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For the above reasons their Lordships will humbly advise His Majesty that the appeal of the plaintiffs fails and should be dismissed, and that the cross-appeal should be allowed and the order of *Angas Parsons* J. restored. The appellants will pay the costs of all parties (other than Kathleen Pittar Kingston) of the appeal to the High Court and of the present appeal and cross-appeal, except that, as it was unnecessary that the Public Trustee should be represented on the hearing before the Board, no order will be made as to the costs of his appearance on these appeals. The respondent Kathleen Pittar Kingston will take her costs as between solicitor and client out of the trust estate.

Disod *FCT v WE Fuller Pty Ltd* (1959) 101 CLR 403

Appl *Taxes, Commissioner of (Vic) v Nicholas* (1938) 59 CLR 230

Appl *Lonsdale Sand & Metal Pty Ltd v FCT* (1998) 162 ALR 220

[HIGH COURT OF AUSTRALIA.]

JAMES . . . . . APPELLANT;

AND

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

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MELBOURNE, *June* 2, 3.

SYDNEY, *Aug.* 13.

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

Income Tax—Assessment—Income—"Profits or bonus credited or paid" to shareholder of company—Capitalization of profits—Bonus declared—Shares issued in satisfaction of bonus—Value of shares—Income Tax Assessment Act 1915-1921 (*No.* 34 *of* 1915—*No.* 32 *of* 1921), *secs.* 10, 14 (*b*), 15.

A company, which had a large sum of accumulated profits, by extraordinary resolution resolved that it was desirable to capitalize those profits, and accordingly that such sum should be distributed as a bonus amongst the shareholders in proportion to the shares held by them respectively, and that the directors should be authorized to distribute amongst the shareholders in like proportion such number of unissued shares of £1 each paid up to 10s. as should be equivalent to the amount to be capitalized in satisfaction of such bonus. Pursuant to that resolution and to a resolution of the directors, an agreement was entered into between the company and a trustee on behalf of the shareholders that the company should allot and issue to each shareholder his respective proportion of the unissued £1 shares each credited as paid up to 10s., that the shares should be credited as paid up to 10s., and that the shares so credited should be accepted in satisfaction of the bonus. In the books of the company each shareholder was credited with his proportion of the bonus in payment of 10s. in respect of each of the shares so allotted and issued to him.

Held, that the proportion of the bonus so credited to each shareholder was "profits or bonus credited" to him within the meaning of sec. 14 (*b*) of the *Income Tax Assessment Act* 1915-1921, and therefore was properly included in his income.

Inland Revenue Commissioners v. *Blott*, (1921) 2 A.C. 171, and *Webb* v. *Federal Commissioner of Taxation*, (1922) 30 C.L.R. 450, distinguished.

Held, also, that the excess of the value of such shares over the amount credited as paid up in respect of them was not income of the shareholder.

CASE STATED.

On the hearing of an appeal to the High Court by Thomas James from an assessment of him by the Federal Commissioner of Taxation for income tax for the year 1920-1921, *Knox* C.J. stated a case, which was substantially as follows, for the opinion of the Full Court :—

1. The Australian Portland Cement Co. Pty. Ltd. is a company incorporated and carrying on business in the State of Victoria.

2. The appellant is a shareholder and a director in the said company.

3. At an extraordinary general meeting of the said company held on 5th November 1920 it was resolved as follows :—"That it is desirable to capitalize the undivided profits of the company standing to the credit of the company's reserve fund and the net profits ascertained up to 30th November next after deduction therefrom of such sum for payment of a dividend for the year ending 30th November 1920 as the directors think proper, and accordingly that the amount to be capitalized as aforesaid be distributed as a bonus upon a date to be fixed by the directors amongst shareholders in proportion (as nearly as may be without regard to fractions) to the shares held by them respectively. And that the directors be authorized to distribute amongst the shareholders in like proportions such number of unissued shares of £1 each paid up to 10s. as shall be equivalent as nearly as may be to the amount to be capitalized in satisfaction of the said bonus. And that the directors be empowered to make such provision in regard to fractional interests as they think expedient and for effectuating and filing an agreement constituting the title of allottees to such shares, and also to dispose of all shares representing fractional interests as they consider proper."

On 26th January 1921 the tenth ordinary general meeting of the company was held, at which the following report and recommendation

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was presented by the directors and adopted by the meeting:— "The net profit for the year ending 30th November 1920 (after allowing for depreciation) was £47,621 15s. 8d., and the balance at credit of profit and loss account now stands at £59,353 9s. 8d. including an amount of £332 16s. 6d. at credit of concrete construction department's profit and loss account. This, together with £25,000 standing at credit of reserve account, your directors recommend be dealt with as follows: To payment of a dividend at the rate of 8 per cent, £8,824; to payment of a bonus at the rate of 2 per cent, £2,206; to be capitalized by the issue of bonus shares, £72,798; leaving a balance to be carried forward of £525 9s. 8d.: Total, £84,353 9s. 8d." The moneys referred to in the said recommendation (or assets representing the same) were in fact available as stated therein, and were dealt with in accordance with the said resolution and recommendation. The said dividend at the rate of 8 per cent and bonus at the rate of 2 per cent were paid to the shareholders; and no other dividends, interest, profits or bonus were credited or paid to them during the period 1st December 1919 to 30th November 1920, unless the transaction with reference to the said bonus shares should amount to a crediting or paying of a dividend, interest, profit or bonus.

4. It has been agreed between the parties hereto that of the said sum of £59,353 9s. 8d. the sum of £10,995 19s. 7d. represents profits earned by the company prior to 1st December 1919.

6. Pursuant to the said resolution, an agreement in writing was made on 10th February 1921 between the said company of the one part and Paul Lovenorn Munster on behalf of all the registered shareholders of the company as at 26th January 1921 and as trustee for them of the other part. The said agreement and the return of shares so allotted were on 24th February 1921 duly filed with the Registrar-General pursuant to the requirements of sec. 96 of the *Companies Act* 1915.

7. The appellant was registered as the holder of 9,600 shares in the said company, and as such became entitled to all rights conferred by the said resolution; and 6,336 shares of £1 each were issued as paid up to 10s. to the appellant prior to 30th June 1921, and the appellant accepted the same.

8. The following entries were made in the books of the company in connection with such transaction :—

SHARE REGISTER.

Thomas James.

		Distinctive Nos.	No. of Shares.	Paid Up.
1920 :				
Nov. 5		59801 to 69400	9600	£4,800
1921 :				
Jan. 26	Bonus shares	260069 ,, 266404	6336	3,168

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		Dr.	Cr.
1921 :			
Jan. 26	Profit and Loss	£47,798	
	Reserve fund	25,000	
Jan. 26	Capitalization of profits as per resolution extraordinary general meeting 5th November 1920		£72,798
Jan. 26	Capital uncalled ..	72,798	
	Capitalization of profits	72,798	
	Capital unissued as per resolution of extraordinary general meeting 5th November 1920		145,596

LEDGER.

Profit and Loss Account.

		Dr.		Cr.
1920 :				
Nov. 30	By balance	Cement	£59,020 13 2	
		Concrete constructions	332 16 6	
			£59,353 9 8	
1921 :				
Jan. 26	To capitalization of profits as per resolution extraordinary general meeting 5th November 1920	£47,798		

Reserve Fund Account.

		Dr.	Cr.
1920 :			
Nov. 30	By balance		£25,000
1921 :			
Jan. 26	To capitalization of profits as per resolution extraordinary general meeting 5th November 1920	£25,000	

Capitalization of Profits.

1921 :			
Jan. 26	By profit and loss as per resolution extraordinary general meeting 5th November 1920		£47,798
	,, reserve fund		25,000
	To capital unissued ..	£72,798	

Capital Uncalled.

1921 :		
Jan. 26	To unissued capital as per resolution extraordinary general meeting 5th November 1920	£72,798

Capital Unissued.

1921 :			
Jan. 26	By uncalled capital ..	£72,798	
	,, capitalization of profit	72,798	

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For the purposes of the present appeal the parties have agreed that at all material times the value of each of the said 6,336 shares issued to appellant as paid up to 10s. was 15s. The value of the said 6,336 shares at 15s. each would be £4,752.

9. The appellant made a return in respect of his income for the year ending 30th June 1921 including therein the dividend of 8 per cent and bonus of 2 per cent paid by the said company for the said period but claiming that the Commissioner was not entitled to levy income tax in respect of the shares allotted to him as aforesaid.

10. By an amended assessment dated 21st May 1924 the respondent assessed the appellant upon the said return, but included in such assessment the sum of £3,168 in respect of the said shares, and assessed income tax accordingly at the sum of £1,322 10s. 1d. but allowed a rebate therefrom, under sec. 16 (2A), of £183 7s. 4d. in respect of the income tax paid by the said company in previous years upon so much of the sum of £25,000 taken from the reserve fund as was used to pay up in part 10s. per share on the appellant's said shares.

11. The appellant, being dissatisfied with such assessment, lodged notice of objection thereto in writing upon the grounds following: (a) The issue of bonus shares to him did not constitute the payment or crediting of a dividend, interest, profits or bonus; (b) no portion of the company's assets was detached, released or severed and made available to him as a shareholder in the shape of income; (c) no payment in cash or money was made to him in respect of the bonus shares referred to.

12. The respondent contends (a) that the memorandum and/or articles of association of the company do not authorize payment of dividends by shares of the company only partly paid up nor authorize the capitalization of profits by a scheme which made it obligatory on a shareholder to accept shares only partly paid up in respect of such shareholder's proportional part of such profits, and (b) that, if the memorandum and/or articles purport to authorize either or both of the matters stated in (a), they are invalid. Save as in this paragraph aforesaid the respondent as regards the proceedings of the company hereinbefore set out does not dispute that the said

meetings, resolution, report, recommendation and agreement were duly summoned, constituted, held, passed, adopted and filed as required by law.

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

> Whether by reason of the provisions of the *Income Tax Assessment Act* 1915-1921 and of the matters herein stated the appellant is liable to be assessed in respect of the said sum of £3,168 or in respect of the said sum of £4,752 or in respect of any and, if so, in respect of what, part thereof respectively.

The agreement referred to in par. 6, which was incorporated in the case, recited the extraordinary resolution of 5th November 1920 which is set out in par. 3, and that in pursuance thereof the directors had determined to distribute as a bonus amongst the shareholders the sum of £72,798 in proportion to the shares held by the shareholders respectively, and had directed that 145,596 shares of the unissued £1 shares of the company paid up to 10s. per share should, in accordance with such resolution, be distributed amongst the shareholders in proportion to the shares held by them respectively on 26th January 1921 in satisfaction of such bonus, and that, pursuant to the resolution and to the articles of association, Paul Lovenorn Munster should be authorized on behalf of the shareholders to enter into the agreement with the company providing for the allotment to such shareholders respectively of their due proportion of such shares credited as paid up to 10s. and in satisfaction of such bonus. The agreement then proceeded :— "Now therefore it is agreed as follows :—(1) The company shall allot and issue to each of the said shareholders as at 26th January 1921 his respective proportion of the said 145,596 unissued £1 shares of the company each credited as paid up to 10s. pursuant to the said resolution. (2) The said shares shall be numbered 220601 to 366196 inclusive and shall be credited as paid up to 10s. each. (3) That the said shares so credited shall be accepted in satisfaction of the said bonus." The articles of association of the company which are material are set out in the judgment of *Isaacs* J. hereunder.

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Latham K.C. (with him *Keating*), for the appellant. The result of what was done in respect of capitalizing the accumulated profits of the company resulted in an increase of the paid-up capital of the company. Nothing was liberated or released by the company to the shareholders. The transaction permitted the shareholders to retain their interest in the assets of the company which constituted its capital; there was a mere change in the shareholders' symbols of interest in the capital, and therefore there was nothing which was income of the shareholders (*Webb* v. *Federal Commissioner of Taxation* (1); *Inland Revenue Commissioners* v. *Blott* (2)). This case is on all fours with the latter case, and on its authority the taxpayer would not be liable to income tax under sec. 10 of the *Income Tax Assessment Act* 1915-1921. As to sec. 14 (*b*), there was no crediting or paying of anything to the shareholders. There was no debt to the shareholders of which they could claim payment and no debt of which the allotment of shares was a satisfaction. The shareholders had no right to take payment in cash. [Counsel referred to *Blott's Case* (3); *Knowles and Haslem* v. *Ballarat Trustees, Executors and Agency Co.* (4); *Mitchell* v. *Hart* (5).]

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

[ISAACS J. referred to *Pool* v. *Guardian Investment Trust Co.* (7).]

If sec. 14 (*b*) were construed as having the effect of imposing a tax upon the bonus shares, it would impose a tax upon capital and not upon income, and would be invalid under sec. 55 of the Constitution (*Harding* v. *Federal Commissioner of Taxation* (8); *Osborne* v. *Commonwealth* (9); *National Trustees, Executors and Agency Co. of Australasia* v. *Federal Commissioner of Taxation* (10)). The fact that the shares issued were partly paid up is immaterial. If the appellant is taxable in respect of the bonus shares, the relevant amount for income tax purposes is 10s. per share, and not the value of the shares.

Sir Edward Mitchell K.C. (with him *Eager*), for the respondent. Sec. 14 (*b*), read in the light of secs. 10 and 15, shows that the

(1) (1922) 30 C.L.R. 450, at pp. 461, 468, 473.
(2) (1921) 2 A.C. 171, at p. 190.
(3) (1921) 2 A.C., at pp. 180, 194, 200.
(4) (1916) 22 C.L.R. 212, at p. 251.
(5) (1914) 19 C.L.R. 33, at p. 41.
(6) (1914) A.C. 231.
(7) (1922) 1 K.B. 347.
(8) (1917) 23 C.L.R. 119.
(9) (1911) 12 C.L.R. 321, at p. 338.
(10) (1916) 22 C.L.R. 367.

intention of the Legislature was to bring such a transaction as this within the taxing provisions of the Act (see *Commissioner of Income Tax (Q.)* v. *Brisbane Gas Co.* (1)). A company has no implied power to compel a shareholder to take shares in lieu of cash in payment of a dividend (*Hoole* v. *Great Western Railway Co.* (2)). Art. 123 of the articles of association permits this company to pay dividends in shares, and, if this transaction is justified by that article, the shares would be taxable as income on their market value (see *Commissioner of Stamp Duties (N.S.W.)* v. *Broken Hill South Extended Ltd.* (3)). If the bonus shares were issued in satisfaction of the dividend, the amount of the dividend was still treated by the company as a dividend; and that is conclusive. [Counsel was stopped.]

Latham K.C., in reply. Sec. 14 (*b*) is directed to what a taxpayer receives, and the appellant only received what the company gave. If the transaction is only valid if authorized by art. 123, the distribution was still a capitalization of profits.

Cur. adv. vult.

Aug. 13.

The following written judgments were delivered :—

KNOX C.J. In my opinion the facts and figures stated in the special case show clearly that £72,798, representing profits of the company, was, as stated in the resolution of the directors at their meeting of 10th February 1921, appropriated as " a bonus " to be distributed among shareholders; a portion of that sum, proportionate to the number of shares held by each shareholder on 26th January 1921, being subsequently credited to him in the books of the company in part payment of his liability on the shares allotted to him, in pursuance of the resolution to allot shares in accordance with the agreement of 10th February 1921 annexed to the special case. The sum of £3,168 so credited to the appellant answers the description of " profits " or a " bonus " credited to a shareholder of the company, and is therefore, by sec. 14 (*b*) of the *Income Tax Assessment Act*

(1) (1907) 5 C.L.R. 96.
(2) (1867) L.R. 3 Ch. 262.
(3) (1911) A.C. 439.

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1915-1918, included in the appellant's income for the purposes of that Act.

In my opinion the question submitted should be answered "In respect of the said sum of £3,168."

ISAACS J. By art. 123 of the articles of association of the Australian Portland Cement Co. Pty. Ltd. it is provided: "The Board may declare and pay dividends in cash in shares or in specie or otherwise out of the net profits of the company." Art. 124 is in these terms: "Subject to any priorities that may be given upon the issue of any shares the profits of the company available in the judgment of the Board for distribution shall be distributed as dividend among the members in accordance with the amounts paid or credited as paid on the shares held by them respectively." In order to give effect to extraordinary resolutions of shareholders passed on 5th November 1920, the Board of Directors resolved that £72,798 undivided profits be distributed as a bonus amongst the shareholders in proportion to the shares held by them respectively; and that 145,596 shares of the value of £1 each paid up to 10s. per share "be in accordance with the said resolution distributed amongst such shareholders in proportion to the said shares held by them respectively in satisfaction of the said bonus and that . . . Paul Lovenorn Munster be and he is hereby authorized on behalf of the shareholders upon the register . . . to enter into an agreement with the company providing for the allotment to such shareholders . . . of their due proportion of the said shares credited as paid up to 10s. and in satisfaction of the said bonus" &c. The agreement was accordingly entered into as annexed to the case stated. The shares were issued and accepted. The extraordinary resolutions of 5th November 1920 are recited in the agreement, and express the desire of the company "to capitalize the undivided profits," and that "the amount to be capitalized as aforesaid be distributed as a bonus" &c., and that the directors be authorized to distribute "such number of unissued shares of £1 each paid up to 10s. as shall be equivalent . . . to the amount to be capitalized in satisfaction of the said bonus." The shares after allotment were entered in the share register of the company; and the appellant's

shares, 6,336 in number, were credited as paid up to the amount of £3,168. The other books of the company by appropriate entries treated the sum of £72,798 profits as capitalized.

The Commissioner claims, and the appellant denies, that the sum of £3,168 is " income " of the appellant by virtue of sec. 14 (*b*) of the *Income Tax Assessment Act* 1915-1918.

The appellant contends that the case is governed by the decision of the House of Lords in *Blott's Case* (1). I am very clear that it is not. The decisive factor is different in each case. In *Blott's Case* the law, as I understand, made the shareholder liable for the profits of the company only so far as he was a person " receiving or entitled unto the same "—that is, in the form otherwise than as capital.

In this case the law, sec. 14 (*b*), declares arbitrarily that " The income of any person shall include . . . (*b*) dividends, interest, profits, or bonus credited or paid to any depositor, member, shareholder," &c., with an exception now immaterial. The word " credited " is all-important. In *Webb* v. *Federal Commissioner of Taxation* (2) I said :—" 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* (3) was : ' Upon the whole, then, I am of opinion that the company did not *pay, or intend 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 (4) : ' 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 (5) 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 10s. *upon each new share.*' The Legislature, as it appears to me, has by

(1) (1921) 2 A.C. 171.
(2) (1922) 30 C.L.R., at pp. 478-479.
(3) (1887) 12 App. Cas. 385, at p. 399.
(4) (1887) 12 App. Cas., at p. 403.
(5) (1887) 12 App. Cas., at p. 404.

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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* (1) or *Bouch* v. *Sproule* (2). I am not aware whether any attention was directed to the word 'credited' in either the *Swan Brewery Case* (3) 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.* (4)). 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." I adhere to that opinion, and it becomes directly necessary here.

In *Blott's Case* (1) the House of Lords solved the question essentially in this way:—The majority held that what was "received" in fact was nothing but shares, that the shares in the circumstances were, on the doctrine of *Bouch* v. *Sproule* (2), capital as against all the world including the Crown for taxing purposes, and that the intermediate operations, whereby the profits divided were appropriated by the company to satisfy the liability on the shares, did not amount in fact or in law *to payment, to a receipt by* the shareholder of the profits themselves. I may refer to the following passages from the judgment of Viscount *Haldane*:—"He neither paid nor received any cash" (5). "It is quite another question whether these profits as such ever reached the respondent and the other shareholders as income" (6). "But if, acting within its powers, it disposes of these profits by converting them into capital instead of paying them over to the shareholders, that, as I conceive

(1) (1921) 2 A.C. 171.
(2) (1887) 12 App. Cas. 385.
(3) (1914) A.C. 231.
(4) (1896) 1 Ch. 559, at p. 564.
(5) (1921) 2 A.C., at p. 179.
(6) (1921) 2 A.C., at p. 180.

it, is conclusive as against all the outside world, including the Crown, and the form of the benefit which the shareholder receives from the money in the hands of the company is one which is for determination by the company alone " (1). " Apply them " (profits) " in paying up the capital sums which shareholders electing to take up unissued shares would otherwise have to contribute. If this is done the money so applied is capital and never becomes profits in the hands of the shareholder at all " (2). So per Viscount *Finlay* (quoting *Rowlatt* J.):—Part of the profits " liberated to him in the sense that the company parts with it, and he takes it " (3). " I am asked to decide whether there was a ' payment ' of this bonus upon the strength of what I consider bare machinery " (4). " They did not *pay over* the accumulated profits to the shareholders to enable them to pay up the new shares. They issued the new shares as fully paid up as representing the increase of capital which resulted from the *detention* by the company of the money which might otherwise have been *paid* as dividend "(5). Viscount *Cave* (6) said : " The resolution did not give to any shareholder a right to sue for the dividend *in cash*, his only right being to have an allotment of fully paid shares in the capital of the company." Lord *Dunedin*, one of the minority, founded himself on *Trevor* v. *Whitworth* (7), which indeeed Lord *Haldane* (8) also relied on, and which is unquestioned. Shares must be paid for, and not by the company's money. Payment had been " imputed." His Lordship proceeded to conclude that therefore the shareholder in law paid in the capital, and therefore he must in law be taken to have received the money from the company. Lord *Sumner* (9) adhered strongly to the position that the declaration of " bonus " and the mode of satisfying it were legally distinct, and (10) held that the share had to be paid for by the allottee, and therefore, in accord with Lord *Dunedin*, that the company's debt had been in contemplation of law discharged by payment. The pivotal consideration in His Lordship's judgment is, as I venture to think, found in the sentence : " When debt for dividend is set off against

(1) (1921) 2 A.C., at pp. 182-183.
(2) (1921) 2 A.C., at p. 184.
(3) (1921) 2 A.C., at p. 194.
(4) (1921) 2 A.C., at p. 195.
(5) (1921) 2 A.C., at p. 196.
(6) (1921) 2 A.C., at p. 200.
(7) (1887) 12 App. Cas. 409.
(8) (1921) 2 A.C., at p. 187.
(9) (1921) 2 A.C., at p. 208.
(10) (1921) 2 A.C., at p. 212.

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debt for calls and the account is squared, the equivalent of payment of a dividend takes place " (1). And see p. 221, last line but three, " there was a payment here."

It appears to me that the point of divergence between the majority and the minority in that case is found in this consideration :—Both agreed that the declaration of dividend entitled the shareholder to his proportion of the profits in some way. Both agreed that he was entitled to have that proportion applied by the company so as to impute payment of his liability in respect of the capital represented by the new shares to be issued. But they differed as to the legal character of that " imputation." The minority considered it as equivalent in law to " payment," that is, an implied cross-payment for two independent debts. The majority considered it, having regard to the doctrine of *Bouch* v. *Sproule* (2), as no payment by the company at all of the proportion of profits, but as an authorized operation of another and inconsistent character. That operation was an authorized application by the company of the money to the creation of share capital, by detaining the money in the coffers of the company both in law and in fact, while crediting it, as the law required, to the shareholder in respect of the new shares issued.

Reverting for brevity's sake to my own above-quoted observations in *Webb's Case* (3), and to the analysis I have just made of *Blott's Case* (4), it appears to me that, so far from the last-mentioned case supporting the appellant's contention here, it is, in its *media concludendi*, quite opposed to that contention.

The declaration of the bonus to be satisfied by the issue of bonus shares paid up to 10s. meant, when the ellipsis is filled by the necessary business operations, that, though the cash representing the share of bonus was not to be actually paid over to and received by the shareholder, yet it should be so applied by the company on behalf of him as to be imputed to and credited as payment *pro tanto* of the liability created by the issue and acceptance of shares. That the declaration of dividend created a debt, there can be no doubt. But it was a debt which from its birth was conditioned to be satisfied, not by payment over, but by a credit in discharge of a liability on

(1) (1921) 2 A.C. at p. 213.
(2) (1887) 12 App. Cas. 385.
(3) (1922) 30 C.L.R. 450.
(4) (1921) 2 A.C. 171.

shares in a process which the law says is, in the result, the creation of capital. The Australian Act, unlike the English Act, does not always wait till the end of the process: it also sometimes seizes an intermediate operation. This is shown unmistakably by the second proviso to par. (*b*) of sec. 14 in these words: "Where it is proved to the satisfaction of the Commissioner that an amount standing to the credit of a profit and loss account before the first day of July one thousand nine hundred and fourteen has been appropriated by a company for the purpose of crediting a dividend to the shareholders and the dividend or a part thereof is retained by the company for the purpose of paying for an increase in value or number of shares issued to the shareholders, the shareholders shall not be liable to pay tax on the dividend or part so retained."

It is impossible, in my opinion, consistently with the actual facts, particularly the expression, in the resolutions and the agreement, "credited as paid" and the actual crediting of £3,168 in the share register, and consistently with the reasoning of all the learned Lords in *Blott's Case* (1), to contend that there have not in this case been "profits" or "bonus" to the amount of £3,168 "credited" to the shareholder. That being so, it is by force of sec. 14 (*b*) of the Act his "income." He is liable to be assessed in respect of that sum, that is, at 10s. per share, and not in respect of the higher sum of 15s. for which the shares could be sold in the market. If so sold, they would, as Viscount *Cave* in *Blott's Case* (2) observes, be realized as a capital asset producing income, and not as income itself. The 15s. per share would not represent a share of profits of the company; it had not in fact so much to give. Therefore, it would not fall within the sub-section. The question should be answered accordingly.

I would add that since this judgment was written the case of *In re Speir*; *Holt* v. *Speir* (3), has come to hand, and strongly confirms the views I had expressed as to the doctrine of *Bouch* v. *Sproule* (4) and the effect of *Blott's Case* (1).

GAVAN DUFFY AND STARKE JJ. The facts are fully stated in the case, and the question for our consideration is whether the appellant

(1) 1921) 2 A.C. 171.
(2) (1921) 2 A.C., at p. 200.
(3) (1924) 1 Ch. 359.
(4) (1887) 12 App. Cas. 385.

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JAMES v. FEDERAL COMMISSIONER OF TAXATION.

Gavan Duffy J. Starke J.

is liable to be assessed to income tax in respect of his proportion of certain accumulated profits of the Australian Portland Cement Co. Pty. Ltd., which that company derived from sources in Australia, and distributed " as a bonus amongst its shareholders," in proportion to the number of shares held by them in the company, by issuing to them certain unissued £1 shares paid up to 10s. " in satisfaction of the said bonus."

The solution of this question depends upon the terms of sec. 14 (*b*) of the *Income Tax Assessment Act* 1915-1921, which provides that the income " of any person shall include . . . dividends, interest, profits, or bonus credited or paid to any . . . shareholder . . . of a company which derives income from a source in Australia . . . "

According to the contention of the appellant, the distribution of the new shares to the shareholders was " a distribution of capital and not of income," and " the shareholders' interest in the profits of the company did not become their income unless severed from the capital funds of the company and liberated and released to them " (*Blott's Case* (1); *Webb* v. *Federal Commissioner of Taxation* (2); *Speir's Case* (3)). But the force of this contention depends, of course, upon the precise words of the taxing Act. The Act may declare that, for its purposes, the dividend, profit or bonus shall be income (see *Swan Brewery Co.'s Case* (4)). And if it does so, then the Courts must enforce the law, subject, in the case of the Commonwealth, to the observance of certain constitutional provisions (The Constitution, sec. 55). Now the Act in this case explicitly provides that any profit or bonus credited or paid to any shareholder of a company shall form part of his income for the purposes of that Act. On the cases, it may be established that the profits were not paid or released to the shareholders; but it is clear, we think, that these profits were credited to the shareholders. The agreement of 10th February between the company and the trustee for the shareholders stipulates (1) that the company shall allot and issue to each of the shareholders his proportion of the unissued £1 shares of the company, each credited as paid up to 10s. pursuant to the company's resolution;

(1) (1921) 2 A.C. 171.
(2) (1922) 30 C.L.R. 450.
(3) (1924) 1 Ch. 359.
(4) (1914) A.C. 231.

(2) that the shares shall be credited as paid up to 10s., and (3) that the shares so credited shall be accepted in satisfaction of the said bonus. Such a transaction could not be carried out, in point of fact or of law, unless the profits had been allocated to the shareholders and treated, in account between the company and the shareholders, as at the "credit" of the shareholders. It was suggested, during the argument, that this view of the effect of sec. 14 (*b*) of the *Income Tax Assessment Act* results in a contravention of sec. 55 of the Constitution. But the argument is met by the decision of this Court in *National Trustees &c. Co.* v. *Federal Commissioner of Taxation* (1). *Blott's Case* (2), we should add, was decided under the *Finance* (1909-1910) *Act* 1910, which contains no such provision as the Federal *Income Tax Assessment Act*. And in *Webb's Case* (3) this Court was of opinion that there was no dividend or bonus credited or paid to the shareholders.

We agree that the amount credited to the shareholders was 10s. per share, and not 15s. per share (the market value).

RICH J. Sec. 14 of the *Income Tax Assessment Act* enacts that "the income of any person shall include . . . (*b*) dividends, . . . profits, or bonus credited or paid to any depositor, member, shareholder, or debenture-holder of a company." It is incontestable on the facts stated, including the entries in the company's books, that £3,168 were credited to the appellant out of the profits of the company in respect of the 6,336 shares, that is, 10s. a share.

That satisfies the statute and, in my opinion, the answer must be that the appellant is liable to be assessed in respect of that sum.

Question answered: *The appellant is liable to be assessed in respect of the sum of* £3,168.

Solicitors for the appellant, *Moule, Hamilton & Kiddle.*

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

B. L.

(1) (1916) 22 C.L.R. 367. (2) (1921) 2 A.C. 171.
(3) (1922) 30 C.L.R. 450.