

[HIGH COURT OF AUSTRALIA.]

GAIR APPELLANT ;

AND

THE FEDERAL COMMISSIONER OF TAXATION } RESPONDENT.

H. C. OF A. *Income Tax (Cth.)—Assessment—Assessable income—Second mortgage of interest in*
 1944. *estate of deceased person—Security for repayment of principal sum on certain*
 { *date with interest thereon in the meantime—Assignment of mortgage—Payment*
 MELBOURNE, *of lump sum in discharge of mortgage and arrears of interest—Sum sufficient to*
Oct. 4 ; cover only principal sum and arrears of interest (if payable after date for repayment
Nov. 6. of principal sum) to date of assignment—Whether any part of sum included in
assessable income—Income Tax Assessment Act 1936-1941 (No. 27 of 1936—
No. 69 of 1941).
 Latham C.J.,
 Rich, Starke,
 McTiernan and
 Williams JJ.

Under a second mortgage of an interest in the estate of a deceased person to secure the repayment of the principal sum of £2,374 on 31st January 1924, the mortgagor covenanted that he would “in the meantime pay interest on the said sum” at the rate of £8 per cent per annum, there being no further covenant for the payment of interest. No interest was at any time paid under the mortgage. The mortgage was assigned several times, the final assignment being made in 1934 to the appellant. In 1939, the trustees of the estate of the deceased person discharged the first mortgage and paid the balance of the estate to the appellant in a lump sum of £4,760. This sum was sufficient to cover only the principal sum, interest to 31st January 1924 (£189 19s., which had been capitalized under the terms of the mortgage) and interest (if payable) at the same rate and as reduced after 1st October 1931 under the *Financial Emergency Acts* (Vic.) from 31st January 1924 to the date of the assignment to the appellant (£2,046 13s.). Out of the sum of £4,760 the appellant appropriated the sum of £2,374 to the discharge of the principal sum.

Held, by Latham C.J., Rich and Williams JJ. (Starke and McTiernan JJ. dissenting), that no part of the lump sum payment should be included in the income of the appellant assessable to income tax under the *Income Tax Assessment Act 1936-1941*.

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Objections by Linda Eloise Gair to assessments of Federal income tax, having been disallowed by the Commissioner, were treated as appeals to the High Court. *Starke J.* stated for the Full Court a case which was substantially as follows:—

1. By an indenture of assignment made on 31st January 1923, one Colin McKenzie assigned to one Mackay John Scobie Gair by way of second mortgage all the share and interest of the said Colin McKenzie to which he was entitled (subject to a prior life interest) in the estate of one Donald McRae deceased. The said life interest was terminated by the death of the life tenant on 30th September 1939.

2. The assignment was to secure the repayment of the sum of £2,374 5s. 9d. which was owing on 31st January 1923 to Mackay John Scobie Gair by the said Colin McKenzie. The mortgagor covenanted to repay the principal sum on 31st January 1924, and that he would “in the meantime pay interest on the said sum” at the rate of £8 per cent per annum, such interest to be paid quarterly on 30th April, 31st July, 31st October and 31st January. The indenture further provided that, if any interest or any interest payable on arrears of interest should remain unpaid after the due date of payment, it should be added to the principal sum and should thenceforth bear interest payable at the rate and on the days aforesaid.

3. By an indenture of assignment made on 19th June 1925, Mackay John Scobie Gair assigned to Caroline Louisa Eliza Gair the right title powers and privileges under the indenture of 31st January 1923 and in the moneys thereby secured.

4. By a further indenture of assignment made on 25th September 1934, Caroline Louisa Eliza Gair in consideration of natural love and affection assigned to the appellant, the above-named Linda Eloise Gair, the right title interest powers and privileges of her the said Caroline Louisa Eliza Gair under the indenture of 19th June 1925 and in the moneys secured thereby.

5. No part of the principal sum of £2,374 5s. 9d. nor any interest thereon was paid to any person by the said Colin McKenzie.

6. Interest accrued due on the principal sum of £2,374 5s. 9d. and interest capitalized under and in pursuance of the said assignment of 31st January 1923 as follows:—

To 31st January 1924	£189 19s. 0d.
31st January 1924 to 1st October 1931 on		
£2,564 4s. 9d.	1,571 18s. 0d.

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1st October 1931 to 25th September 1934

(less statutory deductions of $22\frac{1}{2}$ per cent
under *Financial Emergency Acts*) ..

474 15s. 0d.

25th September 1934 to 9th September 1939

(less statutory deduction of $22\frac{1}{2}$ per cent
under the said Acts)

791 5s. 0d.

7. At the death of the life tenant there was owing on the first mortgage the sum of £3,920 to the Perpetual Executors and Trustees Association of Australia Ltd.

8. Upon the death of the life tenant the trustees of the estate of Donald McRae (whose estate was valued at £8,680) discharged the first mortgage and thereafter in the month of November 1939 paid to the appellant the balance then remaining of the sum of £8,680, namely the sum of £4,760, in full satisfaction of all claims for principal and interest under the assignment of 31st January 1923.

9. Out of the sum of £4,760, the appellant appropriated the sum of £2,374 5s. 9d. to the discharge of the principal sum of £2,374 5s. 9d.

10. Interest at the rate of eight pounds per cent per annum was at all times material to this appeal a reasonable rate to be charged by lenders upon loans secured in the manner set forth in the indenture of 31st January 1923 referred to in par. 1 hereof.

11. In her return of income of the year ended 30th June 1940, the appellant did not include as assessable income any part of the aforesaid sum of £4,760.

12. By notice of assessment dated 30th October 1941, the respondent assessed the appellant to income tax for the financial year ended 30th June 1941 upon a taxable income from property based on her year of income which ended on 30th June 1940 amounting to £2,174 which sum included the sum of £2,136 interest received ascertained as follows :—

Total amount received in respect of assign-			
ment by Colin McKenzie			£4,760
Less amount originally advanced	£2,374		
Less payment to Masterton	250	2,624	

Excess received equalling interest	£2,136
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13. By notice of objection dated 23rd December 1941, the appellant stated the circumstances in which she became entitled to receive payment under the second mortgage, and further stated that in November 1939 the trustee of the estate of Donald McRae deceased paid to her the sum of £4,760 in full satisfaction of all claims for principal and interest under the indenture of 31st January 1923, that of that sum the sum of £2,374 was for principal and the sum of

£2,386 was for interest, that the whole of the latter sum less a deduction of £250 (that is, the sum of £2,136) had been included in her assessable income, and that the whole of the latter sum represented interest which accrued due prior to 25th September 1934 computed in accordance with the indenture of 31st January 1923 up to the date of repayment therein mentioned and thereafter at £8 per cent per annum simple interest. The appellant then objected to the assessment on grounds the substance of which was as follows :—

(1) The sum of £2,136 was in her hands a receipt in the nature of capital and was not a receipt by way of income. It was not therefore assessable to income tax.

(2) The sum of £2,136 was not assessable to income tax in that it represented portion of the payment made to her in satisfaction of the rights assigned to her by way of gift under the indenture of 25th September 1934, and thus represented a portion of the proceeds of the realization of a capital asset.

(3) Alternatively to pars. 1 and 2, the only part (if any) of the sum of £2,136 which was assessable to income tax was the interest (if any) which should in contemplation of law be deemed to have been received by her in respect of the amount of £2,374 between the 25th September 1934 and the month of November 1939. This sum did not in any circumstances exceed £723. The taxable income of £2,136 as shown in her assessment should therefore be reduced by the sum of £1,413.

(4) Alternatively to pars. 1 to 3, of the sum of £2,136 the sum of £73 and no more represented income derived during the year ending 30th June 1940. The taxable income of £2,136 as shown in her assessment should therefore be reduced by the sum of £1,963.

The objection was disallowed, and was treated as an appeal to the High Court.

The following question was stated for the opinion and consideration of the Full Court :—

Was the sum of £2,136 hereinbefore referred to or any and what part thereof income of the appellant assessable to income tax pursuant to the *Income Tax Assessment Act* 1936-1941 for the “ year of tax ” that is the financial year 1940-1941 based on the “ year of income ” which ended on 30th June 1940 ?

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Fullagar K.C. and *Voumard*, for the appellant.

Eager K.C. and *Coppel*, for the respondent.

Cur. adv. vult.

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The following written judgments were delivered :—

LATHAM C.J. Case stated in an appeal against an assessment of Mrs. Linda Eloise Gair to income tax in respect of a sum of £2,136 claimed by the Commissioner of Taxation to represent interest received under a mortgage belonging to Mrs. Gair.

Colin McKenzie had an interest (subject to a prior life interest) under the will of Donald McRae deceased. He mortgaged his interest to the Perpetual Executors and Trustees Association of Australia, which was the trustee under Donald McRae's will. On 31st January 1923 he by second mortgage assigned his interest to M. J. S. Gair to secure the repayment of a principal sum of £2,374 5s. 9d. with interest at the rate of 8 per cent per annum until the date stipulated for repayment, namely 31st January 1924. The mortgage did not contain any covenant to pay interest after that date.

M. J. S. Gair assigned his rights under the mortgage to his wife Caroline Louisa Eliza Gair.

On 25th September 1934, Mrs. C. L. E. Gair, in consideration of natural love and affection, assigned to the appellant, Linda Eloise Gair, all her rights under the mortgage.

No interest was ever paid by the mortgagor under the second mortgage. When the life interest fell in, the trustee discharged the liability on the first mortgage and paid the balance of the estate to the appellant. The capital, £2,374, was outstanding, and a sum of £189 19s. which had become due for interest by 31st January 1924 was capitalized under the mortgage. If interest were regarded as still payable and were chargeable, first at the mortgage rate, and subsequently at that rate as diminished by provisions of the *Financial Emergency Acts* (Vic.), an amount of £2,236 12s. would have been payable as interest up to the date of the assignment of the mortgage to the appellant—25th September 1934. Upon the same assumptions, a further sum of £791 5s. would have accrued due as interest up to the date when the payment was made by the trustee to the appellant.

The amount of money paid to the appellant by the trustee in full satisfaction of all claims under the mortgage was £4,760. The Commissioner has allocated £2,624 to principal and to another liability to one Masterton (upon which no question arises). The difference between this sum and the amount of £4,760 is regarded by the Commissioner as "an excess received equalling interest—£2,136." The question is whether this sum, received during the year of income ending on 30th June 1940, formed part of the appellant's assessable income with respect to the financial year 1940-1941.

It has already been stated that the mortgage provided for the payment of interest for a period of one year, but that there was no covenant to pay interest thereafter. In such a case, it is established that there is no implied covenant to pay interest and that interest is recoverable in an action only as damages for the breach of contract to repay the principal sum: See *Supreme Court Act* 1928 (Vic.), s. 78; *Cook v. Fowler* (1). In a foreclosure action, redemption would be allowed only on payment of interest, even in a case where there was no covenant for payment of interest (*Mellersh v. Brown* (2)). Thus, in the present case, the mortgagee and the present appellant as assignee of the mortgage had no right under the covenant in the mortgage to claim interest as such in respect of any period after 31st July 1924. The sum of £189 which had become due during the first year for interest had been capitalized under the provisions of the mortgage. Accordingly none of the moneys paid to the appellant were paid strictly on account of interest. They were paid in settlement of whatever liability existed in respect of the mortgage at the time when the payment was made.

I propose to consider the case in the first place upon the basis which is most favourable to the Commissioner, that is, upon the footing that the sum of £2,136 was paid to the appellant as interest due under the mortgage, and I therefore inquire whether, if this money was paid as interest, it was therefore income of the appellant.

If the money had been paid to the original mortgagee, M. J. S. Gair, there is no doubt upon this hypothesis (that is, that it was paid as interest) that it would have been part of his income. But when a right to money, which, if received by A, would have been income in A's hands, is transferred to B, it does not necessarily follow that the money when received by B will be part of B's income. If a promissory note is given to A in payment of his salary and A makes a gift of the promissory note to B, B will not receive the money paid under the promissory note as income. If X, not being a dealer in houses and land, sells his home to Y upon terms, and Y pays an instalment of the purchase money by transferring to X a right which he (Y) has to receive a sum due to him by way of salary, then, though, if Y had received the salary, the money would have been part of his income, when it was received by X in part payment for the house which he has sold it is certainly not part of the income of X. He would receive merely part of the consideration for the sale of a capital asset. If Y were to deal with his salary in this way, he would be liable to tax upon the amount of the salary with which he had so dealt, because the *Income Tax Assessment Act*

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(1) (1874) L.R. 7 H.L. 27.

(2) (1890) 45 Ch. D. 225.

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1936-1941, s. 19, provides that "income shall be deemed to have been derived by a person although it is not actually paid over to him but is . . . dealt with on his behalf or as he directs." Accordingly, the amount of salary would have been part of Y's assessable income, but it would not have been part of X's assessable income. Thus the same sum of money may be income in relation to one person and capital in relation to another.

If one person buys accrued rights to the payment of money, then, unless he carries on a business of dealing in such rights, he makes a capital outlay. If he pays £1,000 for the transfer of a mortgage upon which arrears of interest are due, he makes an investment of capital. Interest accrued due in the past, if it had been received by the original mortgagee, would certainly have been part of that mortgagee's income. But when the original mortgagee deals with it by transferring the right to receive it to another person, it does not follow that such interest, when received by that other person, would be part of his income. Interest which accrued due after the transfer of the mortgage would be income derived by the transferee of the mortgagee and he would be taxable in respect thereof. But interest which had fully accrued due before the transfer (as distinct from interest accruing during a current period but not having become due) would not be income derived by the transferee of the mortgage. The case of the gift of a mortgage cannot, in my opinion, be differentiated in any relevant respect from the case of the purchase of a mortgage. For these reasons, I am of opinion that, even if the amount of £2,136 had been payable as interest and had been paid as interest, it would not have been income of the appellant.

But in fact, in the present case, the hypothesis which I have assumed cannot be maintained because no interest was payable after 31st January 1924. The only interest which ever accrued due under the indenture was a sum of £189. The right to this sum was transferred by gift to the appellant. The fact that, if this sum had been received by the original mortgagee, it would have been income in his hands does not show that it was income when received by the appellant. Thus the amount of £189 regarded as forming part of the £2,136 was not income of the appellant. The balance of the sum of £2,136 was not recoverable by any person as interest, but only as damages for detention of money or in a proceeding in which terms for redemption were decreed. If, for the reasons already stated, this sum would not have been taxable in the hands of the appellant even if it had been paid in pursuance of a covenant with the original

second mortgagee to pay interest, there can be no ground for regarding it as taxable if it is regarded as representing damages which might have been (but were not) awarded in an action, or as representing a sum which might have been required to be paid in proceedings for redemption which in fact were never taken.

In my opinion, what has been said is not inconsistent with any of the decisions to which the Court was referred. In a number of cases, it has been held that interest which had fallen into arrear was, when subsequently paid, income of the recipient in the year in which it was received by him. But none of these decisions deals with the case of a transferee of a right to receive interest. Further, they were given under specific provisions of English income tax legislation relating to the taxation of interest as such. They are not authority upon the question whether a sum which, if received by A as interest, would have been part of his income, will be income of B when it is received by B in consequence of a transfer by A to B of his right to receive that sum.

In the case of *St. Lucia Usines & Estates Co. v. St. Lucia (Colonial Treasurer)* (1), the only question decided was whether interest which had accrued due but had not been paid was included within the words "income arising or accruing." It was held that "accruing" in relation to income referred to actual receipt. Although the interest represented a *debt* which accrued in a particular year, it was not *income* arising or accruing in that year. In the case of *Leigh v. Inland Revenue Commissioners* (2), the court interpreted the *Income Tax Act* 1918 (Imp.), s. 5 (3) (c), which provided that in estimating income for purposes of super tax any income chargeable with income tax by way of deduction should be deemed to be income of the year in which it was "receivable." Schedule D, 1 (b) of the First Schedule of the Act charged tax in respect of all interest on money not charged under other schedules and not specially exempted. Accordingly, there was no doubt that any moneys paid as interest and received as such were chargeable to tax. The only question which arose was whether under the particular provision, namely s. 5 (3) (c), to which I have referred, the moneys were chargeable only when actually received. The decision therefore is of no assistance in determining the present case. In *Lambe v. Inland Revenue Commissioners* (3), it was held under the *Finance Act* 1927 that interest which had not been paid and might never be paid should not be included in computing a taxpayer's income for income tax purposes during the year

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(1) (1924) A.C. 508.

(2) (1928) 1 K.B. 73.

(3) (1934) 1 K.B. 178.

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in which it was payable. This decision does not support the contention that if a sum of money is payable as interest to A and the sum of money is in fact paid to B it follows that the money is received by B as part of his income. In *Dewar v. Inland Revenue Commissioners* (1), it was decided that interest is not derived until it is received. It leaves untouched the question whether a sum of money preserves its character as interest to whomsoever it is paid.

Another class of cases is illustrated by *Inland Revenue Commissioners v. Forrest* (2), where the court dealt with a case in which the purchaser of shares upon which a dividend was accruing sought to deduct (as not being part of his income) a portion of the dividend which he received after he had completed the purchase. It was held that the dividend represented income upon the capital asset which he had acquired and was therefore part of his income. This case is, in my opinion, distinguishable from a case in which income has already accrued to one person A, and the right to receive that income is then purchased by B or given to B. *Wigmore v. Thomas Summer-son & Sons Ltd.* (3) is a decision upon the meaning of the word "interest" in the *Income Tax Act* 1918, Schedule D of the First Schedule. It was there held that, where an interest-bearing security was sold during the currency of an interest period, no part of the price received by the seller was interest within the meaning of the Act and the seller was accordingly not liable to pay income tax upon the increase in price which he obtained by reason of the fact that interest was accruing due. This again is not a case of interest already accrued due, the right to which is transferred. Further, it is a decision upon the meaning of the word "interest" and not a decision upon the meaning of "income" generally. It was held that the seller did not receive "interest" from the buyer and that interest alone was the subject matter of taxation. What he received was the price of the expectancy of interest and the point decided is stated in the words—"that is not the subject matter of the taxation" (4).

Accordingly, none of the cases relied upon by the Commissioner appears to me to preclude the adoption of the view which I have expressed on the basis of general reasoning independently of the decisions.

In my opinion, no part of the sum of £2,136 was income of the appellant and the question in the case should accordingly be answered in the negative.

(1) (1935) 2 K.B. 351.
(2) (1924) S.C. 450.

(3) (1926) 1 K.B. 131.
(4) (1926) 1 K.B., at p. 143.

RICH J. It is unnecessary to detail the facts which are already in statement. It is sufficient to state that the appellant is the assignee of a second mortgage of an interest in a deceased estate subject to a prior life interest. Upon the death of the life tenant, the executors of the estate realized it, discharged the first mortgage out of the proceeds of the realization, and paid the balance to the appellant. The mortgage in question secured the repayment of the sum which was borrowed for a fixed period on a day certain with interest down to that day. In such a case, interest is given on the principle, not of implied contract, but of damages for a breach of contract (*Cook v. Fowler* (1)). And in a redemption suit it would form part of the "redemption money" at a rate fixed by the Court. It does not appear that any action was brought to recover such damages or that proceedings were taken by way of redemption or administration. After the first mortgage was paid off, "the surplus of the proceeds of sale" was handed over to the appellant: Cf. *In re Marshfield*; *Marshfield v. Hutchings* (2). Thus the appellant received a sum of money in satisfaction or part satisfaction of the debt owing to her as absolute owner in default of redemption. This sum did not, as I have already mentioned, include either damages or interest. And the fact that the appellant appropriated it to the discharge of interest as well as of principal does not alter or determine the character of the sum received by the appellant vis-à-vis the Commissioner.

In my opinion, the question submitted should be answered in the negative.

STARKE J. The question in this case is whether the appellant is assessable to income tax in respect of a sum of £2,136 for the financial year 1940-1941.

Colin McKenzie was entitled to a share or interest in the residuary estate of Donald McRae subject to a prior life interest which terminated upon the death of the tenant for life in 1939. In 1923, McKenzie assigned this share or interest to one Gair by way of second mortgage to secure a sum of £2,374 5s. 9d. with interest thereon at the rate of 8 per cent per annum. It was an absolute assignment subject to a proviso for redemption whereby it was stipulated that, if McKenzie on 31st January 1924 repaid the principal sum with interest thereon "at the rate and at the times" set forth, Gair would reassign the property mortgaged to McKenzie. The assignment also contained a covenant on the part of McKenzie to pay to Gair the principal sum on 31st January 1924 "and in the meantime pay interest" quarterly on named days. The assignment also contained a power

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(1) (1874) L.R. 7 H.L. 27.

(2) (1887) 34 Ch. D. 721, at p. 724.

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of sale on "default in payment of the . . . principal sum or interest on any of the days hereinbefore appointed for payment of the same respectively" and an authority out of the proceeds to pay and satisfy the moneys owing upon the security of the premises. And there was also a provision for capitalization of overdue interest, which should "thenceforth bear interest payable at the rate and on the days aforesaid." And, finally, Gair agreed, notwithstanding the covenant for payment of interest "on the days and at the times aforesaid," not to "enforce payment thereof on the said days" if so requested until 31st January 1924 and that the same should "remain owing at compound interest as aforesaid."

In 1925, Gair assigned to his wife all his right, title and interest under his assignment and the principal sum therein referred to and the interest accrued and to accrue in respect thereof.

In 1934, the wife of Gair assigned to her daughter, the appellant and the taxpayer, all her right and title under the assignment already mentioned and also the moneys secured thereby.

In November 1939, the trustees of McRae's estate paid off the first mortgage, which was apparently held by the trustees in another capacity, and also paid to the taxpayer the sum of £4,760 in full satisfaction and discharge of all claims for principal and interest under the assignment to Gair of 31st January 1923, which was appropriated by the taxpayer as to the sum of £2,374 5s. 9d. in discharge of the principal sum secured by the assignment. And the Commissioner assessed the taxpayer to income tax in respect of the sum of £2,136, which represented the balance of the sum of £4,760 after a deduction which is immaterial here.

In my opinion, the assessment should be sustained.

But it is said that the assignment by way of mortgage of McKenzie's share in the residuary estate of McRae had become irredeemable because of default in payment of principal and interest upon the appointed days and, in any case, that a redemption decree would have been useless and must have been refused. It is unnecessary to pursue this topic, though I must observe that a mortgage is not necessarily irredeemable because of default in payment of principal or interest on appointed days (*Weld v. Petre* (1)). The essential fact is that the sum of £4,760 was not paid to the taxpayer as or on account of her share or interest in the residuary estate of McRae but as and for principal and interest secured by the assignment and was so accepted by her. Indeed, as already mentioned, the taxpayer appropriated the sum of £2,374 towards principal, and what else but interest did the balance, £2,136, represent? No reason exists

for denying the parties the adjustment of their obligations and rights on this footing, and for the purposes of assessment to income tax the taxpayer "may well be held bound by" her "own actions": See *Commissioner of Taxes v. Melbourne Trust Ltd.* (1).

Next it was said that interest was only payable under the assignment "until the day fixed for payment" and that thereafter interest could only be recovered as damages or allowed in a redemption suit which could not have succeeded on facts such as exist in the present case: See *Re Roberts; Goodchap v. Roberts* (2); *Mellersh v. Brown* (3). In the expression "will in the meantime pay" there is some ambiguity. It may mean "until the day fixed for payment" or "until actual payment." "The latter construction would seem to accord best with the intention" of the parties (*Palmer's Company Precedents*, 14th ed. (1933), Part III. (Debentures), at p. 274). And the provision in the assignment in this case that interest capitalized and added to the principal "shall thenceforth bear interest payable at the rate and on the days aforesaid" is favourable to this construction. Again, I do not find it necessary to pursue this topic, for the sum was paid in discharge of principal and interest and so far as it was not appropriated to the discharge of principal it is an interest or an income receipt and therefore assessable to tax.

Lastly, it was said that the assignor was in a position analogous to that of a seller of principal and interest secured under a mortgage and in any case that capitalized interest converted into principal and accrued interest could not be an income receipt or return.

Where war stock upon which interest was payable at fixed dates was sold during the currency of an interest period with interest rights, *Rowlatt J.*, in *Wigmore v. Thomas Summerson & Sons Ltd.* (4), observed: "The seller does not receive 'interest' from the buyer, and it is interest which is the subject . . . of . . . taxation. He receives the price of the expectancy of interest, and that is not the subject matter of the taxation." The point, however, is not what the seller receives but what the buyer receives. The position of the purchaser is indicated, I think, by *Rowlatt J.*, where he says the seller "sold the principal and accrued interest and the purchaser got it all, and it is upon him that the liability must fall for interest and for super tax" (5). That is clearly so, I venture to think, with regard to accruing interest, and as to capitalized and accrued interest the fact is that it represented a sum paid for the use of money and was paid to and accepted by the taxpayer on that footing.

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(1) (1914) A.C. 1001, at p. 1011.

(2) (1880) 14 Ch. D. 49.

(3) (1890) 45 Ch. D. 225.

(4) (1926) 1 K.B. 131, at p. 143.

(5) (1926) 1 K.B., at p. 145.

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The question stated should be answered in the affirmative as to the whole of the sum of £2,136.

McTIERNAN J. The sum of £2,136, which is the subject of the question submitted for the opinion of the Court, was part of a total sum of £4,760 which the appellant received in November 1939 in satisfaction of her claims under a second mortgage which had been transferred to her on 25th September 1934. The case stated says that in November 1939 the appellant was paid the sum of £4,760 "in full satisfaction of all her claims for principal and interest" under the second mortgage which is described as the "assignment of 31st day of January 1923." The amount of the principal sum secured by this mortgage was £2,734. It is clear from the case stated that the sum of £4,760 was paid to the appellant and received by her on the footing that it was a composite sum of principal and interest.

The first way in which the argument of the appellant was put is that, under the terms of the mortgage, interest had accrued after the due date of the mortgage and that the sum of £2,136 is the total amount of interest in arrear. It is argued that it includes two sums, that is to say, the interest that had accrued down to the time of the assignment and the interest which accrued from that time down to the date of payment in November 1939. It is argued that the former amount is part of the single capital sum received by the transferee of the mortgage. The argument admits that the latter amount is assessable income. Upon these premises, it was argued that there is an analogy between this case and *Commissioner of Taxation (N.S.W.) v. Lawford* (1), in which it was held that debts due and payable to a testator prior to his death were not part of his executor's assessable income. It was held that the executor did not derive these moneys as income and they were debts forming part of the assets which devolve upon the executor. In the present case, however, the second mortgage expressly provided for the payment of interest until the due date of the mortgage, but it did not provide for the payment of interest after that date. The rule applicable to such a case is stated in *Halsbury's Laws of England*, 2nd ed., vol. 23, p. 399, in these terms:—"Where the mortgage provides for interest up to the day fixed for payment, but not beyond, a contract for the continuance of the same rate of interest until payment is not implied, but subsequent interest will be given by way of damages for breach of contract, and if the original rate of interest is a reasonable and

(1) (1937) 56 C.L.R. 744.

usual rate, it is adopted as a proper measure of damages for the subsequent delay. This rule applies both to proceedings on the covenant, and to accounts taken in redemption or foreclosure. In taking such accounts interest cannot be ascertained as damages, but it will be awarded on the same footing as consideration for allowing the loan to remain unpaid." It follows that no interest was in arrear under the terms of the mortgage after the date therein specified for the payment of principal, but in foreclosure or redemption proceedings the court might have awarded interest upon equitable principles or interest might have been awarded under the provision of s. 78 of the Victorian *Supreme Court Act* 1928. For these reasons, I agree with the argument submitted on behalf of the Commissioner that there is no analogy between the present case and *Lawford's Case* (1).

The case stated shows, as I understand it, that the sum of £2,136 was allowed as interest in the account upon the basis of which the appellant received the sum of £4,760.

The sum of £2,136 was, in my opinion, allowed in that account and received by the appellant upon an interest basis. It is not shown that the sum was paid as compensation in the nature of damages: See *Inland Revenue Commissioners v. Barnato* (2).

It appears that no interest at all had been paid under the terms of the mortgage. Hence the sum of £2,136 included a relatively small amount of interest that had accrued due down to the date specified in the mortgage for the payment of principal. In my opinion, upon the assignment, the transferee of the mortgage received only that sum of interest in arrear and the principal of the mortgage as one capital sum. The balance of the amount of £2,136 was, in my opinion, income not capital in the appellant's hands.

The appellant's alternative argument is that, when the trustee paid off the first mortgage, the appellant was then entitled by virtue of the second mortgage to the balance of the estate in the trustee's hands, subject to the right of redemption, and, as this right was not asserted, the effect of the payment of the sum of £4,760 was that the trustee transferred to the appellant the balance of the estate as such in the trustee's hands, and this was a capital sum. If the facts stated bore that complexion, it would follow that no part of the sum of £4,760 was income in the appellant's hands. The paragraphs of the case which it is said bear that complexion are as follows:—
 "7. At the death of the life tenant aforesaid there was owing on the first mortgage aforesaid the sum of £3,920 to the Perpetual Executors and Trustees Association of Australia Limited. 8. Upon the death of the life tenant the trustees of the estate of Donald

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(1) (1937) 56 C.L.R. 744.

(2) (1936) 20 Tax Cas. at pp. 516, 517.

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McRae (whose estate was valued at £8,680) discharged the first mortgage and thereafter in the month of November 1939 paid to the appellant the balance then remaining of the said sum of £8,680 namely the said sum of £4,760, in full satisfaction of all claims for principal and interest under the said assignment of 31st January 1923." The trustee was both trustee and first mortgagee. The meaning which the case stated conveys to me is that the sum of £4,760 was paid as a sum of money to the appellant in satisfaction of her claims to principal and an allowance for interest under the second mortgage. I do not read the case stated as meaning that the trustee transferred the balance of the assets of the estate as such to the appellant as the person entitled to them under the assignment by way of second mortgage. The facts stated mean, in my opinion, that the trustee satisfied the claims of the appellant under this mortgage by payment of a sum of £4,760 but not by the transfer of the property as such, the subject of the second mortgage.

In my opinion, the sum of £2,136 less the interest in arrear under the terms of the mortgage is assessable as income received in the year which ended on 30th June 1940.

WILLIAMS J. The case stated asks the question whether the sum of £2,136 therein referred to or any and what part thereof was income of the appellant assessable to income tax pursuant to the *Income Tax Assessment Act* 1936-1941 for the "year of tax" that is the financial year 1940-1941 based on the "year of income" which ended on 30th June 1940.

The facts are set out in the case and need not be restated in detail. By an indenture made on 31st January 1923, Colin McKenzie assigned to Mackay John Scobie Gair his share and interest in remainder in the trust fund and investments forming part of the estate of Donald McRae by way of second mortgage to secure the sum of £2,374 5s. 9d. and interest thereon. Clause 2 of the indenture provided that if the mortgagor should on 31st January 1924 repay the principal sum with interest thereon at the rate and at the times thereafter set forth the mortgagee would reassign the mortgaged property to the mortgagor; that the mortgagor covenanted with the mortgagee that he would repay to the mortgagee the principal sum on 31st January 1924 and would in the meantime pay interest on this sum at the rate of £8 per cent per annum, such interest to be paid quarterly on 30th April, 31st July, 31st October and 31st January next ensuing; and that if any interest or interest payable on arrears of interest capitalized under the clause should remain unpaid on any of the days on which the same ought to be paid the interest so

in arrears should be added to the principal sum and should thenceforth bear interest payable at the rate and on the days aforesaid and all the covenants and provisions contained in the indenture and all rules of law and equity in relation to interest on the principal sum should equally apply to interest on such arrears.

By an indenture made on 19th June 1925, the mortgagee assigned to Caroline Louisa Eliza Gair all his right, title, interest, powers and privileges under the indenture of 31st January 1923 and also the principal sum therein referred to and the interest accrued and to accrue in respect thereof to hold the same to the use of the assignee subject to the provisions of the indenture of 31st January 1923.

By an indenture made on 25th September 1934 between Caroline Louisa Eliza Gair as assignor and the appellant Linda Eloise Gair as assignee, the assignor by way of gift assigned to the appellant all her right, title, interest, powers and privileges under the indentures of 31st January 1923 and 19th June 1925 and also moneys secured thereby to hold the same to and to the use of the appellant her executors, administrators and assigns absolutely.

The mortgagor, Colin McKenzie, did not pay any part of the interest or principal secured by the indenture of 31st January 1923, so that upon the death of the life tenant, which occurred in September 1939, the whole of the principal sum still remained unpaid and also the following sums in respect of interest, namely to 31st January 1924 on £2,374 5s. 9d., £189 19s. ; and, on the assumption that interest continued to be payable after that date, from 31st January 1924 to 1st October 1931 on £2,564 4s. 9d. (this sum representing the original principal plus £189 19s. capitalized interest for one year), £1,571 18s. ; from 1st October 1931 to 25th September 1934, the date of the assignment of the second mortgage to the appellant (less statutory deductions of $22\frac{1}{2}$ per cent under the *Financial Emergency Acts* (Vic.)), £474 15s. ; from 25th September 1934 to 9th September 1939 (less statutory deductions of $22\frac{1}{2}$ per cent under these Acts), £791 5s. The amount of interest, therefore, which accrued due, assuming that interest continued to be payable after 31st January 1924, prior to the date of the assignment to the appellant, was £2,236 12s.

The case states that, at the death of the life tenant, there was owing on the first mortgage the sum of £3,920 to the Perpetual Executors and Trustees Association of Australia Ltd. This company was also the trustee of the estate of Donald McRae deceased. Upon the death of the life tenant, the trustee discharged the first mortgage out of the estate, which was valued at £8,680, and thereafter, in the month of November 1939, paid to the appellant the balance then

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remaining of the sum of £8,680, namely the sum of £4,760, in full satisfaction of all claims for principal and interest under the indenture of 31st January 1923. Out of the sum of £4,760, the appellant appropriated the sum of £2,374 5s. 9d. in discharge of the principal sum, leaving a balance (less a further payment to one Masterton of £250 the reason for which is not explained) of £2,136. The respondent claims that the whole of this sum of £2,136 is assessable income of the appellant in the relevant year.

At the commencement of the hearing, counsel for the appellant, on the assumption that the covenant for payment of interest in the indenture of 31st January 1923 was a covenant to continue to pay interest quarterly until the principal sum was repaid, stated that he could not contest that the sum of £791 5s. out of the sum of £2,136, this being the amount of interest which, on this assumption, would have accrued due after 25th September 1934, the date of the assignment to the appellant, was part of her assessable income. The amount of interest which would have accrued due on this assumption prior to this date would have been £2,236 12s., so that, in the absence of any appropriation by the debtor, it would have been open to the appellant, as she claimed to do in her notice of objection, to appropriate the sum of £2,136 in payment of the interest that accrued due prior to this date. The contention, therefore, that the receipt by the appellant of any interest which had accrued due prior to this date would be a receipt of capital, would, it seems, be applicable to the whole amount of £2,136, and not to this amount less the sum of £791. But I think it is clear that, where there are arrears of interest, the whole of the arrears are income of the recipient in the year in which they are subsequently paid (*Leigh v. Inland Revenue Commissioners* (1)—Cf. *Champneys' Executors v. Inland Revenue Commissioners* (2), where *Finlay J.* and Lord *Hanworth M.R.* respectively expressed the opinion that *Leigh's Case* (1) was rightly decided; *Dewar v. Inland Revenue Commissioners* (3)).

Counsel for the respondent contended, and I agree with the contention, that, on the true construction of the indenture of 31st January 1923, the covenant for payment of interest was only a covenant to pay interest until 31st January 1924 and that, after that date, there was no express covenant for payment of interest and no such covenant can be implied. But, where at a subsequent date a mortgagee sues on the covenant for repayment of the principal, the court could at common law allow interest at a reasonable rate

(1) (1928) 1 K.B. 73.

(2) (1934) 19 Tax Cas. 375, at pp. 383, 387.

(3) (1935) 2 K.B. 351, at pp. 365-376, 369-372.

by way of damages for a breach of contract in detaining the debt (*Cook v. Fowler* (1); *Goldstrom v. Tallerman* (2); *Halsbury's Laws of England*, 2nd ed., vol. 23, p. 278). The law on the point was given statutory force by *Lord Tenterden's Act*, 3 & 4 Will. IV., c. 42, s. 28, and is now embodied in the *Victorian Supreme Court Act* 1928, s. 78. Although this section refers to the court allowing interest at a certain rate, the interest claimed under the section still arises by way of damages and not under contract express or implied, and it is, therefore, not an amount certain, and a claim for such interest cannot properly be included in a specially endorsed writ (*Coane & Grant v. Thomas Bent Land Co.* (3); *In re State Fire Insurance Co.* (4)).

The indenture of 31st January 1923 is an assignment by way of second mortgage and is therefore an assignment of the equity of redemption. The contractual right to redeem contained in the indenture determined when the mortgagor failed to make the first payment of interest on 30th April 1923. After that date, the mortgagor was still entitled to an equitable right to redeem the mortgaged property which would continue to exist until it was foreclosed or barred by some statute of limitation or the mortgaged property was sold or otherwise disposed of. If the mortgagor sued to redeem the mortgaged property, one of the payments subject to the making of which the Court of Equity would order redemption would be the payment of damages in lieu of interest on the principal sum between 31st January 1924 and the date of repayment (*Mellersh v. Brown* (5)).

The case states that the sum of £4,760 was paid in full satisfaction of all claims for principal and interest under the indenture of 31st January 1923. But no part of this sum was appropriated by the debtor or creditor to payment of principal or interest that had accrued due prior to 31st January 1924. It was simply the payment of a lump sum representing the surplus that remained after repaying the principal and interest owing on the first mortgage.

Under these circumstances, it is impossible, in my opinion, to attribute to the sum of £2,136 the character of interest. It is not feasible, as it was in *Inland Revenue Commissioners v. Barnato* (6) and *Barlow v. Inland Revenue Commissioners* (7), to disintegrate the lump sum into amounts representing capital and interest. In *Barnato's Case* (8), the members of the Court of Appeal are careful to point out that Captain Barnato was entitled on an account to

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(1) (1874) L.R. 7 H.L. 27, at pp. 32, 37.

(2) (1886) 18 Q.B.D. 1, at p. 4.

(3) (1891) 17 V.L.R. 198.

(4) (1865) 34 L.J. Ch. 58, at p. 59.

(5) (1890) 45 Ch. D. 225.

(6) (1936) 20 Tax Cas. 455.

(7) (1937) 21 Tax Cas. 354.

(8) (1936) 20 Tax Cas., at pp. 512, 518-520, 521.

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recover a principal sum and also to recover either the profits which had been made by the use of his property or interest on that sum in lieu of profits. In the instant case, the mortgagor was not liable after 31st January 1924 to pay any interest. It is unnecessary to decide whether damages for a breach of contract by detention of a debt are income, although interest payable on a judgment of the court for the payment of interest from the date of the judgment until payment would be income (*In re Michelham ; Michelham v. Michelham* (1)). Even if such damages, when they have been assessed, can be regarded as income there has never been any such assessment in the present case. The sum of £2,136 does not represent interest or damages assessed in lieu of interest at any particular rate. There has simply been the payment of a lump sum and nothing has occurred to make any part of that payment income. The appellant did in her objections attempt to attribute the payment of £2,136 to interest accrued due prior to 25th September 1934 but it is not in fact interest. She did not include this sum or any part thereof as income in her income tax return and she has objected to its inclusion in her assessable income. Any mistake on her part as to its character cannot abrogate or affect her rights (*Simpson v. Kay* (2); *Inland Revenue Commissioners v. Castlemaine* (3)).

For these reasons, I would answer the question asked in the negative.

Question in case answered—No. Costs of case to be costs in the appeal. Case remitted to Starke J.

Solicitors for the appellant, *Gair & Brahe*.

Solicitor for the respondent, *H. F. E. Whitlam*, Crown Solicitor for the Commonwealth.

D. G. B.

(1) (1921) 1 Ch. 705.

(2) (1929) 14 Tax Cas. 580, at p. 601.

(3) (1943) 60 T.L.R. 2.