[HIGH COURT OF AUSTRALIA.]

COMMISSIONER OF INCOME TAX (QUEENSLAND) . . . . . APPELLANT;

AND

THE BRISBANE GAS COMPANY . . RESPONDENTS.

ON APPEAL FROM THE SUPREME COURT OF QUEENSLAND.

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BRISBANE, *Oct.* 2, 3, 4.

Griffith C.J., Barton and Isaacs JJ.

Income tax—Dividend out of Reserved Funds—Capitalization of profits—Bonus—Consolidated Income Tax Acts 1902-4 (*Qd.*) (2 *Edw. VII. Nos.* 10 *and* 23; 4 *Edw. VII. No.* 9), *secs.* 7 (iv.), 12 (vii.), 20.

The directors of a company which had power to declare and pay dividends only out of profits, reserved or unreserved, and to hold land as part of the capital of the company, declared dividends in 1905 out of an accumulated reserve fund, and out of a sum representing profits on the sale of a piece of land which had been held by the company.

Held.—Both dividends were liable to be assessed for income tax under sec. 7 (iv.) of the Queensland *Income Tax Acts* 1902-4.

No grounds for exemption from such liability are afforded by the fact that the dividend declared from reserve fund was not in fact paid in cash, but was applied, in the exercise of an option given to the shareholders, in payment for new shares issued to them *pro ratâ*; nor by the fact that such dividend was declared from a fund consisting of undistributed profits which had accumulated for some years previous to the *Income Tax Act* 1902, and had already paid income tax upon a lower scale as undistributed profits.

Bouch v. *Sproule* (12 App. Cas., 385), explained and distinguished.

Judgment of Full Court, *Commissioner of Income Tax* v. *Brisbane Gas Co.*, 1907 St. R. Qd., 57, reversed.

APPEAL from the decision of the Full Court of Queensland upholding, on a special case stated, the opinion of the Judge of the Court of Review. The Brisbane Gas Company, as constituted

under its deed of settlement in 1863, and incorporated by Act in 1864, was empowered, *inter alia*, to hold land as part of the capital of the Company, to declare dividends and/or bonuses out of the profits, whether in hand or placed to reserve; and to create new shares, which might be offered to shareholders as fully or partly paid up in payment of the whole or part of any dividend or bonus then payable. In 1902 the company disposed of some land, which had stood in the books at £20,000, for £30,000 thus making a book profit of £10,000. On 1st January 1902 the general reserve fund, which did not include the profit on the land, stood at £15,000, and increased with undistributed profits to more than £20,000 in 1905. About £15,000 of this reserve fund was employed in the business and in extensions of plant and works. In August 1905 the directors of the company, on a special resolution of the shareholders, decided to increase the capital by creating 4,000 new shares at £5 each fully paid up, to be offered *pro ratâ* to the shareholders at their option, and £20,000 of the reserve fund was to be distributed "as a dividend," payable at the option of the shareholders in cash or as a set-off against shares. The company's shares being worth more than double par value, all the new shares were taken up against the dividend, none of which was paid in cash. An ordinary dividend of £16,100 out of the year's profits was also declared, and a bonus of £4,900, which was part of the £10,000 profit on the sale of land. The Commissioner of Income Tax claimed payment on the total amount of £41,000, being the dividends declared for 1905. The company disputed payment on the £20,000 dividend and the £4,900 bonus, and their objections were sustained by the Court of Review and the Full Court (*diss. Chubb* J.) (1).

The Commissioner now appealed to the High Court.

Lukin and *Macgregor*, for the appellant. The respondents, by declaring these sums of £20,000 and £4,900 as a "dividend" and a "bonus," conclusively bring themselves within the operation of sec. 7 (iv.) of the *Income Tax Acts* 1902-1904, in which the amount of dividends declared is adopted as the test of the minimum sum assessable for income tax. The

(1) 1907 St. R. Qd., 57.

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assertions relied upon by respondents, that no amount per share was declared as a dividend, and that no dividend was in fact distributed in money, are irrelevant to the question whether or not a dividend was declared, which is decisive: *R.* v. *Stevenson* (1). This cannot be set up as a distribution of capitalized profits; the directors had power to declare and pay dividends solely out of profits, whether reserved or not, and not out of capital. It is equally immaterial to inquire in what year the profits now distributed as a dividend were earned.

The definition of "dividend" appeared in the *Dividend Duty Act* 1890 (Qd.) (54 Vict. No. 10), secs. 2, 6; this Act was repealed by the *Income Tax Act* 1904, but sec. 7 was adopted from the 1890 Act, and the word "dividend" used in that section must therefore bear the meaning given to it by the 1890 Act: *Mayor &c. of Portsmouth* v. *Smith* (2); *R.* v. *Atkinson* (3); *Parker* v. *Talbot* (4). *Bouch* v. *Sproule* (5), upon which the Courts below relied, is distinguishable, being a case of the construction of rights between a tenant for life and remaindermen; a will speaks of "income" in a very different meaning to that used in a taxing Statute. Also that case turned upon the shareholders having been given no option between taking shares or cash, whereas in the present case such an option was given. *In re Alsbury*; *Sugden* v. *Alsbury* (6); *In re Northage*; *Ellis* v. *Barfield* (7); *In re Malam*; *Malam* v. *Hitchens* (8); *In re Piercy*; *Whitwham* v. *Piercy* (9); *In re Bridgewater Navigation Co.* (10); *In re Armitage*; *Armitage* v. *Garnett* (11).

Although the £4,900 may not have been a true profit of the company's business, but an increase of capital assets, yet the company has chosen to treat it as income and declare it as a bonus or dividend.

Lilley, for the respondents. No tax was payable under the *Income Tax Act* 1902 on profits earned before 1902, nor under the *Income Tax Act* 1904 on profits earned before 1904; the

(1) 7 Q.L.J., 7.
(2) 10 App. Cas., 364, at p. 371.
(3) 3 C.L.R., 632, at p. 639.
(4) (1905) 2 Ch., 643.
(5) 12 App. Cas., 385.
(6) 45 Ch. D., 237.
(7) 60 L.J. Ch., 488.
(8) (1894) 3 Ch., 578.
(9) (1907) 1 Ch., 289.
(10) (1891) 2 Ch., 317.
(11) (1893) 3 Ch., 337.

question is not concluded by the distribution of these profits as a "dividend," as these Acts are intended only to tax current profits made and distributed or accumulated since their enactment: *Income Tax Acts*, 1902-4, secs. 7 (iv.), 39 (iii.). The 1904 Act can only have retrospective action so far as is provided by sec. 2, and then only as regards the years 1902-3-4.

Under sec. 12 (ii.) of the 1902 Act, the Commissioner, in estimating the amount of income tax on profits of a company, must deduct the amount paid by the company in dividend tax; he has the option of choosing between taxing on the dividend at 1s. in the £, or on the income at 6d. in the £. Dividend tax and income tax were alternative to each other. Hence, since the respondent company in 1902-3-4 paid in dividend tax amounts greater than what they would have had to pay at the lower rate in income tax on the whole of the profits made in any of those years, the profits not distributed in those years have passed the time when they would have been liable to income tax. That liability having been compounded for, those profits cannot now be again subjected to that liability. If the appellant is right, undistributed profits must pay 6d. in the £ in the year when earned, and 1s. in the £ when declared as a dividend, a total of 1s. 6d. in the £. The Income Tax Acts operate in annual fiscal periods, and were not intended to follow up the profits in continuous succession; each year is cleared off when it is paid.

No dividend was actually declared at all, in form or in substance; there was only a special resolution, a circular to shareholders, and an allotment of shares, merely a book entry against assets used as capital in the business; it was never intended to be "paid" as a real dividend would be; and, as in *Bouch* v. *Sproule* (1), although an option was held out, there was really no option, because the dividend was not declared against any cash assets: *Gilbertson* v. *Ferguson* (2); *Commissioners of Inland Revenue* v. *Angus* (3); *R.* v. *Stevenson* (4).

The £4,900 was not declared out of profits of the company's business undertakings; it was merely an accretion to capital, an

(1) 12 App. Cas., 385, at p. 398.
(2) 7 Q.B.D., 562.
(3) 23 Q.B.D., 579.
(4) 7 Q.L.J., 7.

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accession of value which was only a windfall, not taxable as profits: *Mooney* v. *Commissioners of Taxation* (N.S.W.) (1).

Lukin in reply. Until 1904 the *Dividend Duty Act* 1890 was separately administered from the *Income Tax Act* 1902; the combination of both Acts in 1904 did not operate to relieve accumulated profits from taxation when declared as a dividend. The 1904 Act did not impose a double burden; it afforded relief, by allowing the deduction of the 6d. in the £ paid on profits under the Income Tax Acts from the formerly additional amount payable at 1s. in the £ under the *Dividend Duty Act* 1890. Whether the dividend was a book entry or not, it was "paid" in substance and in fact; the unanimous choice of the shareholders proved that the allotment of shares was a payment more valuable than actual cash.

Cur. adv. vult.

GRIFFITH C.J. This is an appeal by the Commissioner of Income Tax from the judgment of the Supreme Court, on a special case stated by the Court of Review under the *Income Tax Act* 1902. The claim made is in respect of two sums of £20,000 and £4,900, which were distributed by the respondents amongst their shareholders in the year 1905, and which the Commissioner claims to have been dividends within the meaning of the 7th section of the Income Tax Acts as they now stand, and therefore dutiable as income whether the money was received during the year 1905 or not. Sec. 7 provides that there shall be charged, levied, collected and paid an income tax in respect of the annual amount of the incomes of all persons at the rates following, and then follows a table. Sub-sec. (iv.) of that section provides that the tax on the incomes of all companies shall be one shilling in each and every pound, and then follow two provisoes. The first is:—"Provided that the income subject to the tax of every company having its head office or chief place of business in Queensland shall be assessed at not less than the amount of the dividends declared by such company during the year in respect of which the assessment is made. Provided further that where any

(1) 3 C.L.R., 221.

of the profits of such company remain undistributed amongst the shareholders then upon such undistributed profits only sixpence in each pound shall be payable as income tax; and should any part of such undistributed profits be afterwards distributed as dividends, the amount already paid as tax shall be allowed for in computing the amount of tax payable on such dividend." On that proviso the Commissioner rests his case. He says that it is a fact that the respondents, who are a company, and have their head office in Queensland, declared in the year 1905 a dividend, or rather two dividends of the sums of £20,000 and £4,900, and that by the operation of this section they cannot be heard to say that their income in that year was less than that amount. He says they come within the literal words of the Act, and, in the case of a taxing Act, that is sufficient.

Now the facts with respect to the dividends may be briefly stated thus:—The company was formed in 1864 under a deed of settlement, which was afterwards incorporated in a Statute. By clause 64 of the deed of settlement the directors are authorized from time to time to declare out of the profits of the company—whether the profits have been from time to time placed to the reserved fund or not—a dividend or bonus, or a dividend and bonus; but no such dividend or bonus shall be payable except out of such profits. Before the year 1905 a reserve fund had been accumulated by the company, which in that year stood at a larger sum than £20,000. In that year the directors called a general meeting of the company, at which a resolution was passed that £20,000 of the reserve fund should be distributed amongst the members as a dividend, which dividend might be drawn in cash. It was part of the scheme under which that dividend was declared that 4,000 new shares of £5 each should be issued, and that the shareholders to whom this dividend was payable should have the option of taking up an aliquot number of the fully paid up new shares of the company. As a matter of fact they all agreed to do so—and naturally, because the shares stood at more than 100% premium. The other £4,900 assessed was part of a sum of £10,000 profits earned by the company or received by the company in the year 1902 or 1903, but which had not been treated as part of the current revenue. That was divided in the

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form of a bonus in the year 1905. The sum of £20,000 was all earned before 1905. The respondents maintain, first of all, that these are not dividends at all within the meaning of the Act. The word dividend does not really require any interpretation, although there has been on the Statute Book in Queensland a *Dividend Duty Act*, to which I shall directly refer, in which there was a definition of a dividend. But, when the articles of association of a company provide that the accumulated profits, whether they have been placed to reserve fund or not, may be divided by way of dividend amongst the shareholders, and after that the shareholders by resolution resolve to distribute them, I think it is very hard to say that the amount then distributed is not a dividend. As to the £4,900, there can be no doubt that it was a dividend, called a bonus; but the respondents say, "even if these were dividends, yet this is an Income Tax Act, and the intention of the Act was only to tax income, and this money, although it was in one sense a dividend, and might *primâ facie* come within the meaning of sub-sec. (iv.) of sec. 7, cannot be brought within the true meaning of that section, because the ruling principle of the Act is to tax income." That is a plausible argument, and possibly if the words were ambiguous it might be capable of acceptation. Before doing so, however, it will be worth while to look a little further. That argument is based upon this: The Income Tax Acts, when they were brought in, were to tax future income. There was no intention to tax any previous income. It was further very unlikely, to begin with, that the legislature in an Act dealing with future income would use such a phrase, "shall be assessed at not less than the amount of the dividend declared by such company," if it intended the money earned in the past would be taxed as future income. That argument is very plausible, and if there were no more in the facts or the law, it might possibly be accepted, but I only say, possibly. I doubt whether it should, if the case falls within the literal meaning of the Statute. If we inquire a little further, we find that this section, which from that point of view looks like an unjust attempt to tax past earnings by calling them future income, was in reality not a clause imposing a new liability, but a clause diminishing existing liability—a clause passed in relief of the

company, and not for the purpose of imposing an additional burden upon it. Under the *Dividend Duty Act*, passed in 1890, a tax of one shilling in the pound was imposed on all dividends declared by a company, no matter from what source they came, or when they were earned. In 1902, when the *Income Tax Act* was first introduced, an income tax of 6d. in the pound was imposed on the profits of all companies, whether distributed or not. But the *Dividend Duty Act* 1890 still remained in force, so that there were two taxes—6d. in the pound on the gross income, and 1/- in the pound on all dividends—but there was a proviso that credit should be given as against the tax on income to the extent of the amount actually paid by way of dividend duty. If none of the profits were distributed the company paid the whole 6d. in the pound, and when they came to be distributed, the company paid 1/- in the pound, so that it might easily and generally did happen that they paid 1/6 in the pound on part of their profits. Then in the year 1904 the legislature repealed the *Dividend Duty Act* 1890, and substituted the provision as it now stands, that is to say, the company was to pay 1/- in the pound on all its profits, with a proviso that, "where any of the profits of such company remain undistributed amongst the shareholders then upon such undistributed profits only sixpence in each pound shall be payable as income tax; and should any part of such undistributed profits be afterwards distributed, as dividends, the amount already paid as tax shall be allowed for, in computing the amount of tax payable on such dividend." The result was that, instead of a company being liable to pay 1/6 in the pound, it pays no more than 1/-. It is still, as before, required to pay a tax of 1/- in the pound on all its dividends. That being the change made in the law, a construction, which at first sight seems plausible, becomes highly improbable, and there is no reason why the literal meaning should not be given to the words "that the income subject to the tax . . . shall be assessed at not less than the amount of the dividends declared by such company during the year in respect of which the assessment is made." During the year 1905 the dividends declared by this company included those two sums. There were other dividends declared, but in respect of them no question arises. There is no reason

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why the literal words of the section should not be adopted—there is no escape from it.

It was contended as a subsidiary point, that with respect to the £4,900, the respondents are entitled to the benefit of the proviso I have just read, and that arises in this way: In 1902 the dividend declared was about £15,000, and the dividend duty on that was at the rate of 1/- in the pound. Now £10,000 were the profits earned in that year, of which the £4,900 formed a part, and it was argued that any income tax payable upon it would have been covered by the dividend duty actually paid, because the dividend duty paid would have been sufficient to defray the income tax on an income of £30,000, which was greater than the actual profits, with more than £10,000 added. But they cannot bring this within the proviso, because they did not pay any income tax. They paid dividend duty because they were bound to do it, but they did not in fact pay any income tax on that £10,000, so that they cannot bring it within the words of the proviso, and, for the reasons I have given, I do not think they bring it even within the spirit of it. The majority of the learned Judges of the Supreme Court, and the learned Judge of the Court of Review, thought the case was to a great extent governed by the principles laid down in *Bouch* v. *Sproule* (1), but that was a case between tenant for life and remainderman, under the terms of a will by which the income was given to the tenant for life. Very different questions arise in a case of that sort. There, what the Court had to do was to discover what was the meaning of the testator's words. When he said the tenant for life was to have the income, did he intend to cover a case of a division of past accumulated profits? The House of Lords held in that case that he did not. Here the question is the construction of a taxing Act. The distinction was drawn by *North* J. in the case of *In re Northage*; *Ellis* v. *Barfield* (2), where he adopted what seems to be a rule of common sense, that so much of the dividend as was really payable in cash went to the tenant for life, and anything that represented profits would be for the remainderman. It is quite unnecessary to deal with that subject in this case. All we are concerned with is the interpretation of the Statute. The respondents have been

(1) 12 App. Cas., 385. (2) (1891) W.N., 84.

brought within the literal words of the Act, and there is nothing in the context or in the history of the law to show that these words should have any but their literal meaning. For these reasons I am of opinion that the appeal should be allowed, and that the respondents are liable to be taxed at the rate of 1/- in the pound on both sums. With respect to the £4,900, which represented profits on the sale of land, it was said that that was capital, or, at any rate, came out of the reserve fund. Perhaps it was—I doubt it. Suppose it was—the company declared a dividend of £4,900, and I do not think it lies in their mouth, or the Commissioner of Taxation, to say that that dividend was an unlawful one. They paid the dividend, and they must pay 1/- in the pound upon it. That is made the more clear by the provisions of section 31 (*a*) of the Act, which now imposes upon the company the duty of paying the tax before they pay the dividend.

BARTON J. I have nothing to add. I find myself unable to resist the conclusion that the defendant company has brought itself clearly within the terms of the Act, whatever hardship may appear to be entailed. I therefore concur with the judgment just delivered.

ISAACS J. read the following judgment. This case was in the first instance heard by Judge *Rutledge* sitting as a Court of Review under the *Income Tax Acts* 1902-1904.

In pursuance of sub-sec. 8 of sec. 55 of the Consolidated Acts His Honor stated a special case for the opinion of the Supreme Court, from whose judgment this appeal is brought. To the special case the learned Judge who stated it mentioned in one of the paragraphs that he annexed copies of the notes of evidence taken, the exhibits admitted, and his judgment. The annexures however form no part of the special case itself, and must simply be disregarded. Both the Supreme Court and this Court are confined to the special case for the purpose of ascertaining the facts, and although the reasons of the learned Judge may materially assist an Appellate Court in its deliberations, they are quite outside the statutory material on which the decision of the Court of Appeal must be founded.

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Looking then to the special case, it appears that on 4th August 1905 the company passed resolutions to increase the capital of the company by creating 4,000 new shares of £5 each, the then members of the company to have the option of taking them up in certain proportions, and the sum of £5 to be immediately called up. The 4th resolution is as follows: (His Honor read the resolution and continued). Shares not taken up were to be sold by public auction and the proceeds, less £5 and certain other sums, were to be divided among members declining to take up their proportion of shares. The 6th and 7th resolutions are as follow: (His Honor read the resolutions, and continued).

The directors carried out the resolutions, and it must be assumed, there being no evidence to the contrary, that they acted formally and in accordance with the provisions of the deed of settlement.

Par. 15 of the special case is as follows: (His Honor read the paragraph, and continued).

The Commissioner of Income Tax claims that these facts render the company liable to pay income tax at the rate of 1s. in the pound on £19,730.

Mr. *Lilley* contended in the first place that his client was clear of the *Income Tax Act* 1902 as to these profits, assuming them to be profits, because they were earned before the passing of the *Income Tax Act*.

His argument I confess impressed me considerably. But the words of the Act are too strong to give effect to it, especially when sec. 7 (iv.) is read in conjunction with secs. 12(vii.) and 31 (*a*).

The legislature evidently had in its mind a deliberate intention to tax profits divided in any year by a company among its shareholders quite irrespective of the time when those profits were made by the company. Full protection is given by the 2nd proviso to sec. 7 (iv.) against taxing the same income twice by way of income tax. There is no reason therefore for departing from the primary meaning of the words in sec. 7 (iv.), "The dividends declared by such company during the year in respect of which the assessment is made."

Then a view was urged for the respondents, which has been accepted by both the Court of Review and the majority of the Supreme Court, that the company is at liberty, notwithstanding

the apparent declaration of a dividend, to go behind it, and to show—as it claims it has shown—that it is nevertheless free from the tax, because there never was any real intention to divide profits, or to pay a dividend in cash, but merely to increase capital, and that what the shareholders received, and were always intended to receive, was in fact capital. It is not denied that profits had been made which would certainly at one time have been properly applied to the payment of dividends, but it is said as they had been in fact employed in the business they had ceased to be divisible profits, and had become in some sense capital, and at least were not in such a condition as to justify the conclusion that they were ever intended to be paid over as dividends.

The case of *Bouch* v. *Sproule* (1), was relied on for this position. The decision of the House of Lords determined certain principles of law, which are summarised in *Lindley on Companies*, 6th ed., at p. 742, and then applied them to the facts, the ultimate determination turning entirely on the view their Lordships took of the facts before them.

In arriving at their conclusion of fact the learned Lords took into consideration many circumstances. They thought it important that the company had by its articles of association power to capitalize its profits, they interpreted the directors' annual report and balance sheet, they looked at the financial position of the company, the market value of the shares, the form of the document sent out to shareholders, and the way in which the books were kept, all of which had more or less weight in the minds of their Lordships.

A similar course has been adopted here to sustain the position of the respondents, and the Courts below have held that the view of the facts presented by the respondents is correct.

I lay aside the possible results of establishing that the resolutions did not mean what they plainly said, and that the scheme was to that extent misleading, and in substance a transgression of the provisions of the deed of settlement, and consider the argument solely in its relation to this revenue Statute. I do not think it at all permissible to embark on this elaborate investiga-

(1) 12 App. Cas., 385.

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tion for the purpose of ascertaining liability, or the extent of liability of a company under the *Income Tax Act* where the Commissioner is content to rest on the declaration of a dividend, and therefore I do not examine the facts with any such view. The language of the Statute lends no countenance to such an investigation in that case.

It lays a tax on the income of a company for a given year of 1/- in the pound. But the ascertainment of a company's profits is not always an easy process, the very cases relied on demonstrate that, and it seems to me the legislature by this Act, not only determined by the sections I have already quoted to tax all profits actually divided in any year, but provided also, in the case of a dividend declared, a simple and decisive means of establishing up to a certain limit that there was taxable income and the amount of it, and so of avoiding the complicated inquiry otherwise necessary.

When a company openly asserts that it has profits available for distribution among its shareholders, and formally announces that distribution, then to that extent there was thought to be no need to call for further evidence, for there really can be no better evidence against the company than its own public recognition of the fact, and that is made by the Act conclusive, and the Commissioner, if satisfied to accept that as proving the taxable income, may do so without question.

It would, in my opinion, be altogether reversing the manifest intention of Parliament if the simple and undeniable circumstance of a dividend actually declared were allowed to be controverted and turned into the subject of such difficult questions of law and complicated elements of fact as have been raised here. No such defence is possible, according to my reading of the Act, where the Commissioner relies on the mere declaration of a dividend of profits.

I hold, therefore, that *Bouch* v. *Sproule* (1) has no relevancy whatever to the present case.

With regard to the sum of £4,900, if it were permissible to enter upon an investigation of the items, I should feel some doubt. That doubt would not arise on account of the company

(1) 12 App. Cas., 385.

not carrying on a land business, because the land was held only in connection with the company's actual business. See sec. 11 of the Act and clause 29 of the articles. My hesitation would be occasioned by the provision in clause 29 that the land is to be regarded as part of the company's capital. However, as already stated, I do not think it open to a going company to controvert, either as to fact or amount, what would be ordinarily regarded as a declaration of dividend. This sum must therefore be included in the taxable amount. I agree that this appeal should be allowed.

GRIFFITH C.J. The formal order will be: Appeal allowed, order appealed from discharged, and case remitted with a declaration that the respondents are liable to assessment on the sums of £19,730 and £4,900 at the rate of 1/- in the pound. Respondents to pay the costs of the special case and of the appeal. I do not think we have anything to do with the costs in the Court of Review. The case is remitted and is still pending in the Court of Review. It will have to go back to that Court to dismiss the appeal.

Lukin. Since the appeal the District Court has entered judgment, notwithstanding there was an appeal pending to this Court.

GRIFFITH C.J. Where the appeal is allowed any order consequent upon it must be discharged. The case must go back to the District Court Judge, and he will then dismiss the appeal, and deal with the costs.

Appeal allowed. Order appealed from and consequent orders discharged. Case remitted to District Court.

Solicitor, for the appellant, *Hellicar* (Crown Solicitor for Queensland).

Solicitor, for the respondents, *T. O. Cowlishaw.*

N. G. P.