NO. 1384—HIGH COURT OF JUSTICE (KING'S BENCH DIVISION)—
1ST, 5TH AND 26TH NOVEMBER, 1945

COURT OF APPEAL—22ND AND 25TH FEBRUARY AND 7TH MARCH, 1946

HOUSE OF LORDS—30TH AND 31ST JANUARY, 3RD AND 4TH FEBRUARY AND 31ST MARCH, 1947

AUSTRALIAN MUTUAL PROVIDENT SOCIETY v. COMMISSIONERS OF INLAND REVENUE[1]

Income Tax, Schedule D, Case III, *Rule* 3*—Dominion life assurance society with United Kingdom branch—Investment income of life assurance fund included interest exempt from United Kingdom Income Tax—Calculation of liability under Rule* 3, *Case* III, *Schedule D, Income Tax Act*, 1918.

The Society, having its head office in New South Wales and a branch in London, carried on mutual life assurance business. The Commissioners of Inland Revenue had made a regulation under the proviso to Rule 3 (2), *Case* III, *Schedule D, whereby the income chargeable to United Kingdom tax was to be an amount bearing the same proportion to the whole income from the investments of the Society's life assurance fund as the liability of the Society in respect of its policies held by United Kingdom residents and by non-residents whose proposals were made through a United Kingdom branch or agency bore to its liability in respect of all the life assurance policies issued by it. Among the life assurance fund investments were certain securities in respect of the interest on which the Society was entitled to exemption from United Kingdom Income Tax by reference to Section* 46, *or Rule* 2 (*d*) *of Schedule C, or Rule* 7, *Miscellaneous Rules, Schedule D, Income Tax Act*, 1918.

Consequent upon the decision in Hughes *v.* Bank of New Zealand, 21 T.C. 472, *the Society claimed under Section* 24 *of the Finance Act*, 1923, *that the amount on which tax was chargeable under Rule* 3 *of Case* III *of Schedule D for the years* 1936-37 *to* 1939-40 *should have been calculated by taking the appropriate proportion of the income of the fund and deducting from the result the whole amount of the exempt income. The Special Commissioners rejected the basis of the Society's claim and allowed relief in accordance with the method offered by the Crown which in effect deducted from the appropriate proportion of the whole income of the fund the same proportion of the exempt income.*

The King's Bench Division ordered relief in the amount allowed by the Special Commissioners, but the Court of Appeal decided in favour of the Society's claim. The Crown appealed seeking the reversal of the Order of the Court of Appeal.

The House of Lords were of opinion that no deduction at all was due in respect of the exempt income; they unanimously allowed the appeal and restored the Order of the King's Bench Division.

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[1] Reported (K.B.) 174 L.T. 316; (C.A.) [1946] 1 All E.R. 528; (H.L.) [1947] A.C. 605.

CASE

Stated under the Finance Act, 1923, Section 24, and the Income Tax Act, 1918, Section 149, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the King's Bench Division of the High Court of Justice.*

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 6th January, 1943, Australian Mutual Provident Society (hereinafter called "the Society") appealed against a determination of the Commissioners of Inland Revenue limiting the amount of relief which the Society claimed in respect of an error or mistake in its returns in computing the assessable income of its London branch for the years ending 5th April, 1937, 1938, 1939 and 1940 respectively.

2. The Society carries on mutual life assurance business, having its head office at Sydney in New South Wales and a branch in London. It was established in 1849 and for the years in question was governed by the Australian Mutual Provident Society Act, 1910, an Act of the New South Wales Legislature. The Society is not resident in the United Kingdom for the purposes of United Kingdom Income Tax, and for the years in question is entitled to exemption from United Kingdom Income Tax in respect of interest and dividends on securities and investments falling within Section 46, Rule 2 (*d*) of Schedule C, and Rule 7, Miscellaneous Rules, Schedule D, Income Tax Act, 1918.

3. As the Society carries on business at its London branch it is assessable to Income Tax under the provisions of Case III, Rule 3, Schedule D (and its fore-runner, Section 15 of the Finance Act, 1915) and the following regulation which was made thereunder by the Commissioners of Inland Revenue on 5th April, 1917, following an application therefor by the Society —

> "The income from the investments of the Life Assurance "Fund (excluding the Annuity Fund) of the Society shall be "charged to the following extent, instead of to the extent "directed by the first paragraph of sub-section 2 of Section "15 of the Finance Act, 1915; that is to say, such portion only "of the said income shall be charged as bears the same propor-"tion to that income, as the amount of the liability in respect "of life assurance policies, in cases where the policy holders "are resident in the United Kingdom, and in cases where the "policy holders are resident abroad but the proposals were made "to the Society at or through a branch or agency in the United "Kingdom, bears to the total amount of the liability in respect "of all life assurance policies issued by the Society such liabili-"ties being estimated in the same manner as they are estimated "for the purpose of the periodical returns of the Society to the "Board of Trade under the Assurance Companies Act, 1909".

The regulation, in short, substituted a ratio of United Kingdom "liability" to total "liability" for the ratio provided by the aforesaid Rule itself, namely, the ratio which premiums received from policy holders resident in the United Kingdom and from policy holders whose proposals were made to the Society at or through its office or agency in the United Kingdom bear to the total amount of the premiums received by the Society.

Details of the valuation of the liability in respect of the policies on the London branch register are sent by the general manager in Sydney every year to the London manager, who in turn sends them, with the Board of Trade return and his calculations (showing the above ratio) of the Society's liability to United Kingdom Income Tax, to H.M. Inspector of Taxes.

Taking the year ended 31st December, 1935, as an example (year of assessment 1936-37) the following figures for the above-mentioned items entering into the calculation emerge:

Reserves

Whole Society	£93,799,810
London branch	£5,220,211
Ratio	·05565268

Interest on assurance fund

Whole Society	£4,145,067
London branch (£4,145,067 × ·05565268)	£230,684

The word "reserves" means liability in respect of life assurance policies.

The Society has at all material times held as part of the investments representing its life assurance fund securities and investments falling within the said Section 46, Rule 2 (*d*) of Schedule C, and Rule 7, Miscellaneous Rules, Schedule D, and has been assessed under the said regulation in respect of a portion of the income of the said fund, no exclusion of or relief from tax on the said exempted income being given effect to.

Taking the year ended 31st December, 1935, again as an example (year of assessment 1936-37), the said exempted income amounted to £72,354, made up as follows:—

	£
Section 46, Income Tax Act, 1918 ...	16,630
Rule 2(*d*), Schedule C	29,605
Rule 7, Miscellaneous Rules, Schedule D	26,119
	£72,354

4. Consequent upon the decision in *Hughes* v. *Bank of New Zealand*, 21 T.C. 472, the Society made a claim for repayment of part of the Income Tax charged upon it by virtue of the said regulation mentioned in paragraph 3 upon the ground of error or mistake having been made in the computation of the amount chargeable for the year in question.

In computing the amount of relief to be allowed under this claim the Commissioners of Inland Revenue deducted the income arising from the exempted securities and investments from the total income of the life assurance fund (excluding the annuity fund), and applied the appropriate ratio as defined by the said regulation to the balance of the said income.

The Society claimed that the appropriate ratio should be applied to any income of the life assurance fund (excluding the annuity fund) as calculated under the practice existing prior to the decision in

Hughes v. *Bank of New Zealand*, 21 T.C. 472, and that the income from the exempted securities and investments should be deducted from the resulting figures. The statement attached hereto, marked "A", and forming part of this Case(1), shows the result of the opposing methods.

5. It was contended on behalf of the Society :—

(*a*) that the exemptions from Income Tax contained in the statutory provisions referred to in paragraph 2 of this Case were absolute, and cannot be taken away, qualified or cut down by the manner in which the provisions of Rule 3 of the Rules applicable to Case III of Schedule D are applied;

(*b*) that the portion of the investment income directed to be charged to tax under Rule 3 of Case III of Schedule D should be arrived at by applying the ratio to the whole of the Society's investment income wherever arising, there being no provision in the Rule for making any deduction whatsoever from such investment income; and

(*c*) that therefore in order to give full effect to the exemptions it was necessary to deduct the exempted income from that portion of the income from the investments of the life assurance fund, arrived at as directed by Rule 3 (2) of the Rules applicable to Case III, which is to be charged to tax.

6. It was contended on behalf of the Commissioners of Inland Revenue that the Society carried on a life assurance business through a branch in the United Kingdom, and the income of the Society from the investments of the life assurance fund (excluding the annuity fund, if any) wherever received was deemed to be profits to the extent provided by Rule 3 of Case III, Schedule D, and the regulation made thereunder, and the said profits were chargeable to tax by reference to a ratio of the income of the life assurance fund (excluding the annuity fund) investments which included income specifically exempted from tax, and accordingly such exempted income ought to be excluded before the ratio was applied.

7. We, the Commissioners who heard the appeal, gave our decision in the following terms :—

Approaching Rule 3 of Case III, Schedule D, with a knowledge of the existence of Section 46 and Rule 2 (*d*) of Schedule C, Income Tax Act 1918, and of the decision in *Hughes* v. *Bank of New Zealand* the Crown's method of excluding exempted income altogether from the computation appears to be the obvious and logical one. The Society, however, contends that this method does not give effect to the wording of Rule 3(1) and (2), which purports to charge a proportion of the income of the life fund, whether liable or non-liable under the general provisions of the Income Tax Acts, and to exempt the other portion.

The argument on behalf of the Society seems to be open to to two criticisms. If what is charged is an arithmetical part of the massed investment income of the life fund, how is it possible to say that the part charged to tax contains the whole of the income from the specifically exempted sources or indeed that it

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(1) Not included in the present print

contains any part of the income from such sources, unless it be a corresponding mathematical part — in which case the Society's method would give the same result under Rule 3 as the Crown's. If, on the other hand, what is charged is a sum artificially calculated to represent the business profits of the United Kingdom branch then there is no specific exemption from tax on any part of business profits.

We prefer the Crown's method. To adapt Lord Wright's words in the *New Zealand Bank* case, 21 T.C. 472, at page 494, whatever cupboard the Crown go to it will be bare of exempted income for the purposes of taxation and if it be found to contain exempted income it must be emptied of it before any charging provisions are applied.

8. Immediately upon our determination of the appeal dissatisfaction therewith was expressed on behalf of the Society as being erroneous in point of law, and in due course we were required to state a Case for the opinion of the High Court pursuant to the Finance Act, 1923, Section 24, and the Income Tax Act, 1918, Section 149, which Case we have stated and do sign accordingly.

H. H. C. GRAHAM, } Commissioners for the Special
G. R. HAMILTON, } Purposes of the Income Tax Acts.

Turnstile House,
94/99 High Holborn,
London, W.C.1.
22nd August, 1944.

The case came before Macnaghten, J., in the King's Bench Division on 1st and 5th November, 1945, when judgment was reserved. On 26th November, 1945, judgment was given in favour of the Crown, with costs.

Mr. J. Millard Tucker, K.C., and Mr. J. S. Scrimgeour, K.C., appeared as Counsel for the Society, and the Solicitor-General (Sir Frank Soskice, K.C.) and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Macnaghten, J.—The second of these appeals [1], in which the Society is the Appellant, arises out of a claim by the Society for relief under the Finance Act, 1923, Section 24, on the ground that the assessments made upon it under Case III of Schedule D for the years ending 5th April, 1937, 1938, 1939 and 1940 were excessive by reason of an error or mistake in the returns made by it for the purposes of those assessments.

During each of those years the income from the investments of the Society's life assurance fund included interest and dividends which, by reason of the following provisions contained in the Income Tax Act, 1918, namely: (i) Section 46 of the Act; (ii) Rule 2 (*d*) of the Rules applicable to Schedule C, and (iii) Rule 7 of the Miscellaneous

[1] The first appeal, *Commissioners of Inland Revenue* v. *Australian Mutual Provident Society*, is reported at page 379 *ante*.

(Macnaghten, J.)

Rules applicable to Schedule D, were exempt from Income Tax in the United Kingdom, because the Society is not resident here. The statement, marked "A", which is attached to and forms part of the Case submitted by the Special Commissioners for the opinion of the Court, sets out the total income from the investments of the life assurance fund during the years in question, and also the amount of the interest and dividends comprised in that total which were exempt from United Kingdom Income Tax. Taking the first of those years for example, the statement shows that the total income from the investments of the Society's life assurance fund for the year was £4,145,067, and that of that total £72,354 was income exempted from tax in the United Kingdom. The fraction of the total income, which in accordance with the provisions of Rule 3 and the regulation made by the Commissioners of Inland Revenue thereunder, was ·05565268, and it amounted to £230,684; and that was the amount which, by Rule 3 (1), was to be deemed to be "profits" comprised in Schedule D and to be charged under Case III of that Schedule. But since the total income included the £72,354 which was exempt from tax, the Society complained that it was entitled to relief in respect of that sum, since otherwise tax would be charged on income which was not by law chargeable.

The Commissioners of Inland Revenue recognised the validity of the Society's complaint and gave the following relief. They deducted the £72,354 from the total income, thereby reducing the total income from £4,145,067 to £4,072,713, with the result that the fraction chargeable to Income Tax under Rule 3 was £226,646.

The Society, however, is not content with that concession. It is said, in the first place, that the provisions of Rule 3 afford no warrant for making any reduction of the total income from the investments of the life assurance fund. Since the Rule provides that the income chargeable to tax under Schedule D should be a portion of "any "income of the company from the investments of its life assurance "fund . . . wherever received", I am disposed to think that this criticism is well founded, and that, for the purposes of ascertaining the portion of the income chargeable to tax, it is necessary to take the prescribed fraction of the total income from the investments of the life assurance fund and that it is not permissible to make any deduction from that total.

Proceeding from the contention that the method adopted by the Commissioners of Inland Revenue for dealing with the £72,354 was unwarranted, the Society contends that that sum ought to be deducted, not from the total income of £4,145,067, but from £230,684—the fraction of the total income which by the Rule is deemed to be "profits comprised" within Schedule D—with the result that the chargeable income becomes, as appears in statement "A", £158,330.

Rule 3(4) of the Rules applicable to Case III of Schedule D provides as follows: "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."

(Macnaghten, J.)

The contention put forward by the Society, as I understand it, is that the income from the investments exempted from the payment of tax should be regarded as if it were income which had been "charged to tax by deduction or otherwise" within the meaning of those words in Rule 3 (4). It is not easy to see how the words "income charged to tax" can be construed so as to include income which is not chargeable to tax. But Mr. Tucker, for the Society, urged very strongly that such a contruction was rendered necessary by reason of the decisions in *Hughes* v. *Bank of New Zealand*, 21 T.C. 472, and in *Sinclair* v. *Cadbury Bros., Ltd.*, 18 T.C. 157.

In the former case the Bank of New Zealand, like the Society, was not resident in the United Kingdom, but had a branch in London and, like the Society, was assessable to Income Tax here in respect of the profits of that branch. But it was not assessable under Case III of Schedule D; it was assessable under Case I of that Schedule on the profits made by the branch, computed in accordance with the Rules applicable to that Case. The bank, like the Society, held investments which, under the provisions of the Income Tax Act, 1918, were exempt from United Kingdom Income Tax, and the main question at issue in that case was whether the income received by the branch from those investments ought or ought not to be included as receipts in the computation of its profits. It was held that it ought not to be included in the computation because the exemption from Income Tax was absolute and, if the income from those investments was included as a receipt, it would necessarily be subjected to tax. The decision in the case of *Cadbury Bros., Ltd.* was to the like effect. In that case the company carried on its trade at a factory erected on land which, by an Act passed in 1660, was exempt from all taxation. The company was assessed to tax under Case I of Schedule D in respect of the profits of its trade and the question at issue was whether, in the computation of the profits of the trade carried on by the company, the annual value of the land on which the factory was situate ought to be included as a trade expense. It was held that it ought to be so included because, unless it were so included, the company would, in effect, be charged to tax on the annual value of the land contrary to the provisions of the Act of Charles II.

These cases establish beyond all question that the Crown cannot exact Income Tax, either directly or indirectly, on income which is by law exempted from payment of tax; but, with all respect to Mr. Tucker, I am unable to see how they support the contention that in this case the £72,354, the income which is exempt from the payment of tax, ought to be deducted from the £230,684, which, in accordance with the provisions of Rule 3 and the regulation made by the Commissioners of Inland Revenue, is to be deemed to be profits within Schedule D and to be chargeable to tax under Case III of that Schedule.

In my judgment on the first of these appeals[1] I ventured to point out that the fraction of the total income deemed to be profits comprised in Schedule D—which for the first of the four years in question on this appeal was ·05565268 and amounted to £230,684—is in fact the aggregate of the like fraction of the income of each of the investments of the Society's life assurance fund. Since, therefore,

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(1) *See* page **387** *ante*.

(Macnaghten, J.)

the sum of £230,684 contains that fraction of the £72,354 which is exempt from Income Tax, it follows that no tax can be exacted on so much of the £230,684 as consists of that fraction of the £72,354, not by reason of any express or implied provision to be found in Rule 3, but by reason of the fact that no tax may be exacted, either directly or indirectly, on income which is exempted by law from tax.

As the Special Commissioners pointed out, the actual result of this method of dealing with the £72,354 is precisely the same as that of the method adopted by the Commissioners of Inland Revenue; but it seems to me that it is the more correct method.

In my opinion, therefore, the appeal fails and must be dismissed with costs.

An appeal having been entered against the decision in the King's Bench Division, the case came before the Court of Appeal (Lord Greene, M.R., and Somervell and Cohen, L.JJ.) on 22nd and 25th February, 1946, when judgment was reserved. On 7th March, 1946, judgment was given unanimously against the Crown, with costs, reversing the decision of the Court below.

Mr. J. Millard Tucker, K.C., and Mr. J. S. Scrimgeour, K.C., appeared as Counsel for the Society, and the Solicitor-General (Sir Frank Soskice, K.C.) and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Lord Greene, M.R.—The judgment of the Court will be read by Somervell, L.J.

Somervell, L.J.—The Appellant carries on mutual life assurance business, the head office being in New South Wales with a branch in London. The assessment of such a business to Income Tax is dealt with in Rule 3 of Case III of Schedule D. Under that Rule the assurance company preserves its character as a non-resident, but the Rule provides for a notional apportionment of the income from the investments of its life assurance fund, either in accordance with the principle stated in paragraph (2) of the Rule, or, in the case of assurance companies with their head offices in British possessions, in accordance with a regulation made by the Commissioners of Inland Revenue. Such a regulation was made in the present case on the application of the Appellant, and no question arises as to its terms. Sub-paragraph (2) of the Rule provides that only that part of the income apportioned to represent the income of the branch in the United Kingdom is to be charged to tax. This sub-paragraph must be read with sub-paragraph (4) of the Rule, which reads as follows: "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 propor-"tionately reduced." The effect of this is to allow the company to set off against the tax which would otherwise be chargeable on the apportioned income on its life assurance fund the tax to which it has been charged by deduction or otherwise, not in its capacity as an

(Somervell, L.J.)

assurance company, but in its capacity as holder or owner of United Kingdom investments. It is allowed, in other words, to attribute to the business carried on by the branch the whole of the tax charged on United Kingdom investments.

The dispute in the present appeal arises from the fact that the Appellant at all material times held, as part of the investments representing its life assurance fund, securities and investments the interest and dividends on which are exempted from United Kingdom Income Tax if in the beneficial ownership of a non-resident, either under Section 46 of the Income Tax Act, 1918, or under Rule 2 (*d*) of Schedule C, or under Rule 7 of the Miscellaneous Rules of Schedule D. These exemptions apply to certain British Government securities, and to certain other securities outside the United Kingdom which normally become liable to United Kingdom Income Tax because the interest or dividends are payable in the United Kingdom. We refer to investments falling under these provisions as "exempted "investments."

The effect of these exemptions was considered in the case of *Hughes* v. *Bank of New Zealand*, [1937] 1 K.B. 419; [1938] A.C. 366; 21 T.C. 472. In that case the Bank of New Zealand had a branch office in London. The branch was admittedly assessable to Income Tax under Case I of Schedule D on the profits arising from the trade exercised at the London branch office. The London branch held, as part of its assets, certain exempted investments, the interest on which was included in the trading receipts in the profit and loss account of the London branch. All the classes of exempted securities, as referred to above, were involved. Though the argument in respect of each class differed, the Crown submitted that none of the exemptions applied when the interest, as in that case, came under computation as a trading receipt of a trade exercised in the United Kingdom, but that they should be limited to cases where the owner would, apart from the exemption, be liable under Schedule C or Case III of Schedule D. The Crown took a further point that, if the exemption applied so as to strike the interest out of trading receipts, the expenses referable to the acquisition of the investments should be struck out of the other side of the account. The Crown failed on all points. It was held that the exemptions, being absolute and unlimited, must be construed as excluding the interest from the computation under Case I. It was also held that the expenses, namely, the cost of obtaining the capital engaged in the exempted investments, was deductible, being an expense wholly and exclusively laid out for the purpose of the trade of the London branch. This right to deduct was, in other words, not affected by the fact that the interest was excluded from the Income Tax computation.

This is a clear authority for the unqualified effect to be given to the exemptions, and the question is how it has to be applied in the present case. For the purposes of the argument both sides used round figures, which we will adopt, to illustrate the rival contentions. Assume the total income of a life assurance fund is £500,000. Applying the apportionment formula, one quarter of this, i.e., £125,000, is, under paragraph (2) of the Rule, chargeable to tax in respect of the United Kingdom branch business. The £500,000 income includes £50,000 income from exempted investments.

(Somervell, L.J.)

Mr. Tucker contended that the £50,000 should be deducted from the £125,000 leaving £75,000 to bear tax at the standard rate. He argued that, if the securities had been charged to tax, that tax would have all been brought in in relief of the company's tax liability under Rule 3. Full effect would not be given to the exemption unless the whole of the tax from which the securities were exempted was deducted from the tax which would have been payable if the whole of the life assurance fund had consisted of foreign investments not charged to tax by deduction or otherwise.

The Solicitor-General in effect said that, the basis of the Rule being a notional apportionment, a quarter of the £50,000 should be treated as apportioned to the business done by the United Kingdom branch. He therefore deducted £12,500 from the £125,000, leaving £112,500 to bear tax at the standard rate.

The actual method adopted by the Revenue, which the Solicitor-General supported in the alternative, though it led to the same result, was on a different basis. The Revenue deducted the £50,000 from the total income before apportionment, applying the apportionment fraction of one-quarter to what was left. The learned Judge, who found in favour of the Crown, considered that the first approach was in accordance with the Rule and with principle. We agree with the learned Judge as to the proper method of formulating the argument for the Crown, though it may be there is little, if any, difference in principle as there is clearly none in the result.

Mr. Tucker relied on the case of *Sinclair* v. *Cadbury Bros., Ltd.*, 18T.C. 157. That was a case in which the company was the lessee, at an annual rent, of land on which it built a factory. The land was by an Act of Parliament of 1660 exempted from taxation, and the land was therefore not assessed under Schedule A. Rule 5 of Cases I and II of Schedule D, as amended in 1926(1), provided that the computation of tax was to be made exclusive of the annual value of land occupied for the purpose of the trade and separately assessed and charged under Schedule A. The argument for the Crown was based on the concluding words introduced in 1926. This land was not assesssed under Schedule A and, therefore, it was argued, its annual value could not be excluded. The Company sought to deduct the annual value. This Court, reversing Finlay, J., held that the deduction was admissible. Lord Hanworth, M.R., held that unless the deduction was allowed the Court would be failing to give effect to the immunity conferred by the Act of Parliament(2). In other words, and this is stated by P. O. Lawrence, L.J., the occupiers would be "indirectly "taxed" in respect of land which was given immunity by Act of Parliament(3). Mr. Tucker relied on this case as one in which there was no attempt to tax the exempted property directly. The Court proceeded on the basis that you must look at the result. If the land had not been exempted, the Crown would have got the Schedule A tax ultimately borne by the owner, and Messrs. Cadbury would have deducted the annual value. By refusing to allow the deduction the Crown were indirectly collecting the Schedule A tax from Messrs. Cadbury.

This and the earlier cases lay down quite clearly that, if an

(1) Section 36(1) and Fourth Schedule, Finance Act, 1926. (2) 18 T.C., at p. 172.
(3) *Ibid.*, at p. 173.

(Somervell, L.J.)

exemption is conferred, the Crown must not get the tax either directly or indirectly. The application of this principle to the present case is not without difficulty.

The exempted securities were held as part of the general life assurance fund of the Appellant. They were not, as in the *New Zealand Bank* case[1], assets of the London branch. As Rule 3 is based on the principle of apportionment, one might expect to apportion to the United Kingdom branch the appropriate proportion, and allow the exemption on that amount to operate on the tax liability of the branch. The remainder would go tax free to the funds of the business employed outside the United Kingdom. Mr. Tucker's argument depends on the wording and implications of sub-paragraph (4) set out above. That sub-paragraph is dealing with income from United Kingdom sources charged to tax. Its broad result is to allow that charge, which would, of course, exist even if the company had no branch here, to be set against the tax otherwise exigible on the apportioned income. This may operate as a considerable inducement to a foreign assurance company to establish a branch here. If, for ordinary commercial reasons, it holds United Kingdom securities producing £50,000 of income which would suffer tax by deduction, it can open a branch here without paying any further tax until the income as apportioned to the branch business under the Rule exceeds £50,000.

The words of the sub-paragraph do not, in our opinion, apply to income from exempted securities in the sense which Mr. Scrimgeour suggested. He wished to construe the sub-paragraph as meaning, in effect, that the credit given under it should be extended so as to include the tax which would have been paid on the exempted securities if they had not been exempted. The language will not bear such a construction.

Nevertheless, the Rule must be construed together with the exempting provisions, which, in our opinion, must be regarded as paramount. In so far as the Rule, if taken in isolation, would have the effect of indirectly depriving the company of any part of the benefit of the exemption, its operation must be cut down so as to prevent any such result, and to allow the exemption to operate to its full extent. This appears to us to be the effect of the authorities cited to us. In the present case, if there had been no exemption, the Appellant would have suffered tax by way of deduction on £50,000. In computing the liability of the United Kingdom branch, the tax on the apportioned income would have been reduced by the tax on that £50,000. In other words, the burden of the tax for which credit is to be given under sub-paragraph (4) is treated as a burden falling on the business carried on by the branch. The branch is not fully relieved of that burden as, under the exemption provisions, it ought to be, unless its further tax liability on the excess of the apportioned income over the income of the investments in question is left unaffected. On the figures set out, the £50,000, if charged, would have left £75,000 to bear tax. If the burden of the tax on the £50,000 is to be wholly removed, the figure of £75,000 must not be increased. On the Crown's argument, as appears above, the figure would be increased to £112,500. If, therefore, the capital producing the £50,000 had originally been held by the company in the form of investments taxed

(1) 21 T.C. 472.

(Somervell, L.J.)

by deduction, and those investments had been sold and the proceeds reinvested in exempted securities, the result would have been that the tax liability of the company under Rule 3 would have gone up from the tax on £75,000 to the tax on £112,500 merely by reason of the change to exempted securities. This, as it seems to us, would deprive the company of the greater part of the benefit of the exemption.

For these reasons we think the appeal should be allowed.

Mr. Tucker.—The appeal will be allowed with costs here and below ?

Lord Greene, M.R.—Yes. What other Order do you require?

Mr. Tucker.—The case will have to go back to the Commissioners for adjustment of the assessment in accordance with your Lordships' judgment.

Lord Greene, M.R.—Yes.

Mr. Hills.—Would your Lordships give my clients liberty, if, on considering the matter, they think fit, to appeal to the House of Lords?

Lord Greene, M.R.—Do you raise any objection to that, Mr. Tucker?

Mr. Tucker.—To be quite fair, to my mind, what I should have said, had the decision been the other way, is this. This decision affects a great many insurance companies, not only Dominion, but foreign ones, and, moreover, notwithstanding the legislative alteration in 1940, the question is still a live one as regards investments like war loan. So that I am bound to say I should have submitted it would have been a proper case, and I ought frankly to say so now.

Lord Greene, M.R.—You may take leave, Mr. Hills.

Mr. Hills.—If your Lordship pleases.

The Crown having appealed against the decision in the Court of Appeal, the case came before the House of Lords (Viscount Simon and Lords Wright, Porter, Simonds and Normand) on 30th and 31st January and 3rd and 4th February, 1947, when judgment was reserved. On 31st March, 1947, judgment was given unanimously in favour of the Crown, with costs, reversing the decision of the Court below.

The Solicitor-General (Sir Frank Soskice, K.C.) and Mr. Reginald P. Hills appeared as Counsel for the Crown, and Mr. J. Millard Tucker, K.C., and Mr. J. S. Scrimgeour, K.C., for the Society.

JUDGMENT

Viscount Simon.—My Lords, this is an appeal from an Order of the Court of Appeal (Lord Greene, M.R., Somervell and Cohen, L.JJ.) allowing an appeal by the Respondent Society from the Order of Macnaghten, J. The learned Judge had dismissed the Respondent Society's appeal from a decision of the Commissioners for the Special Purposes of the Income Tax Acts upon a Case stated by those Commissioners.

The Respondent Society carries on mutual life assurance business, having its head office in Sydney, New South Wales, but has a branch in London through which it carries on a portion of its life assurance business.

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The appeal relates to the computation of the assessable income arising from the profits of the London branch for the years ended 5th April, 1937, 1938, 1939 and 1940, respectively, and turns on the proper interpretation and application of Rule 3 of Case III of Schedule D of the Income Tax Act of 1918. That Rule provides as follows: "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 com- "pany 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 invest- "ments 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 pro- "portionately reduced."

Since the Society was not resident in the United Kingdom for the purposes of United Kingdom Income Tax, it was entitled to exemption from that tax in respect of interest and dividends of securities and investments falling either (*a*) within Section 46 of the Income Tax Act, 1918, or (*b*) within Rule 2 (*d*) of Schedule C, or (*c*) within Rule 7 of the Miscellaneous Rules of Schedule D. The investments of the life assurance fund of the Respondent Society included some investments which were exempted from Income Tax under each of these heads. For example, the income from these exempted investments in the calendar year 1935 amounted to £72,354, and if this figure is relevant, it would enter into the calculation of assessable profit for the fiscal year 1936-37.

When the present appeal reached your Lordships' House, a curious and somewhat embarrassing situation was disclosed. In the Courts below, and before the Special Commissioners, it seems to have been assumed, both on the side of the Inland Revenue and on the side of the Respondent Society, that the application of Rule 3 to the latter was in some way affected by the existence of this exempted income,

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and that the question between them was: What was the proper method of making the adjustment called for on this account? But, in the course of the argument before us, the House invited the Solicitor-General to explain why the calculation under Rule 3 was affected by the fact of exempted income at all. A good deal of the subsequent discussion revolved around this point, and consequently your Lordships have now to decide two questions, first, what is the proper construction and application of Rule 3 when an assurance society which falls within that Rule holds investments exempt from Income Tax among the investments of its life assurance fund, and secondly, what is the right decision in the case now before us, where the Revenue has in effect made the concession that the existence of exempted income makes a difference to the calculation.

The present Rule 3 had its origin in Section 15 of the Finance Act, 1915 (5 & 6 Geo. V, c. 62). As Mr. Hills pointed out to us, before the Act of 1915 there was much difficulty in getting Income Tax from a life assurance company resident abroad with a branch here. Such a company could avoid United Kingdom Income Tax on its income from investments, even though it had a branch in the United Kingdom, by so arranging its affairs that its investments were foreign investments, the proceeds of which were not caught by United Kingdom Income Tax. It is true that the company might be regarded as carrying on in this country a trade through its branch, but there was much practical difficulty in arriving at the figure under Case I of Schedule D of annual profits of such a branch, for, in the case of life assurance business, the true profits attributable to the branch could not be ascertained in the normal manner, as is shown by provisions in the Assurance Companies Act, 1909, for a quinquennial valuation.

Section 15 of the Finance Act, 1915, was, it would seem, aimed at meeting this difficulty, and it did so by providing for a conventional figure, which should be "deemed to be profits" comprised in Schedule D, on which a non-resident life assurance company, with a branch in the United Kingdom, would make a contribution to United Kingdom Income Tax however it arranged its investments. The provisions now contained in Rule 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.

The Rule itself is expressed in clear terms, and we are not entitled to read into it anything which is not there, unless upon the true construction of the Income Tax Acts as a whole there is some statutory provision which must be treated as modifying it in order to give it its true effect.

In Sub-rule (1) of the Rule there is no justification for reading "any income of the company from the investments of its life "assurance fund" as though it ran "any income of the company "from such part of the investments of its life assurance fund as "are not exempt from Income Tax". Yet this is the interpretation which is primarily favoured by the Crown. "The investments of "its life assurance fund" must mean all such investments, and not a residue of them after first subtracting what may be called

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"exempted investments." Sub-rule (2) directs how the fraction is to be arrived at which is to be applied to the total of such investments, and naturally involves a comparison between two totals, one attributable to the life assurance business as a whole and the other attributable to the United Kingdom part of it. In the present case the proviso to Sub-rule (2) was put into operation and the necessary fraction was obtained by the use of it. There is no dispute as to what the proper fraction is in this instance, it is roughly one-twentieth.

The language of Sub-rule (4) seems to me to be equally clear. Its effect is to secure that the company's contribution by way of tax under the Rule shall be abated, or even wiped out altogether, to the extent to which the company is charged to tax independently of the Rule. But there is no justification for reading the words "Where a "company has already been charged to tax" as though they meant "Where the company would be charged to tax if the investments it "held were not investments the produce of which is exempt from tax." The relief given by Sub-rule (4) arises from the company paying tax apart from the Rule, not from the company holding exempted investments.

From 1915 to 1938, as I understand, the practice of the Revenue, acquiesced in, or at any rate not challenged in litigation, by life assurance companies with their head office abroad and a branch in the United Kingdom, was to charge tax on the conventional sum thus arrived at, treating as immaterial the fact that the life assurance fund might contain investments the proceeds of which were not subject to tax. But in 1938 this House decided the appeal of *Hughes* v. *Bank of New Zealand*, 21 T.C. 472, upholding a decision in the Court of Appeal given in December, 1936, when my noble and learned friend Lord Wright was presiding as Master of the Rolls. The point there arising had nothing to do with Rule 3 of Case III of Schedule D, and nothing to do with the taxing of life assurance companies. What was being considered was the taxation under Case I of a bank resident in New Zealand with a branch in London. The question was whether, in calculating the profit of the branch by setting off expenses against receipts, it was right to include on the receipts side the interest on certain investments the proceeds of which were by statute exempt from tax. If these amounts were included, the result would be nothing short of the taxing of interest which was not to be taxed. The issue is made exceedingly clear by examining the statement of debits and credits printed on page 518 of Lord Thankerton's opinion and by studying his subsequent observations. In the Court of Appeal Lord Wright had said (page 492): "It would be rather deplorable if, "notwithstanding what I regard as the clear language of Section 46, "the owner, not being ordinarily resident in the United Kingdom, was "still taxed on the interest as part of his trading profits, and in my "view that is not the true construction of the Section . . . If they are "not taxable at all, then obviously they can neither be charged under "Case III of Schedule D nor under any Case of Schedule D at all."

Read in the light of the issue before him, the words of my noble and learned friend, and the decision of this House, do not, in my opinion, help the Respondent Society, and consequently do not call for any change in the practice previously adopted as correct in applying Rule 3 of Case III. In the *New Zealand Bank* case what was in issue

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was the taxing of receipts which were exempt from tax. In the application of Rule 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-rule (4).

The other decision which was thought to be helpful to his case by Mr. Tucker was that of *Sinclair* v. *Cadbury Bros., Ltd.*, 148 L.T. 478; 18 T.C. 157, where it was held, in reference to Rule 5 (1) of the Rules applicable to Cases I and II of Schedule D, that the assessment of profits of Cadbury Brothers must be made by excluding the annual value of certain lands, notwithstanding that these lands of the taxpayer were by a statute of 1660 exempt from every form of taxation and therefore could not be charged to tax under Schedule A. To do otherwise would be to impose tax on an income which was in terms not to be taxed. This decision also does not, as it seems to me, afford guidance in the present case, for the reason already indicated.

Once it is accepted that Rule 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. Section 21 of the Finance Act, 1940, ought not, I think, to be read as establishing that the effect of the previous law was otherwise than as above stated.

As I am differing from the Court of Appeal, when Somervell, L.J., delivered the judgment of the Court, I must indicate why, with the greatest respect to the Lord Justice, I find myself unable to accept his reasoning. He points out that Sub-rule (4) of the Rule permits a set off against the charge on what is to be "deemed to be profits" of the whole of the tax charged by deduction or otherwise in respect of the company's life assurance business, and this set-off may be sufficient to extinguish the charge under the Rule altogether. The argument then proceeds thus. If the source of the set-off was tax borne by investments subject to tax, the set-off would be effective in reducing or might even extinguish the charge under the Rule. If, however, these investments were changed into exempted investments, there would be nothing to set off. This is true, but I cannot agree that such a result amounts to taxing indirectly the exempted investments. The resulting tax flows from the language of the Rule, which authorises a reduction of the tax on the sum arrived at only if contributions to United Kingdom Income Tax have been made from other sources.

In my opinion, therefore, no reduction of liability on the ground that exempted investments enter into the calculations is called for. But, inasmuch as the Crown is merely seeking the reversal of the Order of the Court of Appeal, the motion to be put to the House should be that the appeal be allowed.

My Lords, my noble and learned friend, *Lord Normand*, who is not able to be here this morning, authorises me to say that he concurs in this opinion.

Lord Wright.—My Lords, I have considered in print the opinion which has just been delivered by my noble and learned friend Viscount Simon, and I agree with it.

The question is what effect is to be given to Rule 3 of Case III, Schedule D, and the incorporated statutory regulation. The provisions of the Rule are set out by my noble and learned friend, and I do not repeat them, nor do I recapitulate the facts which he has set out.

It was stated by the Counsel for the Crown that up to 1938 the practice was to treat the Rule as a self-contained provision, enacted in 1915 and directed to secure that non-resident foreign and colonial assurance companies should bear some share of taxation for the benefit of the British revenue in respect of the part of their business carried on at their English branch. As it was difficult to assess their profit in the ordinary method, Rule 3 was devised as a rough and ready way of imposing some tax on their British profits by assessing a definite proportion of their income from the securities of their life assurance fund. The proportion was arrived at by a ratio based on the comparison between one part of their liability (which may be described as British liability), that is their liability on life assurance policies effected on proposals made in Britain or of which the holders are in Britain, and the total amount of their liability on all life assurance policies. This is a conventional charge; the ratio which in this case is roughly one-twentieth of the total premium receipt on life assurance business is fixed and artificial. In the year of assessment 1936-37 this ratio, when applied to the total sum of the life assurance fund, gave a figure of £230,684 as the British income of the Respondent Society on the basis directed by Rule 3. No specific investments were taxed. The Rule provided that the income from the fixed specified percentage of the securities in question was to "be deemed to be "profits" comprised in the Schedule (Schedule D), and was to be charged under Case III of that Schedule. It was, therefore, a charge under the Case on a notional figure deemed to be a figure of profit. No doubt it was possible to give a list of the securities which formed at any particular time the life assurance fund, and to value them individually and add up the total. But there was nothing to show which of these securities were to be deemed to fall within the twentieth portion of the securities.

Of the securities comprising the life assurance fund there were certain investments, amounting in value to £72,354, the income of which was specially exempted from tax. They have been specified by the noble and learned Viscount in his opinion. No allowance was made in the assessment under Rule 3 of Case III on account of these exemptions. That was not at first questioned by the Respondent Society. But after the decision of this House in *Hughes* v. *Bank of New Zealand* (1), [1938] A.C. 366, the Respondent claimed that these exempted securities should have been segregated, and the total amount of the income from them in the year of charge deducted from the total "British" income so that the charge under Rule 3 should have been proportionately reduced. The Society accordingly made a corresponding claim for repayment of part of the tax so assessed on the ground of error or mistake, under Section 24 of the Finance Act, 1923, in its return. But as the hearing of the appeal before your Lordships proceeded, it was pointed out by my noble and learned friend Viscount Simon that the real question to be determined was

(1) 21 T.C. 472.

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whether on the true construction of Rule 3 there had been any error or mistake. To decide that it was necessary to construe Rule 3, and I think that it has now been made clear that the Rule was correctly applied. Its application was not affected by the decision in the *Bank of New Zealand* case[1]. In that case Rule 3 was not considered; it was not necessary to consider it at all. Rule 3 deals with the life assurance fund of assurance companies. The decision just referred to deals with a bank. The exemption under Section 46 of the Income Tax Act, 1918, directly and plainly applied to the specified securities in question. But Rule 3, as already explained, was not a plain or simple clause of exemption as were the clauses considered in the *Bank of New Zealand* case. It was, on the contrary, a charging provision intended to charge the Society on the basis of a fixed percentage of the total income. That was merely a convenient mode of imposing some charge on the assurance company in consideration of the privilege it enjoyed in trading in this country. The charge was a tax on the investment income only as a machinery to tax the general profits of the British business, and as a manner of measuring the charge by an arbitrary figure derived from a percentage of the investment income. In this connection it was not material to distinguish between exempted and unexempted income. All that was needed was a yard-stick. This is borne out by the actual language of Rule 3. It is positive in its terms: the only qualification is to be found in Sub-rule (4) which provides for a set-off of charges on the society outside Rule 3. The effect of the Sub-rule is to secure that the fixed and conventional assessment under Rule 3 is to be reduced proportionately if the company has already been charged apart from the charge under Rule 3.

As my noble and learned friend has pointed out, the decision in the *Bank of New Zealand* case affords no guidance in the present appeal, nor do the expressions which he quotes from my judgment in the Court of Appeal ([1937] 1 K.B. 419, at page 430[2]). What I said there was quite correct in respect of the issue then before the Court and of the securities then in question. The special provisions of Rule 3 were not there relevant, and were not before either the Court of Appeal or this House. In truth, as already observed, the charge under Rule 3 was not a charge on the specified investments except in form; it was an artificial mode of charging the general profit of the British business. Rule 3 not being qualified, except for Sub-rule (4), and being a charging section, must receive its appropriate effect from the Court, notwithstanding an apparent but not real conflict between it and Section 46 of the Income Tax Act, 1918. The difficulties involved in attempting to reconcile Rule 3 and Section 46 and bring them both into operation are illustrated by the judgments in the tribunals below in the present case. But these difficulties do not arise if, as I think, Rule 3 is the dominant and overriding enactment in this regard. If the Court has failed to give effect to the purpose of the Legislature it is for the latter to cure the error. However, as Lord Simon has pointed out, the only amendment of the law, namely, that contained in Section 21 of the Finance Act, 1940, is not retrospective and cannot help the Court in deciding this appeal.

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(1) 21 T.C. 472. (2) *Ibid.*, at p. 492.

(Lord Wright.)

For these reasons, and for the reasons explained by my noble and learned friend, I shall concur in the motion which he will put to the House.

Lord Porter (read by Lord Simonds).—My Lords, the decision in this case turns upon the true construction of Rule 3 of the Rules applicable to Case III of Schedule D of the Income Tax Act, 1918. The facts have already been stated, and the Rule has been quoted in full so that it is unnecessary for me to repeat it.

The Revenue authorities say that the terms of the Rule are plain; its object is to determine what are to be regarded as the taxable profits of a non-resident assurance company with a branch in this country. Tax, in their contention, is not imposed upon the income of its investments in the case of such a company, it is imposed upon a purely notional sum of profits.

They point out that if an assurance company is resident in this country they can either assess it under Case III of Schedule D upon the income from its investments or under Case I of that Schedule upon the profits of the business which it carries on, and agree that if the former alternative is adopted the interest derived from its tax-exempt investments must be excluded in computing what its income is. Indeed, I understand them to be prepared to concede that the exclusion of such interest cannot be avoided if the alternative method of taxing the company on its profits is adopted, since it is not permissible by any device to levy tax on such investments either directly or indirectly—see *Hughes* v. *Bank of New Zealand*, [1937] 1 K.B. 419 and [1938] A.C. 366 (21 T.C. 472).

Similarly, if tax is being levied upon profits, the taxable value of tax-free land must be excluded from the credit side of the account in ascertaining what these profits are—see *Sinclair* v. *Cadbury Bros., Ltd.*, 18 T.C. 157.

In each of these cases, however, the object was to determine what sums were to be brought into computation in ascertaining the actual profit; in the former case the profits of the English branch of a non-resident company charged not upon a conventional basis, but upon the actual profits earned by that branch in this country; in the latter the actual profits of a company which was resident here. In neither case did notional profits come in question nor, indeed, is there any very obvious reason for applying these principles to notional profits calculated by adopting, in the case of a non-resident company with a branch here, some conventional method of finding the proportion which the income of the English branch bears to the income of the business of the company as a whole.

Where, as in this case, notional or conventional profits alone come in question, your Lordships have to decide whether the possession of tax-exempt investments has any effect in reducing the quantum of those profits and, if it has, to determine the extent of that reduction.

The Respondents, on their part, assert in the first place that Rule 3 does not prescribe a method of calculating profits under Case I of Schedule D, but on the contrary the word "profits" in the Rule merely means income which is subject to tax under Case III. Such income, they say, is that which is set out under the specific heads to

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be found in Rule 1 of the Rules applicable to that Case under the sub-headings (*a*) to (*f*), and the matters included under those heads are confined to investment income and nowhere deal with profits as such.

In support of this argument they point to the phraseology used in Rule 3. What is being taxed, in their submission, is "income" not "profits": it is only deemed to be profits, and not even profits of any kind, but profits "comprised in this Schedule" and "charged "under this Case". Nor, they say, can the Revenue authorities escape this result by attempting to assess the Income Tax payers under Case I in respect of profits as an alternative to charging him under Case III. Rule 3, they argue, alone gives validity to the charge and no alternative method is permitted.

If, then, it is income from investments which is being taxed in this country and the company upon which the charge is made holds tax-exempt investments, that company, it is maintained, should have the benefit of the exemption to the extent to which it is assessed to tax, otherwise it is charged on its tax-exempt investments either directly because they form part of its income, or any rate indirectly in being compelled to pay upon the income of its other securities which have not been brought into this country and should be exempt from taxation imposed here.

This criticism would, I think, have force if applied to such circumstances as existed in the *Bank of New Zealand* (1) and in the *Cadbury* (2) cases, in both of which the tax was imposed on actual profits and the tax-free asset was part of the assets of the branch or company upon whom it was imposed. But it has no application to a case where the profits or income, the subject of charge, is a notional sum calculated in a conventional way, nor do I think it matters whether it is or is not established that the tax-exempt investments are assets of the branch carried on in this country.

The stress of the Respondent's argument was laid upon the words "shall be charged under this Case", that is, under Case III, and it was said that those words mean that it is to be charged upon the income of investments as such.

I cannot think so. In the first place it is not accurate to say that Case III is concerned only with investment income. The general description of the content of that Case in Paragraph 2 at the beginning of that Schedule shows a wider ambit. There the field covered by Case III is delineated in the words: "Tax in respect of "profits of an uncertain value and of other income described in the "rules applicable to this Case". In the face of such a demarcation of the extent of the tax, there is no justification for limiting it to a charge on investment income. To do so would be to give effect only to the latter half of the definition, and to confine the attention to "other income described in the rules applicable to this Case" whilst neglecting the opening words "profits of an uncertain value".

In any case, when the Rules speak of income being taxable under Case III they mean, I think, no more than that tax, being imposed under the Rules of that Case and there only, must be charged under that Case. It does not mean that the charge is imposed on the income from investments and not on profits.

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(1) 21 T.C. 472. (2) 18 T.C. 157.

(Lord Porter.)

But, says the Respondent, let it be granted that the Rule means no more than that notional profits are to be ascertained in a conventional way and then subjected to tax, nevertheless the Crown will be charging tax upon tax-exempt securities if we are not given the benefit of all our tax exemption when we are being assessed in respect of the profits of the English branch. Unless the taxpayer gets the benefit of this exemption when assessed in this country he will, they maintain, gain no advantage from his purchase of tax-free securities: not in this country because no allowance is made in his assessment here: not elsewhere because an assurance company not having its head office in the United Kingdom would in any case escape liability unless, of course, the tax were deducted at the source. Sub-rule (4), it is said, gives a benefit to those who have paid tax by deduction in England and, therefore, those who hold tax-free investments should receive a like benefit by being treated as if they had paid tax on those securities, otherwise they are not enjoying to the full the benefit of the exemption.

The answer is, I think, that they receive such benefit as they are given by the Rule, and if no exemption is thus granted, the matter, if this result is not intended, may be one for the Legislature, but is not one with which your Lordships can deal.

No doubt this construction of the Rule, if adopted, may in certain circumstances lead to an anomalous position, for example, if a non-resident company should have invested all its life assurance fund in tax-exempt securities, it would pay tax on the conventionally apportioned sum without any reduction, and would be no better off than if the statutory proportion were wholly liable to tax. I agree that this is a hardship, but it does not entitle your Lordships to disregard the plain meaning of the Rule. So long as the words are in their present form, the result must be looked upon as the price which non-resident assurance companies have to pay for engaging in business in this country.

I would only add that, even if the arguments for the Respondent were accepted in principle, I find difficulty in seeing why the whole of the tax exemption should be regarded as owed to the English branch.

In the case of a bank such as the Bank of New Zealand, and in circumstances such as existed in that case, any quantity of tax-free securities might have been held by the business as a whole, but exemption was only given to the English branch in respect of those held as part of that branch's assets and brought into account in calculating the amount of profits earned here. Both the *Bank of New Zealand* case [1] and *Cadbury's* case [2] do, in my opinion, decide that, when actual profits are being dealt with, the exempted interest or item must not be included as a credit item in the company's account when determining its profits.

It is argued that when in the present case notional profits are being sought for, interest or items of that kind must upon similar principles be excluded from the calculation of such profits. The analogy, however, in my view, if it applies at all, only applies in a case where the quantum of actual, not notional, income is being

(1) 21 T.C. 472. (2) 18 T.C. 157.

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ascertained. In the present case the only actual income which forms a factor in ascertaining the amount of profits is that mentioned in Rule 3 (2), that is, the total income from the investments of the life assurance fund. If, then, that Sub-rule requires the interest derived from tax-free investments to be deducted, the logical course would be to deduct it from the actual total investments of the company which are exempt from tax. I cannot for myself see why it should be deducted from a sum which 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. It is not as if the tax-exempt investments were assets of the English branch, or as if indeed it were possible to separate the assets of the branch from those of the company as a whole—no argument as to or evidence of such a position was presented, and the method of calculating the profits adopted in Rule 3(2) would prevent such a suggestion being put forward.

In any case, however, I think the wording of the Rule too plain to justify even the modified relief which the Crown have been prepared to give since the decision in the *Bank of New Zealand* case [1] was decided.

I agree with your Lordships that the appeal should be allowed and the judgment of Macnaghten, J., restored. This is the Order asked for by the Appellants, and it is not, I think, material that the reasoning of your Lordships, including my own, would lead to the withdrawal even of the relief given by the Commissioners and by the learned Judge.

Lord Simonds.—My Lords, speaking for myself, I also concur.

Questions put:

That the Order appealed from be reversed.

The Contents have it.

That the judgment of Macnaghten, J., be restored and that the Respondent do pay to the Appellants their costs here and in the Court of Appeal.

The Contents have it.

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

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(1) 21 T.C. 472.