[HIGH COURT OF AUSTRALIA.]

McFARLANE . . . . . APPELLANT;

AND

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

H. C. OF A. 1925.

SYDNEY, *April* 6, 7.

Knox C.J., Isaacs and Rich JJ.

War-time Profits Tax—Assessment—Capital of business—Asset created or acquired without purchase—Land used in business—Land of wife used by taxpayer without binding agreement—War-time Profits Tax Assessment Act 1917-1918 (*No.* 33 *of* 1917—*No.* 40 *of* 1918), *secs.* 16, 17.

In 1908 the appellant, who carried on the business of a grazier on certain land belonging to him in fee simple, transferred portion of the land to his wife; and at the same time she made a will devising the transferred land to the appellant in fee simple and executed a deed by which she covenanted with the appellant not to revoke the will so far as it related to the transferred land and not to deal with such land so as to defeat or prejudicially affect the devise. At the same time the appellant stated to his wife that he would continue to use the transferred land in his business, and he did so continue to use it with his wife's knowledge and consent, making improvements thereon and taking all the profits and proceeds therefrom, but his wife was not a trustee for the appellant nor was there at the time of the transfer any binding agreement between them as to the use of the transferred land.

Held, that in determining the capital of the business as existing at the end of the last pre-war trade year, for the purposes of the *War-time Profits Tax Assessment Act* 1917-1918, the value of the transferred land was properly omitted from consideration.

CASE STATED.

On an appeal to the High Court by John Hector McFarlane from an assessment for war-time profits tax for the year ended 30th June 1917, *Rich* J. stated a case, which was substantially as follows, for the opinion of the Full Court:—

1. Prior to and in the year 1908 the appellant was carrying on the business of a grazier on certain lands then held by him in fee simple, such lands being known as "Glensloy" and situate near Young in the State of New South Wales.

2. In the year 1908 the appellant transferred to his wife, Clara Lily McFarlane, in fee simple portion of the said lands, such portion containing an area of about 2,692 acres.

3. At or about the time of the said transfer the said Clara Lily McFarlane executed a will devising to the appellant in fee simple the said lands so transferred, and also by instrument under seal covenanted with the appellant not to alter or revoke the said will so far as the same related to the said lands and not to deal with the said lands in any manner which might defeat or prejudicially affect the said devise.

4. At the time of the said transfer the appellant and his wife were living together at their home upon Glensloy, and thereafter continued so to live with their family. At the time of the transfer of the said lands it was stated between the appellant and his wife that he would continue to go on using the said lands and their proceeds in the course of his said business without any particular period of time being mentioned; and the appellant in fact continued to do so with her knowledge and consent as if the said lands were part of the Glensloy Estate—making and maintaining improvements upon them, and taking all profits and proceeds from them. From such proceeds he in part provided for the maintenance and support of his said wife and family, who were living with him as aforesaid. The appellant does not contend that anything stated in this paragraph should be construed to mean that his wife was a trustee of the lands for him, or that any binding agreement was made between himself and his wife in relation to the use of the lands by him at the time of such transfer.

5. The conditions stated in the last paragraph continued until, in consequence of differences which arose between the appellant and his wife, the latter on 8th January 1921 issued a writ of ejectment in the Supreme Court of New South Wales to recover possession of the said lands. Upon 29th November 1921 a judgment by consent was given in her favour to recover possession as aforesaid.

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6. Owing to the default of the appellant in lodging the prescribed return, the respondent in accordance with sec. 22 of the *War-time Profits Tax Assessment Act* caused an assessment, dated 19th December 1919, to be made in respect of profits derived during the year ended 30th June 1917 from carrying on the said business of the appellant.

7. On or about 7th January 1920 a notice of objection was lodged against the assessment.

8. The respondent considered such objection and decided to allow it in part, and an amended assessment was forwarded to the appellant on or about 22nd August 1922.

9. For the purposes of ascertaining the war-time profits of the subject year the appellant was entitled, by virtue of sec. 16 (8) of the said Act, to a deduction of the percentage standard therein mentioned.

10. For the purpose of the said assessment the respondent calculated the statutory percentage referred to in sec. 16 (9) of the said Act upon the capital of the said business as existing at the end of the last pre-war trade year excluding from such capital the fee simple value of the said lands so transferred, namely, £10,770.

11. The profits of the said business during the year ended on 30th June 1917 were in part derived from the use by the appellant of the said lands in the manner referred to in pars. 4 and 5 hereof.

The following were the questions asked by the case :—

(1) In determining the said capital should the said lands so transferred and employed and used in the said business have been taken into account at their fee simple value ?

(2) If the first question is answered in the negative, is the appellant entitled to appeal on the ground that such lands should have been taken into account on some other basis than the fee simple value ; and, if he is so entitled, at what value or amount or on what basis of value should such lands have been taken into account ?

Sir Edward Mitchell K.C. (with him *Abrahams*), for the appellant. The transferred land was an asset " created " or " acquired " by the appellant within the meaning of sec. 17 (4) of the *War-time Profits Tax Assessment Act*. It was just as much an asset of the business

as it had been before the transfer was made. The word "created" does not mean created by the taxpayer. In any event the asset was "acquired" by the appellant. He had a right to occupy the land and use it until his wife interfered, and he had a possessory title to the land (*Perry* v. *Clissold* (1); *Clissold* v. *Perry* (2); *Russell* v. *Wilson* (3)). The permission to occupy the land made the appellant a tenant at will by implication (*Doe d. Hull* v. *Wood* (4); *Woodhouse* v. *Hooney* (5); *Halsbury's Laws of England*, vol. XVIII., p. 434, par. 899).

[ISAACS J. referred to *Ley* v. *Peter* (6).]

If the appellant was not a tenant at will, he was in lawful occupation of the land and had an interest the value of which is capable of estimation (see *M'Donald* v. *M'Donald* (7); *Ex parte Neal*; *In re Batey* (8)). Par. 4 of the case is not intended to negative any agreement that may be implied from the facts which are stated. [Counsel also referred to *Strickland* v. *Federal Commissioner of Taxation* (9); *McKellar* v. *Federal Commissioner of Taxation* (10).]

E. M. Mitchell, for the respondent. The transferred land could not be called capital of the business (see *Strickland* v. *Federal Commissioner of Taxation* (11); *McKellar* v. *Federal Commissioner of Taxation* (12)). The position is as if the land had been borrowed. Assets used in a business are not necessarily capital of the business (*Commissioners of Inland Revenue* v. *Port of London Authority* (13)). Nothing could be put in a balance-sheet of the business as representing the land (see *The Minister* v. *New South Wales Aerated Water and Confectionery Co.* (14)). The appellant was, at most, using the land by the leave and licence of his wife. Par. 4 of the case negatives any other position than that the appellant and his wife were on the land together, and negatives any possibility of its being assumed that the appellant had any rights of any sort. [Counsel also referred to *Merlimau Rubber Estates Ltd.* v. *Inland Revenue Commissioners* (15).]

(1) (1907) A.C. 73; 4 C.L.R. 374.
(2) (1904) 1 C.L.R. 363, at p. 377.
(3) (1923) 33 C.L.R. 538, at p. 546.
(4) (1845) 14 M. & W. 682, at p. 687.
(5) (1915) 1 I.R. 296.
(6) (1858) 3 H. & N. 101.
(7) (1880) 5 App. Cas. 519.
(8) (1880) 14 Ch. D. 579.
(9) (1921) 28 C.L.R. 602.
(10) (1922) 30 C.L.R. 198.
(11) (1921) 28 C.L.R., at p. 606.
(12) (1922) 30 C.L.R., at p. 203.
(13) (1923) A.C. 507, at p. 521.
(14) (1916) 22 C.L.R. 56.
(15) (1923) A.C. 283, at p. 286.

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Sir Edward Mitchell K.C., in reply.

[RICH J. referred to *Landale* v. *Menzies* (1).]

KNOX C.J. The appellant, before the year 1908, carried on business as a grazier on a property known as "Glensloy." In that year he transferred portion of the land on which the business was carried on to his wife absolutely, and at the same time she made a will disposing of the land transferred in favour of the appellant or his appointees and entered into a covenant not to alter the will or deal with the land in any manner which might defeat or prejudicially affect the devise. Par. 4 of the special case is in the words following:— [His Honor read the paragraph.] I read this as meaning that the appellant had no right or title either legal or equitable to the possession of the land in question for any period, though he in fact occupied it until the year 1921 and continued till that time to use it in the business carried on by him as a grazier. In this state of facts the appellant has, in my opinion, failed to establish that in respect of his occupation of this land there was any asset of the business in existence at any relevant time, or that this land or any estate or interest in it formed part of the capital of the business within the meaning of the Act.

Both questions should be answered in the negative.

ISAACS J. read the following judgment:—In my opinion, the determining factor of this matter is found in the concluding words of the fourth paragraph of the case stated. The taxpayer had, some years before the period of assessment, made a complete gift to his wife of certain land upon which he had been carrying on business. Contemporaneously there were two distinct arrangements made between them. One was of a strict and binding character, by which the wife made a will leaving the land to her husband, and also covenanted not to alter or revoke the will so far as it related to the land and not to deal with the land prejudicially to the devise. The other arrangement was quite informal, namely, that the husband should go on using the land as before, making improvements and taking all profits and proceeds from the land, and this without any

(1) (1909) 9 C.L.R. 89, at p. 129.

particular period of time being mentioned. The husband did go on using the land for his business; and now the question arises whether he is entitled to regard the land in any way or to any extent as part of the capital within the meaning of sec. 17 of the *War-time Profits Tax Assessment Act* 1917-1918.

If it were not for the final clause of par. 4 of the case as stated, I might have had more difficulty in coming to the conclusion I have formed. The case of *Doe d. Hull* v. *Wood* (1), cited by Sir *Edward Mitchell*, might possibly have been applied but for that final clause (see *Landale* v. *Menzies* (2)). That is to say, the circumstances might have led to the implication of a tenancy, and a tenancy is both a contract and the creation of an estate (*Whitehall Court Ltd.* v. *Ettlinger* (3), approved in *Matthey* v. *Curling* (4)). But there cannot be a contract without the intention to make one. Two recent cases will exemplify this. In *Balfour* v. *Balfour* (5) the relationship of husband and wife so entered into the circumstances that the Court of Appeal concluded there was no contractual obligation intended by the parties. The domestic relationship indicated that the promise relied on as a contractual promise was merely friendly and non-enforceable. Again, in *Rose & Frank Co.* v. *J. R. Crompton & Bros. Ltd.* (6) an express clause inserted in an agreement, and stating that the arrangement was not entered into as a formal or legal agreement, affected the whole transaction and prevented it from being a contract (see the authorities cited by *Scrutton* L.J. (7) and the formulation of principle by *Atkin* L.J. (8)). Here the parties negative expressly their intention to enter into a binding agreement. The final clause of par. 4 excludes all fiduciary or contractual obligations in respect of the appellant's user of his wife's land. It might well be that the same conclusion would be eventually arrived at apart from that final clause. It is not improbable that a wife, who had just had a gift of the land for her life from her husband on condition that if she predeceased him he was to have it again, might in an obedient and friendly way assent to his occupying and using it without any idea of contractual obligation arising on either

(1) (1845) 14 M. & W. 682.
(2) (1909) 9 C.L.R., at p. 129.
(3) (1920) 1 K.B. 680.
(4) (1922) 2 A.C. 180.
(5) (1919) 2 K.B. 571.
(6) (1923) 2 K.B. 261.
(7) (1923) 2 K.B., at pp. 288, 289.
(8) (1923) 2 K.B., at p. 293.

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Isaacs J.

side. But I am relieved from considering that possibility by the express admission of the appellant that no "binding agreement" was intended. That circumstance dominates the transaction; for, as was said in *Smith* v. *Overseers of St. Michael, Cambridge* (1), "we must look not so much at the words as the substance of the agreement."

The substance being outside all legal and equitable obligations, the arrangement was nothing in substance but an authority to use by way of loan—so far as that expression can be applied to an immovable—and to return when desired by either party. That being the position in fact, how does the case fall with respect to sec. 17 of the Act? In my opinion, the land was not, nor was any interest in it, "capital" within that section. "Capital" there, apart from accumulated profits and balances brought forward, may be shown if "the owner," that is, the owner of the business, has paid it up either in "money or in kind." If paid up in money, that money is capital of the business. If capital is not paid up in money, but is represented by some "asset"—which necessarily means an asset belonging to the owner of the business, something which represents money by reason of its *value*—then sub-sec. 4 applies. It provides that, where any asset has been (1) paid for otherwise than in cash, or (2) created or (3) acquired without purchase, then its *value* shall be taken to be its value at the time the asset was (a) created or (b) acquired. Now, the word "created" can only apply to a bringing into existence; as, for instance, the building of a store, or the sinking of a well, and so on. The word "acquired" is used to include two cases. The first is where an asset has been paid for otherwise than in cash; and this implies a purchase though not for money. The second is where the asset has been acquired without purchase, as by inheritance or gift. But the asset must be "created" or "acquired" by the owner of the business. In the circumstances of this case, what is the "asset" which in any reasonable sense the taxpayer has "acquired"? The friendly authority to use the land, terminable instantly and referable to no legal relation, could not lead to the "acquisition" of anything in the nature of a capital asset in or appertaining to the land.

(1) (1860) 3 E. & E. 383, at p. 390.

It was suggested that *Perry* v. *Clissold* (1) lent authority for the contrary view. But there the possession was, as Lord *Macnaghten* said (2), "in the assumed character of owner." There are other distinctions between that case and this, but the words quoted are sufficient to make the case inapplicable.

In my opinion the questions should be answered in the negative.

RICH J. It is unnecessary, in my opinion, to label the nature of the precarious occupation of the subject land by the appellant. Clause 4 of the special case precludes the creation of any legal or equitable rights and obligations, express or implied. Consequently I am at a loss to understand how any asset capable of estimation has been acquired by the appellant within the meaning of sec. 17 (4) of the *War-time Profits Tax Assessment Act*.

I answer both questions in the negative.

Both questions answered in the negative.

Solicitors for the appellant, *Gordon, Garling & Giugni*, Young, by *H. C. M. Garling*.

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

B. L.

(1) (1907) A.C. 73.

(2) (1907) A.C., at p. 79.