calculated. The method adopted by the Crown commended itself to the Court of first instance: the method adopted by the Society commended itself to the Court of Appeal: but when the case reached this House, a new point was raised for the first time by the House itself. It was suggested that the tax under Rule 3 was not a tax on investment income at all but a tax on profits, and accordingly that the Society was not entitled to any benefit at all from the exempted investments and could make no deduction at all on that account. Neither party liked the point at all. The Crown, in whose favour it appeared to be, refused to take it. The Solicitor-General said(2):

> "It is not proposed to address the House on the question whether the wording of r. 3 is such as not to permit any deduction at all. The Crown does not, in any event, seek an order putting the respondents in a worse position than the order of the court of first instance."

In spite of the Crown's reluctance, the House was so convinced of the correctness of the point, which it had itself raised, that it decided that the Society was not entitled to any exemption at all. The House did not however carry its point of view so far as to compel the Crown to accept an Order it did not ask for. The House simply reversed the decision of the Court of Appeal, and restored the judgment of the Court of first instance.

(1) 28 T.C. 388. (2) [1947] A.C. 605, at p. 616.

(Lord Denning.)

Looking back on it now, with all the knowledge since acquired, it does seem a pity that the House insisted on its own point so strongly; for it has been turned to great advantage by the mutual societies as against the Crown. It recently compelled the High Court of Australia to decide a case contrary to its own better judgment: see *Mutual Life and Citizens Association* v. *Federal Commission of Taxation,* 33 A.L.J. 54. It compelled the Judges below in the present case to decide it as they did, and Parker, L.J., went so far as to say that he was unable fully to understand the decision of the House. And as it happened, no doubt owing to the unusual course which was adopted, the House in 1947 was never referred to a very relevant decision of its own. It was never referred to the decision in *New York Life Insurance Company* v. *Styles*[1], 14 App. Cas. 381, which holds that a mutual life assurance society does not make profits. That case is quite inconsistent with the notion that the tax under Rule 3 is truly a tax on profits as that word is used in English law. At most it is a tax on a calculated figure which is deemed to be profits, though not so in fact. It is to be treated as being income, that is as if it were income derived from the business, though not so in fact.

My Lords, I ask myself what authority is to be given in these circumstances to the decision of this House in 1947? Is it to be followed from step to step regardless of consequences? Are we to hold that the tax under Rule 3 is a tax on the profits of the business for all purposes, including the purposes of the Double Taxation Agreement, which this House never had in mind at all? I think not. The doctrine of precedent does not compel your Lordships to follow the wrong path until you fall over the edge of the cliff. As soon as you find that you are going in the wrong direction, you must at least be permitted to strike off in the right direction, even if you are not allowed to retrace your steps. And that is what I would ask your Lordships to do. I would invite your Lordships to say that the decision of this House in 1947 has no application to the meaning of the word " profits " in the Double Taxation Agreement. The tax under Rule 3 is not a tax on the profits of the business within the meaning of that Agreement but is rather a tax on income in the form of dividends and interest.

Just consider what would be the result of applying the 1947 decision here. If the Society does make profits from its business, the Double Taxation Agreement says that it is to be taxed here, as if it were completely independent of the Australian head office and were dealing at arm's length with it. But, on this hypothesis, what is the result? If this Society were here completely independent, then, being a mutual society, it would not make any profits so as to be chargeable under Case I; and furthermore, being established in this country, it would not be liable to tax under Rule 3 at all, because that tax does not apply to independent establishments here. So the establishment here would not be liable to tax on profits at all. This cannot have been intended. It is quite contrary to the tenor of the Double Taxation Agreement which assumes that, if the Society does make profits, some of those profits would be attributable to its establishment in the United Kingdom.

The true answer, to my mind, is that the Society does not make any profits from its business within the meaning of the Double Taxation Agreement. But it has a world investment income, and it can be taxed here under Rule 3 upon a proportion of that income. And when it comes to pay Australian tax in Australia on its world investment income it will

(1) 2 T.C. 460.

(Lord Denning.)

receive credit for the amount paid here under Rule 3. If I am wrong, it means that the Australian Society will no longer have to pay the tax it has paid under Rule 3 for 30 years or more. It will have to pay no tax at all in return for the benefit of carrying on the business of life assurance in this country, but only tax on such investments as it may choose at its will to retain in this country. I do not think that this was the intention of the Double Taxation Relief Agreement between the United Kingdom and Australia.

I would therefore allow the appeal.

Questions put:

That the Order appealed from be reversed.

The Not Contents have it.

That the Order appealed from be affirmed and the appeal dismissed with costs.

The Contents have it.

[Solicitors:—Solicitor of Inland Revenue; Bell, Brodrick & Gray.]