Privy Council Appeal No. 22 *of* 1961

Australian Mutual Provident Society – – – – – – *Appellants*

v.

The Commissioner of Inland Revenue – – – – – – *Respondent*

FROM

THE SUPREME COURT OF NEW ZEALAND

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 20TH NOVEMBER 1961

Present at the Hearing
THE LORD CHANCELLOR
LORD DENNING
LORD MORRIS OF BORTH-Y-GEST
LORD HODSON
LORD DEVLIN

[*Delivered by* LORD DEVLIN]

This appeal gives rise to two separate questions upon the interpretation and application of section 149 of the Land and Income Tax Act, 1954. This section provides a short but complete code for the taxation of companies carrying on in New Zealand the business of life insurance. The appellant company is a mutual insurance society (and therefore with no shareholders and paying no dividend) incorporated in Australia and carrying on the business of life insurance principally in Australia but also in New Zealand and the United Kingdom. In common with most companies carrying on this class of business the appellants calculate at the end of each year what are called their " surplus funds ". A life insurance company has surplus funds if and to the extent that its life insurance fund exceeds the net liability, computed by means of actuarial calculations, under its life policies. A large part of these surplus funds is then commonly allotted for the payment of reversionary bonuses to policyholders participating in profits. The sum so allotted, after deducting therefrom " exempt " income, is under section 149 deemed to be the profit derived from the business. The first question in dispute in this case is as to the amount of the funds so allotted by the appellants in respect of the year 1955; and the second is as to the amount of the exempt income to be deducted.

The appellants' surplus funds at the end of 1955 were over £11,000,000. Out of this they decided to allot £8,738,779 as reversionary bonuses. The rest of the surplus was put to reserve or used for writing down assets or other similar purposes or left unappropriated. It is not to be supposed that the figure of £8,738,779 was an exact balance down to the last pound after the other purposes had been served. A reversionary bonus is an additional sum promised by way of bonus on the maturity of each policy and it takes the form of a round sum to be added to each £100 of the nominal value of the policy. The immediate cash allotment that has to be made in order to produce this round sum is something that has to be worked out actuarially, for it depends on the time that is likely to elapse between the date of allotment and the date of maturity of each policy and upon the rate at which the cash allotment is likely to accumulate during that time. The cash allotment is therefore the present value of the reversionary bonuses; it is a sum calculated as sufficient to provide in due course the " face value " of the reversionary bonuses declared to the policyholders. The amount of the surplus fund

available for allotment will tell the company approximately what reversionary bonuses it can declare, that is, to the nearest pound or half-crown or whatever unit it customarily uses as its minimum; and the exact amount of the cash allotment will have to be worked out so as to produce that total.

The Directors' Report of the appellant company for 1955, dated 18th April, 1956, contains the following paragraph under the heading " Bonus Distribution ":—

> " On the advice of the Chief Actuary, your Directors have decided to distribute £7,496,295 of surplus funds among the holders of participating Ordinary policies, thereby providing reversionary bonuses of more than £12,996,000. The corresponding surplus to be distributed to Industrial policy holders is £1,242,484 providing reversionary bonuses amounting to £1,528,000. "

The total of the surplus for both classes of policy, Ordinary and Industrial, is the figure already mentioned of £8,738,779; and that is the figure which appears in the Company's Statement of Surplus and Statement of Liabilities under the description:—" Surplus Divided for year 1955, and allotted as Reversionary Bonuses to participating policies." The total of the face value of the reversionary bonuses for both classes of policy is just over £14½ million.

These figures relate to the total business of the appellant company and section 149 taxes the allotment only in so far as it is " in respect of policies comprised in the New Zealand business of the company ". The proportion of the cash allotment of £8,738,779 that is attributable to the New Zealand business of the appellants is £1,736,492. On 18th July, 1956, the appellants made a return of income to the respondent in accordance with this figure; and they annexed to it a certificate by their Chief Actuary which included the following statement:—

> " Reversionary bonuses for a total face value of £2,929,285 allotted to policies in force at 31st December, 1955. The cash value of the Reversionary bonuses of face value £2,929,285 according to the respective bases employed by the Society in valuing its policies was £1,736,492 at 31st December, 1955. "

The case for the respondent is that the appellants quite plainly and according to their own records have made an allotment of surplus funds within the meaning of section 149 amounting to £1,736,492 and should be assessed accordingly. The case for the appellants is that, notwithstanding what they have said and apparently done, £1,736,492 does not truly represent the sum allotted within the meaning of section 149, and that the true allotment was £1,393,619. The difference between these two figures is £342,873.

To see how the appellants arrive at their figure of £1,393,619 it is necessary to consider the actuarial calculations by which the cash allotment is related to the face value of the reversionary bonus. Different actuarial methods can be adopted for this purpose and the one used by the appellants in 1955 is known as the Net Premium Valuation. In this method it is assumed that the cash allotment will accumulate at the rate of 2½ per cent. It is not disputed that 2½ per cent. is a very conservative rate to take: the appellants' case is that it is not merely a conservative rate but an artificially low rate, deliberately selected as lower than the proper rate, in order to provide an additional and hidden reserve. As a policy advances towards maturity a cash allotment of a given amount would produce a bonus of a continually decreasing face value because, as the policy advances, the period for accumulation continually diminishes. But policyholders, it is said, are interested only in the face value of the bonuses declared and would not like to feel that that was continually decreasing. The Net Premium method avoids this undesirable result because the additional reserve which it creates can be used in the later years. There are other methods of achieving the same result without using an artificially low rate of interest; in particular there is one known as the Bonus Reserve Valuation in which the rate taken is 3¾ per cent. It is not disputed that 3¾ per cent. would be a fair rate to take or that in 1955 it would be closer than is 2½ per cent. to a correct estimate of future interest rates; the rate actually earned by the appellants in 1955 was just over

4 per cent. If the appellants had used the rate of 3¾ per cent, an allotment of £1,393,619 would have been estimated as sufficient to produce reversionary bonuses of the face value promised in the Directors' Report. The excess of £342,873 is therefore, the appellants contend, not an allotment by way of reversionary bonus but an appropriation to an additional or internal reserve. The appellants arrived at this conclusion after they had made their first return showing the larger allotment; and on 25th January, 1957, they made an amended return showing the smaller allotment of £1,393,619. The respondent nevertheless assessed the appellants on their first return. Their objection to this assessment was disallowed by the stipendiary magistrate, whose decision was upheld by the Supreme Court, from whose judgment the appellants now appeal.

Prima facie a question as to the amount of an allotment is a question of fact and the stipendiary magistrate and the Supreme Court so treated it. It is true that there was no physical allotment of cash or securities and no formal appropriation in the appellants' books. But it has not been argued that the Act requires any particular form of allotment: indeed the dispute is solely as to the amount of an allotment admittedly made. There is ample evidence in the documents from which their Lordships have quoted that the amount actually allotted was £1,736,492 and the only evidence that the appellants ever allotted any smaller sum is their statement in the amended return. It is hopeless for the appellants to contest before the Board the concurrent findings of fact by the courts below unless they can satisfy the Board, as they have tried to do, that those findings are based on a misconstruction of the statute.

The material words of section 149 are " Allotment of surplus funds by way of reversionary bonus or otherwise ". The appellants say that on the true construction of the statute the allotment contemplated is the allotment of a reversionary bonus. Therefore, they say, in order to ascertain the amount of the allotment, one must begin by ascertaining the face value of the reversionary bonuses declared and from that calculate their present or cash value. It is the duty of the court, they say, to make that calculation for itself; the court is not bound by any calculation made by the taxpayer, whether it be for or against him. They assert that the calculation they made, using what they describe as the " unrealistic " rate of interest of 2½ per cent, was wrong, but as between themselves and the Commissioner of Inland Revenue they are not bound by that. The court should therefore, they contend, disregard their erroneous calculation and make a fresh calculation objectively and using the rate of interest which on the evidence, they claim, is shown to be the correct one, namely 3¾ per cent.

Their Lordships do not pause to inquire whether, if there are two accepted methods of making a calculation and the taxpayer has for his own purposes chosen one rather than the other, it is open to the court to substitute the other, whether at his request or the request of the Commissioner of Inland Revenue; nor to inquire just what is meant by a " true " or a " realistic " rate of interest. Nor need they consider whether, since the appellants have used the rate of 2½ per cent for two purposes, viz. the calculation of the amount of the surplus funds as well as the calculation of the present value of the reversionary bonuses, it can be changed in the one case and not in the other. Their Lordships deal with this point, in the same way as the Supreme Court dealt with it, by rejecting the proposed construction of the statute. On the plain words of the statute the Commissioner is concerned not with the allotment or declaration of a particular reversionary bonus but with the allotment of surplus funds. Once the Commissioner has ascertained that a specific sum has been allotted for the provision of reversionary bonuses, his task is concluded. He does not have to know whether or not at the same time a specific reversionary bonus was declared or promised to the shareholders; nor, if such a declaration or promise is made, is he concerned to inquire whether the sum allotted is too much or too little to satisfy the promise. On this point Barrowclough, C.J. said:—

> " The subsection makes no reference either to the face value or the cash value of reversionary bonuses . . . The fact that this allocation

may have been the basis for the decision to declare bonuses which on maturity would be worth £2·9 million may have been interesting to policyholders but was not, of course, to the Commissioner."

Their Lordships agree with these observations.

Mr. Bucher for the appellants pressed very hard upon the Board the contention that the construction of the statute adopted by the Supreme Court would lead to double taxation of a part of the allotment, namely, the so-called additional reserve of £342,873. He argued that, so far as can be seen at present, this additional reserve will not be required for the satisfaction of the reversionary bonuses declared, that it will therefore become an unappropriated asset of the company and that before it can reach the policyholders in the form of a reversionary bonus there will have to be a fresh allotment which will attract tax again. Whether or not this sum will have to bear tax again is a matter that is not now in issue and that may have to be decided hereafter. Their Lordships will therefore express no opinion upon that question, but, in order to test the construction they have adopted, will assume that Mr. Bucher's reasoning is sound. In their view it does not assist his argument in this case for two reasons. The first is that double taxation does not follow inevitably from the construction they have placed on the statute and the second that it would not be avoided by the alternative construction proposed. The statute, as their Lordships have said, does not require that the surplus funds should be allotted to the service of a particular bonus. It is true that it is the practice of life insurance companies when they make an allotment also to declare a bonus and it may be that the appellants' rules require them to proceed in the way they have done. But if this be so, the double taxation is a consequence of the practice and the rules, not of the construction of the statute. If it be said that the legislature must be taken to have been aware of the practice and to have legislated in relation to it, the only conclusion that can then fairly be drawn is that the legislature contemplated some degree of double taxation as inherent in the operation of the statute. However " true " and " realistic " the rate of interest adopted, it is impossible to suppose that it would be so accurate as to produce the exact sum required. The practice of insurance companies being to err in their estimates on the side of caution, it is highly probable that the rate of 3¾ per cent would produce an excess to be redistributed and taxed again, though not of course so large an excess as that produced by the lower rate of 2½ per cent. The rate chosen by the appellants makes the weight of the double taxation heavier than it need be; but the argument that in order to reduce this burden the Board should adopt one construction of the statute rather than another is simply a plea *ad misericordiam.*

Their Lordships turn now to the second matter in dispute. The relevant words of the statute, section 149(2), provide that in order to arrive at the profits on which the appellants are to be assessed for 1955, there shall be deducted from " the surplus funds so allotted " " any income derived by the company in that year and exempt from taxation (whether by virtue of section 86 of this Act or otherwise howsoever) ". There must therefore be ascertained what income the appellants derived in 1955 which was " exempt from taxation ", the object of the statute being that where income is so exempted, it shall not be subjected to tax merely because it is distributed by way of reversionary bonus.

In 1955 the appellants had an income from investments of over £540,000. This income came from securities " held " (their Lordships will comment later on the significance of this word) by all three branches of the appellants. Approximately £80,000 was derived from investments held by the New Zealand branch, £14,780 being derived from shares in companies incorporated in New Zealand whose income had borne New Zealand tax and £65,063 from shares in companies incorporated in Australia whose income had borne Australian tax. The remaining £460,000 was derived from shares in companies in England and elsewhere.

Section 86 (1) (i) of the 1954 Act provides as follows:—

> " The following incomes shall be exempt from taxation . . . dividends and other profits derived from shares or other rights of membership in companies, other than companies which are exempt from income tax ".

It is conceded by the Commissioner that the dividends from the New Zealand companies fall within these words and accordingly are deductible under section 149. The question is whether the dividends from the English companies and the Australian companies also fall within them. The Commissioner does not suggest that the word " company " in section 86 is restricted to a New Zealand company, for the definition of " company " in section 2 of the Act extends to all companies wherever incorporated. What the Commissioner contends, and what the stipendiary magistrate and the Supreme Court have held, is that the words " exempt from taxation " do not cover income which is not within the reach of the New Zealand tax laws. The point is succinctly put by the stipendiary magistrate when he says:—" A company cannot be exempt, unless, but for the exemption, it would have been liable ".

The appellants on the other hand contend that " exempt from taxation " means the same as " not subject to taxation " and that as the New Zealand Act does not touch the income of English and Australian companies which is not derived from New Zealand, such income is " exempt ". This is as much as to say that the salary of an Englishman, for example, earned and paid in England, is properly described as exempt from New Zealand taxation. Their Lordships do not consider that that is the natural and primary meaning of the word " exempt ". No doubt it can sensibly bear that meaning in some contexts; and in the Australian statute which was considered in *Australian Machinery & Investment Co. Ltd.* v. *Deputy Commissioner of Taxation* (*W.A.*) (1946) 3 A.I.T.R. 359 it was held by Dixon, J. at 383 to be equivalent to " not subject to tax ". Having regard to the definition of " exempt " in section 6 (1) of that Act and the context in which the word was being used in the section which the High Court of Australia was construing, their Lordships, if they may say so respectfully, see no reason at all to differ from that dictum. But they consider that where, as here, there is nothing in the context to suggest otherwise, the word naturally bears the meaning given to it in the courts below.

Mr. Bucher relied very strongly on the words " or otherwise howsoever " in section 149 (2). They show that the source of the exemption need not be section 86 of the 1954 Act but that it can be granted " otherwise howsoever ". Section 86 (1) (x) itself exempts " income expressly exempted from income tax by any other Act, to the extent of the exemption so provided ". What meaning therefore, Mr. Bucher asked, could be given to the words " otherwise howsoever " unless " exempt " was interpreted to cover income that was not within the New Zealand tax laws at all. The Solicitor-General pointed out that the word would be necessary to cover any exempting section (other than section 86 itself) in the 1954 Act; and he instanced section 140. But in any event this argument does not impress their Lordships. Phrases such as " or otherwise howsoever " are not uncommonly introduced into a statute without the draftsman having in mind any specific enactment to which they are intended to apply and it would be wrong to put an unnatural construction on the word " exempt " simply in order to supply one.

The appellants advanced an alternative argument in respect of the £65,063 derived from Australian companies whose shares were held by the New Zealand branch. Section 167 (a) of the 1954 Act declares that " income derived from any business carried on in New Zealand " shall be deemed to be derived from New Zealand; and by section 165 (2) all income derived from New Zealand is assessable for income tax. The appellants argue that it is part of the business of a life insurance company to invest money, that income from such investments is therefore derived from its business and that if the investments are held in New Zealand, the income is derived from a business carried on in New Zealand. Therefore it is assessable income under section 165 (2) and but for section 86 (1) (i) would be taxable, and therefore is " exempt " within the narrower meaning of that word which their Lordships have approved. The soundness of this argument must depend on whether the income from investments " held " in New Zealand is derived not only from the life insurance business but from that business carried on in New Zealand. The evidence in this case does not elucidate what is meant by " held ". The

investments, of course, belong to the appellants and not to any of their branches. There is evidence that in the appellants' accounts the income from these shares was appropriated to the New Zealand branch and it is said that the securities themselves were kept in New Zealand; there is no evidence to show whether or not the investments had been purchased out of money earned in New Zealand. On these facts their Lordships do not think it can be said that the income from the shares was income derived from the life insurance business which the appellants carried on in New Zealand.

For these reasons, which are altogether in accord with the reasons given by the stipendiary magistrate and in the Supreme Court, their Lordships will humbly advise Her Majesty that this appeal should be dismissed. The appellants must pay the costs of the appeal.

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AUSTRALIAN MUTUAL PROVIDENT SOCIETY

v.

THE COMMISSIONER OF INLAND REVENUE

DELIVERED BY
LORD DEVLIN

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