Solicitors for the Controller, *Malleson, Stewart, Stawell & Nankivell.*

Solicitors for the Broken Hill Proprietary Co., *Moule, Hamilton & Kiddle.*

Solicitors for the Broken Hill South Silver Mining Co., *Blake & Riggall.*

H. C. OF A. 1923.

IN RE AUSTRALIAN METAL CO. LTD.

B. L.

[HIGH COURT OF AUSTRALIA.]

WM. KUHNEL & COMPANY LIMITED . . APPELLANT;

AND

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

War-time Profits Tax—Assessment—Deductions from profits—Commonwealth income tax—Taxpayer a company—Shareholder a trustee—War-time Profits Tax Assessment Act 1917-1918 (*No* 33 *of* 1917—*No.* 40 *of* 1918), *secs.* 15 (4), (5), 18—*Income Tax Assessment Act* 1915-1916 (*No.* 34 *of* 1915—*No.* 39 *of* 1916), *sec.* 26 (1)—*Income Tax Assessment Act* 1915-1918 (*No.* 34 *of* 1915—*No.* 18 *of* 1918), *sec.* 26.

H. C. OF A. 1923.

ADELAIDE, *Oct.* 3, 4.

SYDNEY, *Dec.* 7.

Knox C.J., Isaacs, Higgins, Rich and Starke JJ.

Held, that the proper method for determining the deduction, from the profits of a company provided for by sub-secs. 4 and 5 (*c*) of sec. 15 of the *War-time Profits Tax Assessment Act* 1917-1918, of Commonwealth income tax paid in respect of the profits is (a) as to the accounting periods 1916-1917 and 1917-1918, to find the amounts of income tax that would have been payable by each shareholder of the company if the share of the profits credited or paid to him had been the only income derived by him from sources within Australia, whether the shareholder is a trustee or not; and (b) as to the accounting period 1918-1919, to find the amounts of income tax that would have been payable by each shareholder of the company if the share of the profits credited or paid to him had been the only income derived by him from sources within Australia, but limited where the shareholder is a trustee to the amount for which the trustee is to be separately assessed and liable under sec. 26 (2) of the *Income Tax Assessment Act* 1915-1918.

H. C. OF A. 1923.

KUHNEL & CO. LTD. v. DEPUTY FEDERAL COMMISSIONER OF TAXATION (S.A.).

Sendall v. *Federal Commissioner of Land Tax*, (1911) 12 C.L.R., 653, not followed by *Isaacs* and *Rich* JJ. with respect to the *War-time Profits Tax Assessment Act* 1917-1918.

CASE STATED.

On the hearing of appeals by Wm. Kuhnel & Co. Ltd. to the Supreme Court of South Australia from assessments for war-time profits tax for the several accounting periods 1916-1917, 1917-1918 and 1918-1919, *Murray* C.J. stated, for the opinion of the High Court, a case which, so far as material, was as follows :—

1. The appellant is a company duly registered in the State of South Australia under the provisions of the *Companies Act* 1892 (S.A.) as a limited company.

2. William Kuhnel (hereinafter called " the testator ") late of Ranfurly, Brougham Place, North Adelaide, in the State of South Australia, piano warehouseman, deceased, by his will dated 29th June 1915, probate whereof was granted by the Supreme Court of the said State on 3rd May 1916, appointed Elder's Trustee and Executor Co. Ltd., whose registered office is situate at 29-31 Currie Street, Adelaide, in the said State, his sole executor and trustee.

3. Pursuant to the memorandum and articles of association of Wm. Kuhnel & Co. Ltd. (hereinafter referred to as " the appellant Company ") the capital of the appellant Company is £75,000 divided into 75,000 shares of one £1 each, of which 50,000 shares were deemed fully paid up and were issued to the testator and his nominees as the consideration for the sale by him to the appellant Company of his business mentioned in par. (a) of clause 2 of the said memorandum, and 25,000 shares were reserved to be dealt with as the directors of the appellant Company in their absolute discretion should think fit.

4. At the time of his death the testator was the holder of 74,996 shares in the appellant Company, and the remainder of the said shares therein were held by nominees of the testator.

5. Elder's Trustee and Executor Co. Ltd., as the trustee of the testator, became the registered owner of the shares held by the testator at his death, and four shares, making up the total issued capital of the appellant Company, were registered in the names of

and are still held by certain nominees of Elder's Trustee and Executor Co. Ltd. hereinafter mentioned.

6. The trustee and its nominees hold the aforesaid shares under and by virtue of a provision contained in the will of the testator in the following terms, namely, "I empower my trustee to invest any moneys which may come into its hands for investment under this my will in manner prescribed by law But I authorize my trustee to continue any investments which may be subsisting at the time of my death for such time as my trustee may deem desirable without being responsible for any loss which may arise in consequence thereof."

7. Under the terms of the aforesaid will there are six beneficiaries, daughters of the testator, who are entitled to the income of the trust estate as in the will set forth. In respect of these the trustee is authorized to provide a home until the youngest child shall attain the age of twenty-one years, and authority is given to utilize the income of such of his children as shall be under the age of twenty-one years for the purpose of the upkeep of such home. After making various dispositions and provisions the will continues: "And as to all the income arising from my estate to divide the same quarterly among all my children share and share alike for and during the term of their respective lives and the lives and life of the survivor or survivors of them . . . And from and after the death of the last surviving of my children upon trust as to all the rest and residue of my estate wheresoever and whatsoever to divide the same among all my grandchildren in equal shares *per capita* and not *per stirpes*."

10. The 75,000 shares in the appellant Company of which Elder's Trustee and Executor Co. Ltd. or its nominees are the registered holders form portion of the assets of the estate of the testator.

11. The appellant Company was at all times material to this case subject to assessment under the provisions of the *War-time Profits Tax Assessment Act* 1917-1918, and in consequence thereof the public officer of the Company was required to and did furnish returns thereunder.

12. On 21st November 1919 the respondent under the provisions of the *War-time Profits Tax Assessment Act* 1917-1918 caused an assessment to be made for the purpose of ascertaining the profits

H. C. OF A. 1923.

KUHNEL & CO. LTD. v. DEPUTY FEDERAL COMMISSIONER OF TAXATION (S.A.).

upon which war-time profits tax should be levied for the 1916-1917 financial year ending 30th June 1917, and based on the profits derived during the accounting periods ending 31st December 1916 and 31st December 1917 : the net tax payable on such assessment was £1,217 1s. 11d.

13. On 20th January 1920 the respondent amended the said assessment, and thereupon the net tax payable was £553 15s. 8d.

14. On 3rd December 1920 the respondent further amended the said assessment, and thereupon the net tax payable was £764 0s. 7d.

15. On 6th February 1920 the respondent under the provisions of the said Act caused an assessment to be made for the purpose of ascertaining the profits upon which war-time profits tax should be levied for the 1917-1918 financial year ending 30th June 1918, and based on the profits derived during the accounting periods ended 31st December 1917 and 30th June 1918 : the net tax payable on such assessment was £1,587 10s.

16. On 3rd December 1920 the respondent amended the last-mentioned assessment, and thereupon the net tax payable was £1,441 17s. 6d.

17. On 28th January 1921 the respondent under the provisions of the said Act caused an assessment to be made for the purpose of ascertaining the profits upon which war-time profits tax should be levied for the 1918-1919 financial year ending 30th June 1919, and based on the profits derived during the accounting period ended 30th June 1919 : the net tax payable on such assessment was £4.

18. Objections were lodged by the appellant Company within due time (a) against the amended assessment for the financial year 1916-1917 referred to in par. 14 hereof, (b) against the amended assessment for the financial year 1917-1918 referred to in par. 16 hereof, (c) against the assessment for the financial year 1918-1919 referred to in par. 17 hereof.

20. The said objections were transmitted to the Supreme Court of South Australia as formal appeals.

21. In the assessments in respect of which the said objections were lodged the respondent allowed deductions, under sub-sec. 4 of sec. 15 of the said Act, of Commonwealth and State income taxes paid in respect of the profits, and, in calculating the deductions in

respect of Commonwealth income tax in accordance with par. (*c*) of sub-sec. 5 of the said section, he regarded the words " the aggregate of the amounts of tax that would have been payable by each shareholder if the share of the profits credited or paid to him had been the only income derived by him from sources within Australia " as meaning so far as the profits credited or paid to the trustee of the estate of the testator are concerned the aggregate of the amounts that would have been payable by each of the said beneficiaries in the estate of the testator if her share of the profits credited or paid by the appellant Company to the trustee had been the only income derived by her from sources within Australia.

23. The amount of the appellant Company's profits derived during the accounting period ended 30th June 1919 and credited or paid to Elder's Trustee and Executor Co. Ltd. as trustee of the estate of the testator was £4,875, of which £869 was deemed to be derived from sources exempt from war-time profits tax, leaving a net assessable profit of £4,006.

24. In the original assessments for the financial year 1916-1917 and 1917-1918 referred to in pars. 12 and 15 hereof respectively, the respondent, in determining the deduction in respect of Commonwealth income tax in accordance with par. (*c*) of sub-sec. 5 of sec. 15, calculated the Commonwealth income tax payable upon the amount of dividend credited or paid by the appellant Company to Elder's Trustee and Executor Co. Ltd. (as trustee) as if the latter Company were one individual (not a company).

25. The appeal came on for hearing before me on 29th September 1922, and I decided to state this case for the opinion of the High Court upon the following questions arising in the appeal, which, in my opinion, are questions of law :—

In the circumstances stated, and on the true construction of the *War-time Profits Tax Assessment Act* 1917-1918—

(1) Was the respondent entitled to adopt the method set out in par. 21 of this case in calculating the deduction in respect of Commonwealth income tax to which the appellant Company is entitled under sub-sec. 4 and par. (*c*) of sub-sec. 5 of sec. 15 of the said Act ?

H. C. OF A. 1923.

KUHNEL & CO. LTD. v. DEPUTY FEDERAL COMMISSIONER OF TAXATION (S.A.).

(2) If not, should the method adopted in the original assessments as set out in par. 24 of this case be applied ?

(3) If neither of the above methods be correct, what is the true method of determining the deduction, if any, to be made ?

During the argument it was admitted for the purposes of the case that all relevant income tax had been paid at the proper time.

Napier K.C. and *Skipper*, for the appellant.

Piper K.C. (with him *Ward*), for the respondent.

Cur. adv. vult.

Dec. 7.

The following written judgments were delivered :—

KNOX C.J. The appellant, being assessed to war-time profits tax for the financial years 1916-1917, 1917-1918 and 1918-1919 respectively, appealed to the Supreme Court of South Australia against such assessments. On the appeal coming on to be heard, *Murray* C.J. stated a case for the opinion of this Court on certain questions of law arising on the admitted facts, which are as follows :— One William Kuhnel was at the time of his death the holder of 74,996 shares in the capital of the appellant Company, the only other shareholders being four persons who held one share each. By his will he appointed Elder's Trustee and Executor Co. Ltd. executor and trustee thereof, and directed that the income of his estate should be divided between his children share and share alike during their lives and the life and lives of the survivor and survivors. The children entitled under this direction to share in the income were at all relevant times the six daughters of the testator. At all material times the registered holders of shares in the Company have been as follows, namely, Elder's Trustee and Executor Co. Ltd., 74,996 shares; William Fayers Buchanan, 1 share; Joseph Charles Genders, 1 share; Patrick Francis Pennefather, 1 share; Oswald Tipping, 1 share. The four last-named persons hold their respective shares as nominees of the Trustee Company as trustee of the estate of the testator. Pars. 21 and 24 of the case stated are in the following words :—[Those paragraphs were here set out.]

The questions stated for the opinion of this Court are :—" In the circumstances stated, and on the true construction of the *War-time Profits Tax Assessment Act* 1917-1918—(1) Was the respondent entitled to adopt the method set out in par. 21 of this case in calculating the deduction in respect of Commonwealth income tax to which the appellant Company is entitled under sub-sec. 4 and par. (*c*) of sub-sec. 5 of sec. 15 of the said Act ? (2) If not, should the method adopted in the original assessments as set out in par. 24 of this case be applied ? (3) If neither of the above methods be correct, what is the true method of determining the deduction, if any, to be made ? "

In my opinion the answer to question 1 should be " No." The deduction allowed is income tax paid in respect of the profits, and the method of ascertaining the amount of this deduction in the case of a company is prescribed by sub-sec. 5 (*c*) in words of which the meaning appears to me to be clear. The first factor is the amount of the tax paid by the Company ; as to this no question arises. To this amount is to be added the aggregate of the amounts of tax that would have been payable by each shareholder if the share of the profits credited or paid to him had been the only income derived by him from sources within Australia. To find this aggregate the following questions must be answered, namely, (a) How much was credited or paid to each shareholder out of the profits of the accounting period ? and (b) What amount of income tax would have been payable by each shareholder on the hypothesis that the amount so credited or paid to him had been the only income derived by him from sources within Australia ? In order to ascertain these amounts it is necessary to apply the provisions of the relevant Income Tax Assessment and Income Tax Acts to the case of each shareholder, the only assumption in the calculation being that mentioned above. If the shareholder happens to be a trustee and to receive his share of the profits in that capacity, the ascertainment of the amount of tax that would have been payable by him requires the application of the provisions of the relevant Income Tax Assessment Act dealing with the case of trustees. These provisions vary in the Income Tax Assessment Acts of different years, and the provisions of the appropriate Act must be applied in each case. I can find nothing in the

H. C. OF A. 1923.

KUHNEL & CO. LTD. v. DEPUTY FEDERAL COMMISSIONER OF TAXATION (S.A.).

KNOX C.J.

War-time Profits Tax Assessment Act which supports the contention of the Commissioner that where the shareholder is a trustee the amounts of tax which would have been payable by the beneficiaries are to be substituted for the amounts of tax which would have been payable by the shareholder.

In my opinion the answers to the questions submitted should be (1) No; (3) The deduction to be made in respect of the share of the profits of each accounting period credited or paid to Elder's Trustee and Executor Co. Ltd. should be the amount of tax which would have been payable by that Company as trustee of the will of William Kuhnel under the income tax laws in force for the time being, if the share of the profits so credited or paid to the Company had been the only income derived by the Company as such trustee from sources within Australia.

ISAACS AND RICH JJ. Wm. Kuhnel and Co. Ltd., the taxpayer, is a company formed in 1907 under the South Australian *Companies Act* 1892. Its capital is divided into 75,000 shares, of which all but four were held by William Kuhnel and those four by his nominees. William Kuhnel died in 1916, leaving a company called Elder's Trustee and Executor Co. Ltd. his sole executor and trustee. The Executor Company is and at all material times has been a registered shareholder in Wm. Kuhnel and Co. Ltd. for 74,996 shares, four nominees of the executor holding one share each. It follows that the whole 75,000 shares form part of William Kuhnel's estate. This case is concerned with three accounting periods under the *War-time Profits Tax Assessment Act*. Those periods are the respective financial years : (a) 1st July 1916 to 30th June 1917, (b) 1st July 1917 to 30th June 1918 and (c) 1st July 1918 to 30th June 1919.

The competing contentions of the parties have reference to the proper method of applying the provisions of par. (*c*) of sub-sec. 5 of sec. 15 of the *War-time Profits Tax Assessment Act* to the dividends distributed by the taxpayer out of its profits for the respective accounting periods. The contention may be thus stated :—The Commissioner's view is that the deductions should be calculated on the basis that the executor is a trustee, and not beneficially entitled to the dividends, and that the deductions should be made as if the

profits were distributed by the Company to the beneficiaries in their respective proportions. The taxpayer contends that the executor alone can be regarded in calculating the deductions, the income from dividends must be deemed to be that of the executor, and of course as its only income, the beneficiaries for this purpose being disregarded. The question can only be solved by a strict adherence to the directions of the Legislature.

The *War-time Profits Tax Assessment Act* (to which we shall refer as the War-time Act) was passed in September 1917. Sec. 18 directs that the first assessment of war-time profits tax shall be as for the financial year commencing 1st July 1915, and that there shall be a subsequent assessment for each succeeding financial year. So that the war-time profits tax assessment is always considerably over a year after the income tax for the same period is payable and presumably has been paid. That is exemplified in the present case. The assessment for the first financial year in question ending 30th June 1917 was made on 21st November 1919, that for the next financial year ending 30th June 1918 was made on 6th February 1920, and that for the third financial year ending 30th June 1919 was made on 28th January 1921. This was following the statutory direction, and is of considerable importance in understanding the provisions of the Act we have to interpret.

Sec. 15 of the War-time Act deals with the computation of profits. Sub-sec. 3 enumerates certain allowable deductions. Sub-sec. 4 provides that a deduction shall be allowed from the profits of an accounting period of (*b*) " Commonwealth and State income taxes paid in respect of the profits "—the rest is immaterial. Sub-sec. 5 interprets the expression " income tax paid in respect of the profits," first, in relation to the case of an individual taxpayer, that is, an individual owning the whole business ; next, in relation to the case of a partnership owning the business ; and, lastly, by par. (*c*), in relation to the case of a company owning the business. We use the word " owning " for convenience only.

Now, as to the last case (which is the one concerning the matter in hand) the provision is that " income tax paid in respect of the profits shall be "—we divide for clarity sake the words of the paragraph—(a) " the amount of the tax (if any) paid by the company, together

H. C. OF A. 1923.

KUHNEL & CO. LTD. v. DEPUTY FEDERAL COMMISSIONER OF TAXATION (S.A.).

Isaacs J. Rich J.

with " (b) " the aggregate of the amounts of tax that would have been payable by each shareholder if the share of the profits credited or paid to him had been the only income derived by him from sources within Australia." As to (a) no question arises. As to (b) the first thing to do is to endeavour to understand the legislative direction, and then we have to apply it. The meaning of the direction does not appear to us doubtful. The Legislature contemplates, in the first place, that in respect of the company's profits during the financial period under consideration all income tax has already been paid, whether payable by the company or by shareholders. It also contemplates that income tax payable by any shareholder in respect of the share of profits credited or paid to him has been already paid in accordance with the income tax law, which treats his income as a whole, and therefore that this tax may have been paid on his share of profits at a high rate referable to the full amount of his taxable income. As, however, under the War-time Act each business is a taxable entity, and is segregated for that purpose, the notion is preserved in par. (*c*) by looking upon the share of profits credited or paid to a shareholder as if it had been his only taxable income. As to each and every shareholder, then, instead of considering what he *did pay* in income tax in respect of his share of the profits, the paragraph prescribes that what has to be ascertained is what " would have been payable " on the notional basis of segregated income just mentioned. In other words, the paragraph looks to the past for the actual amount of the company's profits, for the actual amount of those profits not distributed, and for the actual amount of income tax paid by the company in respect of those undistributed profits ; then it looks to the actual amount of profits distributed to each separate shareholder, but looks, not to the actual amount of tax he paid in respect of those profits, but to the amount of income tax that " would have been payable " in respect of those profits so actually credited or paid on the basis mentioned. Having ascertained this for each and every shareholder, the amounts of shareholders' income tax (amounts that are actual though possibly reduced) are aggregated and their sum is added to the actual amount paid by the company, and the total forms the deduction allowed by sub-sec. 4. That operation has to be worked out separately as to Commonwealth income tax and State income

tax, and the results may be quite different not merely in amount but even in principle. That arises from the fact that the problem now set is this: what would have been payable by the *shareholder*, that is, (a) to the Commonwealth and (b) to the State? The State income tax gives rise to no contest in this case. To resolve the problem as to Commonwealth income tax we have to turn to the appropriate income tax law.

Before stating our conclusions, we wish to emphasize in advance what has been stated in other cases, namely, that a statutory duty is placed on this Court in a case like the present to hear and determine the question of law as put by the Court which states the case and desires this Court's opinion for the purpose of finally settling the rights of the parties (sec. 29, sub-sec. 4, of the Act). It matters not, in our opinion, what the parties argue, or how they argue, and whether they do not argue at all. Our opinion being asked, we have to give it to the Court which states the case unless, for some legal reason, that is impossible. Holding that view, we proceed to answer the questions in the way we understand them, and so as to assist as far as we can the learned Chief Justice of South Australia to finally determine the matter before him. At the same time we respectfully recognize that, as some of our brethren think it sufficient to give a more general answer, our own view cannot bind the Supreme Court of South Australia. Our view happily includes that general answer, and so we can concur in it. It is simply that our conception of what the law demands of us leads to a fuller investigation of the matters inquired into, and we now state our conclusions.

So far as the Commonwealth is concerned the relevant income tax law is (a) for the first financial period the *Income Tax Assessment Act* 1915-1916, for the second the same, and for the third the *Income Tax Assessment Act* 1915-1918, a highly important alteration being made by the Act No. 18 of 1918. Now, in respect of the first two periods what income tax "would have been payable" by the Executor Company as shareholder of the taxpayer company in respect of the profits credited or paid to it? The difficulty arises from the fact that it received those profits as trustee only. The income tax law for the first two periods provided by sec. 26 of the Assessment Act is as follows: "Any person who derives income as

H. C. OF A. 1923.

KUHNEL & CO. LTD. v. DEPUTY FEDERAL COMMISSIONER OF TAXATION (S.A.).

Isaacs J. Rich J.

a trustee shall be assessed and liable in respect of income tax *as if he were beneficially entitled to the income.*" Other provisions, important but immaterial, follow in the section. What tax then " would have been payable " by the trustee " if he were beneficially entitled to the income " it received from the Company ? That is, as we understand, if it were beneficially entitled to the whole income so received. We are aware that in *Sendall* v. *Federal Commissioner of Land Tax* (1) it was held that under words substantially identical a trustee was to be assessed as if he were not, but as if some other person were, beneficially entitled. In that case it was the *Land Tax Assessment Act* 1910 which was under consideration, and the words were " as if he " (the trustee) " were beneficially entitled to the land," which we take to mean *the whole land* and every interest in it. It was certainly held by two Judges that, nevertheless, a trustee must be assessed as if he stood in the position of the beneficial owner of some limited interest who was being assessed for his limited beneficial interest. We are, with the deepest respect, utterly unable to follow the reasoning that led to that conclusion; and the Acts being different Acts we do not feel bound to adopt the conclusion even though the decision referred to should stand on the terms of the *Land Tax Assessment Act*. We are clearly of opinion that to read the words referred to in sec. 26 of the *Income Tax Assessment Act* 1915-1916 as the Commissioner contends for would be to insert the word " not " before the word " beneficially." That being quite beyond the power of a Court, we perforce reject it. We consider that we are supported by the reasoning of the Privy Council in *Syme* v. *Commissioner of Taxes* (2), which was later than *Sendall's Case* and reversed a decision running very much on the same lines as *Sendall's Case*.

As to the first two periods we hold that the tax that " would have been payable " by the Executor Company as shareholder " as if it were beneficially entitled to the income " received must be calculated on the whole sum thus received at the rate which a person beneficially entitled to the whole of that income would have been liable on the hypothesis that that was his only Australian income for that year. And we would add that the course pursued by the

(1) (1911) 12 C.L.R., 653.

(2) (1914) A.C., 1013; 18 C.L.R., 519.

Commissioner up to the end of the financial period 1917-1918 as stated in par. 24 of the case, was in accordance with the law then existing.

In 1918, by Act No. 18, sec. 26 was repealed, and another enactment substituted as follows :—" (1) *A trustee shall not be liable to pay tax as trustee, except as provided by this Act*, but each beneficiary who is not under a legal disability and who is presently entitled to a share of the income of the trust estate shall be assessed in his individual capacity " &c. " (2) *A trustee shall be separately assessed and liable to pay* tax in respect of that part of the income of the trust estate which if the trustee were liable to pay tax in respect of the income of the trust estate, would have been the income of the trust estate remaining after allowing all the deductions under this Act, except the deduction under section nineteen, and (*a*) which is proportionate to the interest in the trust estate of any beneficiary who is under a legal disability ; or (*b*) *to which no other person is presently entitled and in actual receipt thereof and liable as a taxpayer in respect thereof*." Sub-sec. 3 is immaterial, except as showing that it provides for further contingencies. Henceforth a trustee is " not liable to pay tax as trustee " at all, except in respect of beneficiaries under some legal disability, and of other beneficiaries not falling within the terms of par. (*b*) of sub-sec. 2 of sec. 26. Part III. of the *Income Tax Assessment Act* is headed " Liability to Taxation," and sec. 10 imposes the liability to pay the tax. It is a very convenient method to assess a trustee on the basis adopted here ; but in determining the actual liability we must have regard not to conventional procedure but to the substance of the legislation. If, on the one hand, the trustee and not the beneficiaries must be regarded as the " shareholder " as that word is found in par. (*c*) of sub-sec. 5 of sec. 15 of the War-time Act, and if, on the other hand, where the facts do not satisfy par. (*b*) of sub-sec. 2 of sec. 26 of the *Income Tax Assessment Act*, the beneficiaries not under legal disability and not the trustee are the persons made liable by the *Income Tax Assessment Act* for income tax in respect of their income, how can it be said that any income tax in respect of the income of beneficiaries not under legal disability where the statutory conditions are not complied with " would have been payable " by " the shareholder," the Executor Company ?

H. C. OF A. 1923.

KUHNEL & CO. LTD. v. DEPUTY FEDERAL COMMISSIONER OF TAXATION (S.A.).

Isaacs J. Rich J.

It is plain to us that the hypothetical basis created in par. (*c*) by the words " if the share of the profits credited or paid to him had been the only income derived by him from sources within Australia " is confined to a segregation of the share of profits from all other income of the " shareholder," whether he is a trustee or not. But we are unable to see how those words can be further extended so as to divide up that share of profits received by the " shareholder " into as many items of income as a trust deed or a will may require, and so to create several amounts of war-time tax payable by the taxpayer company by consideration of the complexity of trusts entirely foreign to the company and quite outside the contemplation of sec. 15 (4) and (5) (*c*) of the *War-time Profits Tax Assessment Act* itself.

The amount of income tax " which would have been payable " is as respects each " shareholder " an integer, and an indivisible integer. It may, and indeed must, be arrived at by considerations of income tax law that, applying to the shareholder, require diverse factors, but the amount of tax is single and is an amount payable by a single " shareholder "—single, that is, in the sense of interest and in contemplation of the law respecting " shareholders." Applying these conclusions, the amount of tax which " would have been payable " by the Executor Company as " shareholder " is the sum arrived at by, first, adding together the portions of the dividend income attributable to (a) the beneficiaries under legal disability and (b) the beneficiaries not under legal disability, and not *actually received by them* in the third financial period, and then calculating the proper amount of tax, assuming the sum of the two factors, if there be two factors, were the Executor Company's only income in Australia. For no other tax would the Executor Company have been liable in respect of the dividends for that year, and, therefore, for no other amount should the deduction be made. In calculating the second factor the direction in the will to divide quarterly may be very important. It is on account of this provision that we have framed our answer.

HIGGINS J. This case stated raises a question as to the proper deduction to be made, under the *War-time Profits Tax Assessment*

Act, from the profits of a company made in the years 1916-1917, 1917-1918 and 1918-1919. It seems to be assumed in the case that there can be no difference in the rule applicable to the several periods.

The tax is levied on the excess profits of a business realized under war conditions; but under sec. 15 (4) and (5) a deduction is to be made from the profits of each year, when ascertained, of income taxes —Commonwealth and State—paid in respect of those profits. The object is obvious—substantially, to prevent the war-time profits tax from falling on such of the profits as have to be applied in payment of income tax.

The taxpayer here is a company—the Kuhnel Company; and under sec. 15 (5) (*c*) there are to be two deductions—(1) of the amount of income taxes paid by the Company, (2) " of the aggregate of the amounts of tax that would have been payable by each shareholder if the share of the profits credited or paid to him had been the only income derived by him from sources within Australia."

Under the Commonwealth *Income Tax Assessment Act* 1915-1918 a company has to pay income tax on the profits not distributed (sec. 16 (1)), and the shareholders have to pay income tax on the profits distributed to them (sec. 14 (*b*)); and this is the reason for the double deduction. No difficulty arises as to the deduction of the income tax paid by the Company. Counsel on both sides admit it has been paid and must be deducted. The difficulty arises as to income tax fictionally payable by the shareholders.

Now, so far as the profits for the year 1916-1917 and 1917-1918 are concerned, the position is clear. As to the profits for these years, a shareholder in the Company, whether he is a trustee or not, was originally liable to pay to the Commissioner any income tax payable to the Commissioner in respect of the shares which he held (*Income Tax Assessment Act* 1915, sec. 26); and under sec. 15 (5) (*c*) of the War-time Act, the Company was entitled to deduct the fictional tax which would have been payable on the share of the profits distributed to the shareholders respectively, if they had no other income from Australia.

But an amendment of the *Income Tax Assessment Act* was made on 19th June 1918. By this amendment a new section was substituted for sec. 26 of the Act of 1915; and by this new section it is enacted that " A trustee shall *not* be liable to pay tax as trustee, except as

H. C. OF A. 1923.

KUHNEL & CO. LTD. v. DEPUTY FEDERAL COMMISSIONER OF TAXATION (S.A.).

Higgins J.

provided by this Act, but each beneficiary who is not under a legal disability and who is presently entitled to a share of the income of the trust estate shall be assessed in his individual capacity in respect of (*a*) his individual interest in the income of the trust estate." It is unnecessary in the facts of this case, to consider the further provisions of the new sec. 26.

The facts are that there is a company—the Kuhnel Company—to be taxed on its war-time profits. There are only five shareholders—the Elder's Trustee and Executor Co. Ltd., which is executor and trustee of the late William Kuhnel, and by virtue of its position is actually on the register of shareholders as holder of 74,996 shares out of the 75,000 issued by the Kuhnel Company; and, in addition, four persons, A, B, C and D, nominees of the Elder's Company, holding one share each. Under the will of William Kuhnel, his six daughters are presently entitled to the income of his estate. It appears in the case stated that these daughters are entitled to the income of the trust estate as in the will set forth—the whole income, including the income from the Kuhnel Company; and it is not stated that any of these daughters is an infant or under any other legal disability.

But the amendment of sec. 26 of the original *Income Tax Assessment Act* applies only to assessments for income tax for the financial year 1918-1919 and all subsequent years (*Income Tax Assessment Act* 1918, sec. 48 (3)). Therefore, assessments for income tax for the years 1916-1917 and 1917-1918 have to be dealt with under the original sec. 26 of the *Income Tax Assessment Act* 1915; and the shareholder, even if a trustee for others, is liable to pay the tax to the Commissioner on the share of the profits of each of these two years that has come to the shareholder as dividends. The result is, that as regards these two years sec. 15 (5) (*c*) is fully applicable, and the fictional income tax that would be payable by each of the five shareholders has to be deducted from the profits of the business.

The position is different, however, as to the third year's profits, 1918-1919. The amending *Income Tax Assessment Act* 1918 applies to the assessment for this third year, and under sec. 26 of the *Income Tax Assessment Act* 1915-1918 as amended, a trustee is *not* liable to pay tax as trustee. Prima facie, therefore, sec. 15 (5) (*c*) as to deductions is not applicable; for it cannot be said, in accordance with the

words of that section, that the shareholders would have been liable on any basis as to these shares held in trust for others. Elder's Company and A, B, C and D are trustees of the shares. Of course, the result of this prima facie view is that the object of the Act is, to a large extent, defeated. The ladies who are beneficiaries would have to include their part of the profits received from the Company in their actual returns for income tax ; and yet the Kuhnel Company is not to be allowed any deductions from the profits of the business in respect of the dividends paid on the shares. There would be a deduction from these profits so far as regards the profits *not* distributed by the Kuhnel Company, but no deduction so far as regards the profits which have been distributed. The Kuhnel Company has to send in its return for each year's net profits after deductions (sec. 18 of the *War-time Profits Tax Assessment Act* ; cf. sec. 15 (4)). It has no means of ascertaining whether its shareholders are trustees or not ; on the contrary, under the South Australian *Companies Act* of 1892 (which follows the English *Companies Act* 1862) no notice of any trust express, implied or constructive, can be entered on the register of members or be receivable by the Registrar. But, on the view urged by the Commissioner, he is entitled to tell the company " These shareholders are trustees, and therefore you are not entitled to any deductions of their (fictional) income taxes." Under the circumstances (this is a taxing Act) I have struggled to find some legitimate method of construing these Acts which would enable the Court to prevent such a fiasco ; but I have not succeeded. It seems that there can be no deducton of the (fictional) income tax payable by these shareholders, for they are trustees for others ; and that there can be no deduction of any income tax payable by the beneficiaries, for beneficiaries are not mentioned in sec. 15 (5) (*c*), nor is there mention of income tax payable by the beneficiaries. The *War-time Profits Tax Assessment Act* 1917 was amended in many respects on 25th December 1918, after the *Income Tax Assessment Act* was amended (19th June 1918) ; and although the *War-time Profits Tax Assessment Act* contained many amendments even of this section 15, it contains no amendment of sec. 15 (5) (*c*). I cannot but regard the failure to amend sec. 15 (5) (*c*), in the view of the change made in sec. 26 of the *Income Tax Assessment Act*, as an oversight.

H. C. OF A. 1923.

KUHNEL & CO. LTD. v. DEPUTY FEDERAL COMMISSIONER OF TAXATION (S.A.).

Higgins J.

Taking now the precise questions asked of us, I find that neither question 1 nor question 2 can be answered without qualification; and it is better to answer question 3—"If neither of the above methods be correct, what is the true method of determining the deduction if any to be made?" I have already intimated that I should read the case as stated as alleging (in substance) that the daughters of the testator are all adult and entitled to receive all the income of the estate; but, as I understand from my learned colleagues that during the argument the infancy of some of the daughters was alleged and not denied, I am quite willing to answer this question in words which will be applicable to either position of the facts. My answer to question 3 would be—The true method for determining the deduction to be made (a) as to the profits of each of the accounting periods 1916-1917 and 1917-1918 is to find the amounts of income tax that would have been payable by each shareholder in the Kuhnel Company if the share of the said profits credited or paid to him had been the only income derived by him from sources within Australia whether the shareholder is a trustee or not, and (b) as to the profits of the accounting period 1918-1919 is to find the amounts of income tax that would have been payable by each shareholder in the Kuhnel Company if the share of the said profits credited or paid to him had been the only income derived by him from sources within Australia but limited where the shareholder is a trustee to the amount for which the trustee is to be separately assessed and liable under sec. 26 (2) of the *Income Tax Assessment Act* 1915-1918.

But I accept the answer proposed by my learned colleagues, as I understand it.

STARKE J. The appellant, Wm. Kuhnel & Co. Ltd., has been assessed to war-time profits tax for the financial years 1916-1917, 1917-1918 and 1918-1919, and it is entitled under the *War-time Profits Tax Assessment Act* to a deduction from the profits of each accounting period of the Commonwealth income tax paid in respect of the profits (sec. 15, sub-sec. 4). And for the purposes of the section, income tax paid in respect of the profits shall be, in the case of a company, the amount of the tax (if any) paid by the company, together with the aggregate of the amounts of tax that would have

been payable by each shareholder if the share of the profits credited or paid to him had been the only income derived by him from sources within Australia (sec. 15, sub-sec. 5). Wm. Kuhnel & Co. Ltd. has a capital of 75,000 shares of £1 each, and the registered proprietors of these shares are Elder's Trustee and Executor Co. Ltd., holding 74,996 shares, and its four nominees each holding one share. The Trustee Company and its nominees hold these shares under and subject to the trusts of the will of the late William Kuhnel. And substantially the question submitted to this Court is whether " the aggregate of the amounts of tax that would have been payable by each shareholder " should be ascertained by reference to the profits credited or paid to each shareholder in the Kuhnel Company or by reference to the shares or interests in those profits of the beneficiaries under the will of William Kuhnel. The *War-time Profits Tax Assessment Act* plainly prescribes the former method, but it is suggested that the provisions of the Income Tax Acts render the latter method necessary. Under the *Income Tax Assessment Act* 1915-1916 a trustee is assessed and liable in respect of income tax as if he were beneficially entitled to the income, but there are provisions for deducting from the tax assessable to him a certain proportion in respect of income distributed to the beneficiaries (see secs. 26, 27 and 52). And under the *Income Tax Assessment Act* 1915-1918 a trustee is not liable to pay tax as trustee except as provided by the Act, but each beneficiary who is under no legal disability and is personally entitled to a share of the income is assessed in his individual capacity (sec. 26). Now these Acts enable us to say in what cases a trustee is or is not assessable to income tax, but they do not warrant the substitution of the beneficiary for the shareholder for the purposes of ascertaining the deduction authorized by the *War-time Profits Tax Assessment Act*. The amount of income tax " that would have been payable by each shareholder " must necessarily depend upon the application of the relevant Income Tax Assessment Acts to the given case. Thus, if the shareholder be a trustee, the amount of tax that would have been payable by him in respect of the profits involves the following steps : (a) ascertaining the share of the profits of the accounting period credited or paid to the shareholder, (b) determining, pursuant to the Income Tax Assessment Acts, the liability of the shareholder to

H. C. OF A. 1923.

KUHNEL & CO. LTD. v. DEPUTY FEDERAL COMMISSIONER OF TAXATION (S.A.).

income tax in respect of those profits and the extent of that liability, (c) calculating the tax that would have been payable by the shareholder, if the profits credited or paid to him and in respect of which he is assessable to income tax, had been the only income derived by him from sources within Australia.

Question 3 *answered as follows*:—*The true method for determining the deduction to be made* (*a*) *as to the profits of each of the accounting periods* 1916-1917 and 1917-1918 *is to find the amounts of income tax that would have been payable by each shareholder in the Kuhnel Company if the share of the said profits credited or paid to him had been the only income derived by him from sources within Australia whether the shareholder is a trustee or not*; *and* (*b*) *as to the profits of the accounting period* 1918-1919 *is to find the amounts of income tax that would have been payable by each shareholder in the Kuhnel Company if the share of the said profits credited or paid to him had been the only income derived by him from sources within Australia but limited where the shareholder is a trustee to the amount for which the trustee is to be separately assessed and liable under sec.* 26 (2) *of the Income Tax Assessment Act* 1915-1918, *and particularly as to Elder's Trustee and Executor Co. Ltd. the amount of the tax is to be arrived at by first adding together as factors the portions of the dividend income attributable to* (*i.*) *beneficiaries under legal disability and* (*ii.*) *beneficiaries not under legal disability so far as they had not actually received it in the third accounting period, and then by calculating the proper amount of tax, assuming the sum of all the said dividend factors to have been Elder's Trustee and Executor Co.'s own and only Australian income for the period.*

Solicitors for the appellant, *Scammell & Skipper*.

Solicitor for the respondent, *Gordon H. Castle*, Crown Solicitor for the Commonwealth, by *Fisher, Ward, Powers & Jeffries*.

B. L.