[HIGH COURT OF AUSTRALIA.]

MICHELL . . . . . APPELLANT;

AND

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

H. C. OF A. 1927.

MELBOURNE, *Oct.* 12, 13.

Starke J.

Income Tax (Cth.)—Assessment—Wool and skin business—Wool and skins bought in Australia and sold overseas—Apportionment of income of business—Income Tax Order 816*—Income Tax Assessment Act* 1922-1927 (*No.* 37 *of* 1922—*No.* 32 *of* 1927).

The Federal Commissioner of Taxation assessed the taxpayer on the basis that the business of the firm of which he was a member consisted of a series of operations, some carried out in Australia and others overseas, and that the income thereof resulted from a series of operations and not from any one operation. In assessing the amount of income tax the Commissioner applied a departmental order, No. 816, and apportioned the income in the proportion that f.o.b. costs in Australia bore to costs overseas.

Held, that no fixed rule or formula was possible in the circumstances and that apportionment must depend upon business judgment and experience applied to the facts of the particular case, the nature and character of the business and the mode in which it was actually carried on.

The business of the firm was buying wool and skins in Australia and selling them overseas, sometimes in the state in which they were bought and sometimes after the same were submitted, mainly overseas, to various processes of manufacture. The control of the business resided in Australia and the arrangement of the financial operations of the business was made in Australia; otherwise the bulk of the operations of the firm were carried on overseas.

Held, upon the facts, that for the purposes of assessment to Federal income tax the income of the taxpayer derived from consignments of wool and skins in the business carried on by the firm should be apportioned on the basis that one-half thereof and no more was derived directly or indirectly from sources within Australia.

Federal Commissioner of Taxation v. *Lewis Berger & Sons (Australia) Ltd.*, (1927) 39 C.L.R. 468, followed.

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APPEAL from the Federal Commissioner of Taxation.

This was an appeal by George Henry Michell to the High Court from his assessment by the Federal Commissioner of Taxation to income tax in respect of his income for the year ending 30th June 1923. The appeal was heard by *Starke* J., in whose judgment the facts and arguments sufficiently appear.

H. Thomson, for the appellant.

Owen Dixon K.C. and *C. Gavan Duffy*, for the respondent.

Cur. adv. vult.

Oct. 13.

STARKE J. delivered the following written judgment :—

This is an appeal against an assessment to income tax for the year 1923-1924, based on income received during the twelve months ending on 30th June 1923. The taxpayer is the head of the firm of G. H. Michell & Sons, of Hindmarsh, South Australia. The firm does a certain amount of wool-scouring, but its main business is buying wool and skins in Australia and selling the same overseas, sometimes in the state in which they were bought, and sometimes after the same had been submitted, mainly overseas, to various processes of manufacture. To illustrate what I mean, wool was sometimes bought at auction, shipped overseas, and sold ; at other times the wool was shipped overseas for manufacture into tops or carbonized products, and then sold. So, too, with skins : sometimes sheepskins were bought in Australia, classified according to quality, shipped overseas, and then sold ; at other times the skins bought were classified according to quality, shipped overseas for treatment, and the resultant product sold. Exhibit C details the various classes of transactions entered upon and the manner in which they were dealt with respectively. By these means the taxpayer derived a considerable income during the period on which the assessment is based.

The question is, how much of this income is taxable income derived directly or indirectly by the taxpayer from sources within Australia. The Commissioner has assessed the taxpayer on the

basis that the business of the taxpayer and his partners consists of a series of operations, some carried out in Australia and others overseas, the income as a whole resulting from the series of operations and not from any one operation. Consequently, the place where one operation was performed cannot be fastened upon as the locality from which the whole income is derived. An apportionment thus became necessary. So far the Commissioner seems to have acted in accordance with decisions which are binding upon him and upon me (*Commissioners of Taxation* v. *Kirk* (1); *Commissioners of Taxation* (*N.S.W.*) v. *Meeks* (2); *Mount Morgan Gold Mining Co.* v. *Commissioner of Income Tax* (*Q.*) (3); *Dickson* v. *Commissioner of Taxation* (*N.S.W.*) (4)). No rule of apportionment has been laid down by the statute, though this is, perhaps, to be desired. In *Federal Commissioner of Taxation* v. *Lewis Berger & Sons* (*Australia*) *Ltd.* (5), however, I said that no fixed rule or formula of apportionment is possible, and that any apportionment must depend upon business judgment and experience applied to the facts of the particular case, the nature and character of the business, and the mode in which it was actually carried on.

After reconsideration and an attempt to find a rule or formula, I adhere to that view, and regard the problem as one entirely of fact. In the present case the Commissioner has applied a departmental rule, which is to be found in what is called Income Tax Order 816. As I understand it, income is to be apportioned in the proportion that f.o.b. costs in Australia bear to costs overseas. I decline to adopt that rule in this case, for it works most unfairly to the taxpayer. There is no real relation between expenses and profits. One result in this case is that the purchase price of the wool and the skins is treated as part of the f.o.b. cost, and so far as I can see the trading capital of the firm has been used many times over to swell the aggregate f.o.b. cost of the commodities dealt with by the taxpayer's firm. Various factors in this case, in my opinion, require consideration such as the control of the business, the financial arrangements for carrying it on, and the locality where the operations of the business were carried on. The control of the business

(1) (1900) A.C. 588.
(2) (1915) 19 C.L.R. 568.
(3) (1923) 33 C.L.R. 76.
(4) (1925) 36 C.L.R. 489.
(5) (1927) 39 C.L.R. 468.

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undoubtedly resided in Australia, but apparently the business worked so smoothly that active interference overseas was not often required. Again the arrangement of the financial operations of the business was made in Australia, though the credit of the taxpayer's firm was so good that little or no trouble was experienced in those operations. Apart from the control of and financial arrangements for the business, the bulk of operations of the taxpayer's firm were carried on overseas. Buying was done in Australia and also some scouring, but the selling was wholly done overseas and so were the manufacturing processes and treatment to which large quantities of the wool and skins sent abroad were submitted. Looking at the matter broadly, and giving the best judgment I can upon the facts placed before me, I have come to the conclusion that the income of the business should be apportioned in equal parts as between Australia and places overseas.

Allow appeal. Direct that the income of the taxpayer derived from consignments of wool and skins in the business carried on by the firm of G. H. Michell & Sons for the twelve months ending on 30th June 1923 should be apportioned on the basis that one-half thereof and no more is derived directly or indirectly from sources within Australia. Order assessment of the taxpayer be reduced or varied in accordance with the foregoing direction. Liberty to apply. Commissioner to pay the taxpayer's costs of this appeal.

Appeal allowed accordingly.

Solicitors for the appellant, *Varley, Evan & Thomson*, Adelaide, by *Arthur Robinson & Co.*

Solicitor for the respondent, *W. H Sharwood*, Crown Solicitor for the Commonwealth.