[HIGH COURT OF AUSTRALIA.]

JAQUES . . . . . APPELLANT;

AND

THE FEDERAL COMMISSIONER OF TAXATION RESPONDENT.

H. C. OF A. 1923-1924.

SYDNEY, *Dec.* 6, 7, 15, 1923.

Rich J.

SYDNEY, *April* 1, 2, 1924.

MELBOURNE, *June* 10, 1924.

Knox C.J., Isaacs and Starke JJ.

Income Tax—Assessment—Deduction—Calls in mining companies—Agreement or arrangement for purpose of relieving person from tax—Genuine transaction—Mining company—Cement works—Dominant character of company—Income Tax Assessment Act 1915-1918 (*No.* 34 *of* 1915—*No.* 18 *of* 1918), *secs.* 18 (1) (*i*), 53.

A company which carried on the businesses of coal mining and of cement making, having decided to reconstruct, went into voluntary liquidation, and the liquidator entered into agreements with two new companies to one of which he agreed to transfer the colliery business and to the other the cement business, the consideration to the old company being paid-up shares in the new companies which were to be distributed among the shareholders of the old company. After the agreements had been executed and the transaction had been otherwise partly completed, for the avowed purpose of enabling the shareholders of the new companies to obtain under the *Income Tax Assessment Act* 1915-1918 deductions from their incomes in respect of calls paid, a new scheme was adopted and carried into effect under which, in substance, the old company sold its assets to the new companies respectively for specified sums, contributing shares were issued by each of the new companies to the shareholders of the old company, and upon those contributing shares calls were made of a sufficient amount to satisfy the purchase-money, which calls were to be paid out of the shareholders' respective interests in the assets of the old company. The payment of the calls and of the purchase-money was effected by an exchange of cheques between the liquidator of the old company and the new companies.

Held, on the facts, that a shareholder in one of the new companies was not entitled under sec. 18 (1) (*i*) of the *Income Tax Assessment Act* to a deduction in respect of calls paid :

By *Knox* C.J., on the ground that the new scheme was not a genuine transaction, but was carried out to conceal the nature of the real agreement between the parties, which was an issue to the members of the old company of fully paid-up shares in the new companies, and to enable members of the old company to escape wholly or in part from their liability to pay income tax on their true taxable income by obtaining a deduction under sec. 18 (1) (*i*) to which they were not entitled, and that the transactions on which the claim to a deduction was rested constituted an arrangement having the purpose of relieving the shareholders of the old company from liability to pay income tax which on the true facts they were liable to pay and were to that extent avoided by sec. 53 of the Act;

By *Isaacs* and *Starke* JJ., on the ground that, although the transactions which were carried out under the new scheme were genuine, to the extent that they had or purported to have the effect of relieving the shareholders from liability to income tax they fell within sec. 53 of the Act and were void.

Per Isaacs and *Starke* JJ.: A company whose main business is that of making cement and manufacturing cement goods, and which for that purpose removes limestone and shale from the earth by means of blasting and otherwise, and conveys such limestone and shale in skips to crushers whence the crushed material is transported to the cement factory by aerial transport, is not a "mining company" within the meaning of sec. 18 (1) (*i*).

Decision of *Rich* J. affirmed.

APPEAL from *Rich* J.

Charles Alfred Jaques made a return of his income for the year 1920-1921 pursuant to the *Income Tax Assessment Act* 1915-1918, in which he claimed as deductions £3,750 for calls paid to the Kandos Cement Co. Ltd. and £1,875 for calls paid to the Kandos Collieries Ltd., a total of £5,625. The Commissioner of Taxation in his assessment did not allow either deduction. Jaques objected to the assessment on the grounds that the sum of £5,625, representing calls paid to the Kandos Cement Co. Ltd. and the Kandos Collieries Ltd., was a proper deduction from the income shown in the return and should have been allowed as such. The objection was transmitted to the High Court as an appeal, and the appeal was heard by *Rich* J., in whose judgment the material facts are stated.

Brissenden K.C., *J. A. Browne* and *Harper*, for the appellant.

Innes K.C. and *E. M. Mitchell*, for the respondent.

Cur. adv. vult.

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Dec. 15, 1923.

RICH J. delivered the following written judgment:—This is an appeal under sec. 38 of the *Income Tax Assessment Act* 1915-1918. The appellant was dissatisfied with the assessment made by the Commissioner of the income tax payable by him for the financial year 1920-1921, and lodged an objection thereto under sec. 37 of the Act, stating the following reasons for his objection: (1) that the amount of tax as assessed and levied is contrary to law; (2) that the sum of £5,625 representing calls paid to Kandos Cement Co. Ltd. and Kandos Collieries Ltd. is a proper deduction from the income shown in the return and should have been allowed as such. The Commissioner disallowed the objection, which now comes before me as an appeal under sec. 37.

The real question in contest is stated in the second reason above quoted. The appellant's case is primarily rested on sec. 18, sub-sec. 1 (*i*), of the *Income Tax Assessment Act*, which is in the following terms:—"five per centum of the total amount paid in the year in which the income is derived in respect of calls on the shares of a company carrying on operations in Australia: Provided that the total amount of calls paid in the year in which the income is derived shall be deducted in the case of calls on shares in a mining company or syndicate carrying on mining operations in Australia." The appellant relies on the proviso.

The facts before me establish beyond controversy that the sum of £5,625 was paid in the year in which the income was derived as calls on shares in the Kandos Companies, which I shall assume for the purpose of this case are carrying on mining operations in Australia. On that basis the appellant is prima facie entitled to deduct the full amount of £5,625 from his total assessable income for the year in order to arrive at his taxable income.

But the Commissioner relies on sec. 53 of the Act, which is in these terms: "Every contract, agreement, or arrangement made or entered into, in writing or verbal, whether before or after the commencement of this Act, shall, so far as it has or purports to have the purpose or effect of in any way, directly or indirectly—(*a*) altering the incidence of any income tax; or (*b*) relieving any person from liability to pay any income tax or make any return; or (*c*) defeating, evading or avoiding any duty or liability imposed on any

person by this Act; or (*d*) preventing the operation of this Act in any respect; be absolutely void, but without prejudice to its validity in any other respect or for any other purpose."

A considerable amount of evidence, some oral and some documentary, has been given. The general features of the transaction upon which I have to determine this case are not seriously disputed. It is rather the legal effect of them as bearing upon sec. 53 that is in contest. They comprise a number of contracts, agreements and arrangements, beginning with two contracts between a reconstructing company and two other companies—the results of reconstruction; then two other contracts and some less formal arrangements replacing the two original contracts, and, lastly, the taking up of shares in the two new companies followed by calls made upon these shares and the payment of those calls.

The arguments of the parties were respectively directed to the question whether the transactions to which I have referred regarded in their entirety could be said to fall or not to fall within the provisions of sec. 53. As I regard the matter the real issue takes a simpler form. The question relates to the tax liability of the appellant. I do not wish to deny that the Commissioner might succeed if he had to establish that the transactions in their entirety constituted a scheme amounting in law to a "contract, agreement, or arrangement" falling within the provisions of sec. 53; as to that I decide nothing. I reduce the question to a simpler proposition. Inasmuch as the calls were paid by virtue of the appellant's own personal "contract, agreement, or arrangement" with the companies by which he became a shareholder liable to pay calls if they were made, I content myself with inquiring whether that "contract, agreement, or arrangement" falls within the section. In order to determine that question, however, it is clearly necessary to ascertain whether it had or purported to have "the purpose or effect of in any way, directly or indirectly," doing any of the things mentioned in pars. (*a*), (*b*), (*c*) or (*d*) of sec. 53. If it had, it is declared by the section to be void; and in that case the moneys so paid would not fall within the ambit of par. (*i*) of sec. 18, sub-sec. 1. In order to satisfy my mind regarding the purpose or effect of the appellant's application for shares it is necessary to see how that application

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came about. This involves an inquiry into the history of the series of transactions leading up to the application; and these I now proceed to narrate.

On 22nd May 1913 the New South Wales Cement Lime and Coal Co. Ltd. was incorporated as a limited company under the provisions of the New South Wales *Companies Act* 1899. The appellant was a director of the company, and held 3,750 fully paid-up shares in it. The company continued to carry on business as a cement and coal company until its reconstruction in 1920. In April and May of that year the directors of the company decided to submit to the shareholders resolutions for the reconstruction of the companies.

The basis of reconstruction was that two new companies should be formed, one to be called "Kandos Cement Co. Limited" with a capital of £500,000 divided into 500,000 shares of £1 each, and the other "Kandos Collieries Limited" having a capital of £225,000 shares of £1 each. The assets of the old company were to be distributed in such a way that those represented by the cement works, limestone deposits, &c., were to be transferred to Kandos Cement Co. Ltd. The consideration for such transfer was to be the sum of £400,000 to be satisfied by the allotment to the shareholders of the old company of one fully paid share in the new company of £1 for every share held in the old company. The assets represented by the old company's coal lands, collieries, &c., were to be transferred to Kandos Collieries Ltd. for the consideration of £200,000 to be satisfied by the allotment to the shareholders of the old company of 200,000 fully paid shares of £1 each. The reconstruction was to be carried out under sec. 261 of the New South Wales *Companies Act* 1899, which necessitated the voluntary liquidation of the old company.

In the meantime draft agreements for carrying out the reconstruction and memoranda of association of the new companies were prepared. On 17th May 1920 an extraordinary general meeting of the old company was held, when the following resolutions were carried unanimously:—"(1) Proposed by the chairman (Mr. L. J. Davies) and seconded by Mr. Justice Heydon, that it is desirable to reconstruct the company, and accordingly that the company be wound up voluntarily and that Charles Colin Campbell be and he is

hereby appointed liquidator for the purpose of such winding up. (2) Proposed by the chairman (Mr. L. J. Davies) and seconded by Mr. Justice Heydon, that the said liquidator be and he is hereby authorized to consent to the registration of two new companies to be named respectively 'Kandos Cement Company Limited' and 'Kandos Collieries Limited' with memoranda and articles of association which have already been prepared with the privity and approval of the directors of the present company. (3) Proposed by the chairman (Mr. L. J. Davies) and seconded by Mr. Justice Heydon, that the draft agreements submitted to this meeting and made respectively between this company and its liquidator of the one part and Kandos Cement Company Limited of the other part and this company and its liquidator of the one part and Kandos Collieries Limited of the other part be and the same are hereby approved and that the liquidator be and he is hereby authorized under sec. 261 of the *Companies Act* of 1899 to enter into agreements with such new companies when incorporated in the terms of the said draft and to carry the same into effect subject to any modifications which he may think expedient." On 1st June 1920 these resolutions were confirmed. On 22nd June 1920 the two new companies were duly incorporated.

Some time after the execution of the agreements referred to in the third resolution above mentioned, Mr. Campbell, who combined the duties of liquidator of the old company with those of secretary of the new companies, received certain advice from Mr. Johnson, one of the auditors of the three companies: "Mr. Johnson told me this matter could be arranged in another way and that way would save the Cement Company stamp duty—a large amount of stamp duty—and later on the shareholders would receive a benefit of deducting calls paid with the new company from the Federal income tax." Legal advice was then taken, with the result that two new agreements were prepared. No meeting of the old company was called, but the new agreements were placed before directors' meetings of the new companies on 25th August 1920, when the following resolution was passed:—Meeting of Directors of Kandos Cement Co. Ltd.—"The proposals relating to the altered form of the reconstruction were explained, and it was resolved that the resolutions

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passed at the meeting of directors held on 23rd June 1920 relative to the execution and filing of the agreement then produced be rescinded, and that the agreement now submitted be approved and the same be duly executed and the seal of the company affixed thereto, having been previously sealed by the New South Wales Cement Lime and Coal Co. Ltd. by its liquidator and signed and sealed by him as liquidator." Meeting of Directors of Kandos Collieries Ltd.—" The proposals relating to the altered forms of the reconstruction were explained, and it was resolved that the resolutions passed at the meeting of the directors held on 23rd June relative to the execution and filing of the agreement then produced be rescinded, and that the agreement now submitted be approved and the same be duly executed and the seal of the company affixed thereto, which was accordingly done, having been previously sealed by the New South Wales Cement Lime and Coal Co. Ltd. by its liquidator and signed and sealed by him as liquidator."

At this meeting " the explanation " of Mr. Oakden, the general manager, was that by making an agreement for the sale of the company's assets a large amount of stamp duty would be saved, and by making the sale by verbal arrangement for the balance it would enable the shareholders of the new company to take advantage of the clause in the income tax form to deduct any " calls paid." " They could deduct what calls were paid by them, and would be able to claim as a deduction the whole of their capital in the old company."

The agreements of 25th August 1920 were then executed. The main difference between these agreements and the original agreements is that, instead of a sale of the assets of the old company to the new companies for fully paid shares in these companies, representing the whole of the consideration for the sales, there is substituted an arrangement by which the " immovable " property of the old company representing the cement proposition is sold to Kandos Cement Co. Ltd. for £135,723, and similar property representing the coal proposition is sold to Kandos Collieries Ltd. for £90,375. In entering into these new contracts the liquidator of the old company interpreted very liberally, to say the least of it, the power of modification given him by the third resolution of 17th May. There

were, however, in fact, no dissentients from the substituted arrangement, and its validity under sec. 261 of the *Companies Act* is not relevant to the present inquiry.

After the execution of the new agreements formal transfers were made of the property referred to in the agreements. The next step taken in the reconstruction scheme was a letter dated 8th September signed by Mr. Campbell, purporting to act as liquidator of the old company, addressed to the shareholders in the old company. As this document and the authority signed by the appellant are, in the view I take of the case, the crux of the matter I set them out in full:—"Perpetual Trustee Chambers, 33-39 Hunter Street, Sydney.—8th Sept. 1920.—Dear Sir or Madam,—New South Wales Cement Lime & Coal Co. Ltd.—Reconstruction.—Herewith form of authority, which kindly sign and return to me at your earliest convenience. This request is rendered necessary owing to some slight modification in the method of carrying through the reconstruction agreement having been decided upon. On receipt by me of authorities from all the shareholders of the above-named company, I will be in a position to obtain for you your proper quota of shares in both Kandos Cement Co. Ltd. and Kandos Collieries Ltd. as under:— Shares in Kandos Collieries Ltd. of £1 each paid up in full. Shares in Kandos Cement Co. Ltd. of £1 each paid up in full. Shares in Kandos Cement Co. Ltd. of £1 each paid up to 2s. Your liability of 18s. per share of these last-mentioned shares I will satisfy when I receive from you the sum of £ representing the call on your contributing shares in the New South Wales Cement Lime and Coal Co. Ltd., which falls due on the 24th day of April 1921. Should you desire, you may pay this call at any time prior to the due date, in which event these shares in Kandos Cement Co. Ltd. will thereupon be paid in full and rank for dividend accordingly. In order that there may be no undue delay in distributing the shares in the two new companies I am asking all shareholders to return forms of authority immediately. Should you desire the whole or part of your quota of paid-up shares in the new companies to be issued in names other than your own, kindly supply me with the particulars.—Yours faithfully, C. C. Campbell, Liquidator." "To

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the Liquidator, New South Wales Cement Lime and Coal Co. Ltd., Sydney.—Dear Sir,—I hereby direct you to lodge application for me in Kandos Cement Co. Ltd. for 3,750 shares and in Kandos Collieries Ltd. for 1,875 shares, and I direct you to retain and utilize the moneys to which I am entitled as a shareholder in New South Wales Cement Lime and Coal Co. Ltd. upon the distribution of the assets thereof in satisfying any calls made upon the shares so applied for.—Yours faithfully, C. A. Jaques." In passing, it will be noticed that this document does not indicate in any way that the shareholders were entitled to receive in cash their respective proportions of the consideration money paid to the old company. Mr. Campbell as liquidator had no duty imposed or power conferred on him to apply for shares in this way, and in so doing he was acting altogether outside his office as liquidator.

On 19th October 1920, Mr. Campbell applied to the directors of the new companies for allotment of a certain number of shares to the persons named in the lists accompanying the applications. In this document it is not expressed that Mr. Campbell is acting as liquidator. The appellant's name was included in the lists for 3,750 shares in Kandos Cement Co. Ltd. and 1,875 shares in Kandos Collieries Ltd.

Then, on 20th October 1920, the directors of Kandos Cement Co. resolved to issue at par 399,993 £1 shares of the authorized and unissued capital of the company. The "liquidator," who was also acting at the meeting in his capacity of secretary, thereupon handed in an application for 293,909 shares, which was considered, and these shares were allotted to (among others) the appellant. The secretary was directed to give notice of the allotment and also to inform allottees of certain numbered shares, including the appellant, that a call of £1 per share would forthwith be made on such shares. The directors also resolved to acquire certain assets of the old company, as specified in the schedule handed in by the liquidator, at the price fixed by him. These assets comprised those not included in the agreement of 25th August 1920 with Kandos Cement Co. Ltd., and consisted of the assets which would pass by delivery. The price had been arrived at by the liquidator of the old company and the general manager of the new company by deducting £135,723, the

amount fixed for the property in that agreement, from the paid-up capital of the company. The sum of the two amounts, £360,913 6s., was the amount payable by Kandos Cement Co. to the liquidator for all assets transferred to that company. The directors further resolved that, as Kandos Cement Co. Ltd. was already in possession of all the assets, the company should pay forthwith to the liquidator a cheque for the amount of the total consideration agreed upon. On 3rd November 1920 similar resolutions were passed by the directors of Kandos Colliery Co. Ltd., and the liquidator and the general manager went through a similar process of fixing the price for the assets not included in the agreement of 25th August with Kandos Collieries Ltd., the total consideration amounting to £200,000.

The appellant thus became the allottee of 3,750 contributing shares, numbered 57686 to 61435, in Kandos Cement Co. Ltd. and of 1,875 contributing shares numbered 36001 to 37875 in Kandos Collieries Ltd. On the same date both companies made calls on the appellant, amongst others. On 3rd November 1920 Mr. Campbell notified the shareholders of Kandos Cement Co. Ltd. of the allotment of the shares and of the call, and stated " which call I will now pay in accordance with your instructions." On 12th November 1920 he gives a similar notice and makes a similar statement to the shareholders of Kandos Colliery Co. Ltd. On 6th December 1920 Kandos Cement Co. Ltd. and Kandos Collieries Ltd. drew cheques for the sums of £360,913 6s. and £200,000 respectively, and handed them to Mr. Campbell as liquidator in payment for the assets transferred. On 16th December 1920 he as liquidator drew cheques for the same amounts (less a small sum for exchange) in payment of calls made or anticipated. On that date Campbell deposited both sets of cheques at the bank—the first set to the credit of the old company and the second set to the credit of the new companies. The payment for the assets and of the calls was effected by an exchange of cheques, which resulted only in cross-entries in the bank accounts of the three companies.

I have now reached the point when it is possible to assess the situation of the appellant relatively to the call made upon him by the new companies. The complicated series of events which I have narrated was deliberately entered upon for the purpose of

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culminating, and did in fact culminate, in an obligation to pay the calls by reason of which the deduction is claimed. In my opinion, the Legislature has permitted the deduction where it is the legitimate result of a call arising from the ordinary situation of a shareholder in a mining company. But sec. 53, in my opinion, also excludes a deduction which is not the result but the animating purpose of a call deliberately incurred, as this was, for the purpose of the deduction. I may state at once that, although very able arguments on both sides were addressed to me touching the reality or unreality of the transactions I have to investigate, and as to whether they did or did not amount to an evasion of the income tax legislation, I do not propose as to those arguments to say more than this :—Numerous judicial decisions have dealt with the subject of sham transactions and transactions said to be " evasions " of the law. There is always great difficulty in determining in any particular case whether a transaction is a lawful or unlawful " evasion " of a statute. I apprehend that the Commonwealth Parliament, in passing sec. 53, recognized the difficulties I have referred to and determined to get away from them. It laid down its own test of avoidance for its own purposes. Therefore, what I have to do is not to consider the question of " evasion " by the light of the standard authorities on that subject. Nor do I see on the facts before me how I can treat what has been done as an unreality. Sec. 53 regards the " contract, agreement, or arrangement " as possibly a very real one, but attaches consequences to the purpose or effect. It is on this basis that I am proceeding.

If I assume, as I do for the purposes of this judgment, that the series of transactions, down to and including the later contractual and other relations between the old company and the new companies, stands in full validity and unimpeachable either under sec. 53 or otherwise, what was then the personal situation of the appellant ? As a shareholder in the old company he would have been entitled to his proportionate share of the money payable by the new companies to the old company as consideration for the assets transferred. That proportionate share would have amounted to £5,625. Had he so received it, he would have been liable in the ordinary way to pay income tax, not on that sum, but on his general

income. Then, as a purely personal arrangement unconnected in law but very closely connected in fact with what had gone before —to all of which he had been an active party—the appellant authorized Campbell as his agent to apply for shares in the new companies, and to pay over, also as his agent, to the new companies for calls which it was arranged should be made, the share of the old company's assets which Campbell as liquidator held for the appellant. This application for shares and appropriation of assets are legally separate from and independent of the preceding arrangements, which stand, so to speak, as preparation for it. They were admittedly made for the very purpose of creating the deduction now sought.

I am of opinion that the appellant's contract or agreement with the new companies to take the shares plus the arrangement to make the call amounted, in the circumstances, to a " contract, agreement, or arrangement " for one or more of the purposes or effects mentioned in sec. 53.

I therefore disallow the deduction, and dismiss the appeal with costs.

From that decision Jaques now appealed to the Full Court.

Brissenden K.C. (with him *Harper*), for the appellant. The new agreement under which the calls were made is not hit by sec. 53 of the *Income Tax Assessment Act*. The parties to an agreement which has been entered into may lawfully cancel the agreement and carry out its object in another way. As long as there is a real transaction the motive which brought it about is not material for the purpose of sec. 53 (*Yorkshire Railway Wagon Co.* v. *Maclure* (1)). Sec. 53 is intended to hit only agreements which are for the purpose of evading tax which is already due. There must be in the transaction impeached something concealed or colourable (see *Purcell* v. *Deputy Federal Commissioner of Taxation* (2); *Waterhouse* v. *Deputy Federal Commissioner of Land Tax (S.A.)* (3)). In this case the proper inference is that there was a call validly made and validly

(1) (1882) 21 Ch. D. 309, at p. 318.
(2) (1920) 28 C.L.R. 77.
(3) (1914) 17 C.L.R. 665, at p. 673.

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paid, and the transaction was a real one (*Salomon* v. *A. Salomon & Co.* (1); *Gramophone and Typewriter Ltd.* v. *Stanley* (2); *South Brisbane Gas and Light Co.* v. *Hughes* (3)).

[KNOX C.J. referred to *Daimler Co.* v. *Continental Tyre and Rubber Co. (Great Britain)* (4).]

There was a valid legal call enforceable by the new companies, and it was not rendered invalid by any want of authority on the part of the liquidator in what he did. The shareholders, in applying for shares, validated what he had done. All the shareholders having concurred in what was done, it cannot be said by anyone that the new arrangement was not merely a modification of the old agreement. Sec. 53 of the *Income Tax Assessment Act* is intended to deal only with what are known as schemes or devices for evading taxation. If the transaction is genuine, it does not fall within the section, and the motive for entering into the transaction is immaterial (see *Simms* v. *Registrar of Probates* (5); *Attorney-General* v. *Duke of Richmond, Gordon and Lennox* (6)).

[KNOX C.J. referred to *Commissioner of Stamp Duties* v. *Byrnes* (7).]

Innes K.C. and *E. M. Mitchell*, for the respondent. The transaction under which the calls were made falls within sec. 53 of the *Income Tax Assessment Act*. It was not a mere modification of the original transaction (*Mercantile Investment and General Trust Co.* v. *International Co. of Mexico* (8); *Northern Assurance Co.* v. *Farnham United Breweries Ltd.* (9)). The same result was brought about as the original transaction would have achieved, and the new transaction was a mode of carrying out the original agreement devised for a purpose which is illegal under sec. 53. There was an evasion, and not an avoidance, of taxation (*Bullivant* v. *Attorney-General for Victoria* (10)). The Kandos Cement Co. is not a mining company within the meaning of sec. 18 (1) (*i*). On the evidence the manufacture of cement is the predominant operation and the

(1) (1897) A.C. 22, at pp. 37, 49.
(2) (1908) 2 K.B. 89.
(3) (1917) 23 C.L.R. 396.
(4) (1916) 2 A.C. 307.
(5) (1900) A.C. 323.
(6) (1908) 2 K.B. 729; (1909) A.C. 466.
(7) (1911) A.C. 386.
(8) (1893) 1 Ch. 484 (note 2), at p. 490.
(9) (1912) 2 Ch. 125.
(10) (1901) A.C. 196, at p. 207.

obtaining of the limestone from the earth is a minor operation, and the limestone is obtained by quarrying and not by blasting (see *Rugby Portland Cement Co.* v. *London and North-Western Railway Co.* (1)). The case is governed by *Australian Slate Quarries Ltd.* v. *Federal Commissioner of Taxation* (2).

Brissenden K.C., in reply. The parties were at liberty to use all lawful means to escape taxation (*Inland Revenue Commissioners* v. *Blott* (3)), and the means they have used are lawful. The Kandos Cement Co. is a mining company under the decision in *Australian Slate Quarries Ltd.* v. *Federal Commissioner of Taxation* (2). Whatever proportion the cost of obtaining the limestone bears to the total cost of the manufactured cement, the company carries on very large mining operations, which are a substantial business of the company. [Counsel also referred to *Great Western Railway Co.* v. *Carpalla United China Clay Co.* (4).]

Cur. adv. vult.

June 10, 1924.

The following written judgments were delivered :—

KNOX C.J. The appellant, in his return of income tax for the year ending 30th June 1921, claimed deductions of £3,750 and £1,875 in respect of calls paid on shares in the Kandos Cement Co. Ltd. and Kandos Collieries Ltd. The deductions so claimed having been disallowed, an appeal was brought to this Court under sec. 38 of the *Income Tax Assessment Act* 1915-1918. My brother *Rich* dismissed the appeal, and it is against his order that the present appeal is brought.

The appellant, in order to succeed, must establish that during the year 1st July 1920 till 30th June 1921 he paid the sums he claims to deduct in respect of calls on shares in mining companies carrying on mining operations in Australia (*Income Tax Assessment Act* 1915-1918, sec. 18 (1) (*i*)). In the view which I take of the case it is unnecessary to decide whether the companies—the Kandos Cement Co. Ltd. and the Kandos Collieries Ltd.—to which the payments

(1) (1908) 2 K.B. 606.
(2) (1923) 33 C.L.R. 416.
(3) (1921) 2 A.C. 171, at p. 184.
(4) (1909) 1 Ch. 218, at p. 231.

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are alleged to have been made were mining companies carrying on mining operations in Australia, and I assume in the appellant's favour that they were.

The facts are not in dispute. The appellant was at all material times a shareholder in and a director of the New South Wales Cement Lime and Coal Co. Ltd. (hereinafter called the old company), and on 31st May 1920 his holding in that company consisted of 3,750 shares fully paid up. On 5th May the directors resolved that an extraordinary meeting of shareholders should be called to consider proposals for the reconstruction of the old company, and notice was accordingly given that a meeting would be held on 17th May 1920 for the purpose of considering the following resolutions, namely :— "(1) That it is desirable to reconstruct the company and accordingly that the company be wound up voluntarily and that Charles Colin Campbell be and he is hereby appointed liquidator for the purpose of such winding up. (2) That the said liquidator be and he is hereby authorized to consent to the registration of two new companies to be named respectively 'Kandos Cement Company Limited' and 'Kandos Collieries Limited' with memoranda and articles of association which have already been prepared with the privity and approval of the directors of the present company. (3) That the draft agreements submitted to this meeting and made respectively between this company and its liquidator of the one part and Kandos Cement Company Ltd. of the other part and this company and its liquidator of the one part and Kandos Collieries Ltd. of the other part be and the same are hereby approved and that the liquidator be and he is hereby authorized under sec. 261 of the *Companies Act* of 1899 to enter into agreements with such new companies when incorporated in the terms of the said draft and to carry the same into effect subject to any modifications which he may think expedient."

The notice was accompanied by an explanatory letter, the material parts of which are as follows, namely :—"The basis on which the company is to be reconstructed is as follows :—(a) Two new companies to be formed, one to be named 'Kandos Cement Company Limited' and one to be named 'Kandos Collieries Limited'; (b) Kandos Cement Co. Ltd. to have a capital of £500,000 divided into 500,000

shares of £1 each; (c) the objects of the Kandos Cement Co. Ltd. to include the objects of the present company and such additional objects and powers as may be considered expedient; (d) part of this company's assets, namely, its cement works, limestone deposits, rope-way, water supply, unsold freehold land, book debts, including balances due on sold land and uncalled capital, and also its liabilities, to be transferred to Kandos Cement Co. Ltd.; (e) the consideration payable to this company by Kandos Cement Co. Ltd. to be the sum of £400,000, such consideration to be satisfied by allotment to the shareholders of this company of one fully paid share in the new company of £1 each for every share now held in *this company* on terms which are fully set out in the reconstruction agreement which will be read at the meeting; (f) Kandos Collieries Ltd. to have a capital of £225,000 divided into 225,000 shares of £1 each; (g) the principal object of Kandos Collieries Ltd. to be the acquisition of *this company's* coal lands, collieries, colliery plant, equipment, coal railways sidings, and also its holding of fully paid shares in the Newcastle Slag Cement Co. Ltd. and West Australian Portland Cement Co. Ltd.; (h) the consideration payable to be the sum of £200,000 to be satisfied by allotment to the present shareholders of *this company* of 200,000 fully paid 'A' shares of £1 each on terms which are fully set out in the reconstruction agreement above referred to (par. (e)); (i) Kandos Cement Co. Ltd. will acquire for cash 1,000 paid-up 'B' shares of £1 each; (j) the 1,000 'B' shares in Kandos Collieries Ltd. will carry special voting rights so as to assure the permanent control of the coal company being vested in the new cement company; (k) the reconstruction to be carried out under sec. 261 of the *Companies Act* of 1899, and accordingly the existing company to go into voluntary liquidation and to authorize the liquidator to carry out the reconstruction immediately so that there may be no interruption of the business.—The general effect of the carrying through of these proposals will be to provide the shareholders in *this company* with share for share in Kandos Cement Co. Ltd. and one free share in Kandos Collieries Ltd. for every two shares held in *this company*. It is contemplated that Kandos Cement Co. Ltd. will shortly after incorporation offer 100,000 shares (contributing) at par to the shareholders of this company in such

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manner as to equitably protect the interests of its fully paid and contributing shareholders. At the above-mentioned meeting the resolutions necessary for carrying out the reconstruction will be proposed."

At this time 330,521 of the shares in the old company were fully paid up, but on the remaining 69,479 shares only 2s. had been paid, and, in order to facilitate the distribution among shareholders in the old company of fully paid-up shares in the new companies, the directors of the old company, on 14th May 1920, made a call of 18s. per share on those shares. At the meeting of 17th May 1920 the resolutions of which notice had been given were carried without amendment, and at a meeting held on 1st June 1920 they were duly confirmed.

The provisions of the agreement with the Cement Company referred to in the resolutions were substantially as follows, namely :—After reciting that the resolutions had been duly passed and confirmed it was provided that the old company should transfer and the new company take over the old company's cement business and undertaking and the goodwill thereof and certain specified assets, being substantially all the assets connected with the cement business, except such as the liquidator should select to be applied in payment to the members of the old company of a dividend for the period between 1st January 1920 and 31st May 1920. The consideration for the transfer was stated to be (a) an undertaking by the new company to pay and perform the liabilities of the old company, (b) an indemnity against such liabilities and against the costs of the liquidation and transfer, (c) the allotment to the liquidator, or as he should direct, of (1) one fully paid-up share in the new company for each fully paid-up share in the old company, (2) one fully paid-up share in the new company for every ten contributing shares in the old company, and (3) fully paid-up shares in the new company to the amount of the calls paid by holders of the contributing shares in the old company in compliance with the resolution of 14th May 1920.

The agreement with the Collieries Company was that the old company should transfer and the Collieries Company take over the old company's coal business and the goodwill thereof and certain

specified assets being substantially all the assets connected with the coal business and certain shares in other companies. The consideration for the sale was expressed to be the issue to the liquidator, or as he should direct, of 200,000 fully paid-up shares in the Collieries Company to be distributed among the members of the old company in the proportion of one share in the new company for every two shares held by them respectively in the old company. It was further agreed that on payment of £1,000 to the Collieries Company by the Cement Company the Collieries Company should issue to the Cement Company 1,000 fully paid management shares in the capital of the Collieries Company.

Each agreement contained provisions that the directors of the old company should be directors of the new company, and that the new company should cause some sufficient agreement to be filed pursuant to sec. 55 of the *Companies Act* of 1906 prior to the allotment of the fully paid-up shares. No money was to pass between the old company or its members and the new companies. On 22nd June 1920 the new companies were incorporated. The memorandum of association of each company stated that one of its objects was to acquire and take over the appropriate portion of the business and assets of the old company, and for that purpose to enter into the agreement above referred to and to carry the same into effect with or without modifications. The precise date at which the new companies went into possession of the business and assets of the old company is not stated; but the evidence shows that the new companies, when incorporated, opened banking accounts, and that they received the profits of the business from 1st June 1920, a dividend being paid by each of the new companies out of the profits of its business for the period from 1st June 1920 to 31st December 1920. I infer from the facts proved that the new companies obtained possession of the assets of the old company on or shortly after the date of their incorporation, and that thereafter the old company ceased to carry on business and the new companies carried on the respective portions of the business of the old company which they had respectively acquired. On 23rd June 1920 a meeting of the directors of the Cement Company was held at which the following resolution was carried, namely: "The agreement mentioned in the

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resolutions passed by the New South Wales Cement Lime and Coal Co. Ltd. on the 17th day of May 1920 and confirmed by that company on the 1st day of June 1920 and which agreement is made between that company and its liquidator of the one part and Kandos Cement Co. Ltd. of the other part was taken into consideration and it was resolved that the same be executed by this company, whereupon it was duly signed and sealed with the seal of the company, having been previously sealed by the New South Wales Cement Lime and Coal Co. Ltd. by its liquidator and signed and sealed by him as liquidator." It was further resolved "that the solicitors be instructed to forthwith stamp and file such agreement with the Registrar of Joint Stock Companies, and that they notify the secretary when this has been done so that a meeting of the Board may be held at which the fully paid-up shares mentioned in the agreement may be allotted." On the same day a meeting of the directors of the Collieries Company was held, at which a resolution in similar terms was carried. The agreements were duly executed by the new companies on 23rd June as stated in these resolutions.

At this point the position is clear. Binding agreements existed between the old company and each of the new companies which, if carried out, would result in (a) the acquisition by the new companies of the whole of the business, undertaking and assets of the old company with the exception of certain specified assets, (*b*) the assumption by the Cement Company of all the liabilities and obligations of the old company, (c) the allotment to the holder of each fully paid share in the old company of one fully paid share in the Cement Company, (d) the allotment to the holders of fully paid shares in the old company of one fully paid share in the Collieries Company for every two fully paid shares in the old company. So far as the members of the old company were concerned, no payment whatever was to be made by any member either to the old company or to the new companies except the amount of the call payable to the old company in accordance with the resolution of 14th May 1920, and except to the extent of payments made in respect of this call no member of the old company would be entitled to any exemption under sec. 18 (1) (*i*) of the *Income Tax Assessment Act* in respect of calls paid to the old company or in respect of any payment

to either of the new companies on the shares agreed to be issued by them respectively, there being in fact no liability to make any such payment.

Before proceeding to consider in detail subsequent events, I may observe that, subject to the contention that the effect of the later transactions has been to relieve the members of the old company wholly or in part from liability to income tax, the old company and its members and the new companies occupied, after these transactions had been completed, precisely the positions they would have had if the agreements of 23rd June had been carried into effect in the ordinary course. The old company had parted with its business and assets, which had been acquired by the new companies, and the members of the old company held shares, said to be fully paid up, in the new companies in the agreed proportions.

After the execution of the agreements of 23rd June, nothing remained to be done except the transfer to the new companies respectively of such portions of the assets of the old company as did not pass by delivery, the filing of the agreements with the Registrar of Joint Stock Companies, the payment of the call made on the contributing shares in the old company, and the allotment of shares in the new companies respectively to the liquidator of the old company or to its members as his nominees in accordance with the agreements. But before any further steps were taken to carry the agreements into effect, it was suggested by the auditor of all the companies concerned that a scheme could be arranged which, without interfering with the ultimate results which it was sought to bring about, would make it appear that the transaction between the companies involved the acceptance by the members of the old company of contributing instead of fully paid-up shares in the new companies and the payment by them of calls to the extent of the face value of the shares allotted to them respectively. He told the liquidator of the old company, who was also secretary of the new companies, the matter could be arranged in another way, which would save the Cement Company stamp duty and enable the shareholders to receive a dividend by deducting calls paid to the new companies from the Federal income tax. The suggestion was in due course communicated by the general manager to a meeting

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of directors of each of the new companies held on 25th August 1920, and at each meeting the following resolution was carried, namely: "The proposals relating to the altered forms of the reconstruction were explained, and it was resolved that the resolutions passed at the meeting of the directors held on 23rd June relative to the execution and filing of the agreement then produced be rescinded, and that the agreement now submitted be approved and the same be duly executed and the seal of the company affixed thereto, which was accordingly done, having been previously sealed by the New South Wales Cement Lime and Coal Co. Ltd. by its liquidator and signed and sealed by him as liquidator." It may be noted that the proposals were said to relate to the altered *form of the reconstruction*—a recognition that the reconstruction was still existent. The agreement of 23rd June 1920 having in fact been duly executed in pursuance of the resolution of that date, it is difficult to attribute any effect to the purported rescission of that resolution so far as it authorized the execution of that agreement. The resolution itself states that the agreement was duly signed and sealed with the seal of the company; and no rescission of the resolution could get rid of the fact of execution. The later resolution did not purport expressly to rescind the agreement of 23rd June, and apparently its only effect was to cancel the authority previously given for the filing of that agreement. In pursuance of this resolution new agreements were on the same day executed by the old company and the liquidator of the one part and the new companies respectively of the other part. The form and contents of each agreement are significant as indicating an intention to conceal the real nature of the transaction initiated by the resolution of 17th May and the agreements of 23rd June 1920. The recital that by the articles of association it was provided that the company should forthwith enter into that agreement (i.e., the agreement of 25th August) is untrue in fact. The articles clearly referred to the agreements of 23rd June. The recital of the resolutions omits the whole of clause 3 approving of the draft agreement which was executed on 23rd June. This omission is the more significant because the resolution omitted authorized the liquidator *under sec.* 261 *of the Companies Act* 1899 to enter into agreements with the new companies when incorporated,

thus clearly indicating, as the fact was, that the object of the resolution was to enable a sale to be made by the liquidator in consideration of allotment of shares in the new companies. The recital of clause 1 of the resolutions omits the words "that it is desirable to reconstruct the old company and accordingly." The effect of these omissions is to make it appear that there was no question of reconstruction, that the old company had simply gone into liquidation, and that the liquidator was proceeding to sell certain specified assets of the old company for cash. This impression is confirmed by the omission of any reference to the business or undertaking or goodwill of the old company as being included in the assets sold. The agreement with the Cement Company provides, by clause 7, that the new company should collect on behalf of the old company and its liquidator and at his direction such of the book debts, &c., of the old company as might be sufficient to satisfy the liabilities of the old company including the costs of liquidation, and that the sum so collected should be applied by the liquidator in discharge of such liabilities and costs. The natural inference from this clause is that the book debts, &c., of the old company were not included in the assets agreed to be sold to the new company, whereas in fact they were specifically included in the assets to be transferred and taken over under the agreement of 23rd June, and it appears from the evidence that in the result they were taken over by the new company and that the new company also took over the liabilities of the old company. On its face each agreement purports to be an unconditional agreement for the sale of certain specified assets of the old company in consideration of a cash payment by the new company, and contains no indication that that was not the whole agreement between the parties. Neither agreement refers expressly or by implication to the fact that an agreement between the same parties for the sale of (*inter alia*) all the assets included in the later agreement had been executed some months before.

These new agreements having been executed on 25th August, the liquidator on 8th September sent to each shareholder in the old company a circular letter the material portion of which is as follows :— "Herewith form of authority, which kindly sign and return to me at your earliest convenience. This request is rendered necessary

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owing to some slight modifications in the method of carrying through the reconstruction agreement having been decided upon. On receipt by me of authorities from all the shareholders of the above-named company, I will be in a position to obtain for you your proper quota of shares in both Kandos Cement Co. Ltd. and Kandos Collieries Ltd. as under :— Shares in Kandos Collieries Ltd. of £1 each paid up in full. Shares in Kandos Cement Co. Ltd. of £1 each paid up in full. Shares in Kandos Cement Co. Ltd. of £1 each paid up to 2s. Your liability of 18s. per share on these last-mentioned shares I will satisfy when I receive from you the sum of £ representing the call on your contributing shares in the New South Wales Cement Lime and Coal Co. Ltd., which falls due on the 24th day of April 1921. Should you desire, you may pay this call at any time prior to the due date, in which event these shares in Kandos Cement Co. Ltd. will thereupon be paid up in full and rank for dividend accordingly." The authority enclosed is in the words following, namely :—" To the Liquidator, New South Wales Cement Lime and Coal Co. Ltd., Sydney.—Dear Sir,—I hereby direct you to lodge application for me in Kandos Cement Co. Ltd. for 3,750 shares and in Kandos Collieries Ltd. for 1,875 shares, and I direct you to retain and utilize the moneys to which I am entitled as a shareholder in New South Wales Cement Lime and Coal Co. Ltd. upon the distribution of the assets thereof in satisfying any calls made upon the shares so applied for." The first paragraph of this circular shows clearly that the liquidator regarded, or professed to regard, "*the reconstruction agreement*"—an expression which could only be read by the shareholders as referring to the agreement of June 1920, the drafts of which had been submitted to the general meeting held in May—as an existing agreement which was to be carried into effect with "some slight modifications." The circular contained no hint or suggestion that the original agreement had been rescinded or superseded by the agreement entered into in August, or that any such agreement existed. It is significant that all reference to the real objects of the so-called modifications in the method of carrying out the agreement is discreetly omitted. The circular itself does not suggest that the member will, by signing the authority, incur a pecuniary liability

to the extent of the face value of the shares applied for—though it is true that the enclosed authority would probably indicate to the member that calls might be made on the shares applied for and that, if such calls were made, they would be satisfied out of moneys in or coming into the hands of the liquidator on his behalf. It must have been news to the members who were acquainted with the details of the scheme of reconstruction which had been submitted to them that any such moneys would be available. Presumably an authority in this form was signed by each member of the old company.

On 13th October 1920 a meeting of the directors of the Cement Company was held, at which, according to the minutes of the meeting, the Board was asked to consider the acquisition of certain of the assets of the old company, other than the assets contained in the agreement of 25th August, at a price which was discussed with the liquidator; and after a general discussion the matter was deferred. It is difficult to understand why the acquisition of assets of the old company should have been discussed at a time when the new company had been in possession of the assets and business of the old company for some months, and in view of the fact that such assets were covered by the agreement of 23rd June, which the liquidator apparently regarded as still in force; and still more difficult, in view of the evidence which will be referred to later, to take seriously the statement that the price of these assets was discussed with the liquidator.

On 19th October 1920 the liquidator lodged applications with the Cement Company for the allotment of 293,909 shares among the persons named in the lists attached, and in the proportions therein set out. In these lists 247,460 shares were described as 20s. shares and 46,443 as 2s. shares. The persons named in the list were members of the old company, and the number of shares of each class set opposite their names appear to have been the same as the number of shares of the same class held by them in the old company. On 20th October 1920 a meeting of directors of the Cement Company was held at which, according to the minutes :—" It was unanimously resolved that certain of the assets of the New South Wales Cement Lime and Coal Co. Ltd. (in liquidation) as specified in the schedule

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handed in by the liquidator of that company be acquired at the price fixed by such liquidator. It was unanimously resolved that as the company is already in possession of such assets and also of the assets sold to it by the liquidator by agreement dated 25th of August that the company pay forthwith to the liquidator a cheque for the amount of the total purchase consideration agreed upon. It was unanimously resolved that in accordance with the arrangement come to with the liquidator the company accepts the responsibility for and undertakes to pay and satisfy the liabilities of the old company. It was unanimously resolved that the company forthwith issue at par 399,993 shares of the authorized and unissued capital of £500,000 in £1 shares. The liquidator thereupon handed in an application for 293,909 shares. The application was then considered and it was resolved that 293,909 shares in the capital of the company of £1 be allotted as follows :—" (List of shareholders) " and that the secretary do give notice of such allotment to the above-named persons accordingly and that the allottees of shares numbered 8 to 247466 be informed that a call of £1 per share will forthwith be made on such shares and that the allottees of shares numbered 353344 to 400000 be informed that a call of 2s. per share will be forthwith made on these shares." The statement that the price of the assets specified in the schedule was fixed by the liquidator, if not untrue, is certainly calculated to mislead. The evidence shows that no attempt was made to ascertain the value of these assets, and that the " price was fixed' by calculating the amount which, when added to the £135,723 mentioned in the agreement of 25th August, would, after allowing for certain necessary adjustments, make the amount payable by the Cement Company exactly equal to the amount appearing to be paid upon the shares to be issued by that company to the members of the old company. The admission that the Cement Company was already in possession of the assets which the meeting resolved to acquire naturally suggests an inquiry how such assets came into their possession. The only agreement prior to this date which dealt with these assets was the agreement of 23rd June 1920, and the natural inference is that the Cement Company was put in possession of these assets under that agreement. Otherwise, so far as appears, it had no right whatever to be in possession of them. On 3rd

November 1920 a meeting of the directors of the Cement Company was held, at which it was resolved that a call of £1 per share be made on the shares numbered 1 to 247466, and a call of 2s. per share on the shares numbered 353344 to 399786, and that such call should be payable forthwith. The total amount of these calls was £252,110 6s. On 3rd November notice of these calls was sent to the applicants for the shares in question, together with notice of allotment of the shares which they had authorized the liquidator to apply for in their names, and they were informed that the liquidator would "now pay the call in accordance with" their instructions.

At a meeting of the directors of the Cement Company held on 17th November 1920, the liquidator handed in further applications for 106,097 shares, which were allotted, completing the issue of 400,000 shares. These shares also were allotted to members of the old company in numbers corresponding with the shares held by them in the old company. No call was made on these shares until 27th January 1921, when a meeting of directors of the Cement Company was held at which it was resolved that a call of £1 per share be made on shares numbered 247467 to 353343 and of 2s. per share on shares numbered 399787 to 400000 (amounting in all to £106,118 8s.) payable forthwith. These are the numbers of the shares allotted on 17th November 1920, and, according to the case now made by the appellant, the full amount payable on these shares, 20s. or 2s. as the case might be, is to be taken to have been paid by the transactions of 16th December 1920 which will be referred to hereafter. The fact that a call was solemnly made in respect of these shares more than a month after the holders of them had, according to the case now made by the appellant, paid the full amount payable on them throws some light on the true nature of the whole series of transactions which began with the resolution of 25th August.

A similar course of procedure to that adopted by the Cement Company was followed by the Collieries Company. I do not propose to deal in detail with the steps taken in connection with the allotment of the shares in that company, but one matter calls for comment as showing the want of reality in the transaction. On 12th November 1920 the liquidator by circular letter informed each member of the

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old company of the allotment to him of the appropriate number of shares in the Collieries Company, and added that a call of £1 per share had been made on the shares so allotted, which call the liquidator would "now pay in accordance with your instructions." The fact is that no call was made on any of the shares in the Collieries Company until 1st December 1920, some weeks after the announcement by the liquidator that a call had been made and that he would pay it.

All the preliminary steps having been taken, it remained only to go through a form by which it should be made to appear that the calls on the shares in the Cement Company and the Collieries Company had been paid by the allottees. The method adopted was as follows:—On 6th December 1920 the liquidator drew two cheques on the Bank of New South Wales, Sydney, one for £360,911 18s. 6d. in favour of the Kandos Cement Company and the other for £200,000 in favour of the Kandos Collieries Ltd. On the same day in his capacity of secretary of the Cement Company he obtained from the directors of that company a cheque on the same bank for £360,913 6s. in favour of the old company, and as secretary of the Collieries Company obtained from the directors of that company a cheque for £200,000 in favour of the old company. On 16th December he attended at the bank with these cheques and paid them in to the respective accounts of the payees named at the same moment, and in due course debit and credit entries were made in the respective accounts in the books of the bank. The evidence shows that no arrangement had been made with the bank for payment of any of these cheques, and it is not suggested that any of them would have been met if presented in the ordinary course unaccompanied by the cheque which enabled a cross-entry to be made. In my opinion it is clear that the cheques were drawn and passed through the bank accounts for the sole purpose of giving an appearance of reality to the transaction. In truth, from first to last there was no intention that the new companies should make any real payment to the old company or its liquidator or that the liquidator or the members of the old company should make any real payment to the new companies. What was done appears to have been done for the purpose of creating entries in the books of the bank which might be

used as evidence that, in law, the transactions amounted to payment of money to and by the liquidator. Whether the transaction, such as it was, would be held to amount to payment in cash within the meaning of the *Companies Act* 1899 is a question which does not now arise.

In my opinion the appellant has failed to establish that either the alleged sale for cash to the new companies or the alleged payments by and to those companies were genuine bona fide transactions intended to create real rights and obligations. I think the proper conclusion to be drawn from the facts to which I have referred is that the transactions which began with the resolution of 25th August 1920 and ended with the belated resolution of 27th January 1921 were in no sense real genuine transactions, but were devised and carried out in order to conceal the true nature of the real agreements between the parties, namely, the agreement of 23rd June 1920, which provided for the issue to the members of the old company without any payment being made by them to the new companies of fully paid shares in those companies, and to enable the members of the old company to escape wholly or in part from their liability to pay income tax on their true taxable income by obtaining a deduction under sec. 18 (1) (*i*) of the *Income Tax Assessment Act* to which they were not on the real facts entitled. These transactions, on which the appellant's claim to a deduction is rested, constitute in my opinion an arrangement having the purpose of relieving the appellant, in common with other members of the old company, from liability to pay income tax which on the true facts he was liable to pay, and so fall within sec. 53 of the *Income Tax Assessment Act* 1915-1918. If the agreement of 23rd June 1920 had been carried into effect in the ordinary course, the appellant would have had fully paid-up shares in the new companies, and would not have been entitled to any deduction under sec. 18 (1) (*i*) of the Act. That agreement has in truth been carried into effect, and sec. 53 of the Act prevents the appellant from availing himself of the devious methods employed for the purpose of enabling him, in common with other members of the old company, to claim a deduction in respect of calls alleged to have been paid by him to the new companies.

In my opinion the appeal should be dismissed.

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ISAACS J. I am of opinion that the appeal should be dismissed, and substantially for the reasons given by *Rich* J.

The learned Judge of first instance has elaborately stated the facts, and little is left to me except to state, in my own words and with as little repetition of his narration as possible, why, in view of the arguments addressed to us, I am in accord with the judgment appealed from.

On 23rd June 1920, as appears by Exhibit K (the minutes of meetings of directors of the Kandos Cement Co. Ltd. and of the Kandos Colleries Ltd.), there were created, as between the New South Wales Cement Lime and Coal Co. Ltd. and the Kandos Cement Co. Ltd. and as between the first-named company and the Kandos Collieries Ltd., contractual obligations of a definite character. These obligations, added to the statutory rights of the shareholders of the old company, gave rise to the following legal positions :—(1) The old company and the new Cement Company were bound respectively by a sale and purchase of the cement assets of the old company in consideration of 500,000 fully paid shares in the new company. (2) The old company and the new Collieries Company were bound respectively by a sale and purchase of the colliery assets of the old company in consideration of 200,000 fully paid-up shares in the new company. (3) Each shareholder in the old company was entitled by force of the Companies' Statute to share proportionately in the winding up of that company in its assets, which would then be represented by the paid-up shares to be received from the two new companies, subject, of course, to equalization within the old company by paying up their calls. Those legal positions were in full accordance with the company law and the winding-up resolutions of the old company, and no shareholder could object to them.

In that state of affairs, however, each shareholder would in respect of his ordinary Federal income tax be utterly unaffected by the several company transactions. Whatever income he had outside those transactions would be subject to the operation of the *Income Tax Act*, and his liability would be determined accordingly. That liability would not be lessened if the bargains were carried out and the statutory distributions effected according to law. But

before those obligations were performed an idea occurred to one of the auditors of the three companies which he communicated to Mr. Campbell, who occupied a chameleonlike position. He was secretary of each of the three companies, and also liquidator of the old company. He also, in the course of the subsequent transactions, acted as the personal agent of the numerous shareholders of the old company. The idea from which sprang the later transactions was that, by what is euphemistically called "a slight modification in the method of carrying through the reconstruction agreement," the shareholders might escape the taxation of their ordinary income by obtaining deductions amounting in all to over £500,000. The "slight modification" was a distinct departure from the winding-up resolution, and had no direct authority from the law. Any shareholder in the old company could have objected. Nothing but the personal assent of the shareholders to the new arrangement could sustain it. But the arrangement was so obviously beneficial to them that, even apart from their express consents to Campbell, their dissent was unthinkable. And so the new arrangement constituting the slight modification went through. I entirely agree with *Rich* J. that it must be regarded as a real arrangement. The new companies agreed to it formally and lawfully from their side of the transaction. The old company agreed by its liquidator. The shareholders of the old company are each and all precluded from objecting; and indeed they are unanimous in fervently adhering to it, and endorsing the liquidator's action. The new companies in fact issued contributing shares on which there was full liability of £1 each. They made a call of the whole amount; and that liability, thereby becoming a debt, has been discharged by what is in law equivalent to payment. If they were to sue a shareholder on a new call, they would fail. If in a winding up creditors claimed that the shareholders were contributing for £1 each, they would fail. On the other hand, the old company has in law been paid by the new companies, and the shareholders in the old company have in effect received their respective shares of its assets. The method by which these results were mutually achieved were no doubt devious, but as between the parties themselves it has legally operated as intended.

The reality of the transaction in law is established by the principle

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of *Salomon* v. *A. Salomon & Co.* (1). This reality includes the complete individual distinctness of the new companies from the old company. The fact that what is commercially known as "reconstruction" is the purpose of a winding up and a transfer to another company does not in the smallest degree affect the separateness of the two or the legal operation of whatever transfers of property or contracts are employed in the process. My reasons for this are stated with some fulness in *Webb* v. *Federal Commissioner of Taxation* (2). In *Wankie Colliery Co.* v. *Inland Revenue Commissioners* (3) this view is verified. The whole House of Lords recognized this position, and two of their Lordships thought that determined the case. The majority, however, thought that, notwithstanding that undoubted position (4), the enactment made the "business" liable even in the hands of a totally distinct owner.

The reality here, then, is complete according to State law, which governs these transactions; and according to State law nothing has been suggested in argument which would disturb their binding force, it having been established that all concerned acquiesced in and joined in carrying them out.

But then comes the Federal income tax law, by which the Commonwealth Parliament, in its own absolute discretion, declares the primary liability, permits deductions in certain cases, and also, by sec. 53, declares occasions when (*inter alia*) deductions shall not be allowed. Sec. 53, which in no way affects any transaction so far as its effect under State law is concerned and in no way affects it with respect to any other Federal law, does avoid a transaction coming within its purview for all the purposes specified in the section. That the transaction is a reality is no reason for the non-application of the section. On the contrary, if the transaction were not real and effective apart from the section, that section would be unnecessary. A sham transaction is inherently worthless, and needs no enactment to nullify it. But supposing it real and otherwise effective, what kind of transaction is struck at by sec. 53? The words are "Every contract, agreement, or arrangement made or entered into, in writing

(1) (1897) A.C. 22.
(2) (1922) 30 C.L.R. 450, at pp. 471, 472.
(3) (1922) 2 A.C. 51.
(4) (1922) 2 A.C., at pp. 56, 62, 69.

or verbal, . . . so far as it has or purports to have the purpose or effect of in any way, directly or indirectly "—then follow the pars. (*a*), (*b*), (*c*) and (*d*). It must be a "contract, agreement, or arrangement." "Arrangement" is no doubt an elastic word, and in some contexts may have a larger connotation. But in this collocation it is the third in a descending series, and means an arrangement which is in the nature of a bargain but may not legally or formally amount to a contract or an agreement. The section does not include a conveyance or transfer of property, legal or equitable, as such. It presupposes that apart from the "contract, agreement, or arrangement" a taxpayer would bear a certain liability either to make a return, or to pay tax in respect of certain income. Then, assuming that the income (if any) still remains that of the taxpayer (because sec. 53 does not contemplate an instrument actually changing the real ownership), the section supposes some "contract, agreement, or arrangement" which apart from the provisions of the section itself would legally operate or purport to operate in one or more of the ways set out in pars. (*a*), (*b*), (*c*) and (*d*). Then, says the section, such a "contract, agreement, or arrangement" shall be "absolutely void" for any such purpose, but is not otherwise affected. The effect is that the taxpayer's liability to make a return, or in respect of any other liability under the Act, remains just as if there were no such "contract, agreement, or arrangement." The ingenious but necessarily artificial process of arriving in this case, by means of legal doctrines intended to facilitate commercial transactions without burdensome formalities, at a certain legal situation in ordinary cases carries its special purpose as well as its effect on its face. There is hardly needed the express admission that exists, that it was with the design of securing a deduction for income tax. It is not at all on the same footing as an ordinary purchase of shares in an existing company, even with the accompanying object of satisfying the requirements of the law as to payment of calls. In that case the enterprise exists, and offers the opportunity of investment. There the investor is doing nothing more than the Legislature contemplated the taxpayer might legitimately do, or even be induced to do, and none the less that besides the risk of

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capital the advantage of a deduction in relation to income tax was part of the inducement.

But here, as in effect is said by the learned primary Judge, the combined arrangement entered into by the three companies and the shareholders in the old company—Mr. Campbell acting in various and even conflicting capacities as intermediary—was simply to manufacture a situation to get the better of the *Income Tax Act*. It in no way altered the income of the taxpayer or changed its ownership. It was in no true sense a business operation. But, by first deliberately preparing the ground for the misuse of legal expedients recognized as equivalents for payment, and then by such misuse, a factitious liability to pay a call and a factitious payment of the call ensued, but throughout, from conception to completion, except for a similar object of escaping stamp duty, with the express and sole purpose of lessening the statutory liability of the taxpayers.

Therefore, though it cannot be said there was not a call, or that there was not a payment of the call, so as to satisfy sec. 18: yet, for the reasons given, that payment cannot, in the circumstances, be taken advantage of, and the appeal should be dismissed.

The learned primary Judge thought it unnecessary to consider whether the Cement Company was a mining company within sec. 18. I also do not think it necessary to decide the point. But I am of opinion it is not a mining company. The principles we have laid down in the *Slate Quarries Case* (1) lead, in the circumstances of the present case, to the conclusion that the dominant character, and therefore the true character, of the Cement Company is that of a manufacturing company and not a mining company.

STARKE J. I am also of opinion that this appeal should be dismissed.

The facts are very fully stated in the judgment of my brother *Rich* which is under appeal; and I adopt his statement. The appellant claims to deduct two sums from his assessable income, one a sum of £3,750 claimed to have been paid in respect of calls on shares of the Kandos Cement Co. Ltd., the other a sum of £1,875 claimed to have been paid in respect of calls on shares in the Kandos Collieries

(1) (1923) 33 C.L.R. 416.

Ltd. The claim is based upon the proviso to sec. 18 (1) (*i*) of the *Income Tax Assessment Act* 1915-1918, which allows a deduction of the amount of calls paid on shares in a mining company carrying on mining operations in Australia.

My brother *Rich* assumed, for the purposes of his judgment, that each of these companies was a mining company carrying on mining operations in Australia. But it seems to me that one of them, the Kandos Cement Co. Ltd., was not a mining company carrying on mining operations in Australia. Its main business is that of making cement, and manufacturing cement goods such as concrete pipes, &c. And for this purpose it procures limestone and shale from the earth by means of blasting and otherwise. These materials are forwarded by means of skips to the crushers, and from the crushers by aerial transport to the factory. These operations are, no doubt, of great importance to the company commercially, and possibly its business could not be carried on at a profit without them. But, nevertheless, they are simply a step in its business processes, and do not in any way characterize it as a mining company (see *Slate Quarries Case* (1)). Consequently the claim for the deduction of £3,750 fails at the outset. And no claim has been suggested under sec. 18 (1) (*i*) for a deduction of five per centum in respect of the calls claimed to have been paid on shares in the Kandos Cement Co. Ltd.

There remains the claim for £1,875 in respect of calls claimed to have been paid on shares in the Kandos Collieries Ltd. It is not open to doubt that the Collieries Company is a mining company carrying on mining operations in Australia; and the fact was not disputed. But the Commissioner insisted that the transactions following upon the agreements of August 1920 constituted an arrangement for the purpose, or having the effect, of evading or avoiding the tax imposed on shareholders of the companies already mentioned, under the provisions of the *Income Tax Assessment Act*, and were, to that extent, absolutely void (*Income Tax Assessment Act* 1915-1918, sec. 53). My brother *Rich* saw no reason for treating these transactions as unreal; nor do I. It is impossible, in my opinion, to say that they were not genuine transactions, and were devised to conceal the nature of the real agreements between the parties.

(1) (1923) 33 C.L.R. 416.

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There is nothing wrong in companies and shareholders entering, if they can, into transactions for the purpose of avoiding, or relieving them of, taxation (*Simms* v. *Registrar of Probates* (1); *Deputy Federal Commissioner of Taxation* v. *Purcell* (2)); and it depends wholly upon the construction of the taxing Act whether they have succeeded. The form the transactions took, in this case, was admittedly devised for the purpose of securing a deduction of calls. But the transactions did not, in any business sense, alter the position of the shareholders: their income was not diminished, nor their property increased. As my brother *Rich* rightly said, under the first scheme the appellant "as a shareholder in the old company . . . would have been entitled to his proportionate share of the money payable by the new companies to the old company as consideration for the assets transferred. That proportionate share would have amounted to £5,625. Had he so received it, he would have been liable in the ordinary way to pay income tax, not on that sum, but on his general income"; whilst under the second scheme the appellant applied for shares in the new companies and agreed to pay over to the new companies for calls, which it was arranged should be made, his share in the old company's assets, namely, £5,625. Such an arrangement is, in my opinion, struck by the provisions of sec. 53, and is avoided to the extent mentioned in that section. This view renders untenable any claim for a deduction of five per centum of the amount claimed to have been paid in respect of calls on shares in the new companies.

Appeal dismissed with costs.

Solicitors for the appellant, *Stephen, Jaques & Stephen.*

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

B. L.

(1) (1900) A.C., at p. 333.

(2) (1920-21) 29 C.L.R. 464, at p. 472.