

Privy Council Appeal No. 29 of 1965

Desmond Lees Peate - - - - - *Appellant*

v.

The Commissioner of Taxation of the Commonwealth of
Australia - - - - - *Respondent*

FROM

THE HIGH COURT OF AUSTRALIA

JUDGMENTS OF THE LORDS OF THE JUDICIAL COMMITTEE OF
THE PRIVY COUNCIL, DELIVERED THE 17TH MAY 1966.

Present at the Hearing:

VISCOUNT DILHORNE
LORD MORRIS OF BORTH-Y-GEST.
LORD PEARCE
LORD DONOVAN
LORD PEARSON

Majority Judgment delivered by VISCOUNT DILHORNE

The appellant, Dr. Peate, was for a time employed by a number of doctors in partnership at Cessnock in New South Wales. He received a salary and any fees he earned through the practice of his profession were handed over to the partnership. In 1954 he became a partner and in 1956 he was entitled to 14% of the profits of the partnership after the deduction of expenses.

On the 29th June 1956 a company called Westbank Ltd. was formed and on the 18th August 1956 the eight doctors who were then in partnership were appointed directors of the company. Two days later the appellant was appointed Chairman.

One of the objects of the company was to carry on "the business of chemists, druggists and providers of medicinal" (sic) "surgical and hospital facilities of all kinds whether alone or in conjunction with any other person, firm or corporation."

On the 28th August it was agreed that the partnership should be dissolved and on the 31st August 1956 it was dissolved. The same day eight companies were formed, each of which was conveniently described by Menzies J. as the 'family' company of one of the eight doctors.

The 'family' company of the appellant was called Raleigh Ltd. Two solicitors who were members of the firm advising the doctors were the original directors. One of the objects of this company was "to carry on the business of . . . providers of medical surgical and hospital services and facilities of all kinds".

The next day, the 1st September, this company purchased the appellant's practice, his library, plant, motor cars, etc. for a sum which was eventually fixed at £9,542 and entered into a service agreement with him.

By this agreement the appellant agreed to serve the company "as Medical Practitioner in the business carried on by the company" at a salary. He covenanted that he would act as agent for the company or its nominee to ensure that any person whom he treated, contracted with the company or its nominee that payment for the treatment "is due to the company or its nominee directly and even although the account for such services may be rendered by the company or its nominee in the name of the doctor".

He also by this agreement authorised the company or its nominee to render in his name accounts for all treatment given by him and he undertook when

required by the Board of Directors to serve any company carrying on a similar business to the company as a medical practitioner.

Each of the other seven doctors who had been members of the partnership entered into a similar agreement with his 'family' company.

At a second meeting of the directors of Raleigh on the 1st September 1956, the appellant and his wife were appointed directors in place of the original directors.

The same day Westbank entered into separate agreements with each of the 'family' companies and each of the eight doctors. By the agreement with Raleigh and the appellant it was agreed that Raleigh would for a fee arrange for the appellant to serve Westbank as a medical practitioner and that the fee would be 14% of the balance of the gross income of Westbank after deduction of the expenses of that company including the salaries of doctors who were not directors of the company but employed by it.

The other agreements with the 'family' companies and the other former partners were of a similar character. In 1959 consequent upon the withdrawal of one of the eight doctors, his 'family' company received only 4.235% instead of 12.5% of the profits of Westbank with the result that Raleigh's share was increased to 14.993%. In 1960 in consequence of other changes it was increased 15.815%.

Not only were the fees paid for the services of each doctor by Westbank to each 'family' company the same percentage of the profits that each doctor in the partnership had been receiving but the shares in Westbank were allotted to each of the 'family' companies in similar proportion. Raleigh held 28 out of the 200 shares.

As these arrangements meant that all the net profits of Westbank would be distributed to the 'family' companies in service fees and that no dividends would be paid by that company, it was later agreed that Westbank should each year keep £5,000 for the payment of taxes and dividends and that the service fees would be paid out of the balance remaining after the deduction of this sum and the expenses of the company.

The shares in Raleigh were held by the Trustees of Settlements for the children of the appellant and his wife.

The result of this somewhat complicated series of transactions can be summed up as follows:—Westbank replaced the partnership. The doctors who had been partners became directors of that company. The fees earned as a result of their carrying on the practice of medicine were to be paid into that company's account instead of into the partnership account; and after deduction of expenses, including the cost of employment of the other doctors and the £5,000 referred to, were to be paid to each of the 'family' companies as service fees. Each 'family' company would get the same percentage of the net income less £5,000 of Westbank as each doctor got of the profits of the partnership. Each 'family' company would get the same percentage share of any dividends declared by Westbank out of the £5,000 retained; and each of the eight doctors would get a salary from his family company.

Raleigh in addition to paying the appellant his salary under the agreement between that company and him, also paid his wife a salary of £1,200 later increased to £1,300 per annum for her services as secretary of the company. Dividends declared by Raleigh went to the trustees of the two settlements for the benefit of their children.

Dr. Peate stated in evidence that there were a number of reasons for the replacement of the partnership by Westbank and the creation of the 'family' companies. He said that he knew that there were certain tax benefits which could be gained.

In 1958 in his return of income the appellant stated that his only professional income was the salary of £1,560 paid to him by Raleigh. This was not accepted by the respondent who assessed his taxable income for this year at £4,298. This sum was arrived at in the following way. The net income of

Westbank in that year as returned by that company was £5,013. To that the Commissioner added the service fees paid by the company of £41,574 and superannuation payments of £1,200, making a total of £47,787. He then treated 14% of this sum, namely £6,690 as the appellant's income and treated some of the expenses claimed as deductions by Westbank Ltd. and Raleigh Ltd. as allowable deductions from the appellant's income. He disregarded the salary paid to the appellant by Raleigh Ltd. entirely. Similar returns were made by the appellant for the years 1959 and 1960 and similar assessments by the Commissioner for those years. In 1959 his taxable income was assessed at £3,243 and he had returned his income as £1,399 and in 1960 he was assessed at £3,574 when his income as returned was £1,731.

In justification of his assessments, the respondent relied on section 260 of the Income Tax and Social Services Contribution Assessment Act 1936-60 which, so far as material, reads as follows:—

‘Every contract, agreement or arrangement made or entered into, orally or in writing, . . . shall, so far as it has or purports to have the purpose or effect of in any way, directly or indirectly

- (a) altering the incidence of any income tax
- (b) relieving any person from liability to pay any income tax or make any return
- (c) defeating evading or avoiding any duty or liability imposed on any person by this Act: or
- (d) preventing the operation of this Act in any respect be absolutely void as against the Commissioner or in regard to any proceeding under this Act, but without prejudice to such validity as it may have in any other respect or for any other purpose.’

The first question therefore to be determined is did the contracts, agreements and arrangements made in 1956 or any part of them have one of the purposes or effects stated in this section.

In the opinion of their Lordships the answer is in the affirmative. Before these arrangements were made in 1956 the appellant received 14% of the net profits of the partnership and was assessed accordingly. After they were made, the doctors who had been partners treated patients in the same way as they had before but as a result of these arrangements, their incomes from the practice of their profession were reduced to the salaries received from the ‘family’ companies who received either by way of service fees or dividends the same percentage of the net profits of Westbank as the doctors had been entitled to under the partnership agreement.

In their Lordships opinion these arrangements have the purpose and effect of avoiding a liability imposed on each doctor by the Income Tax and Social Services Contribution Assessment Act.

It follows from this conclusion that the respondent was right to treat as void as against him or in regard to any proceedings under the Act the whole or any part of any contract, agreement or arrangement which directly or indirectly had this effect.

Section 166 of the Act places on the respondent the duty of assessing the taxable income of the taxpayer. Section 17 provides that income tax shall be levied upon the taxable income derived during the financial year by the taxpayer and section 19 provides that the income shall be deemed to have been derived by a person although it is not actually paid over to him but is reinvested, accumulated, capitalised, carried to any reserve, sinking fund or insurance fund however designated or otherwise dealt with on his behalf or as he directs.

What then was the taxable income of the appellant in each of the three years in question? The arrangements made in 1956 divested him of income which he would have received if they had not been made. Tax was avoided on the difference between the salary he and his wife as directors of Raleigh Limited agreed that he should receive and the amount received each year by Raleigh Limited from Westbank Limited in service fees and dividends.

Now, as Kitto J. said in the course of his judgment in this case, section 260 "operates only to destroy: it supplies nothing". It only operates notionally to destroy, for the validity of the transactions is only affected so far as the Commissioner and proceedings under the Act are concerned. He cannot treat some of the arrangements which come within section 260 as void and others not. He is given no option.

The difficulty in this case lies in determining the taxable income derived by the appellant or deemed by virtue of section 19 to have been derived by him with such of the contracts, agreements and arrangements as come within section 260 being treated as void. If the Act provided that the Commissioner had power to make an assessment to counteract the tax advantage sought to be obtained by the arrangements coming within section 260 this difficulty would not arise. Such a provision is contained in section 28 (3) of the Finance Act 1960 of the United Kingdom.

Section 260 has to be construed with sections 17 and 19. It can only have practical effect in preventing tax avoidance if the Commissioner is entitled to make an assessment on the basis that the contracts, agreements and arrangements rendered void by it, had never been made. This necessarily involves treating the taxpayer as having derived income in excess of that derived by him pursuant to the arrangements. In their Lordships' opinion, reading these three sections together, the Commissioner was entitled to assess the appellant on the income he would have received in each of the three years if the arrangements coming within section 260 had not been made in 1956.

The agreement to dissolve the partnership, its dissolution, the formation of the two companies, Westbank and Raleigh and the agreements between the appellant and Raleigh and between the appellant, Raleigh and Westbank were all part of the scheme and directly or indirectly had the purpose and effect of avoiding liability to tax and so came within section 260. The Commissioner was therefore entitled to proceed on the basis that these arrangements had not been made.

He was therefore entitled to treat the partnership as continuing until, if in fact it had been in existence it would have been dissolved by operation of law. Until then he was entitled to treat the income in fact received by Westbank Limited as if it had been received by the partnership, and to treat as the appellant's share the same percentage of the net income of that company as he was entitled to of the income of the partnership; that is, the same percentage as that provided in the service agreement between the appellant, Raleigh and Westbank.

In 1959 one of the doctors who had been partners withdrew. He ceased to be a director of Westbank and such fees as he earned ceased to be received by the company. If in fact the partnership had continued until his withdrawal, it would then have ceased by operation of law. The Commissioner cannot therefore treat the original partnership as existing after that date. To do so would be not to destroy but to supply.

Section 6 of the Act defines a partnership for the purposes of the Act as *inter alia* 'an association of persons . . . in receipt of income jointly'.

Disregarding, as the Commissioner was required by section 260 to do, the formation and so the existence of Westbank Limited, for its formation was part of the arrangement to avoid tax, there was after the withdrawal of this doctor an association of persons in receipt of income jointly; and so, for the purposes of the Act the Commissioner was entitled to treat the income received by Westbank as the income of a partnership. Following upon this withdrawal, the proportion of the net income of Westbank paid to Raleigh was increased to 14.993% although the agreement between the appellant, Raleigh and Westbank only provided for payment of 14%. The doctors must have agreed to this increase and the Commissioner is entitled to treat the appellant's income during the period when Raleigh was paid 14.993% as that percentage of the net income of Westbank.

Further changes were made in 1960 as a result of which Raleigh's share increased to 15.815%. After these changes and disregarding the existence

of Westbank, there was still an association of persons in receipt of income jointly and similarly the Commissioner is entitled to treat the appellant's income as 15.815% of the net income of Westbank for the period during which that percentage was paid to Raleigh.

On behalf of the appellant it was argued that the contracts made by the patients with Westbank to pay Westbank for the treatment they received from the doctors could not be regarded as replaced by contracts with the doctors either jointly or individually. That, it was argued rightly, would not be just to treat the original contracts as void but to substitute others in their place and section 260 gives no power to do that.

Whether patients in fact contracted to any substantial extent with Westbank is open to doubt. Taylor J. in his judgment in this case pointed out that "the evidence disclosed that all governmental and institutional fees were paid by cheques payable to the doctors concerned and that most of the private fees that were paid by cheque were paid by cheques in which the doctor and not the company (Westbank) was named as the payee and that where necessary the doctors endorsed cheques to enable them to be paid into Westbank's bank account." In these circumstances the bulk of the income earned found its way in the first instance into the hands of one or other of the doctors concerned.

In so far as patients did in fact contract to pay Westbank for the treatment they received, treating the income of Westbank as that of the doctors does not in their Lordship's opinion require any substitution of any contract for that made by the patient. The sums received by Westbank from such patients were, as were the fees earned by the doctors employed by Westbank at a salary, part of the income of the doctors who were, if the existence of Westbank is disregarded, in receipt of income jointly.

In their Lordships' opinion the conclusion arrived at by the High Court of Australia and by Menzies J. was correct and for the reasons stated their Lordships will humbly advise Her Majesty that the appeal should be dismissed.

The appellant must pay the costs of the appeal.

Dissenting Judgment by LORD DONOVAN

Immediately before the 31st August 1956, Dr. Peate was practising his profession as a doctor in New South Wales in partnership with seven other doctors. Their relations were governed by a partnership deed under which their respective shares in the capital and in the profits were defined. Dr. Peate's share was 14%.

On 31st August 1956 this partnership was by agreement dissolved. The dissolution was consequent upon the decision of the partners to re-arrange their affairs so that, among other things, a lighter burden of income tax would be attracted.

In broad outline the plan adopted achieved these results:

- (1) fees received from patients no longer belonged to the doctors themselves but to a limited company;
- (2) the limited company after paying certain expenses made payments to its shareholders;
- (3) these shareholders were other limited companies—eight in all, one for each doctor;
- (4) each of these eight companies used its receipts, partly to pay a salary for his medical services to the doctor concerned, and partly to make provision for his family;
- (5) each doctor then returned for income tax purposes as professional earnings only his salary. This was considerably less than his previous share of the partnership profits.

Naturally enough, this result was not welcome to the Commonwealth Commissioner of Taxation, whom I will hereafter call "the Commissioner".

Nevertheless for the first fiscal year in which it took effect, he accepted it. This was the year ended 30th June 1957. In that year, from 1st July 1956 up to 31st August 1956 Dr. Peate had been a member of the partnership. This having been dissolved on 31st August 1956 he was, for the rest of the year, a salaried employee of the company. He included in his tax return for the year his share of partnership profits up to the 31st August, and his salary thereafter. The income tax assessment was computed on the income so returned.

For the following fiscal year, i.e. the year ending 30th June 1958, the Commissioner took a different view. He treated Dr. Peate as still carrying on a medical practice in partnership with his former colleagues and still entitled directly to a share of the income so produced. The fact that this income had gone to a limited company in pursuance of the new arrangements mattered not. In the Deputy Commissioner's words:

“ . . . it is considered that the gross income shewn in the company's return was, in fact and in law, derived by the partnership. Correspondingly, the expenditure claimed in the company's returns . . . is considered to have been incurred by the partnership and you through the agency of the companies.”

The basis for this view was that medical services had been personally rendered to the patients by Dr. Peate and his colleagues, and that the receipt of fees by the company was simply an application of income after it had been earned by the doctors. The view was buttressed by a reference to the New South Wales Medical Practitioners Act 1938 providing, inter alia, that only a registered medical practitioner can treat certain diseases, and sue for fees. The limited companies were not registered medical practitioners and could not therefore legally derive the income in question.

For the following two fiscal years, namely the year ending 30th June 1959 and 30th June 1960, the Commissioner repeated these views and assessed Dr. Peate in accordance with them.

Dr. Peate having appealed against the foregoing three assessments, the matter eventually came before the High Court of Australia in September 1962 and was heard by Menzies J. Before him, the Commissioner, while apparently maintaining the argument that what the patients paid was the doctors' income supported the assessment on a new ground which he put in the forefront of his case. This was that the assessments were justified by s.260 of the Income Tax and Social Services Contribution Assessment Act 1936-1960. This claim was upheld by Menzies J. and subsequently, on appeal, by the Full Court; and it is this claim upon which your Lordships have now to pronounce.

I do not find it surprising that a contention which so far has commanded universal judicial assent was not put forward by the Commissioner when he made the assessments. Section 260 is limited in its scope, for while it operates to destroy a taxpayer's defences in certain cases, it authorises no new construction in their place. In particular it does not deem some situation to exist which will support assessments to income tax designed to counter the avoidance. Those assessments must still be based on facts, namely the facts remaining after s.260 has done its work. This limitation of the section's scope may produce much difficulty in particular cases. In order to ascertain its precise effect in the present case, it is necessary now to describe in a little more detail how Dr. Peate and his colleagues re-arranged their affairs.

The partnership had commenced on 1st October 1954 and was regulated by a deed dated 30th November 1954. Originally it consisted of nine doctors, one of whom retired on 1st July 1956. In the new partnership which resulted from this retirement, and which consisted of the remaining eight doctors, Dr. Peate's share in the capital, profits and losses was 14%.

As a result of discussion with their legal and their accountancy advisers, the partners caused the following steps to be taken:

Westbank Limited (whom I will call 'Westbank') was incorporated under the Companies Act of New South Wales on 29th June 1956. One of its objects was to carry on the business of providing medicinal and surgical services.

Its nominal capital was £25,000 divided into 25,000 shares of £1 each. By September 1956, 200 of these shares had been issued, 28 of them to a company called Raleigh Limited (whom I will call 'Raleigh'). Dr. Peate and his seven partners were appointed the directors of Westbank.

Raleigh was incorporated under the Companies Act of New South Wales on 31st August 1956, as a proprietary company. One of its objects was to purchase the business of any person or partnership, and another was to carry on the business of providing medical services. Its nominal capital was £25,000 divided into 25,000 shares of £1 each. These were divided into various classes. A number of 'C' class shares were held in trust for Dr. Peate's infant son John: and a number of 'D' class shares were held in trust for Dr. Peate's infant daughter Carolyn. Dr. Peate and his wife were directors of Raleigh and Dr. Peate the Governing Director. It was, in fact, his 'family company'. On the 31st August 1956 the partnership between the eight doctors was dissolved.

On 1st September 1956 Raleigh agreed to purchase the goodwill and assets of Dr. Peate's practice, for a price which was settled at £9,542, of which goodwill accounted for £7,500.

On the same day Dr. Peate agreed to serve Raleigh as a medical practitioner at a salary of £1,000 p.a., or such other sum as might be agreed upon from time to time. He further agreed to serve any other company carrying on a similar business to that of Raleigh if the directors of Raleigh should so direct.

On the same day another agreement was entered into between Westbank, Raleigh and Dr. Peate. Under this agreement:

1. Raleigh arranged for Dr. Peate to serve Westbank as a medical practitioner.
2. In consideration, Westbank was to pay Raleigh 14% of the net income of Westbank.
3. Dr. Peate agreed that all fees due from patients he treated were to be due to, and belong to, Westbank and authorised Westbank to render accounts for such services in his name.

On 3rd September 1956 Dr. Peate rented to Raleigh the surgery at 230 Main Street, Cessnock, New South Wales (which had apparently been one of the surgeries used by the recent partnership) with the right to sub-let the same.

On the same day Dr. Peate's wife was appointed Secretary of Raleigh.

Each of the other doctors, the former partners of Dr. Peate, made similar arrangements. In particular, each had his own family company corresponding to Raleigh holding shares in Westbank, and each doctor agreed to serve his family company, or its nominee, as a medical practitioner in return for a salary. Each doctor was asked by his family company so to serve Westbank and each agreed.

The practice carried on by the partnership up to 31st August 1956 was, pursuant to the foregoing arrangements, carried on thereafter as follows. The same surgeries were used, and the eight doctors rendered medical services there in the same manner as before. Notices were however exhibited at Dr. Peate's surgery indicating that the doctors were the employees of Westbank to whom fees were due. Most of the patients, however, perhaps not unnaturally, paid their accounts by cheques payable to the doctor personally. All fees were duly accounted for to Westbank and Westbank paid all necessary outgoings, save some which were paid by Raleigh.

The first fiscal year during which these arrangements were effective i.e. the year ending 30th June 1957 passed, as I have said, without challenge from the Commissioner. For the next year however he raised the contention already indicated that the income remained that of the doctors and that Westbank paid the expenses as their agent. So far as Dr. Peate was concerned the Commissioner worked out that on this basis his assessable income for the year ended 30th June 1958 was £4,298 as opposed to the £1,232 which the doctor had returned.

It is important, having regard to the present reliance of the Commissioner upon section 260, which he says requires him to pay no regard to the formation

of Westbank and the various agreements which followed, to see exactly how the Commissioner arrived at the figure of £4,298.

He began with the profit and loss account of Westbank for the year ended 30th June 1958. From that he discovered that the gross fees paid or payable to Westbank in respect of the medical services it had caused to be rendered through the medium of the doctors was £56,245 (I ignore shillings and pence throughout). Westbank's total expenditure for the year was £51,245. The net profit was thus £5,000.

The expenses of £51,245 included service fees payable to Raleigh and the other family companies pursuant to the agreements whereby these companies made the services of the doctors available to Westbank. The total sum so paid to the family companies by Westbank in this year was £41,574. In the case of Raleigh the fee so paid for Dr. Peate's services was £5,820, i.e. 14% of £41,574.

The Commissioner proceeded to re-calculate Westbank's income. In its return that company had shewn a taxable income of £5,013. The Commissioner added to it the foregoing service fees totalling £41,574, plus a disbursement of £1,200 for superannuation contributions which he regarded as an inadmissible deduction. He thus arrived at a net income for Westbank of £47,787. He took 14% of this as the income of Dr. Peate, the 14% being Dr. Peate's share of the profits of the previous partnership, dissolved in August 1956. This gave a figure of £6,690.

From this figure the Commissioner then allowed certain deductions. The salary of Dr. Peate from Raleigh was, consistently with the Commissioner's contentions, one of them. This amounted to £1,560. The expenditure incurred by Raleigh during the year, namely £4,767, was also allowed, less however the salary of £1,560 and less certain other expenses deemed to be inadmissible in whole or in part. The net amount of Raleigh's expenditure then allowed to Dr. Peate was £2,066. This, plus the salary of £1,560, now to be excluded from Dr. Peate's income, gives a total deduction of £3,626.

Dr. Peate had returned as his taxable income the sum of £1,232. The Commissioner added to this the above sum of £6,690, plus a £2 subscription regarded by him as an inadmissible deduction. This gave a total of £7,924. The Commissioner then deducted the foregoing £3,626, leaving a net income for Dr. Peate on this basis of £4,298.

The calculation is perfectly intelligible on the hypothesis, for which the Commissioner was contending at the time, that Westbank and Raleigh were simply Dr. Peate's agents. The calculation remained unchanged when the prime contention was altered to reliance on section 260. How it squares with that contention, which requires the Commissioner to proceed on the basis that Westbank and Raleigh are to be disregarded, is one of the serious difficulties of the case.

For the succeeding two fiscal years Dr. Peate's income was computed on similar lines.

I now turn to section 260. It appears in Part VIII of the Act, headed 'Miscellaneous' and so far as it is necessary to quote it in this case, it reads:

"Every contract, agreement or arrangement made or entered into, orally or in writing, whether before or after the commencement of this Act, shall so far as it has or purports to have the purpose or effect of in any way, directly or indirectly,

- (a) altering the incidence of any income tax;
- (b) relieving any person from liability to pay any income tax . . . ;
- (c) defeating, evading or avoiding any duty or liability imposed on any person by this Act; or
- (d) . . . ;

be absolutely void, as against the Commissioner, or in regard to any proceeding under this Act, but without prejudice to such validity as it may have in any other respect, or for any other purpose."

In regard to any proceeding under the Income Tax and Social Services Contribution Act, therefore, the section thus sweeps away contracts, agreements or arrangements of the kind described. The Commissioner must proceed as though they did not exist. Clearly, however, the section does not authorise the Commissioner to put something new and fictitious in their place. When Kitto J. said in the present case that the section "operates only to destroy: it supplies nothing" he was repeating in effect what has been said judicially many times.

There is no doubt, in my opinion, that the conditions precedent prescribed in section 260 exist in Dr. Peate's case. The whole arrangement was designed to relieve him of some liability to tax, and it was, in fact successful in doing so in the first year of its existence. One need hardly consider therefore the remaining content of section 260, though I should have thought it could also rightly be said that the arrangement had the object of altering the incidence of income tax on what would ordinarily have been the doctor's professional earnings.

If then the purpose of each of the contracts, agreements or arrangements was to secure relief from income tax, they are wholly void as against the Commissioner, or in regard to any proceeding under the Act. The Commissioner in his Case submits that this involves treating as void—

- (1) the separate corporate existence of Westbank
- (2) the agreement between Dr. Peate and Raleigh
- (3) the agreement between Westbank, Raleigh and Dr. Peate
- (4) the agreements (if any) made between Westbank, the patients and Dr. Peate, in so far as they provided that the fees should be the property of Westbank.

With this I agree. I would add, however, that it involves also disregarding the existence of Raleigh, the formation of which was also part of the plan for tax avoidance.

The liability of Dr. Peate now depends on the facts left after the foregoing transactions are treated as void and are therefore disregarded.

What is so left as regards Dr. Peate? The situation, in my opinion, is this:

1. He is found giving medical services to patients.
2. In return the patients pay him money.
3. He cannot, for present purposes, be treated as accountable to Westbank for this money. Thus he is accountable to no one for it, and it may, again for present purposes, be treated as his own.
4. This money therefore represents the gross, or "assessable" income which he derives from treating patients. But the Act does not tax gross income but "taxable income" which means that all allowable deductions must be made.
5. The allowable deductions are defined by section 51. They are "all losses and outgoings to the extent to which they are incurred in gaining or producing the assessable income . . ."
6. The section does not in terms require that it must be the taxpayer himself who disburses the outgoings, though ordinarily, of course, this will be the fact. The deductions which have been allowed to Dr. Peate in the present case were made by Westbank and Raleigh and the amounts have been extracted by the Commissioner from their accounts. How, one may ask, does this square with section 260 which requires the Commissioner to ignore the existence of those companies? Once section 260 is invoked he is not entitled to recognise these companies for some purposes and disregard them for others. In so far as the formation of these companies were part of the arrangement which had the purpose of relieving Dr. Peate and others from liability to pay income tax, that formation is absolutely void as against the Commissioner "or in regard to any proceeding under this Act". They are, to use his own expression, "annihilated". How, in the face of this, the companies are nevertheless brought to life again for the purposes of seeing what expenses they incurred and then allowing those expenses to Dr. Peate, I do not understand.

7. What then follows? Is Dr. Peate to be taxed as though his assessable income is the same as his taxable income? Or is some liberty to be taken with the words of section 260, so as to accord him the benefit of expenditure by the two companies? Or is the truth that section 260 is inadequate to deal with this sort of case, particularly when one still has to face the problem—What part of the expenditure in question related to Dr. Peate's own activities?
8. I return to this aspect of the matter presently; but assuming for the moment that the difficulties about allowing deductions are surmountable, then section 260 permits the taxation of Dr. Peate upon what he received for treating the patients he himself attended less his necessary outgoings. The facts which are left after section 260 has done its work entail nothing less and nothing more. It means further, in my opinion, that he must be assessed on a cash basis, for the facts which remain do not include any debt to him from patients for unpaid fees.

I come now to consider the very different basis of liability which has been upheld.

The Commissioner, as has been seen, began with the net income of Westbank as disclosed by its accounts, made a number of additions to it, and attributed a particular portion to Dr. Peate. From this he allowed certain expenses incurred by Raleigh. This was consistent with the Commissioner's original contention that Dr. Peate himself owned the fees paid for medical services which he rendered; and that in paying expenses Westbank and Raleigh were simply his agents. But it is wholly, and obviously, inconsistent with section 260 which treats the arrangement which brought these companies into being as wholly void against the Commissioner or in regard to any proceeding under the Act. To persist in this basis of assessment as the Commissioner did when relying upon section 260 is not to apply that section but to contradict it.

What has to be discovered is what is left after section 260 has done its work, and what liability to tax is thereby supported. By way of introduction to this problem, Menzies J. in the High Court said this:

“The next question is how much of the arrangement and what was done to carry it out is void against the Commissioner in assessing Dr. Peate and in these proceedings it seems to me that it was the making of the agreements with Westbank and the making of Dr. Peate's agreement with Raleigh which effectuated the tax avoiding purpose with regard to Dr. Peate. These agreements must therefore be disregarded.”

Here, it will be seen, the arrangement is dissected and the two agreements mentioned are isolated as the matters upon which alone section 260 operates since they “effectuated” the tax avoiding purpose.

I have the misfortune to disagree with this analysis. In the first place the two agreements would not have effected the tax avoiding purposes without the existence of Westbank and Raleigh. In the second place the test prescribed by section 260 is not merely whether some contract agreement or arrangement “effectuates” such a purpose, but whether the contract agreement or arrangement “has or purports to have the *purpose or effect* . . . in any way, directly or indirectly”. In the face of this language, I do not understand how the formation of Westbank can be treated as being outside it; and I agree with the Commissioner who, in his case, adopts as his main contention that the existence of Westbank is also to be disregarded. I would repeat that in my opinion the same must be said of the formation of Raleigh.

The treatment of the formation of Westbank as being unaffected by section 260 facilitates, however, the conclusion of the learned Judge, which he proceeds to express as follows:

“What then is left is a group of doctors practising together but without any formal agreement of partnership using Westbank to receive all fees paid, to provide services for the group, to pay group expenses, and to make distributions of what remained in agreed proportions, and using

their family companies to receive those distributions and to pay the individual expenses of practice. On this basis the assessable income of the doctors as a group was the total of gross fees earned."

For me, at least, this reasoning is vitiated by its reliance upon the existence and the actions of Westbank and Raleigh notwithstanding section 260. In this context it is not without significance that the Commissioner and his advisers take a different view of "what was left". They say it was (a) the appellant practising as before; (b) income being produced by that practice; (c) that income being paid with other income into a bank account; (d) the payment thereof of the cost of production of the entire income; (e) the dealing with part of that income (after such payment) in accordance with the appellant's directions. I respectfully think that this analysis though not perfect is, at any rate, more in accordance with the effect of section 260.

Other questions are provoked by the passage I have quoted from the judgment of Menzies J. which was substantially adopted by the full Court. First, what is the significance of the reference to "a group of doctors practising together but without any formal agreement of partnership"?

The pre-existing partnership between the doctors was dissolved on 31st August 1956. It was clearly part of the entire tax avoiding arrangement. The Commissioner is at liberty therefore to treat the agreement for dissolution as void as against him, or in relation to any proceeding under the Act. But what does this involve?

In your Lordships' view the consequence is that the Commissioner was entitled "to treat the partnership as continuing until, if in fact it had been in existence, it would have been dissolved by operation of law".

I regret that I am unable to share in this conclusion which admittedly substitutes fiction for fact, and is thus in conflict with repeated judicial pronouncements that section 260 does not permit such inventions. If your Lordships' view is correct, it would surely have been shared and applied both by the Commissioner and by the six judges in Australia who have considered this case. It would also have made all the elaborate arguments to which both they and your Lordships have listened largely unnecessary. And the Commissioner would presumably have called for a return of the partnership income pursuant to section 91 of the Act which he has not done.

It may well be asked, "What is the point of declaring the deed of dissolution void, unless the result be to keep the partnership alive"? The answer is, I think, simply this: that in considering what liability flows from the facts which are left after section 260 has done its work, the Commissioner is not to be affected by the circumstance that the doctors formally dissolved partnership on 31st August 1956. He is to consider the facts which remain after that date untrammelled by that fact.

This is what the Commissioner and the High Court proceeded to do, and in my respectful view, this was the right approach. It is noteworthy, moreover, how partnership, as a conclusion from the facts surviving the application of section 260, is carefully avoided. The Commissioner speaks of "the appellant carrying on his practice in association with a group of other medical practitioners"; and Menzies J. (see above) of "a group of doctors practising together without any formal agreement of partnership etc."

In my opinion the 'facts exposed' do not themselves support the conclusion of partnership. The sharing of gross returns, if Australian law be the same as English law in this respect, would be no evidence of partnership. The sharing of net profits, on the contrary, is *prima facie* evidence of partnership. But the crucial point is whether these eight medical practices were carried on *in common* pursuant to some agreement to that effect, express or implied. The facts which remain include the fact that this is the one thing the doctors intended should *not* happen after 31st August 1956, which seems to be highly relevant, though by itself not conclusive. Moreover I can find a sharing of net profits only by tracing the gross receipts through Westbank and Raleigh taking into account the payment of expenses by those companies, and attributing to Dr. Peate monies which he did not receive. The doctors, it is

true, used the same surgeries as before, and may be said to have practised as a 'group', both of which features carry one hardly any distance along the road to partnership. What really stands out in this context is the absence of evidence which points unequivocally to the conclusion that despite the doctors' intention to practise otherwise than in partnership, they nevertheless in fact continued to do so.

But section 6 of the Act contains an extended definition of partnership. It is "an association of persons carrying on business as partners or in receipt of income jointly . . ." As regards these last words Dr. Peate received no monies 'jointly'. What was paid to him for his services was received by him alone, not by the other doctors as well. Nor did he receive, jointly with them, the fees they received for services which they rendered. This result is not reversed by the fact that all the money was paid into one account not in the doctors' names.

If no partnership is exposed when section 260 has done its work, I do not know what significance, in relation to Dr. Peate's income tax liability, is to be attached to the reference to "a group of persons practising together etc." The doctor and his colleagues seem to have used the same surgeries as before, and no doubt this had its conveniences, one doctor coming to the help of another in times of difficulty. In this sense they can be said to be practising together as a group, as doctors do in some of our own towns. Short of partnership, however, the circumstance is, in relation to tax liability, irrelevant.

Next, in the passage I am considering from the judgment of Menzies J. comes the reference to the doctors "using Westbank to receive all fees paid, to provide services for the group, to pay group expenses and to make distributions of what remained in agreed proportions, and using their family companies to receive those distributions and pay the individual expenses of practice". I repeat that, after section 260 has directed that the whole tax avoiding arrangement be regarded for present purposes as absolutely void, this resurrection of the companies which were an essential part of that arrangement, for the purpose of fixing liability upon the taxpayer, is, in my opinion, wholly inadmissible.

The argument before your Lordships did not seek to support the opposite proposition. On the contrary it was said, *inter alia*, that the formation of Westbank was avoided. It was added that so far as Raleigh was concerned it was unnecessary to contend that its formation was also avoided. I can understand this view; but whether the contention were necessary or not, the formation of Raleigh clearly fell within the scope and effect of section 260.

The Commissioner, for his part, contends that the application of section 260 exposes Dr. Peate carrying on practice, receiving monies, paying those monies into a bank account, and the other doctors doing the same. Then part of that income, after payment of the expenses, is dealt with in accordance with the appellant's directions, and thus liability to tax on that part is brought home to him.

This, if I may say so, is the most attractive way in which the case for the Respondent can be put. But on analysis this, too, is found to be contravening section 260. Thus the justification for the expression "after payment of the expenses" is that Westbank paid them. If, for example, the Commissioner challenged the admissibility of any of the expenses, it is the accounts of Westbank which would have to be produced in support of the deduction sought, and evidence from Westbank which would have to be produced if the purpose of any particular disbursement were challenged. Then as regards the "application of part of that income in accordance with the Appellant's directions", the Appellant himself gave no personal directions on this matter. He joined in the collective decision of the Board of Directors of Westbank. If Westbank is to disappear pursuant to section 260, the board and its actions disappear with it. In its place there is not left a decision by individuals acting on their own, and to proceed on the basis that such a decision is one of the facts "which are left" is again to employ a fiction.

Before stating my conclusions I should perhaps say a word about section 19 of the Act which enacts that "income shall be deemed to have been derived

by a person although it is not actually paid over to him but is re-invested, accumulated, capitalized . . . or otherwise dealt with on his behalf or as he directs". This section is not one which imposes liability in the present case independently of section 260. It does not apply, for example, to make Westbank's income the income of Dr. Peate and his colleagues whether section 260 applies or not. Section 19 is not intended to override contracts which make a particular piece of income legally and beneficially the income of someone else. Otherwise the income of a limited company might be treated as the income of the board of directors who could direct how it should be dealt with. The section deals with, and defeats, any possible argument of a taxpayer that income which would otherwise be "derived" by him is not to be so treated because it has been accumulated re-invested or capitalized etc. It comes into play in the present case if section 260 has the effect of making the fees received by Dr. Peate from the patients he treated his own income. Then, whatever other answer he might have to section 260, he could not be heard to say that in any event he had diverted most of that income elsewhere.

In the end I reach these conclusions:

- (1) The purpose of the whole arrangement was relief in some measure from income tax.
- (2) The application of section 260 would involve treating the fees paid to Dr. Peate for the services he rendered to patients as his gross or "assessable" income.
- (3) The deduction of expenses to arrive at his net or "taxable" income involves looking at the accounts of Westbank and Raleigh; and in as much as the formation of these two companies is, under section 260, to be regarded as absolutely void "in regard to any proceedings under this Act" this procedure is not permissible. The result is not to make Dr. Peate taxable on his gross or "assessable" income, for this would be contrary to the Act. It is, on the contrary, to raise serious doubt as to the applicability of section 260 to such a case as the present.
- (4) This doubt is increased when the amount of net income to be attributed to Dr. Peate can be determined only by attributing to him and his colleagues a decision which they never took except as directors of Westbank.
- (5) Section 260 does not, in truth, meet such a case as the present with which its terms are inadequate to cope. It is a section which dates back, it is said, to 1915 when tax avoidance schemes were less sophisticated and complex. If a charge is created on income so as to lessen the tax; or property is transferred for that purpose; then section 260 will work. The charge and the transfer can be ignored as void, leaving the income as it was. But when a taxpayer puts an end to one source of income and creates another in its stead, the section does no more than destroy the new arrangements so far as the Commissioner and the Act are concerned. This is not enough. The old order is not revived by thus annihilating the new. What is needed is authority for the Commissioner to make such assessments to tax as in his view are required to prevent the avoidance of tax which would otherwise occur. Section 260 contains no such authority; and without it, the attempt to impose liability in accordance with "the facts that remain" leads to difficulty and frustration. The section is obeyed at one time and disobeyed at another. The Commissioner was quite right in my opinion in his initial disregard of the section and on better ground in his attempt to establish liability by contending that Westbank and Raleigh were mere agents of the doctors, and that the doctors themselves owned the income that their efforts procured. This does not mean that I think the contention right, for it involves treating the agreements between the doctors and Westbank, and between themselves and their family companies, as shams. On the evidence I do not at present see how this contention can be sustained. But if it fails then, unless and until the legislature adds further and

suitable provisions to section 260, the Commissioner must take the facts as he finds them, and assess Dr. Peate on the basis of the doctor's own return.

I therefore respectfully dissent from your Lordships' conclusion, and would humbly advise Her Majesty that the appeal should be allowed.



In the Privy Council

DESMOND LEES PEATE

v.

THE COMMISSIONER OF TAXATION
OF THE COMMONWEALTH OF AUSTRALIA

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