of such money as aforesaid. Costs of the respondents Clancy of this appeal to be paid by the appellants.

H. C. OF A. 1920. GLEESON v. FITZPATRICK.

Solicitor for the appellants, *P. W. McCarthy*, Lockhart, by *S. L. Ridge*.

Solicitors for the respondents, *P. W. McCarthy*, Lockhart, by *S. L. Ridge*; *Walsh & Blair*, Wagga Wagga, by *McDonell & Moffitt*.

B. L.

Foll Public Prosecutions, Director of v Tzo-Martinez (1961) 119 ALR 517

Foll Thomson v Taxation, Federal Commissioner of (1923) 33 CLR 73

[HIGH COURT OF AUSTRALIA.]

CORNELL . . . . . APPELLANT;

AND

THE DEPUTY FEDERAL COMMISSIONER OF TAXATION (SOUTH AUSTRALIA) } RESPONDENT.

H. C. OF A. 1920. MELBOURNE, *Oct.* 14, 15, 18, 25. Knox C.J., Isaacs, Higgins, Gavan Duffy, Rich and Starke JJ.

Income Tax—Assessment—Income—Shareholder in company—Undistributed income of company—Legislative power of Commonwealth Parliament—Ultra vires—Commissioner of Taxation—Judicial power—The Constitution (63 & 64 *Vict.* c. 12), *secs.* 51 (II.), 55, 71—*Income Tax Assessment Act* 1915-1918 (*No.* 34 *of* 1915—*No.* 18 *of* 1918), *sec.* 16.

Sec. 16 (2) of the *Income Tax Assessment Act* 1915-1918 provides that "Where, in the opinion of the Commissioner, a company has not in any year distributed to its members or shareholders a reasonable proportion of its taxable income, the taxable income of the company shall be deemed to have been distributed to the members or shareholders in proportion to their interests in the paid-up capital of the company, if the Commissioner is satisfied that the total tax payable on it as distributed income is greater than the tax payable on it by the company."

Held, that the provisions of the sub-section are within the powers conferred on the Parliament of the Commonwealth by sec. 51 (II.) of the Constitution.

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Osborne v. *The Commonwealth*, 12 C.L.R., 321; *Attorney-General for Queensland* v. *Attorney-General for the Commonwealth*, 20 C.L.R., 148; 22 C.L.R., 322; *Morgan* v. *Deputy Federal Commissioner of Land Tax* (*N.S.W.*), 15 C.L.R., 661; *National Trustees, Executors and Agency Co. of Australasia* v. *Federal Commissioner of Taxation*, 22 C.L.R., 367, followed and applied.

Waterhouse v. *Deputy Federal Commissioner of Land Tax* (*S.A.*), 17 C.L.R., 665, distinguished.

The sub-section does not purport to confer judicial power upon the Commissioner of Taxation.

The effect of the sub-section is that, where the Commissioner is of opinion that less than a fair proportion of the profits of a company has been distributed to the shareholders, the whole amount of profit which would otherwise have been taxable income of the company is to be deemed to have been distributed to the shareholders.

The fact that the Commissioner has assessed a taxpayer for a smaller amount of tax than that for which the taxpayer is liable is not a reason for setting aside the assessment at the instance of the taxpayer.

CASE STATED.

On an appeal by Frederick William Cornell from an assessment of him for Federal income tax for the year 1918-1919, *Starke* J. stated a case for the Full Court which was substantially as follows :—

1. The appellant is a shareholder in Cornell Ltd. (hereinafter called " the Company "), a company registered under the *Companies Act* 1892 (S.A.), and having its registered office and principal place of business at No. 122 Pirie Street, Adelaide, in the State of South Australia.

2. The public officer of the Company duly furnished to the respondent a return setting forth a statement of the income derived by it from sources in Australia during the year ended on 30th June 1918.

3. The appellant duly furnished to the respondent a return setting forth a statement of the income received by him during the said year.

4. On 9th April 1919 the respondent caused an assessment to be made for the purpose of ascertaining the taxable income of the appellant, and on 2nd May 1919 gave written notice of such assessment to the appellant.

5. On 24th October 1919 the respondent advised the public officer of the Company that sec. 16 (2) of the *Income Tax Assessment Act*

1915-1918 had been applied to the Company's assessment for the year ended 30th June 1918, that the balance shown in the profit and loss account (£12,663) was deemed to have been distributed, and that of that amount £4,534 was deemed to have been distributed to the appellant.

6. On the said 24th October 1919 the respondent issued to the public officer a notice of assessment which set out that the Company had been assessed on a taxable income of £2,344, which was arrived at as follows :—Profit as per profit and loss account £12,663 ; add Federal income tax £1,071, reserve for doubtful debts £1,000, increase in discount reserve £130 and depreciation disallowed £143 : Amended income £15,007. Less amount deemed to have been distributed as above £12,663 :—Net taxable income £2,344.

7. On 16th October 1919 the respondent caused an alteration to be made in the appellant's said assessment by adding to the amount of taxable income included therein the said sum of £4,534 as the amount deemed to have been distributed to the appellant as aforesaid, and on 24th October 1919 notified the appellant of the said alteration.

8. The said alteration and another alteration effected thereby had the effect of increasing the appellant's existing liability, and of imposing fresh liability on him, to the extent of £1,243 16s. 5d. (which was paid on 25th November 1919), making a total claimed liability for income tax of £1,284 13s. 5d.

9. On the said 25th November 1919 the appellant lodged a written objection with the respondent against such altered assessment, stating as reasons for the objection : (*a*) that such assessment was excessive ; (*b*) that he, the appellant, did not derive any income from dividends from the Company and was not assessable in respect of any portion of the profits of that company ; (*c*) that the said sec. 16 (2) was *ultra vires*, and its provisions without the powers of the Commonwealth Government.

10. On 16th January 1920 the respondent gave to the appellant written notice that he wholly disallowed the said objection, and that the appellant was then entitled to have his notice of objection treated as a notice of appeal, and specified the Courts to which such appeals might be made.

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11. On 13th February 1920 the appellant asked the respondent to treat his objection as an appeal.

12. By the articles of association of the Company it is provided (art. 123) that the profits of the Company shall be divisible among the members in proportion to the nominal amount of the shares held by them respectively subject to the rights of members entitled to shares issued upon special conditions.

13. By the said articles it is also provided (art. 124) that the Company in general meeting may declare a dividend to be paid to members according to their rights and interests in the profits; but that no larger dividend shall be declared than is recommended by the directors.

14. By the said articles it is further provided (art. 127) that the directors may, before recommending any dividend, set aside out of the profits of the Company such sum as they think proper as a reserve fund to meet contingencies, or for equalizing dividends, or for benefits to employees, or for repairing or maintaining the works connected with the business of the Company or any part thereof; and for such other purposes as the directors shall in their absolute discretion think conducive to the interests of the Company; and to invest the several sums so set aside upon such investments (other than shares of the Company) as they may think fit, and from time to time to deal with and vary such investments and dispose of all or any part thereof for the benefit of the Company and to divide the reserve fund into such special funds as they shall think fit, with full power to employ the assets constituting the reserve fund in the business of the Company and that without being bound to keep the same separate from the other assets.

15. The Company did not during the said year in general meeting declare a dividend, and the appellant's return mentioned in par. 3 hereof did not include any dividend received from the Company.

16. The appellant is the proprietor of 16,615 shares in the capital of the said Company, but is not the holder of any shares in the said Company issued upon any special conditions which entitle him to any further income from the said Company than that shown by him in his said return, nor have the directors of the said Company set

aside for the appellant any portion of the profits of the said Company placed to reserve as aforesaid.

17. The profits of the said Company placed to reserve as aforesaid have been placed to a general reserve fund.

18. On the hearing of the said appeal before me the following questions arose, which, being in my opinion questions of law, I state accordingly for the opinion of the High Court :—

(1) Whether sec. 16 (2) of the *Income Tax Assessment Act* 1915-1918 is beyond the legislative powers of the Commonwealth and invalid.

(2) Whether (if the Commissioner is of opinion that a company has not distributed to its shareholders a reasonable proportion of its taxable income) the whole of the taxable income of the company or only a reasonable proportion thereof is to be deemed to have been distributed.

(3) Whether the respondent validly assessed the appellant upon the sum of £4,534 as mentioned in par. 7 hereof, or any and what part thereof ?

Art. 155 of the articles of association of the Company, which were incorporated in the case, provided that, if the Company should be wound up, the assets remaining after payment of the costs and expenses of the liquidation and the debts and liabilities of the Company should be applied in the first place in or towards repaying to the members the amounts paid up, or deemed so to be, on their shares, and the surplus, if any, should be distributed among all the members *pro ratâ* according to the number of the ordinary shares held by them respectively, but that this provision should be without prejudice to the rights of the holders of shares issued upon special conditions.

Glynn K.C. (with him *Robert Menzies*), for the appellant. Sec. 16 (2) of the *Income Tax Assessment Act* 1915-1918 is beyond the legislative power of the Commonwealth for the following reasons :— The Federal power of taxation does not extend to the regulation, and control does not extend to the regulation and control of the constitution of companies incorporated under State laws. Sec. 16 (2) purports to impose a tax upon incomes of individuals which,

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according to the law of South Australia as to companies, have not been directly or indirectly derived by the taxpayer, that is, which have not arisen or accrued to him, and which he has not received and to which he has not become entitled. The distribution of dividends by companies must depend on the law of the States and the articles of association (*Oakbank Oil Co.* v. *Crum* (1)). Under the articles of association dividends must be distributed in proportion to the nominal amount of the shares held by the members (art. 123), and not in proportion to their interests in the paid-up capital of the company; so that sec. 16 (2) is a direct interference with the law of the State. The case of *Morgan* v. *Deputy Federal Commissioner of Land Tax* (*N.S.W.*) (2) is distinguishable, for there is an essential difference between land and income: the land always actually exists, but income does not exist apart from the person who earns, derives or receives it. The Parliament can only tax as income that which actually exists (*Waterhouse* v. *Deputy Federal Commissioner of Land Tax* (*S.A.*) (3)). Sec. 16 (2) has the effect of imposing a penalty and not income tax, and is therefore a contravention of sec. 55 of the Constitution and of no effect. If it imposes a penalty but is not in contravention of sec. 55 of the Constitution, it is not within the express or incidental powers of the Commonwealth Parliament. Sec. 16 (2) violates the provisions in sec. 71 of the Constitution as to the judicial power of the Commonwealth, for it vests in an executive officer judicial authority in respect of a tax or a penalty. It is not within the power of the Federal Parliament to declare that an event shall be deemed to have taken place which has not taken place. The operation of sec. 16 (2) depends on an impossible condition, for, reading sec. 16 (2) with sec. 16 (1), if the company distributes anything during a particular year, the amount distributed is deducted in arriving at the taxable income, and therefore cannot be a distribution of taxable income, and taxable income cannot be calculated until the end of the year has arrived, and therefore cannot be distributed during the year. [Counsel also referred to *Commissioners of Inland Revenue* v. *Blott* (4); *Gibbons* v. *Mahon* (5); *Harding* v. *Federal Commissioner of*

(1) 8 App. Cas., 65.
(2) 15 C.L.R., 661.
(3) 17 C.L.R., 665.
(4) (1920) 2 K.B., 657.
(5) 136 U.S., 549.

Taxation (1); *Osborne* v. *The Commonwealth* (2); *National Trustees, Executors and Agency Co. of Australasia* v. *Federal Commissioner of Taxation* (3); *Kensington Income Tax Commissioners* v. *Aramayo* (4); *Lynch* v. *Turrish* (5); *Southern Pacific Co.* v. *Lowe* (6); *Attorney-General for Ontario* v. *Attorney-General for the Dominion* (7); *Lynch* v. *Hornby* (8); *Daimler Co.* v. *Continental Tyre and Rubber Co. (Great Britain)* (9); *Burland* v. *Earle* (10); *Huddart, Parker & Co. Proprietary Ltd.* v. *Moorehead* (11).]

[KNOX C.J. referred to *Salomon* v. *Salomon & Co.* (12).]

Owen Dixon and *Claude Robertson*, for the respondent, were not called on.

Cur. adv. vult.

Oct. 25.

THE COURT delivered the following written judgment:—

The appellant is a shareholder in Cornell Ltd., a company formed under the law of South Australia. The articles of the Company contain the usual provision relating to the distribution by way of dividend of the profits of the Company. Art. 124 provides that no amount shall be paid by way of dividend in excess of that recommended by the directors. In the year 1917-1918 the Company made a profit of £12,663, but no portion of this amount was distributed among the shareholders. The Deputy Federal Commissioner of Taxation, being of opinion that a fair proportion of the profits had not been distributed, availed himself of the power given him by sec. 16 (2) of the *Income Tax Assessment Act* 1915-1918, and the whole sum of £12,663 has been treated by him as if it had been distributed among the shareholders in proportion to their interests in the paid-up capital of the Company. The result is that the appellant has been assessed for income tax as if he had received £4,534 from the Company by way of dividend during the year in question, and his appeal is against this assessment.

(1) 23 C.L.R., 119.
(2) 12 C.L.R., 321, at p. 335.
(3) 22 C.L.R., 367, at p. 372.
(4) (1916) 1 A.C., 215.
(5) 247 U.S., 221.
(6) 247 U.S., 330.
(7) (1896) A.C., 348.
(8) 247 U.S., 339, at p. 343.
(9) (1916) 2 A.C., 307, at p. 338.
(10) (1902) A.C., 83, at p. 95.
(11) 8 C.L.R., 330, at p. 349.
(12) (1897) A.C., 22.

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The main contention on behalf of the appellant was that sec. 16 (2) of the *Income Tax Assessment Act* was beyond the power of the Commonwealth Parliament. In support of this contention Mr. *Glynn* urged a number of grounds, of which all but two are in our opinion covered in principle by the decisions of this Court in *Osborne* v. *The Commonwealth* (1); *Attorney-General for Queensland* v. *Attorney-General for the Commonwealth* (2); *Morgan* v. *Deputy Federal Commissioner of Land Tax* (*N.S.W.*) (3), and *National Trustees, Executors and Agency Co. of Australasia* v. *Federal Commissioner of Taxation* (4).

The subject of taxation under sec. 16 (2) of the *Income Tax Assessment Act* 1915-1918 is income in the same sense as land is the subject of taxation under sec. 39 of the *Land Tax Assessment Act* 1910-1916. And the proposition that the Legislature "must take things as it finds them, according to State law, and tax or not tax them accordingly" was made in *Morgan's Case* (3) and directly met by the decision in that case and also in the *National Trustees Co. Case* (4). As was said by *Isaacs* J. in *Morgan's Case* (5), "the Commonwealth Parliament . . . cannot be limited by any artificial creations or restrictions which the varying policies of State Legislatures may devise." The fundamental fact, in the present case, is that the shareholders of the Company are the "real and only masters" of the undistributed income in the possession of the Company.

The case of *Waterhouse* v. *Deputy Federal Commissioner of Land Tax* (*S.A.*) (6) was relied upon, but it is sufficient for present purposes to say that the Court there held that the appellant had no interest in the land according to law or the real substance of the case. We have already indicated the very real interest that the appellant in the present case had in the undistributed income of the Company. This is sufficient to distinguish the present case from *Waterhouse's Case*, and to render any further observations upon it unnecessary.

Returning now to *Morgan's Case* (3), the enactment under consideration was sec. 39 of the *Land Tax Assessment Act*, which provided in effect that the shareholders in a company owning land

(1) 12 C.L.R., 321.
(2) 20 C.L.R., 148; 22 C.L.R., 322.
(3) 15 C.L.R., 661.
(4) 22 C.L.R., 367.
(5) 15 C.L.R., at p. 669.
(6) 17 C.L.R., 665.

should be deemed to be joint owners of the land belonging to the company and that each shareholder should be liable for land tax in respect of a portion of the value of such land corresponding to his share in the capital of the company. The shareholder had under the law of the State no legal or equitable estate in the land belonging to the company, but it was held that he had a sufficient interest in the land to justify the provision by which he was "deemed to be the owner" of a portion of such land. The section now under consideration is indistinguishable in substance from that dealt with in *Morgan's Case* (1), the only difference being that in *Morgan's Case* the Act dealt with *land* of the company, while in this case the subject matter is *income* of the company. In this case, as in that, the shareholder is not entitled either at law or in equity to obtain for himself, except in accordance with the law of the State and the regulations of the company, any portion of the subject matter dealt with, but in this case, as in that, the Commonwealth Act in no way affects or purports to affect the rights or liabilities of the company and the shareholders *inter se* under State law. In both cases the whole body of shareholders had power, by taking a proper course of action (*e.g.*, by bringing into operation art. 155), to insist on the property in question being actually distributed among them, and it was this circumstance which in *Morgan's Case* was held to give rise to the right of the Commonwealth Parliament to impose taxation on the shareholders in respect of the property of the company.

Mr. *Glynn* challenged the constitutionality of this Act on two other grounds, with which we now proceed to deal. The first of these as stated by Mr. *Glynn* was: "it violates the Constitution by vesting judicial power in respect of tax or penalty in an executive or administrative officer" (2). It is a sufficient answer to this contention to point out that the Commissioner of Taxation, in exercising the power conferred on him by sec. 16 (2), is not in any relevant sense acting judicially—that is, he is not exercising judicial power. His power is merely to determine as an administrative officer whether in his opinion the company has distributed by way of dividend a fair proportion of its profits. The remaining ground is: "its operation depends on an impossible condition;

(1) 15 C.L.R., 661. (2) See 8 C.L.R., at p. 355.

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i.e., under sec. 16 (2) read with sec. 16 (1)—(1) if it distributes anything during a particular year the amount distributed is deducted in arriving at the taxable income and therefore cannot be a distribution of taxable income; (2) taxable income cannot be calculated until the end of the year has arrived and therefore cannot be distributed during the year." In our opinion there is no foundation for this contention, and if it were well founded it would go not to the constitutionality of the provision but to the possibility of applying it.

It follows that question 1 of the special case should be answered: No.

Question 2 of the special case is as follows: "Whether (if the Commissioner is of opinion that a company has not distributed to its shareholders a reasonable proportion of its taxable income) the whole of the taxable income of the company or only a reasonable proportion thereof is to be deemed to have been distributed." On this question it is unnecessary to say more than that in our opinion it is clear on the words of the sub-section construed literally that, when the Commissioner is of opinion that less than a fair proportion of the profits have been distributed, the whole amount of profit which would otherwise have been taxable income of the company is to be deemed to have been distributed to the shareholders. This question should therefore be answered: The whole of the taxable income of the company.

With regard to question 3 it appears from the facts stated in the special case that the Commissioner might have treated the sum of £15,007 instead of the sum of £12,663 as having been distributed among the shareholders, and consequently that he has assessed the appellant for a smaller sum in this respect than was permissible. We do not think the fact that an assessment is for too small an amount is any reason for setting aside the assessment at the instance of the person assessed. This question should therefore be answered: Yes.

Costs of special case costs in the appeal from assessment.

Questions answered: (1) *No*; (2) *The whole of the taxable income*; (3) *Yes. Costs of special case to be costs in the appeal.*

Solicitors for the appellant, *Gillott, Moir & Ahern*, for *Baker, Glynn, Parsons & Co.*, Adelaide.

Solicitor for the respondent, *Gordon H. Castle*, Crown Solicitor for the Commonwealth.

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[HIGH COURT OF AUSTRALIA.]

RAMACIOTTI . . . . . APPELLANT;

AND

THE FEDERAL COMMISSIONER OF TAXATION . . . . . RESPONDENT.

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SYDNEY, *Nov.* 10, 11.

Knox C.J., Isaacs and Rich JJ.

Income Tax—Assessment—Exemption—Person on "active service"—Service within Australia during the War—Mobilization—Income Tax Assessment Act 1915-1916 (*No.* 34 *of* 1915—*No.* 39 *of* 1916), *sec.* 13—*Defence Act* 1903-1915 (*No.* 20 *of* 1903—*No.* 3 *of* 1915), *sec.* 4.

Sec. 13 of the *Income Tax Assessment Act* 1915-1916 provides that "this Act shall not apply to any person who is on active service during the present war with the military or naval forces of the Commonwealth . . . so far as regards income derived from personal exertion and earned prior to the commencement of this Act or during the present state of war."

Held, that the words "active service" in that section have the same meaning as they are given by sec. 4 of the *Defence Act 1903-1915*, namely, "service in or with a force which is engaged in operations against the enemy and includes any naval or military service in time of war."

Held, therefore, that an officer of the Military Forces of the Commonwealth who had been mobilized for duty in 1915, and during the year ending on 30th June 1917 was District Commandant of the 2nd Military District and Inspector-General of Administration, was on active service during that period and was entitled to the benefit of sec. 13 in respect of income tax for that year although his service was performed within Australia.