[HIGH COURT OF AUSTRALIA.]

WEBB . . . . . APPELLANT;

AND

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

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MELBOURNE, *May* 8-12.

BRISBANE, *June* 19.

Knox C.J., Isaacs, Higgins, Gavan Duffy and Starke JJ.

Income Tax—Assessment—Company—Shareholder—"Profits or bonus credited or paid"—Company having accumulated profits—Reconstruction—Sale of assets to another company—Shares received as consideration—Distribution of shares among shareholders—Income Tax Assessment Act 1915-1918 (*No.* 34 *of* 1915—*No.* 18 *of* 1918), *secs.* 14 (*b*), 16—*Companies Act* 1915 (*Vict.*) (*No.* 2631), *secs.* 342, 406, 408, 416.

Sec. 14 of the *Income Tax Assessment Act* 1915-1918 provides that "The income of any person shall include . . . (*b*) dividends, interest, profits, or bonus credited or paid to any depositor, member, shareholder, or debenture-holder of a company which derives income from a source in Australia . . . Provided . . . that where a company distributes to its members or shareholders any undistributed income accumulated prior to the first day of July one thousand nine hundred and fourteen the sum so received by the member or shareholder shall not be included as part of his income" &c.

A no-liability company incorporated in Victoria under Part II. of the *Companies Act* 1890 (Vict.)—corresponding to Part II. of the *Companies Act* 1915 (Vict.)—had assets the value of which was substantially four times as great as the amount of its paid-up capital, the excess of assets representing accumulated profits. Pursuant to a scheme of reconstruction approved by resolution at an extraordinary general meeting of the company, a new company with limited liability was incorporated under Part I. of the *Companies Act* 1915 (Vict.), each of the shares of the new company being of the same nominal value as the shares of the old company, and the new company purchased the undertaking, property and assets of the old company and as consideration (*inter alia*) agreed to allot to the nominees of the old company all the shares, credited as fully paid up, in the new company. In further pursuance of the

scheme the old company then went into voluntary liquidation and, in accordance with the resolution for winding up, the shares in the new company were allotted to the members of the old company in the proportion of four shares of the new company for each share of the old company held by them.

Held, that no part of the shares of the new company allotted to a member of the old company was "profits or bonus credited or paid" by the old company to the member within the meaning of sec. 14 (*b*) of the *Income Tax Assessment Act* 1915-1918, and that the member was not liable to assessment for income tax under that Act by reason of the allotment to him of such shares.

Knowles v. *Ballarat Trustees, Executors and Agency Co.*, (1916) 22 C.L.R., 212; *Fisher* v. *Fisher*, (1917) 23 C.L.R., 337; *Bouch* v. *Sproule*, (1887) 12 App. Cas., 385, and *Inland Revenue Commissioners* v. *Blott*, (1921) 2 A.C., 171, considered.

Swan Brewery Co. v. *The King*, (1914) A.C., 231, and *Pool* v. *Guardian Investment Trust Co.*, (1922) 1 K.B., 347, distinguished.

SPECIAL CASE.

On the hearing of an appeal by John Langley Webb from an assessment of him by the Federal Commissioner of Taxation for income tax for the year 1919-1920, a special case was stated by *Gavan Duffy* J. which was substantially as follows, the facts therein stated having been agreed upon by the parties:—

1. The Broken Hill South Silver Mining Co. No Liability (hereinafter called "the old Company") was incorporated in 1893 under Part II. of the *Companies Act* 1890 of Victoria with a capital of £200,000 divided into 200,000 shares of £1 each. At all relevant times the whole of these shares were issued, 131,108 being fully paid up and 68,892 paid up to 9s. 6d. per share.

2. At an extraordinary general meeting of the members of the old Company held on 30th August 1918 it was resolved to reconstruct the Company, and the scheme of reconstruction submitted to the meeting was approved. Such scheme provided (*inter alia*) that (*a*) a new company to be called "Broken Hill South Limited" (hereinafter called "the new Company") should be formed and incorporated in Victoria with a capital of £800,000 divided into 800,000 shares of £1 each, and such new Company should acquire from the old Company as on and from 1st July 1918 the whole of the undertaking and assets of the old Company except its uncalled capital and a sum sufficient to enable the old Company

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to repay to its fully paid-up shareholders the sum of 10s. 6d. per share, being the amount of capital paid up in excess of that paid up on the contributing shares; (*b*) the new Company should allot to the old Company or its nominees 800,000 fully paid-up shares in the new Company, such number being equivalent to four of such shares for each share in the old Company; (*c*) the new Company should undertake and free the old Company from all its debts and liabilities; (*d*) the new Company should pay all costs and expenses of the carrying into effect of the scheme and of the winding up of the old Company; (*e*) the old Company should in due course and when free from debt be wound up voluntarily, and its assets distributed amongst its shareholders in specie so that each fully paid-up shareholder in the old Company should receive 10s. 6d. for each fully paid-up share as per clause (*a*) and each shareholder in the old Company whether paid up or contributing should receive four fully paid-up £1 shares in the new Company in respect of each share in the old Company.

3. On 31st August 1918, subsequent to the incorporation of the new Company, an agreement was entered into between the old Company and the new Company for the sale and transfer to the new Company as on 30th June 1918 of all the undertaking, property and assets of the old Company (except as aforesaid).

4. The following is a short statement of the effect of the said agreement:—In effect the old Company thereby sells and transfers to the new Company as on and from 30th June 1918 the whole of the old Company's undertaking, assets and property (save as aforesaid) for the following considerations, namely:—(*a*) As part of the consideration for the said sale the new Company shall (i.) undertake, pay, satisfy and discharge all the debts, liabilities and obligations of the old Company whatever, including for the purposes hereof the liability to pay all or any portion unpaid of either or both of the dividends which may be declared by the old Company as provided in clause 2 of the agreement, and (ii.) perform and fulfil all contracts and engagements binding on the old Company, and shall at all times keep the old Company, its liquidator and contributories indemnified against all such debts, liabilities, obligations, contracts and engagements and against all actions, proceedings, costs, damages, claims and

demands in respect thereof; (*b*) as a further part of the said consideration the new Company shall pay all the costs, charges and expenses of or incidental to the carrying into effect of the said scheme and (if and when the old Company winds up) all the costs, charges and expenses of or incidental to the winding up and dissolution of the old Company (including the remuneration of the liquidator), and shall indemnify the old Company, its liquidator and contributories against all actions, proceedings, costs, claims and demands in respect thereof; (*c*) the residue of the said consideration shall be the allotment and issue to the old Company or its nominees of 800,000 shares in the new Company (inclusive of the shares taken by the subscribers of the new Company's memorandum of association) of £1 each credited as fully paid up. The agreement states that no part of the said consideration is payable for goodwill.

5. On 27th September 1918 the old Company resolved to wind up voluntarily and to distribute its assets amongst its shareholders in specie so that each fully paid-up shareholder should receive 10s. 6d. for each fully paid-up share, and each shareholder, whether paid up or contributing, should receive four fully paid-up £1 shares in the new Company in respect of each share he held in the old Company.

6. On 5th October 1918 the old Company and its liquidators requested the new Company to allot to the persons on the register of the old Company on 27th September 1918, as nominees of the old Company and in satisfaction of the consideration mentioned in the said agreement, 800,000 fully paid shares of £1 each in the capital of the new Company, so that each of such persons might be allotted four fully paid shares in the new Company for each share held in the old Company.

7. On 11th October 1918 the directors of the new Company allotted the said 800,000 shares (except certain shares which had already been allotted to directors to qualify them for so acting) in accordance with the said agreement and request, and an agreement was executed by the old Company and the new Company and by the liquidators of the old Company whereby it was mutually agreed that in pursuance of the agreement of 31st August 1918 and of the above request the new Company should allot to the members of the old Company, whose names were set out in a schedule, the number

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of shares set opposite their names, and that those shares should be deemed for all purposes to be fully paid up and be treated as in satisfaction of the shares to be allotted in accordance with that agreement.

8. The scrip for the said shares was subsequently prepared and handed to the liquidators of the old Company, who distributed it amongst the shareholders in that Company.

9. The cash received by the old Company from the new Company in pursuance of the agreement of 31st August 1918 was a sum of £128,726. In the winding up the liquidator of the old Company paid out of the said sum to the fully paid shareholders of the old Company an amount of £68,726, being a repayment to them of the amount of capital (10s. 6d. per share) paid up by them in excess of the amount paid up on the contributing shares. The balance of the sum so received from the new Company (£60,000) was expended in paying to the shareholders of the old Company a dividend for the year ended 30th June 1918.

10. The liquidator of the old Company closed off its books with certain entries. The appellant contends that the facts stated in this and the last preceding paragraph are irrelevant.

11. The appellant herein was registered as the holder of 500 fully paid shares in the old Company, and as such became entitled to the allotment of 2,000 fully paid shares in the new Company and these shares were allotted to him accordingly.

12. The appellant made a return in respect of his income for the year ending 30th June 1919, but did not include as part of such income the shares received from the new Company or any of them or any amount (save and except the dividend for the year ending 30th June 1918) as representing profits or bonus credited or paid to him by the old Company.

13. The Commissioner of Taxation assessed the appellant in respect of the income shown in such return, and subsequently issued an amended assessment whereby an amount equal to 57 per cent. of the face value of the said shares in the new Company received by the appellant from the liquidator of the old Company was included as taxable income.

14. The appellant, being dissatisfied with such amended assessment, lodged notice of objection thereto in writing upon certain grounds.

15. The Commissioner on 8th March 1921 decided the said objections against the appellant, who, being dissatisfied with such decision, gave notice asking the Commissioner to treat such objections as an appeal, and to forward them to the High Court of Australia for hearing. The appellant and the Commissioner have agreed that the questions should be settled by the said Court upon this case.

16. In arriving at the amount mentioned in par. 13, the Commissioner allowed that 43 per cent. of the value of the 800,000 fully paid-up shares of £1 each in the new Company distributed by the liquidator of the old Company to shareholders of that Company represents (*a*) repayment of capital to the extent of 9s. 6d. per share additional to the 10s. 6d. per share above mentioned, together with (*b*) distribution of profits shown by the old Company's accounts to have been accumulated prior to 1st July 1914 or standing to the credit of the old Company's profit and loss account at that date, and is therefore not taxable; but the Commissioner contends that the balance, equal to 57 per cent. of the value thereof, is a payment in respect of profits earned and accumulated since the said date and credited or paid to the shareholder, and that therefore the shareholder is liable to assessment under sec. 14 (*b*) of the Act on the amount of 57 per cent. of the face value of the shares received by him.

The question for the opinion of the High Court was as follows:—

Whether the appellant is liable to be assessed in respect of the said last-mentioned amount as claimed by the Commissioner or at all by reason of the allotment to him of such shares representing such amount.

Weigall K.C. and *C. Gavan Duffy* (with them *Owen Dixon* K.C.), for the appellant. No part of the shares in the new Company received by a shareholder of the old Company was income of the shareholder either in the ordinary sense of the word "income" or under sec. 14 (*b*) of the *Income Tax Assessment Act* 1915-1918. Income implies a recurrence of payments. In no case has anything received by a shareholder in the winding up of a company been

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regarded as his income, and even if a payment of cash would have been income the receipt of these shares is not. What the old Company did was in substance to sell its assets for 800,000 £1 shares, to go into liquidation and in that liquidation to distribute the whole of its assets in specie. This it might properly do under secs. 408 and 416 of the *Companies Act* 1915 and the provision in r. 130 of the Rules of the old Company that, if the Company shall be wound up, all or any of the assets divisible among the shareholders may be divided in specie. The case of *Inland Revenue Commissioners* v. *Blott* (1) does not apply, for there the distribution of shares was while the company was a going concern, not in a winding up of the company. These shares were not "profits or bonus credited or paid" to the shareholders within the meaning of sec. 14 (*b*). The preceding word "dividends" shows that what the subsection is referring to are payments made while the company is carrying on its business in the ordinary way. It cannot be said that anything was "credited" or "paid" to the shareholder by the Company. The effect of the transaction is that the shareholder has received a certificate that he has the same proportionate interest as he had before in the same mass of assets. It is merely a change in the form of investment (*Mooney* v. *Commissioners of Taxation (N.S.W.)* (2); *Commissioners of Taxation (N.S.W.)* v. *Mooney* (3)).

[ISAACS J. referred to *Pool* v. *Guardian Investment Trust Co.* (4).

[KNOX C.J. referred to *Commissioner of Taxation (W.A.)* v. *Newman* (5).]

The shares which the appellant had in the old Company were, and those shares in the new Company which he received for them remain, capital. It is immaterial whether the assets which the shares represented were profits of the old Company or not (see *Knowles* v. *Ballarat Trustees, Executors and Agency Co.* (6); *Fisher* v. *Fisher* (7)). Sec. 14 (*b*) should be construed having regard to sec. 55 of the Constitution, and therefore the profits credited or paid to a shareholder must be something in the nature of income in the ordinary

(1) (1921) 2 A.C., 171.
(2) (1905) 3 C.L.R., 221.
(3) (1907) 4 C.L.R., 1439, at p. 1445.
(4) (1921) 38 T.L.R., 177; (1922) 1 K.B., 347.
(5) (1921) 29 C.L.R., 484.
(6) (1916) 22 C.L.R., 212, at pp. 222, 227.
(7) (1917) 23 C.L.R., 337.

meaning of that word. [Counsel also referred to *Commissioner of Taxes (Vict.)* v. *Melbourne Trust Ltd.* (1); *In re Crichton's Oil Co.* (2); *R.* v. *Commissioners for Special Purposes of Income Tax*; *Ex parte Dr. Barnardo's Homes* (3); *Inland Revenue Commissioners* v. *Blott* (4); *Eisner* v. *Macomber* (5).]

[STARKE J. referred to *Swan Brewery Co.* v. *The King* (6).]

Latham K.C. (with him *Eager*), for the respondent. Before the reconstruction the assets of the old Company represented paid-up capital and profits. After the scheme had been partly carried out and the old Company had gone into liquidation, the liquidator had assets in his hands for distribution among shareholders consisting partly of shares in the new Company, and those assets still represented paid-up capital and profits. The old Company merely changed the form of its assets, and there is no difference between a change of form *en bloc* and a change of form piecemeal. The important thing for the purposes of the *Income Tax Assessment Act* is the receipt by the shareholder. The appellant has received disposable things, namely, shares in the new Company, which are different in fact and in law from the things which he had before, namely, shares in the old Company. There is no essential difference between a distribution in money and a distribution in kind (see *Pool* v. *Guardian Investment Trust Co.* (7); *Tennant* v. *Smith* (8); *South Brisbane Gas and Light Co.* v. *Hughes* (9); *Forrest* v. *Federal Commissioner of Taxation* (10)), and to the extent to which the shares distributed represent profits their value is taxable as income of the shareholder. Profits of a company do not cease to be profits on a winding up (*In re Armitage*; *Armitage* v. *Garnett* (11); *In re Bridgewater Navigation Co.* (12); *Bishop* v. *Smyrna and Cassaba Railway Co.* [*No.* 1] (13); *In re Spanish Prospecting Co.* (14)).

[ISAACS J. referred to *In re Ramel Syndicate Ltd.* (15).]

(1) (1914) 18 C.L.R., 413, at p. 420; (1914) A.C., 1001.
(2) (1902) 2 Ch., 86, at pp. 91, 93.
(3) (1920) 1 K.B., 468, at p. 482.
(4) (1921) 2 A.C., at pp. 180, 183, 195, 212; (1920) 2 K.B., 657, at pp. 668, 675-676.
(5) (1920) 252 U.S., 189.
(6) (1914) A.C., 231.
(7) (1921) 38 T.L.R., 177; (1922) 1 K.B., 347.
(8) (1892) A.C., 150, at p. 156.
(9) (1917) 23 C.L.R., 396, at p. 404.
(10) (1921) 29 C.L.R., 441.
(11) (1893) 3 Ch., 337, at p. 345.
(12) (1891) 2 Ch., 317, at p. 327.
(13) (1895) 2 Ch., 265, at pp. 269, 271.
(14) (1911) 1 Ch., 92, at p. 103.
(15) (1911) 1 Ch., 749.

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Sec. 14 (*b*) of the *Income Tax Assessment Act* makes it necessary to inquire, in every case of a payment in money or in kind by a company to a shareholder in his capacity as a shareholder, whether it is or is not a payment of profits of the company as such. Here the payment is in specie consisting of the shares of another company. The nominal value of the shares is much greater than the capital he subscribed, and the surplus must be profits. [Counsel also referred to the *Companies Act* 1915 (Vict.), secs. 408, 415, 416; *Bouch* v. *Sproule* (1); *Palmer's Company Precedents*, 8th ed., Part II., p. 519.]

[KNOX C.J. referred to *In re Thomas*; *Andrew* v. *Thomas* (2).]

Owen Dixon K.C., in reply, referred to *Gover on Capital and Income*, 2nd ed., pp. 14, 15; *Halsbury's Laws of England*, vol. xxv., p. 610, sec. 1075.

Cur. adv. vult.

June 19.

The following written judgments were delivered:—

KNOX C.J., GAVAN DUFFY AND STARKE JJ. At an extraordinary general meeting of the members of the Broken Hill South Silver Mining Co. No Liability (hereinafter called "the old Company") held on 30th August 1918, it was resolved to reconstruct the company, and a scheme of reconstruction was submitted to the meeting and approved. Such scheme provided (*inter alia*) that (*a*) a new company to be called "Broken Hill South Limited" (hereinafter called "the new Company") should be formed and incorporated in Victoria with a capital of £800,000 divided into 800,000 shares of £1 each, and such new Company should acquire from the old Company as on and from 1st July 1918 the whole of the undertaking and assets of the old Company except its uncalled capital and a sum sufficient to enable the old Company to repay to its fully paid-up shareholders the sum of 10s. 6d. per share, being the amount of capital paid up in excess of that paid up on the contributing shares; (*b*) the new Company should allot to the old Company or its nominees 800,000 fully paid-up shares in the new Company, such number

(1) (1887) 12 App. Cas., 385. (2) (1916) 2 Ch., 331.

being equivalent to four of such shares for each share in the old Company; (*c*) the new Company should undertake and free the old Company from all its debts and liabilities; (*d*) the new Company should pay all costs and expenses of the carrying into effect of the scheme and of the winding up of the old Company; (*e*) the old Company should in due course and when free from debt be wound up voluntarily, and its assets distributed amongst its shareholders in specie so that each fully paid-up shareholder in the old Company should receive 10s. 6d. for each fully paid-up share as per clause (*a*) and each shareholder in the old Company whether paid up or contributing should receive four fully paid-up £1 shares in the new Company in respect of each share in the old Company.

On 31st August 1918, subsequent to the incorporation of the new Company, an agreement was entered into between the old Company and the new Company for the sale and transfer to the new Company as on 30th June 1918 of all the undertaking, property and assets of the old Company (except as aforesaid). In effect the old Company sold and transferred to the new Company as on and from 30th June 1918 the whole of the old Company's undertaking, assets and property (save as aforesaid) for the following considerations, namely:—As part of the consideration for the said sale the new Company undertook (i.) to pay, satisfy and discharge all the debts, liabilities and obligations of the old Company whatever, including the liability to pay all or any portion unpaid of either or both of the dividends which might be declared by the old Company as provided in clause 2 of the agreement, and (ii.) to perform and fulfil all contracts and engagements binding on the old Company, and to keep the old Company, its liquidator and contributories indemnified against all such debts, liabilities, obligations, contracts and engagements, and against all actions, proceedings, costs, damages, claims and demands in respect thereof. As a further part of the said consideration the new Company agreed to pay all the costs, charges and expenses of or incidental to the carrying into effect of the said scheme and (if and when the old Company winds up) all the costs, charges and expenses of or incidental to the winding up and dissolution of the old Company (including the remuneration of the liquidator), and to indemnify the old Company, its liquidator and contributories against all actions,

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proceedings, costs, claims and demands in respect thereof. The residue of the said consideration was the allotment and issue to the old Company or its nominees of 800,000 shares in the new Company (inclusive of the shares taken by the subscribers of the new Company's memorandum of association) of £1 each credited as fully paid up. The agreement states that no part of the said consideration is payable for goodwill.

On 27th September 1918 the old Company resolved to wind up voluntarily, and to distribute its assets amongst its shareholders in specie so that each fully paid-up shareholder should receive 10s. 6d. for each fully paid-up share, and each shareholder, whether paid up or contributing, should receive four fully paid-up £1 shares in the new Company in respect of each share he held in the old Company.

On 5th October 1918 the old Company and its liquidators requested the new Company to allot to the persons on the register of the old Company on 27th September 1918, as nominees of the old Company and in satisfaction of the consideration mentioned in the said agreement, 800,000 fully paid shares of £1 each in the capital of the new company for each share held in the old Company. On 11th October 1918 the directors of the new Company allotted the said 800,000 shares (except certain shares which had already been allotted to directors to qualify them for so acting) in accordance with the said agreement and request. The scrip for the said shares was subsequently prepared and handed to the liquidators of the old Company, who distributed it amongst the shareholders in that Company.

The appellant was registered as the holder of 500 fully paid shares in the old Company, and as such became entitled to the allotment of 2,000 fully paid shares in the new Company and these shares were allotted to him accordingly. The appellant made a return in respect of his income for the year ending 30th June 1919, but did not include as part of such income the shares received from the new Company or any of them or any amount (save and except dividends for the year ending 30th June 1918) as representing profits or bonus credited or paid to him by the old Company. The Commissioner of Taxation assessed the appellant in respect of the income shown in such return, and subsequently issued an amended assessment whereby an amount equal to 57 per cent. of the face value of the said shares in the new

Company received by the appellant from the liquidator of the old Company was included as taxable income.

The appellant, being dissatisfied with such amended assessment, lodged notice of objection thereto in writing, and the question for our consideration is whether he is liable to be assessed in respect of the said last-mentioned amount as claimed by the Commissioner or at all by reason of the allotment to him of such shares.

Let us first consider whether the shares distributed constituted income apart from any statutory provision. If the old Company had detached any part of its profits and distributed that part among shareholders, the portion received by each shareholder would have become part of the income of such shareholder, but until such detachment every shareholder's interest in the whole of the undistributed assets of the Company remained part of his capital. There was no such detachment in this case, but it is said that what was done constituted a payment or crediting to the shareholders of profits of the company within the meaning of sec. 14 (*b*) of the *Income Tax Assessment Act*. We think it did not. Nothing was either paid or credited to the shareholders, because they neither received any specific sum of money in currency, nor did they obtain the benefit of any such sum by way of credit entry, set-off, or other statement of account. Nor was the distribution of "profits" within the meaning of sec. 14 (*b*). In our opinion the words "profits credited or paid" in that sub-section mean moneys detached from the assets of the company suitable for distribution to the shareholders. On distribution such moneys become their income in contradistinction to their interest in the remaining assets of the company which continue to be their capital. In this case there was no detachment. The real transaction permitted the shareholders to retain their interest in the assets of the old Company, which constituted their capital, but enabled the old business to be carried on under a new constitution.

None of the cases cited to us are precisely in point; but *Blott's Case* (1) rests, in the final analysis, upon the view that the shareholders' interest in the profits of a company does not become their income unless severed from the capital funds of the company and

(1) (1921) 2 A.C., 171.

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liberated and released to them. "In the present case," says Viscount *Finlay* (1), "the bonus or so-called dividend was not severed from the capital; on the contrary, it was added to it." Again, in *Pool* v. *Guardian Investment Trust Co.* (2), *Sankey* J. adopted the same principle, though he held that there was in that case such a *severance of assets from the capital funds of the company*, which assets were liberated and released to the shareholders. And a much earlier case, *Tennant* v. *Smith* (3), had suggested that, if assets in the form of substantial things of money value capable of being turned into money were handed over or liberated to a person, they might represent money's-worth and be taxable as income.

The crux of the present case lies in the question whether the shares handed over to the shareholders were or were not severed from the capital funds of the Company and liberated to the shareholders as profits or income. These shares were acquired in consideration of a transfer of a mixed mass of assets representing partly subscribed capital and partly accumulated profits of the Company. In point of fact these assets were not distinguished, in the transactions between the old and the new Company, as capital or income. Much stress was also laid upon the fact that the distribution of the shares was made in the winding up of the Company. Consequently it was insisted, there was, and could be, no severance of the profits of the Company from its capital funds, but a mere distribution of the surplus assets of the Company or of what remained of the capital funds of the Company after satisfying creditors and other proper claims. In this connection the opinions of Viscount *Haldane* in *Blott's Case* (4), and of *Scrutton* L.J. in the same case in the Court of Appeal (5), were referred to. The argument is strong, but we must not forget that the distribution in the case before us was in fact made pursuant to a scheme of reconstruction passed during the life of the Company.

Again, the cases of *Bouch* v. *Sproule* (6), and of *Knowles* v. *Ballarat Trustees, Executors and Agency Co.* (7) and *Fisher* v. *Fisher* (8) in this

(1) (1921) 2 A.C., at p. 195.
(2) (1921) 38 T.L.R., 177; (1922) 1 K.B., 347.
(3) (1892) A.C., at p. 156.
(4) (1921) 2 A.C., at p. 183.
(5) (1920) 2 K.B., at pp. 675-676.
(6) (1887) 12 App. Cas., 385.
(7) (1916) 22 C.L.R., 212.
(8) (1917) 23 C.L.R., 337.

Court, were relied upon as establishing that the distribution of the shares in the present case could not be treated as a distribution of income. All these cases related to the rights of tenants for life and remaindermen, but *Blott's Case* certainly applies the principle of *Bouch* v. *Sproule* to cases arising under the Income Tax Acts of Great Britain. *Knowles's Case* and *Fisher's Case* do, however, in our opinion, cover the present case in principle. *Swan Brewery Co.* v. *The King* (1) was relied upon by the Commissioner, but since *Blott's Case* we must treat this case as a decision upon the special words of a particular statute and in no wise contravening the general principle. We prefer, in the case before the Court, to rest our decision upon the principle itself rather than upon any decided case.

Applying that principle, then, we find that there was in fact no detachment or severance of the profits of the Company from its capital funds and no liberation of profits of the Company, in money or in money's-worth, to the shareholders, because the old Company did not detach any portion of the assets transferred to the new Company from its capital funds. Such of the assets of the old Company as were transferred to the new Company passed over as a mixed mass, though a great part may have been acquired out of profits made by the Company. Still, as Viscount *Haldane* said in *Blott's Case* (2), "there is no doubt that the money in question formed originally part of profits made by the company on which it was liable to pay income tax. It is quite another question whether these profits as such ever reached the . . . shareholders as income." The substance of the scheme was reconstruction and not a distribution of profits in money or in money's-worth. The object and result of the transaction was to reconstitute the Company, retain the profits in a new Company and carry on business as before. The method adopted did not, as in *Blott's Case*, "capitalize" the profits, that is, increase the capital of the old Company; but reconstruction, though not a legal but a commercial term, is a well-recognized and lawful expedient for preserving and transferring the business of a company, not to outsiders, but to another company consisting substantially of the same shareholders, with a view to its being continued by the

(1) (1914) A.C., 231. (2) (1921) 2 A.C., at p. 180.

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transferree company (see *Halsbury's Laws of England*, under title "Companies," vol. v., p. 584, par. 1007; *Palmer's Company Precedents*, 11th ed., Part I., p. 1431).

In our opinion the answer to the question submitted should be "No."

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ISAACS J. The essential facts of the present case may be reduced to a small compass. We have, however, been told that the law involved may govern several other cases more or less similar and involving considerable amounts of revenue. To avert further litigation if possible by affording a sufficient guide, it seems to me desirable to deal with the various important points so fully and ably argued by learned counsel on both sides. A no-liability company was formed in 1893, under Part II. of the *Companies Act* 1890 (corresponding to Part II. of the Act of 1915) and had a capital of £200,000, divided into 200,000 shares of £1 each partly paid up. In 1918 it reconstructed. It had assets which, after providing sufficient to pay off all liabilities and to return all capital paid up, left accumulated profits amounting to the value of £705,000. I say "profits," because, although there is "no formula which can discriminate in all circumstances what are and what are not profits of a trade" (per Lord *Loreburn* in *Liverpool and London and Globe Insurance Co.* v. *Bennett* (1)), yet that sum of £705,000 after certain specific provisions represented what Lord *Wrenbury* described, in a phrase adopted as an apt expression by Lord *Loreburn* in the case referred to (2), as "'the fruit derived from a fund employed and risked' in a business" and, therefore, profits. The process of reconstruction was to promote a limited mining company under Part I. of the *Companies Act* 1915 (trading) having a capital of £800,000 divided into 800,000 shares of £1 each, and then to sell to the new Company all the old Company's assets with exceptions and upon terms which, apart from one special term to be presently mentioned, need not be stated, since they have been taken into account in arriving at the sum of £705,000 of residual profits. The one special term referred to was that part of the consideration for the property purchased was the allotment

(1) (1913) A.C., 610, at p. 620. (2) (1913) A.C., at p. 619.

and issue to the old Company or its nominees of the 800,000 shares in the new Company of £1 each "credited as fully paid up." So it is stated in clause 5 of the agreement of sale. That agreement was made on 31st August 1918 between the two Companies. No question is raised as to the validity of this transaction. On 27th September 1918 the old Company passed a resolution to wind up voluntarily, and to distribute its assets amongst its shareholders in specie, so that each fully paid-up shareholder should receive 10s. 6d. for each fully paid-up share, and each shareholder, whether paid up or contributing, should receive four fully paid-up £1 shares in the new Company, in respect of each share he held in the old Company.

Now, what was the position of the old Company at the moment the winding-up resolution was passed? It had already parted with its mine and all its other assets (with specified exceptions), which prior to the sale of 31st August 1918 had belonged to it. In those assets it had not, nor had its shareholders, at the date of the winding-up resolution, any interest whatever. Its only property (apart from the 10s. 6d. a share) consisted of the 800,000 shares which, actually or potentially, belonged to it as the consideration referred to. We must assume that in accordance with the requirements of sec. 408 of the Act all its liabilities were at an end, and, therefore, no outsiders had any interest in or claim upon the assets, by which I mean, of course, the 800,000 shares and the money for the 10s. 6d. per share return of capital. The facts raise no question as to sec. 45A of the *Income Tax Assessment Act*. The repayment of 10s. 6d. in respect of fully paid-up shares was out of excepted property and to adjust the position with relation to shares on which only 9s. 6d. was paid, and is here immaterial.

The receipt by every shareholder of four shares in the new Company was the receipt of his share of the £800,000 worth of assets previously mentioned. Those four shares had been procured at the price of £4 paid to the new Company, paid, it is true, "in kind" as any sale may be paid for "in kind" (*South Australian Insurance Co.* v. *Randell* (1)). Unless that were so, the issue would have been illegal (per Lord *Macnaghten* in *Stamp Duties Commissioner* v. *Broken Hill*

(1) (1869) L.R. 3 P.C., 101.

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South Extended Ltd. (1)). Consequently, in law, it is undeniable that each shareholder received his proportion of shares in another company which shares as a whole represented, not *in formâ specificâ*, but in transmuted form, partly (that is, as to £95,000) capital of the old Company and partly (that is, as to £705,000) profits of the old Company. Each shareholder of the old Company therefore, as such, received a proportionate share of that property in transmuted form, namely, 9s. 6d. per share, representing his paid contribution to capital, and £3 10s. 6d. per share, representing his proportion of the old Company's profits, some of which were accumulated before and some since 1st July 1914.

The appellant became entitled to 2,000 of these distributed shares. The Crown contends that within the meaning of sec. 14 (*b*) of the *Income Tax Assessment Act* there was thereby "credited or paid" to the appellant "profits" of the old Company accumulated since 1st July 1914, and that, consequently, income tax is chargeable against him in respect of those profits. This is the only question of law reserved, and whether or not the facts would establish taxable income in any other aspect of the Act is not involved in this case.

As between the old Company and the appellant I regard the distribution of the shares in point of law as if they were money, that is, as if the old Company in passing its winding-up resolution had determined, instead of providing for a distribution in specie, to sell the shares and distribute the proceeds. It had the legal right to do so. It had the legal obligation under sec. 408 of the *Companies Act* to decide (1) as to "the course to be pursued by the directors for the purpose" (that is, for the purpose of winding up the Company without resort to the Court), and (2) "the mode of disposal of any surplus of the company's property which may remain after the completion of the winding up." So that the Act cast on the Company, if it desired to wind up without resort to the Court, the duty of providing the necessary directions, instead of leaving it to the process followed in winding up under the Court (see *Westralia Proprietary Gold Mining Co. No Liability* v. *Long* (2)). If the Company had chosen to determine on a sale of the shares before distribution,

(1) (1911) A.C., 439, at pp. 445-446.
(2) (1897) 23 V.L.R., 36; 18 A.L.T., 227.

that would have been binding (see *Great Central Freehold Mines Ltd.* v. *Brandon* (1)). The fact that the profits have been invested in shares of another company, whether a banking company or a trading company, cannot alter their essential nature in relation to the old Company.

At this point it is necessary to observe—in order to keep the exact problem before us—that it is admitted there was an actual distribution to shareholders of the whole property of the Company whatever that property was. The Company ceased to own it, and each shareholder became the legal owner in possession of an aliquot part of it. So that no question arises, as has arisen in some other cases, as to whether the particular assets pass to the shareholders or not by a so-called distribution. But before dealing directly with the question of whether this distribution, supposing it to have been in the form of actual cash, of the proceeds of the sale of the shares would have fallen within sec. 14 (*b*), I should stop to notice one argument that was put forward to support the appellant's case. One is that the reconstruction scheme is one transaction, and that when so regarded the intention of the old Company was that its profits should not be turned into money but should be distributed solely in the form of shares of the new Company, that is, as capital of the new Company. This it was said brought the case within the decision of *Knowles* v. *Ballarat Trustees, Executors and Agency Co.* (2). In that case there was simply a distribution of cash, called " distribution of assets, 10s. per share," by a company while a going concern. The trustees of a will which gave income to a life tenant and capital to remaindermen accepted the money as given. There was no issue of shares actual or referred to, nor was there any reduction of capital expressed or implied. It was simply a division of profits styled " distribution of assets." True, the company contemplated at a later date winding up, but the fact was that the company while a going concern assumed the power of changing its profits into capital *de facto* without converting them into capital *de jure*. Therefore, it was held, the trustees having received the money without objection, the money was for the purposes of the will turned into " capital " of the company and belonged to the remaindermen.

(1) (1905) V.L.R., 97 ; 26 A.L.T., 146.

(2) (1916) 22 C.L.R., 212.

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As the recent case of *Blott* (1), which was relied on, determines that, when a company converts profits into capital, that is an effectual conversion for the purposes of an Income Tax Act, it is evident that the doctrine of *Knowles's Case* (2) and of *Fisher's Case* (3)—which followed it and went even further, because it carried the doctrine into another company, very much as here—is highly important, not merely to trustees and beneficiaries throughout Australia, but also to every public Treasury, Commonwealth and State. Lord *Sumner* put the question relevant here very succinctly in *Blott's Case* (4), in these words: "Could a company declare and pay a dividend in the ordinary way and yet, by first calling it 'capital' and saying it was not 'income,' prevent the cash from being taxable as income in the shareholders' hands?" As I read *Blott's Case* that question is answered in this way: Lord *Sumner* answers "No," even if done in the only way profits can be converted into capital, namely, under powers given directly by the statute or under articles *intra vires* and in the course of applying the money to the creation of share capital of the company. So does Lord *Dunedin*. The majority, however, answer "Yes," if lawfully converted into share capital of the company under powers statutory as given by articles *intra vires*.

If I were judicially compelled, notwithstanding what seems to be the line of reasoning adopted by every member of the House of Lords in 1921, up to the point where the minority distinguished the Crown, to regard as binding the reasoning in *Knowles's Case* (2), decided in 1916, and the decision in *Fisher's Case* (3), in 1917, I should necessarily, in obedience to those cases, feel constrained to say the shares received by the appellant were "capital" and not "profits." Those cases are, on the admitted facts of this case, decisive on that point; and, if they stand unqualified, then, in conformity with what I said in *Fisher's Case*, I have no right judicially to consider it even possible to assume for a moment that what the appellant received was "profits." Lord *Wrenbury*, in *In re South African Supply and Cold Storage Co.* (5), shows that in reconstruction the commercial *intention*

(1) (1921) 2 A.C., 171.
(2) (1916) 22 C.L.R., 212.
(3) (1917) 23 C.L.R., 337.
(4) (1921) 2 A.C., at pp. 215-216.
(5) (1904) 2 Ch., 268, at pp. 285-286.

is not to realize or distribute the assets in the ordinary way, and that would in itself attract *Knowles's Case*; and then, as the appellant was intended to take and actually received the shares in the new Company, that attracts *Fisher's Case*, and this controversy is at an end, because it is entirely outside sec. 14 (*b*) of the *Income Tax Assessment Act*. In other words, unless some good judicial reason exists for holding *Knowles's Case* and *Fisher's Case* in suspense for further consideration, I should be acting inconsistently in passing on further upon the assumption that the shares received could possibly be "profits."

The original "*intention*" being once ascertained by the terms of the combined scheme of reconstruction, resolved upon on 30th August 1918, when the Company was a completely going concern, a scheme of which the winding-up process was a mere mechanical method of carrying out the intention, it is obvious that the winding up itself is otherwise immaterial, and cannot change the nature of the property which the scheme as a whole had impressed upon it. The "surplus" to be distributed under sec. 416 among the parties entitled would therefore necessarily retain its conventional character of "capital" and not "profit." Consequently I should, as it appears to me, have to hold: (1) The "shares" received by the appellant were "capital" and not "profits" as between him and either Company; and (2) therefore, by *Blott's Case* (1), they were "capital" and not "profits" as against the Crown.

What, then, is the position in view of *Blott's Case* which was strongly pressed upon the Court? Technically, I am aware, a decision of the House of Lords does not bind this Court. But there are certain matters I cannot but remember. One is that a decision of the House of Lords is binding on that House and cannot be departed from except by fresh legislation. Then I have to consider that, if the same learned Lords were, when sitting in the Privy Council, to give precisely the same decision for the majority reasons, I should have to regard those reasons as controlling whatever it decided. Next, I look upon the observations of the Privy Council in *Trimble* v. *Hill* (2) as a clear suggestion involving, at all events, that a relevant decision of the House of Lords should be accepted by an Australian Court as decisive.

(1) (1921) 2 A.C., 171. (2) (1879) 5 App. Cas., 342, at p. 344.

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And this for a reason given further on in that judgment (1), namely, that " it is of the utmost importance that in all parts of the Empire where English law prevails, the interpretation of that law by the Courts should be as nearly as possible the same." Having regard to these considerations, I only desire to say that upon the best reading I can give to *Blott's Case* (2) I do not feel judicially at liberty to act unhesitatingly on *Knowles's Case* (3) and *Fisher's Case* (4), as I should otherwise have acted. I would add that if ever the full effect of the reasoning in *Blott's Case* upon *Knowles's Case* and *Fisher's Case* comes before the Court for consideration, it will be useful to peruse the very learned and careful treatment of the subject of the respective rights of settlor, life tenant and remainderman in the treatise of Mr. *Irving*, published in Edinburgh and London in 1910, in which not only *Bouch* v. *Sproule* (5) but numerous other cases, English and Scottish, are brought into review.

I have said—and this is only on the facts that I am at liberty to decide upon apart from *Knowles's Case* and *Fisher's Case*—that in my opinion the appellant did in the process of distribution get, in a very large proportion, a share of the profits of the old Company. This was contested by the appellant, who said the assets were all capital. The Crown's view was in effect that, whatever the nature of the property of the old Company was the moment before the winding-up resolution, it remained so the moment after. Had there been sufficient cash retained by the old Company to restore all the capital actually paid by the shareholders, the whole 800,000 shares would have been profits of the Company. And the fact that they were distributed could not alter their character. It is, in my opinion, clear that whoever participated in those shares on the winding up participated in the *profits of the old Company*.

In an ordinary winding up, if " the surplus is more than sufficient to return to each shareholder the capital paid up by him, there is a profit, and the question then is *how the profits are to be shared*" (*Lindley on Companies*, 6th ed., p. 1171, and see subsequent pages). It was contended that " surplus assets " in such a case were not

(1) (1879) 5 App. Cas., at p. 345.
(2) (1921) 2 A.C., 171.
(3) (1916) 22 C.L.R., 212.
(4) (1917) 23 C.L.R., 337.
(5) (1887) 12 App. Cas., 385.

"profits" but "capital," that is, capital in the only relevant sense in apposition to "profits" in sec. 14 (*b*), namely, capital of the Company. Obviously, if "profits" of the Company, the section is so far satisfied, and it is immaterial whether in some way the property can be designated some one else's "capital."

It is almost tedious to support the statement from *Lindley* by authorities, but it is, I think, in the circumstances necessary. I shall simply, however, cite the references: *Birch* v. *Cropper* (1) (particularly Lord *Herschell's* judgment); *In re Weymouth and Channel Islands Steam Packet Co.* (2); *In re Armitage*; *Armitage* v. *Garnett* (3) (per *Lindley* L.J.); *In re New Transvaal Co.* (4); *In re Ramel Syndicate Ltd.* (5); *In re Springbok Agricultural Estates Ltd.* (6). And as Lord *Moulton* (when Lord Justice) said in *In re Spanish Prospecting Co.* (7), "profits may exist in kind as well as in cash." But it was urged that reconstruction altered this. One argument was that you must look at the transaction as a whole and see what the old Company ultimately intended to effect, and in the end effected, namely, the conversion of its assets into capital of the new Company. I cannot accede to the argument. As the Privy Council in the *Swan Brewery Case* (8) observed of a much less complicated case:—"True, that in a sense it was all one transaction, but that is an ambiguous expression. In business, as in contemplation of law, there were two transactions." There have been various views of the application in that case of those observations, but there can scarcely be any doubt about this:—In the first place, as a matter of authority the case of *Stamp Duties Commissioner* v. *Broken Hill South Extended Ltd.* (9) is inconsistent with the argument referred to. Next, if it be approached from the standpoint of reasoning, the position is as follows:—The fact that the distribution was part of a scheme of reconstruction does not alter the legal position. Lord *Wrenbury*, when a Judge of first instance, said (*In re South African Supply and Cold Storage Co* (10)) that "reconstruction" was a commercial and not a legal term, and even as a commercial term had no definite

(1) (1889) 14 App. Cas., 525.
(2) (1891) 1 Ch., 66, at p. 76.
(3) (1893) 3 Ch., at p. 346.
(4) (1896) 2 Ch., 750, at p. 755.
(5) (1911) 1 Ch., at p. 753.
(6) (1920) 1 Ch., 563.
(7) (1911) 1 Ch., at p. 100.
(8) (1914) A.C., at pp. 235-236.
(9) (1911) A.C., 439.
(10) (1904) 2 Ch., at pp. 281-282.

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meaning. In that case his Lordship had to consider whether certain steps were taken for *the purpose of* reconstruction. He said (1):— "They did not go into liquidation for the purpose of winding up in the sense of realizing their assets and dividing the proceeds amongst themselves. They went into liquidation for the purpose of giving effect to this particular form of *enjoying their assets*, namely, by getting for them shares in another company and dividing those shares, or having the potentiality of dividing them—if proper resolutions were passed by the several companies—among the shareholders in the way that is detailed in those speeches." Then the learned Judge goes on to say what he thinks is in substance a "reconstruction." Adopting his views, the operation in this case was a reconstruction. But, granting that, was not the sale a real sale? Was not the consideration given a real consideration? And, if so, were not the former assets of the old Company, consisting of capital assets and profit assets, transmuted into shares of the new Company? Lord *Lindley*, in his work on *Companies* (6th ed., at p. 1211), says in dealing with reconstructions: "In point of law, the two companies are, however, distinct persons." The second company would not be a continuance of the first, even if it were of the same nature (*Simpson* v. *Palace Theatre Ltd.* (2)). Much less can it be so, when one is a no-liability mining company, and the other is a limited liability trading company, the extent of the charter of which we do not know. As *Wood* V.C. said in *In re Empire Assurance Corporation*; *Ex parte Bagshaw* (3), it is a "new concern." The purchasing company might have been one in another State or even another country (see *In re Irrigation Company of France*; *Ex parte Fox* (4)). Consequently, I cannot regard the transaction of selling the assets of the old Company for a price consisting of the shares in the new Company as any transformation of profits into capital. It was simply, as Lord *Wrenbury* said in the passage quoted from the *South African Company's Case* (5), a form of *enjoying their assets*, by getting shares in the new company.

I ought, in passing, to notice an argument raised on the strength of

(1) (1904) 2 Ch., at pp. 285-286.
(2) (1893) 69 L.T., 70.
(3) (1867) L.R. 4 Eq., 341, at p. 347.
(4) (1871) L.R. 6 Ch., 176, at pp. 192-193.
(5) (1904) 2 Ch., 268.

sec. 16. It was said that sec. 16 when applied to sec. 14 had the effect of showing that sec. 14 (*b*) did not add anything to the statutory meaning of "income" that that term would not otherwise have. In other words, notwithstanding the express terms of sec. 14, the word "income" had its bare natural meaning as in *Lawless* v. *Sullivan* (1), where no extending definition existed. It was said that sec. 16 showed that the "profits" which a company was by sec. 14 (*b*) contemplated as paying or crediting were profits which were in the hands of the company "taxable income." For instance, it was said that the sale of an asset at however great a profit did not produce a profit within sec. 14 (*b*) unless it was a "trading profit." It was conceded that it was or might be a "profit" which a trading company could distribute, and that a dividend might validly be declared and paid in respect of it, but it was said that, unless it could be shown to be part of the company's taxable income (see *Mooney's Case* (2)), it was not part of the shareholder's income. I think that is not a construction that accords either with the words or the spirit of the enactment. *Whatever the company divides as "profits" and is received as such by the shareholders is taxable.* The Treasury is not concerned to travel behind that fact and investigate further. The Legislature declares that those "profits" of the company so credited or "paid" *shall* be *shareholders'* "income" for taxation purposes, even though otherwise they would not be so comprehended.

That brings me to the most substantial point made and stated very clearly, and I think unanswerably, by Mr. *Weigall*, namely, that this was not profits "credited or paid" to a shareholder within the meaning of sec. 14 (*b*). As to whether it was "profits" I have said that in my opinion it was. The shares actually reached him, and they represented mostly "profits." I discard the argument that he had only the same proportion in the same assets as before the sale to the new Company. Whatever weight be given to a new issue of shares in the same company, this was a different entity, a different company, with a different enterprise. Commercial equivalence, even if it exists between two distinct enterprises, does not destroy their legal separateness. In my opinion, the whole problem

(1) (1881) 6 App. Cas., 373. (2) (1905) 3 C.L.R., 221.

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comes down at last to the one question: Can these profits which the appellant obtained on the winding-up distribution be said to have been "credited or paid" to him within the meaning of sec. 14 (*b*)? I stated during the argument that this was, in my opinion, the crux of the case; and, after full consideration, once we find that the shares were "profits," I still think so. The answer to the question depends on the legal effect of the way he got profits. The no-liability company was subject to Part II. of the Act of 1915. Sec. 408 has been referred to. It confers, in common with corresponding legislative provisions for voluntary winding up, the power of controlling the matter without the intervention of the Court. One of the great difficulties that at one time existed in the case of incorporated companies was that, except by the intervention of the Court of Chancery, the shareholders were unable to wind up their affairs. This section—first securing that no creditors can possibly be prejudiced—puts the matter entirely in the hands of the shareholders. It enables the statutory majority to stop the undertaking and wind up their joint affairs. It requires them by the same majority to instruct the directors as to the course to be pursued "for the purpose." This, in my opinion, includes all directions as to continuing the operations or not, and, if continuing them, then "for the purpose" of winding up. Nothing can be "for the purpose" which is inconsistent with winding up. The company has then entered the first stage of dissolution and is legally moribund. The "purpose," however, includes directions as to getting in outstanding property or claims and debts owing to the company and the mode of realizing assets, if necessary, for distribution or otherwise, and generally for completing the winding up. The expression "the course to be pursued by the directors" is analogous to the words "Course to be pursued by Liquidator," which form the heading of Subdivision 4 of Division 3 of Part II. and the group of sections 386 to 389 inclusive. The class of acts comprised in that group are certainly included in the quoted words contained in sec. 408.

In the case of a winding up by the Court, sec. 406 provides that the *Court* is to adjust the rights of the contributors *amongst themselves* and "distribute any surplus that may remain amongst the parties entitled thereto." I quote that section as showing (*inter alia*) that

it is not the company or the liquidator that does these things: it is *the Court*. The words in sec. 408 "the mode of disposal of any surplus of the company's property which may remain after the completion of the winding up" may, and probably do, have reference to assets which for some reason are not distributed before dissolution. Such cases have arisen, as in *Mayor of Colchester* v. *Brooke* (1) and in *Re Henderson's Nigel Co.* (2). I do not think those words relate to the mere mode of realization of the assets for the purpose of distribution among the shareholders; and this for three reasons: first, because the words that precede them are sufficient for the purpose; secondly, because the words "mode of disposal" are equivalent to the words "disposed of as such majority shall direct" in sub-sec. 2, the word "disposal" being very extensive; and lastly, because of the words "remain after the completion of the winding up," which, of course, includes distribution, and I do not think that the Act contemplates the dissolution of the company before the surplus property is actually distributed so far as is practicable.

Now, the resolutions of 27th September 1918 consist of (1) a resolution to wind up voluntarily and (2) a resolution to distribute the assets in specie, with a direction that the cash is to be distributed by giving 10s. 6d. to each fully paid-up shareholder, and the shares in the new Company to be distributed by giving each shareholder, whether paid up or contributing, four shares for every share he held in the old Company.

The first part is clearly competent. The second part is equally clearly competent as far as relates to the direction to divide *in specie*. And then, when we come to the provision about the proportion each one is to get, we are brought face to face with the real problem in the case. The 10s. 6d. is admittedly return of capital, and no question of taxation is raised as to that. Nevertheless, it is very important in considering the resolution, because Part II. of the Act does not contemplate capital being returned, except in winding up. The point we have now to determine is whether the division of the shares, so far as they consist of profits of the old Company, is a *payment* of those profits or not, within the meaning of "paid" in sec. 14 (*b*).

(1) (1845) 7 Q.B., 339, at p. 384. (2) (1911) 105 L.T., 370.

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Did the appellant owe his receipt of the shares to any *act* of the old Company which can fairly be called *payment*? In my opinion, he did not. The resolution of the Company as to the 10s. 6d. and the shares was superfluous. It was more an explanation than a determination, and, if it was a determination, it merely determined what the law required if such a determination had not been arrived at. Sec. 408 must be read with sec. 416. The latter section applies to winding up by the Court as well as to winding up voluntarily, but the part common to both is this:—"If after all the liabilities of a no-liability company are discharged there remains any surplus of its property the surplus shall be distributed amongst *the parties entitled thereto.*" Who are "parties entitled thereto"? The Act does not say. It leaves it even more indefinite than do the trading companies' provisions, for there we find the surplus is to be distributed in voluntary winding up "among the members according to their rights and interests in the company." Here we have "the parties entitled thereto." That throws us back on the task of ascertaining who are "the parties entitled thereto," and then what each is "entitled" to. Perhaps the first question is the meaning of "surplus." In sec. 416 "surplus" clearly means the sum remaining (when the assets are estimated in money) after providing for the liabilities. As these have, *ex hypothesi*, been discharged in this case before the winding-up resolution, "the surplus" means the whole 800,000 shares. The parties entitled thereto, since they are not designated by the Act, have to be ascertained *ex necessitate* by the rules so far as these are valid. I mean that the rules cannot either go beyond the scope assigned to them by the Act or go counter to any express or implied requirement of the Act. By sec. 355, rules are "for the management and purposes of the company." *Bisgood* v. *Henderson's Transvaal Estates Ltd.* (1) is important to remember in this connection; and it has been followed in *Etheridge* v. *Central Uruguay Northern Extension Railway Co.* (2). Here, however, the Rules contain nothing contrary to the Act, and, as to r. 130, I consider it as nothing more than a harmless statement of what could be done without it. It could not relieve the Company from complying with sec. 408 in giving the necessary instructions to the

(1) (1908) 1 Ch., 743. (2) (1913) 1 Ch., 425, at p. 436.

directors as to how they are to proceed. But the rights of the shareholders after the Company has ceased to function are not affected.

The case falls to be determined on general principles of law. The principles applicable are fully stated in *Birch* v. *Cropper* (1). It is quite unnecessary to state them; for, in doing so, it would be merely repeating the words of Lord *Herschell* or Lord *Macnaghten*, and, as no one contests the principle or the conclusion, any quotation of the judgments of those learned Lords would be effort without result. The conclusion so far is that, the shareholders' contributions having been equalized, they participate in the remaining assets of the old Company in proportion to the number and value of their shares; that is, they get four shares in the new Company. But that only determines *who* are entitled and in *what proportion*, and still leaves open the essential question in debate. Are those shares, so far as they represent profits, "*credited or paid*" to the shareholder within the meaning of sec. 14 (*b*). To say the shareholders are by the operation of the Act entitled in such proportions and through their shares is as true of an ordinary dividend as of the general assets in winding up. The matter must therefore be further examined.

In my opinion, the answer is: "No, the profits are not so credited or paid"; and the reason for my answer is summed up in a phrase: *There was no debt.* The words "credited" and "paid" in the collocation found in sec. 14 (*b*), namely, "dividends, interest, profits, or bonus credited or paid to any depositor, member, shareholder, or debenture-holder of a company" &c., imply *a debt* from the company. "Company" (by sec. 3) "includes all bodies or associations corporate or unincorporate," but does not include partnerships. It includes therefore, for instance, building societies and insurance companies. "Depositor" includes a depositor in a building society. "Interest" includes interest on the deposit by such a person, as well as interest on advanced share contribution. "Profits" means profits which the company has made, and as to "bonus," there is no line of demarcation which delimits a dividend from a bonus: it conveys the notion of an abnormal distribution. "Dividend"

(1) (1889) 14 App. Cas., 525.

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carries with it in general practice the idea of a more regular distribution, more regular in point of time and method and amount; while "bonus" carries a sort of intimation that in some way it is to be regarded as exceptional. But in law there is no distinction. Both "dividend" and "bonus" connote, unless by express words or necessary implication the contrary appears, that as between company and shareholder the company continues its undertaking as a going concern and retains its capital for that purpose. In the case of the old Company it may be noted that it could not lawfully declare a dividend except out of profits arising from the business of the Company (sec. 342). The terms "dividend," "interest" and "bonus" are clearly not applicable here. The case must depend solely on the force of the word "profits." As between "dividend" and "bonus," or equivalent terms, little if any weight can, since *Bouch* v. *Sproule* (1), be attached to the mere difference of terminology. If, for instance, a company were to use neither "dividend" nor "bonus" but some such word as "distribution" or "division" or "interest" or "sharing" or "participation," it would make no difference. *Bouch* v. *Sproule,* however, in marking *a new boundary-line for the determination of "capital" and "income,"* used certain expressions that legislation has been careful to note, and this is important to observe. In that case, the will used the words "interest dividends and annual income"; the company declared a "bonus dividend," which Lord *Herschell* (2) called a "bonus"—the word Lord *Erskine* had used in *Witts* v. *Steere* (3). And see p. 397, also Lord *Herschell,* and at p. 400 by Lord *Watson.*

The employment of all these terms marks the anxiety of the Legislature that, in whatever form profits of a company are "credited or paid" to the members, &c., "credited or paid" shall be regarded as the recipient's income for the purpose of taxation. Whether it becomes "taxable income" depends on circumstances stated in the Act.

As to the words "credited or paid," the conclusion of Lord *Herschell's* judgment in *Bouch* v. *Sproule* (4) was: "Upon the whole, then, I am of opinion that the company did not *pay, or intend*

(1) (1887) 12 App. Cas., 385.
(2) (1887) 12 App. Cas., at p. 391.
(3) (1807) 13 Ves., 363, at pp. 368-369.
(4) (1887) 12 App. Cas., at p. 399.

to pay, any sum as dividend, but intended to and did appropriate the undivided profits dealt with as an increase of the capital stock in the concern." Lord *Watson* says (1): "It was equally within the power of the company to capitalize these sums by issuing new shares *against them to its members* in proportion to their several interests." He says (2) that the money "should not be *paid* to the shareholder, but should simply, by means of *an entry in the company's books, be imputed in payment of the call of* £7 10*s. upon each new share.*" The Legislature, as it appears to me, has by the word "credited" sought to reach cases where, through a member or shareholder *who* has not been "paid" the dividend or bonus, there has been credit in the company's books imputed to the share he holds. This may or may not be satisfied under the Federal *Income Tax Assessment Act* by such a transaction as took place in *Blott's Case* (3) or *Bouch* v. *Sproule* (4). I am not aware whether any attention was directed to the word "credited" in either the *Swan Brewery Case* (5) or *Blott's Case*, and I leave that entirely open for consideration should the question arise. But, at all events, "profits credited or paid" are, as it seems to me, pointed to "profits" which have in some way been made a *debt* by the company to the shareholder, &c. In the case of a shareholder, that would be by a "dividend or bonus" —or even by "interest" used in the sense of distribution of profits. But the declaration of a "dividend" creates a *debt* (*In re Severn and Wye and Severn Bridge Railway Co.* (6)). Where there is no debt, or "*debit*," the word "credit" or the word "pay," in relation to profits, is meaningless, for there is nothing calling for payment and there is no balance to be struck. And in its essence the distribution of surplus assets in winding up creates nothing in the nature of a debt by the company to anybody (see *Spence* v. *Coleman* (7)). Nor is it a payment. The debts owing by the company have been paid; the debts owing to the company are gathered in; the contributories' positions are equalized or are as agreed; and the property of the company falls to be divided, not *by the corporation, but among the corporators*, for the company has itself ceased to have

(1) (1887) 12 App. Cas., at p. 403.
(2) (1887) 12 App. Cas., at p. 404.
(3) (1921) 2 A.C., 171.
(4) (1887) 12 App. Cas., 385.
(5) (1914) A.C., 231.
(6) (1896) 1 Ch., 559, at p. 564.
(7) (1901) 2 K.B., 199.

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any use for it since its undertaking is at an end (*Wallace* v. *Universal Automatic Machines Co.* (1)) and it is on the road to dissolution.

The Act itself bound the corporators together for a common purpose, and gave them, so bound, a new legal identity; the Act itself then severs the bond and destroys that new identity. It gathers together initially for the common purpose individual contributions, and makes them the property not of the aggregate of the individuals but of the new entity created and equipped for the common purpose. When that purpose is terminated, the fundamental reason for association has gone, and so the Act starts to retrace its steps and to undo the results it effected, even to complete dissolution of the corporation. On the way, it proceeds to restore the individual rights of the corporators to the contributions they made, together with all that those contributions have produced, that is to say, the "surplus assets" of the company. (*Cf. In re Printers and Transferrers Amalgamated Trades Protection Society* (2).) Those "surplus assets" are not the "capital" of the company, because they may include "profits" (see per *Stirling* J. in *In re Jones*; *Clegg* v. *Ellison* (3)), but they "represent" the capital, in the sense that they have been produced by the capital of the company, and, since they are "surplus," they are cleared of any other claim. But the individual rights now existing in the surplus assets are not a "debt" by any person natural or artificial to the shareholder. The company owes him nothing, not even the capital necessary for adjustment. His rights are in relation to his fellow shareholders and them alone. As *James* L.J. observed in *In re Contract Corporation*; *Gooch's Case* (4), "a winding up is, in truth, a partnership suit, and the official liquidator is the receiver and manager of the partnership assets, and also fills the character of an accountant to make up the books and accounts, so as to ascertain each partner's share of liability and share of surplus, if there should be any." The Lord Justice there spoke of a winding up in Court, but though the machinery is different in the voluntary mode, the principle is the same, and, substituting "directors" for "liquidator," the observations apply. Indeed, the real truth of the matter comes out more clearly in a voluntary

(1) (1894) 2 Ch., 547, at p. 553.
(2) (1899) 2 Ch., 184, at p. 189.
(3) (1898) 2 Ch., 83, at p. 89.
(4) (1872) L.R. 7 Ch., 207, at p. 211.

winding up than it does at first sight in a compulsory proceeding. The Act has entrusted, not to a mere majority of the partners, as I may call the shareholders for this purpose, to say the common enterprise shall be abandoned, but has fixed a statutory majority. But this statutory majority is what *Jessel* M.R. calls "a domestic tribunal" to determine whether the common purpose shall be further pursued or abandoned. The shareholders decide by this majority according to their view of what is most for their interest, and if they determine to abandon the enterprise and realize their shares by division of the property—for that is one mode of realization (see *In re Dawson*; *Pattisson* v. *Bathurst* (1))—they may do so. A "share" in a company is simply a portion, an aliquot portion, of the company's *capital* (see *Bartholomay Brewing Co. of Rochester* v. *Wyatt* (2)). In the distribution of surplus assets, whether or not that aliquot portion is in the circumstances when equalized (*In re Wakefield Rolling Stock Co.* (3)) the sole measure of the right to share the whole assets, the distribution obliterates and *destroys the share in the capital.* It does not cancel a debt; it does not give rise to a payment or a credit.

And for this reason, and this reason alone, I am of opinion that the appellant should succeed.

HIGGINS J. Company A transfers to Company B its undertaking and assets. Part of the consideration for the transfer is the allotment and issue by Company B to Company A or its nominees of shares in Company B fully paid up to £1 each. The nominees of Company A are its existing shareholders. The Commissioner claims that each shareholder should pay income tax on the value of the shares issued to him (less certain deductions which are immaterial for the present purpose).

At first sight, the claim seems absurd. The consideration for the transfer is not "income" either of the Company or of the shareholder; it is of the nature of purchase-money paid to Company A, and distributed under the Act and regulations of the Company to the shareholders on winding up. Even if it were all clear gain to

(1) (1915) 1 Ch., 626, at p. 635. (2) (1893) 2 Q.B., 499, at p. 516.
(3) (1892) 3 Ch., 165, at p. 173.

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the shareholders in Company A, that gain is not income. A legacy is not income; the price given for one's house and land is not income; an asset which comes to a shareholder in the distribution of the surplus assets of the Company on winding up is not income. A man may buy a house for £5,000 in 1893, and sell it for £10,000 in 1918, the difference is not to be included in his income tax return. There is always something of periodicity, or recurrence or regularity connoted by the word "income." In the *Standard Dictionary* "income" is defined as "the amount of money coming to a person or corporation within a specified time or regularly (when unqualified, annually), whether as payment for services, interest, or profit from investment; revenue."

But Company A—the Broken Hill South Silver Mining Co. No Liability—has been a most profitable enterprise. Starting in 1893 with 200,000 shares of £1 each, of which £163,831 were paid up, it sells all its undertaking and assets as a going concern—all that remains after much extraction of minerals—as from 30th June 1918, for (in addition to other considerations) £800,000 in 800,000 shares fully paid up to £1 each. The Commissioner argues that these shares issued by the new Company, fully paid up to £1 each, represent (after deduction of the capital paid up on each share, &c.) "profits" or "bonus" "credited or paid" to the shareholder by the old Company (par. 12). The Commissioner makes no distinction as to income tax as between an original shareholder and any shareholder who may have bought his share at ten times the face value—all shareholders are to pay irrespective of their actual profits, and as if they were original shareholders.

This attitude seems rather extraordinary. If the mine belonged to one person, AB, and if he paid £163,831 for it, and sold it after thirty years for £800,000 in money or in shares, no income tax would be payable by AB on the £800,000. That is admitted. It is not income in the sense of the Act; it is a corpus payment. But because the corpus payment is made to a company and the company's shareholders derive the benefit, it is said that each shareholder, after deduction of the capital paid on his shares, &c., must treat the rest of the consideration, or his proportion thereof, as income for the purpose of income tax.

The Commissioner relies on the words of the *Income Tax Assessment Act* 1915-1918 as justifying his claim, in particular on sec. 14 (*b*). Under sec. 14, "the income of any person shall include . . . (*b*) dividends, interest, profits, or bonus credited or paid to any depositor, member, shareholder, or debenture-holder of a company which derives income from a source in Australia." This provision is perfectly intelligible if it be read as applying to a live company carrying on its business, deriving profits from the business, and distributing some of its profits, as dividends or under any other name, to its shareholders. The scheme of the Act is that the company has to pay income tax on its assessable income, after deducting any part of that income that is distributed to the shareholders of the company (sec. 16 (1)); and that the shareholder has to pay tax on his whole income, including any dividends (or shares of profits) that are credited or paid to him in such distribution. Moreover, as the words of sec. 14 (*b*) show, if a man is paid or credited with any interest as a depositor with the company, or as a debenture-holder, that interest must be included in his taxable income. The words "profits or bonus" seem to be used mainly for the purpose of preventing attempts to evade the tax by word-juggling: the Act looks at the substance of the matter—is there a payment or credit of any part of the profits of the company to the shareholder? The word "profits" would be also applicable to a debenture-holder where the debenture-holder is entitled to a share in the profits as well as to interest.

It seems to me obvious that sec. 14 (*b*) and sec. 16 (1) are mutually complementary. Under sec. 10 income tax is levied upon the taxable income derived by every taxpayer from sources within Australia during the twelve months ending on 30th June preceding the financial year for which the tax is payable. But, under sec. 16 (1), there is to be deducted from the total assessable income of any company taxpayer so much of the assessable income as is available for distribution and is distributed to the shareholders; and, under sec. 14 (*b*), everything that is distributed out of the company's income to the shareholders is to be treated as taxable income of each shareholder. The fact that a going company distributes anything among its shareholders is treated as showing that it is a distribution

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out of the company's income; for the company cannot distribute any of its capital to the shareholders. This is the law as to such companies, even if there were not the express provision in r. 99 that "no dividend shall be payable except *out of the profits arising from the business of the Company.*" But when a company, about to dissolve, is winding up its affairs, and, after paying all its liabilities and repaying to the shareholders the amounts contributed to the capital, distributes any remaining assets according to law, the distribution is not a distribution of income of the company, and the money or property does not come to the shareholder as part of his income. The fact that the assets distributed would not be so great but for profits made by the company in past years does not affect their character as residuary assets of the company distributed on its winding up. In a recent case from Western Australia, this Court decided that a tax on income "arising from the business" of a person did not apply to the difference between the price paid for assets by him, and the price received for those assets on a sale of the business (*Commissioner of Taxation (W.A.)* v. *Newman* (1)). Here, under r. 99, the only profits that can be distributed by this Company as a going concern, are profits "arising from the business of the Company," and sec. 14 (*b*) applies, in my opinion, to nothing but dividends, or something in the nature of dividends, declared and paid or credited to shareholders out of the profits of the Company.

I am strongly inclined to think also, that sec. 14 (*b*) applies to distribution *by the company*, not to distribution by law; and that this distribution is not a distribution by the company. The second proviso to sec. 14 (*b*) excepts from that sub-section sums received by a shareholder "where a *company* distributes to its . . . shareholders any undistributed income accumulated prior to the first day of July one thousand nine hundred and fourteen." Sec. 16 (2) provides that "where . . . a *company* has not in any year distributed to its . . . shareholders a reasonable proportion of its taxable income, the taxable income of the company shall be deemed to have been distributed to the . . . shareholders in proportion to their interests in the paid-up capital." These clauses refer to distributions at the will of the company or of

(1) (1921) 29 C.L.R., 484.

its directors; here the distribution is not dependent on that will, but on the law. By sec. 416 of the *Companies Act* it is provided that "if after all the liabilities of a no-liability company are discharged there remains any surplus of its property the surplus shall be distributed among the parties entitled thereto." Looking now at the regulations of the Company to find what parties are entitled, and to what, we find (r. 130) "if the Company shall be wound up all or any of the assets divisible among the shareholders may be divided in specie or may (with the sanction of a general meeting) be transferred to trustees for the shareholders entitled thereto.". Neither Act nor rules say in what proportion the shareholders are entitled to the assets; but the law implies, in the absence of any express provision to the contrary, that any surplus after return of capital is to be distributed among the shareholders in proportion to the number of shares respectively held (*Birch* v. *Cropper* (1); *In re Driffield Gas Light Co.* (2)). No doubt, these cases were decided under the English *Companies Act* of 1862, but I can find nothing in Part II. of the Victorian Act that renders the implication less applicable. But this tentative view is not essential to my opinion on this special case.

I do not base my opinion on the recent decision of the House of Lords in *Inland Revenue Commissioners* v. *Blott* (3). In that case, a live, going company, in pursuance of its articles, resolved that out of its undivided profits a bonus should be paid to its shareholders and that, in satisfaction of that bonus, a distribution might be made among the shareholders of unissued shares fully paid up. The majority of the Law Lords held that the shares so allotted to a shareholder could not be treated as part of his "total income from all sources for the previous year." They were an addition to the shareholder's capital, not to his income. The minority held, in substance, that the allotment of shares, when analysed, meant (1) a distribution in money of profits arising from the business and (2) an application of that money in paying up the amount of each share. Whatever view we may take as to this decision, it does not seem to me to affect the case before us here. In *Blott's Case* the shares were not

(1) (1889) 14 App. Cas., 525. (2) (1898) 1 Ch., 451.
(3) (1921) 2 A.C., 171.

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distributed as assets distributable on a winding up : they were distributed by a going company by way of dividend from its undistributed profits. In the much discussed case of *Bouch* v. *Sproule* (1), also, the distribution was not of assets on a winding up : it was a distribution of profits as such by a going company. So too, in a very recent case before *Sankey* J. (*Pool* v. *Guardian Investment Trust Co.* (2)) and in the cases before this Court of *Knowles* v. *Ballarat Trustees, Executors and Agency Co.* (3) and *Fisher* v. *Fisher* (4).

It is probably expedient to explain that neither party to this special case suggests that what has been done by way of reconstruction is invalid. So far as I can see, there is no provision in the *Companies Act* for a liquidator in the winding up of such a company. The case speaks of a liquidator acting, but there is no substantive allegation that a liquidator was appointed by the Company.

Moreover, there is no statement (assuming the Commissioner to be right in principle), that 57 per cent. is the true proportion attributable to profits earned and accumulated since 1st July 1914. But both parties concede that, notwithstanding the form of the question asked, we should only decide whether the shares received from the new Company are to be treated as income of the shareholders at all.

Again, there is no direct statement that any of the shares received from the new Company (or their value) are due to profits earned and accumulated since 1st July 1914 ; it is merely stated (par. 16) that the Commissioner " contends " to that effect. But, as both parties have treated the statement as if made, I treat it as if made. There is no doubt, when one examines the closing entries in the books, that, in estimating the assets transferred to the new Company, the old Company was credited with the sum of the amounts credited to profit and loss of the Company, and to the reserve account, the equalization reserve account and appropriation for dividend account. But it by no means necessarily follows that these profit funds are due to assessable income of the Company, within sec. 16 (1) ; they may have been due to mere increase in the value of the assets of the Company; and we are not told on what system this Company

(1) (1887) 12 App. Cas., 385.
(2) (1921) 38 T.L.R., 177 ; (1922) 1 K.B., 347.
(3) (1916) 22 C.L.R., 212.
(4) (1917) 23 C.L.R., 337.

calculated its profits—whether it included appreciation in value of its assets, or merely the difference between receipts and expenditure (see *Lee* v. *Neuchatel Asphalte Co.* (1); *Ammonia Soda Co.* v. *Chamberlain* (2)).

There is not even any statement that any part of the profits of the Company was "credited or paid" to this shareholder, within the meaning of sec. 14 (*b*). *Primâ facie*, "payment" implies money payment, not satisfaction in shares or other assets; and "credited" implies some accountancy entry. But, in my view of the position, it is unnecessary to rely on such a defect in the statement of the case as agreed to by the parties.

My answer to the question must be No.

Question answered—No.

Solicitors for the appellant, *Blake & Riggall.*

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

B. L.

(1) (1889) 41 Ch. D., 1.

(2) (1918) 1 Ch., 266.