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IN THE PRIVY COUNCIL No. 29 of 1965

ON APPEAL

FROM THE HIGH COURT OF AUSTRALIA

BETWEEN

DESMOND LEES PEATE Appellant

- and -

THE COMMISSIONER OF TAXATION OF THE COMMONWEALTH OF AUSTRALIA Respondent

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CASE FOR THE APPELLANT

RECORD

CIRCUMSTANCES OUT OF WHICH THE APPEAL ARISES

(1) This is an appeal pursuant to Special Leave granted by The Queen's Most Excellent Majesty in Council on the 29th day of January 1965 to appeal from the judgment and orders of the Full High Court of Australia (McTiernan, Kitto, Taylor, Windeyer and Owen JJ.) delivered and made on the twelfth day of August, 1964. Pp 220-221; p 185. 219

(2) The judgment and orders of the Full High Court of Australia dismissed three appeals by your Appellant against the judgment and orders of Menzies J. (a Justice of the said Court) delivered and made on the third day of December 1962 whereby Menzies J. dismissed three appeals by your Appellant against the disallowance by the Respondent of objections by your Appellant against assessments of the taxable income of your Appellant made by the Respondent in purported pursuance of the Income Tax and Social Services Contribution Assessment Act 1936 as amended, for the three Pp 136, 178; PP 9-11, 24-26 36-38; pp 5-8, 19-23, 31-35

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taxation years from 1st July 1957 to 30th June, 1960.

(3) Your Appellant was at all material times a duly qualified medical practioner registered under the Medical Practitioners Act 1938, as amended, of the State of New South Wales.

pp 71, 141

(4) Your Appellant submits that the salient facts proved in the case were:-

p. 72

(i) For some years before the relevant years of income the Appellant practised in partnership with various other doctors. As at 31st August, 1956 the then existing partnership was dissolved by mutual agreement.

pp. 97-98
pp. 223-228
pp. 450-451

(ii) On 1st September, 1956 the Appellant sold his practice, plant and equipment to W. Raleigh Pty. Limited (hereinafter called "Raleigh").

(iii) On 1st September 1956 the Appellant by agreement in writing dated that day became an employee of Raleigh.

pp. 229-233

(iv) On 1st September, 1956 Raleigh (joining in the Appellant) entered into an agreement in writing dated that day with A.E. Westbank Pty. Limited (hereinafter called "Westbank") whereby Raleigh agreed to make the services of the Appellant available to Westbank in return for fees to be paid by Westbank to Raleigh.

p. 73, 11, 23-26
p. 80
pp. 94 11 18-31

(v) The former partners of the Appellant also ended up in the same situation as the Appellant on 1st September 1956 - i.e. they became employees of Companies variously named and these Companies and the other former partners entered into agreements with Westbank similar to that between Raleigh, the Appellant

and Westbank

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(vi) The doctors, including the Appellant, practised no longer in partnership with one another but each of them attended to patients on behalf of Westbank.

p. 77 l.34
p. 79, ll.37-47
pp.80-83

(vii) Raleigh was incorporated on 31st August, 1956 and one of the objects in the Company's Memorandum was:-

p. 550

"45. To carry on the business of importers and dealers in pharmaceutical, medicinal, chemical, industrial and other preparations and articles and providors of medical, surgical, hospital services and facilities of all kinds".

(viii) Westbank was incorporated on 29th June 1956 and one of the objects in the Company's Memorandum was :-

p. 503

"9. To carry on the business of and dealers in Anatomical, orthopaedic, radiological, scientific, chemical, photographical and surgical appliances of all inds and the business of chemists, druggists and providers of medicinal (sic) surgical and hospital facilities and services of all kinds whether alone or in conjunction with any other person firm or corporation".

p. 505 ll. 43-51

(ix) Westbank provided medical services permedium of legally qualified medical practitioners some of whom had been members of the partnership existing prior to 31st August 1956, some of whom were engaged from time to time on a service fee basis similar to the basis of the fee paid to Raleigh and some of whom were paid on a salaried basis. From time to time changes in personnel took place.

pp. 77-83
pp. 57 ll. 10, 41
pp. 92 ll. 10-13

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p.50 11.30-31
p.92 11. 9-10
p.45 11.40-48
46 11. 1-18
p.90 11.31-32
p.234-269

(x) Westbank also employed nursing and clerical staff, made contributions to a superannuation fund for employees, and paid business expenses.

p.44 11.40-45
p.45 11.1-2, 12-16
p.51 11.7-20, 42-43
p.52 11.1-5, 30-33
p.56 1. 14-26

(xi) All payments received by Westbank, the medical practitioners or employees of Westbank were paid into the bank account of Westbank.

(xii) In respect of the medical services provided and payment therefor Kitto J set forth the position as follows :-

p.187 11. 30-32
p.188 11. 1-15

"Each doctor bound himself by an agreement to which Westbank was a party to ensure that every patient should contract with Westbank that payment for treatment should be due to Westbank directly, even though the Doctor might have rendered services in his own name. The doctor further bound himself, if he should fail to carry out the obligation just mentioned, to pay Westbank as liquidated damages an amount equivalent to usual fees for the treatment and he agreed that in satisfaction of such damage any money tendered or forwarded to him by any person in respect of fees should be the property of Westbank. What happened in fact was that some payments in respect of the doctors' services to patients were made to Westbank, while others were made to the doctors, but the doctors passed on the amounts they received to Westbank".

From 1st September, 1956 your

		RECORD
	Appellant gave medical treatment only on the basis that payments therefor were to be the property of Westbank.	
(xiii)	From time to time the Directors of Westbank held meetings and in their capacity as Directors declared dividends payable to the shareholders therein which were Raleigh and other similar Companies employing doctors.	p.82 11.39-48 p.463 11.19-22 pp.478 11.22-45 p.83 11. 31-33 p.84 11.16-23 p.85 11.45-46 p.86 11.1-3
(xiv)	Initially service fees payable by Westbank to Raleigh and other similar companies employing doctors were calculated on the same basis as the partnership shares payable under the dissolved partnership. However, as Kitto J said: "The proportions did not always correspond exactly with the proportions in which the profits of the partnership had been divided".	p.82 11. 9-38 p.189 11. 6-9
(xv)	The Directors of Westbank from time to time determined the amount of service fees payable not only to Companies employing such Directors but also payable to medical practitioners entitled to service fees.	p.82 11.32-48 p.83 11. 7-9
(xvi)	The issued shares in Raleigh (except two subscriber shares) were held by trustees for members of the Appellant's family. The Directors of Raleigh were the Appellant and his wife, the Appellant being the Governing Director. His wife was the Secretary of Raleigh. The Appellant and his wife received salaries from Raleigh.	p.564 11.30-38 p.94 11.43-48 p.455 11. 10-26 p.270-298 p.451 11.38-43 452 11.18-23 467 11.27-32 p. 310
(xvi)	In the financial year ending 30th June 1957 the Appellant made a return showing as his income his share of the partnership up to 31st August, 1956, when it was dissolved, and the salary received by him from 1st September 1956 to 30th June, 1957. Tax was assessed on this income as returned	pp.300-306 p.307
(xviii)	In the financial year ending 30th June, 1957 Westbank made a return showing as income the whole of the earnings from the provision of medical	pp.332-345

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services by means of medical practitioners including the Appellant and showing as deductions the service fees paid, contributions to superannuation fund, and all expenses properly incurred in provision of staff, accountancy, bank charges, cleaning, laundry, drugs and medical supplies, printing and stationery and such like. Although the Respondent disallowed the contributions to superannuation fund, upon objection by Westbank to this disallowance, tax was assessed on the income as returned.

pp. 309-322 (xix) In respect of the financial year ending 30th June, 1957 Raleigh returned as income the service fee received from Westbank and made deductions for salary paid to the Appellant and his wife and for superannuation payments and expenses. After objections against the disallowance of superannuation payments and the salary of the Appellant's wife were allowed, tax was assessed on income as returned.

pp 1-8
pp 15-23
pp 27-35 (xx) In respect of the three financial years ending 30th June, 1958, 1959 and 1960 the Respondent did not assess tax on your Appellant's returns on a similar basis to the year ending 30th June, 1957. Instead the Respondent had regard to Westbank's returns for these three years, made on a credit basis (the Appellant's returns having been made on a cash basis). The Respondent in each year took the nett income of Westbank as returned and added thereto the deductions claimed by Westbank of service fees and superannuation payments. Of the total figures so obtained the Respondent attributed to the Appellant 14 per cent of the total figure for 1958, approximately 14.993 per cent of such figure for 1959 and approximately 15.815 per cent of such figure for 1960.

p 43 11.22-43
p 44 11. 1-37
p 688

Pp 7 11.26-47 (xxi) In respect of the amounts so

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attributed to the Appellant from Westbank's returns the Respondent allowed as deductions to the Appellant the deductions claimed by Raleigh in its returns for the said three financial years. The deductions so allowed were subject to adjustments. — pp 21 ll.31-39, pp 22 ll. 1-23, pp 33 ll.31-39, pp 34 ll. 1-24

(xxii) Although in respect of the taxation year ending 30th June 1957 Westbank and Raleigh were assessed to tax in respect of the whole of the income derived by them the Respondent has not yet issued assessments to such Companies in respect of the income derived by them for the three taxation years from 1st July 1957 to 30th June 1960. — p 321, p 344, p 7, p 21, p 33

(xxiii) Your Appellant made the following submission in the High Court of Australia:-

> "Westbank pays tax, Raleigh pays tax, Peate pays tax; all the money is taxable".

(5) Section 260 of the said Act is in the terms following:-

"260. Contracts to evade tax void. - 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 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

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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".

p. 8 ll.1-4
p.22 ll.23-26
p.34 ll.25-28

(6) Although in making the said assessments the Respondent claimed that the disputed income was "in fact and in law" derived by your Appellant and did not claim that Section 260 of the said Act applied to render certain contracts, agreements and arrangements void as against the Respondent it was contended by the Respondent in the appeals that Section 260 did so apply and your Appellant's appeals were dismissed by the said High Court on the ground that the application of Section 260 made your Appellant liable for the tax levied.

(7) It was not submitted by the Respondent before Menzies J or the Full Court of the High Court of Australia that the agreements and transactions referred to above were not legally effective, except against the Respondent by virtue of Section 260, and Menzies J said :-

P. 152 ll. 29-33

> "It appears that some of the foregoing facts were proved to forestall a submission which was not in the event made, that Westbank was nothing but a facade behind which things went on exactly the same as previously".

(8) At the hearing before Menzies J it was contended that the Medical Practitioners Act of New South Wales would prevent a Company providing medical services by means of employed medical practitioners but Menzies J held that the Act "did no more than prevent both Raleigh and Westbank from suing for fees for medical services". In this respect the judgment of Menzies J. was not questioned by the Respondent before the Full Court of the said High Court.

CONTENTIONS FOR THE APPELLANT

(9) (i) Section 260 has no application to

the facts and circumstances of your Appellant's case.

(ii) Your Appellant did not receive any of the moneys sought to be attributed to him as income nor was he entitled in law to receive such moneys.

(iii) Westbank and Raleigh are assessable to tax in respect of the moneys sought to be attributed to your Appellant as income. Rowdell Pty. Limited v The Commr. of Taxation 111 C.L.R. 106.

(iv) It is open to your Appellant to enter into a contract, agreement or arrangement with a company or another person whereby your Appellant obliges himself for reward to exert his activities to produce income for such company or other person.

(v) In the circumstances outlined in 9 (iv) it cannot be said that the taxpayer is diverting income away from himself to a company or another person.

(vi) It is not open to the Respondent, in the facts and circumstances of this case, to attribute either the income or outgoings of Westbank or Raleigh to your Appellant.

(vii) The Respondent having called in aid Section 260 to annihilate contracts, agreements and arrangements cannot then seek to call the Section in aid to give a nature quality and complexion to parts of the contracts, agreements and arrangements different from the nature, quality and complexion which the contracts, agreements and arrangements have in law. For instance, the resolution of the Directors of Westbank and Raleigh as to disposal of the moneys have been ignored as having any efficacy against the Respondent as resolutions dispoing of the income of those Companies yet it is said in effect that these resolutions, although annihilated, can have put upon them the colour of personal agreement between the doctors.

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Section 260 is thus being used beyond its annihilating function to accomplish an unauthorised reconstruction of what occurred which is not in accordance with the true facts.

(viii) The judgments of the High Court of Australia are erroneous in holding in effect that Section 260 applies not only to annihilate those parts of contracts, agreements and arrangements which have the purpose and effect of avoiding tax, but also applies to supply a notional derivation of income by the taxpayer when the income is not found in the hands of the taxpayer.

(ix) The judgments of the High Court of Australia are erroneous in that they really lay down the proposition that income is deemed to be notionally derived by a taxpayer if he could have chosen to act in respect of the income in such a manner that the income would have been derived by him but instead has chosen to act in such a manner that the income has been derived by another who is liable to be assessed to tax thereon.

(x) If an endeavour be made to apply Section 260 to your Appellant's case it is submitted that the exposed facts are the corporate existence of Westbank and Raleigh, the moneys in the bank accounts of Westbank and Raleigh and payments thereout for various expenses and to various persons including the doctors. It is submitted that the prima facie position would be that possession by Westbank and Raleigh of moneys in their bank accounts would indicate beneficial interest in such moneys by those Companies and a liability to tax on such moneys by such Companies.

(xi) After the purported application of Section 260 to your Appellant's case there is not to be found -

(a) a partnership,

(b) an "association" of doctors,

(c) an "agreement" to pool gross income,

(d) any control of the Westbank bank account by the doctors as individuals or partners or in association,

(e) any agreement as to "group" expenses,

(f) any agreement as to distribution of income,

(g) any contract between the Appellant and a patient.

All that is to be found is a number of doctors rendering medical attention, moneys in the bank account of Westbank, no agreement between the doctors as to payment of expenses, salaries, remuneration or distribution of moneys.

(xii) The Respondent has not sought to assess your Appellant on the amount of moneys either physically received by him or produced by his activities in the medical treatment of patients but has sought by the application of Section 260 to create a partnership within the meaning of Section 6 of the said Act with other doctors and agreements between the said doctors as to - inter alia - expenses and distribution of moneys where no such agreements exist

(10) Your Appellant respectfully submits that neither in the judgment of Their Lordships in Newton v Commissioner of Taxation 1958 A.C. 450 nor in any judgment of the High Court of Australia has it been held that a taxpayer is liable to tax upon moneys which have not come into the hands of the taxpayer but which might or would have come into the hands of the taxpayer if he had entered into a transaction into which he did not in fact enter. The authorities in the High Court of Australia are to the contrary - for instance, Clark v Federal Commissioner of Taxation (1932) 48 C.L.R. 56; War Assets Pty.

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Limited v Federal Commissioner of Taxation (1954) 91 C.L.R. 53; Hobart Bridge Co. Limited v Federal Commissioner of Taxation (1951) 82 C.L.R. 372; W.P. Keighery Pty. Limited v Federal Commissioner of Taxation 100 C.L.R. 66; Hancock v Federal Commissioner of Taxation 108 C.L.R. 259 Cecil Bros. Pty. Limited v Federal Commissioner of Taxation (1965) A.L.R. 416

(11) Your Appellant respectfully submits that the judgments and orders of the High Court of Australia dismissing your Appellant's appeals are erroneous and ought to be reversed and that your Appellant's present appeals should be allowed for the following.

R E A S O N S

(1) Because your Appellant's contentions are correct in law.

(2) Because of the proper construction of Section 260 of the Income Tax and Social Services Contribution Assessment Act 1936, as amended.

(3) Because of the rights in law of the Appellant, Westbank and Raleigh to the moneys upon which tax has been assessed.

(4) Because the Respondent has failed to show that moneys have come into the hands of the Appellant which the Respondent is entitled to treat as income derived by him.

Hermann Jenkins

R.B. Murphy

COUNSEL FOR THE APPELLANT

IN THE PRIVY COUNCIL No.29 of 1965

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BETWEEN:

DESMOND LEES PEATE

Appellant

-and-

THE COMMISSIONER OF TAXATION
OF THE COMMONWEALTH OF AUSTRALIA

Respondent

CASE FOR THE APPELLANT

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