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WESTERN AUSTRALIAN TIMBER WORKERS' INDUSTRIAL UNION OF WORKERS (S. W. LAND DIVISION) v. WESTERN AUSTRALIAN SAWMILLERS' ASSOCIATION.

consistently with decided cases and with the Constitution, can operate to protect this order if made without jurisdiction.

I answer the third question No.

Questions answered as follows: (1) *Yes*; (2) *No*; (3) *No*.

Solicitors for the applicant and the Court of Arbitration of Western Australia, *Lawson & Jardine*, Melbourne, by *E. S. Dunhill*.

Solicitors for the respondent, *Gillott, Moir & Ahern*, Melbourne, by *P. L. Williamson & Co.*

J. B.

[HIGH COURT OF AUSTRALIA.]

SHELLEY . . . . . APPELLANT;

AND

THE FEDERAL COMMISSIONER OF TAXATION RESPONDENT.

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SYDNEY, *Aug.* 7.

MELBOURNE, *Nov.* 4.

KNOX C.J., ISAACS and DIXON JJ.

Income Tax—"*Co-operative company*"—*Allowances on purchases made by members*—*Rebate or reduction in price*—*Taxable income*—*Income Tax Assessment Act* 1922-1928 (*No.* 37 *of* 1922—*No.* 46 *of* 1928), *secs.* 4, 20 (1A), 23 (1) (*a*).

Sec. 4 of the *Income Tax Assessment Act* 1922-1928 provides that "'Income' . . . does not include (*c*) any rebate received by a member of a co-operative company based on his purchases from that company where the Commissioner is satisfied that ninety per centum of its sales is made to its own members."

Held, that a company which had the following features was not a "co-operative company" within this provision:—(i.) It was composed of merchants whose businesses required that commodities should be bought in large quantities. (ii.) The objects in its memorandum were numerous and together enabled it to do almost anything and to do it on ordinary commercial or capitalist principles, but the leading objects were (a) to carry on the business of a co-operative store and general supply society in all its branches and to transact all

kinds of agency business; (b) to promote economical buying on the co-operative principle; (c) to control, conduct and organize the trade of its members and promote their mutual benefit, and (d) to disseminate trading intelligence amongst its members and mitigate bad debts. (iii.) The company was limited by shares, and the transfer of shares was restricted by the articles to persons approved by an extraordinary resolution of the company, but there was no express limit on the number of the shares a member was permitted to hold nor any prohibition on the quotation of the shares on the Stock Exchange. (iv.) The company in fact supplied to its members commodities in which they trade, and this formed at least ninety per cent of its trade. (v.) The articles provided in effect that subject to any extraordinary resolution the profits of the company not placed to reserve should first be applied in paying a dividend of 8 per cent on capital and the balance should be divided among the members in proportion to the amount of their purchases from or through the company, and the company substantially observed this method of distribution. (vi.) The articles also provided in effect that upon liquidation surplus assets should be distributed in proportion to the amount of purchases made by shareholders from the company within two years.

A member received from the company during the year ended 30th June 1926 a sum calculated upon his purchases from the company during the year ended 31st December 1924 and a sum calculated upon his purchases from the company during the year ended 31st December 1925.

Held, that neither of these sums should be excluded in arriving at his taxable income derived during the year ended 30th June 1926:

By *Knox* C.J. and *Dixon* J., on the ground that the company was not a "co-operative company" within sec. 4; and

By *Isaacs* J., on the grounds (1) that these sums were mere reductions or diminutions of the expenditure which was allowable as a deduction from assessable income derived during the year ended 30th June 1926, and as they were not "income" sec. 4 did not enable the taxpayer to exclude them; (2) that the company was not a "co-operative company" within the definition of sec. 20 (1A), which applied to sec. 4.

CASE STATED.

The appellant, Harry Mansfield Shelley, lodged with the Federal Commissioner of Taxation an objection against his assessment for income tax for the financial year ended 30th June 1926 and, being dissatisfied with the Commissioner's decision on the objection, requested him to treat the objection as an appeal and to forward it to the High Court. The objections to the assessment were substantially (1) that the assessment was excessive and contrary to law, and (2) that the assessment should be reduced as an amount of £971

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had been wrongly included, such amount representing rebates received by the appellant as a member from, and as a member of, the Distributors Commercial Co. Ltd., which was a co-operative company within the meaning of the *Income Tax Assessment Act* 1922-1925.

The appeal came on for hearing before *Knox* C.J., who stated a case, which was substantially as follows, for the opinion of the Full Court :—

1. This is an appeal from assessment of income tax under the above-mentioned Act for the financial year which commenced on 1st July 1926. The said assessment is based upon income derived by the appellant in the year which ended on 30th June 1926.

2. The appellant Harry Mansfield Shelley of Sydney in the State of New South Wales is a member of a company named Distributors' Commercial Co. Ltd. (hereinafter called the Company) and was one of the subscribers to the memorandum and articles of association of the Company.

3. The Company is a company limited by shares which was on 1st December 1916 incorporated in the said State under the name of Distributors' Co-operative Co. Ltd.

4. On 17th December 1924 a special resolution was duly confirmed (1) that it was desirable that the Company be registered as a society under the *Co-operation, Community Settlement, and Credit Act* 1923, and (2) that the directors be requested and directed forthwith to apply for the registration of the Company as a society under the said Act.

5. On 11th December 1925 a special resolution was duly confirmed that the first resolution in the preceding paragraph mentioned be rescinded, and that the name of the Company be changed to Distributors' Commercial Co. Ltd. Thereafter the said name was duly changed to Distributors' Commercial Co. Ltd. The nature of the business carried on by the Company has not changed since the date of its incorporation.

7. The appellant and the other members of the Company are all merchants carrying on business in the State of New South Wales.

8. The Company carried on the business of purchasing goods and reselling them to its members and others, and other business.

9. The respondent is satisfied that the percentage of the sales made by the Company to its own members during each of the years ended on 31st December 1924 and 31st December 1925 exceeded ninety per cent of the total sales of the Company.

10. Since its incorporation the financial year of the Company has ended on 31st December each year.

11. During each of the years ended on 31st December 1924 and 31st December 1925 the requirements of the members of the Company in respect of certain commodities (specified in schedule A) were met in the following manner:—It was agreed by and between the Company and the manufacturers or importers of the said commodities that a special discount in addition to the usual trade and cash discounts should be allowed to the Company in respect of the commodities supplied as hereinafter stated. The Company from time to time ascertained by correspondence with all its members the aggregate of the requirements of all its members of each particular commodity. An order for that quantity for immediate delivery was then given by the Company to the manufacturer or importer of the particular commodity. The said commodities were either delivered to the members direct on the instructions of the Company or after delivery to the Company were taken delivery of by the members at the place of receipt (e.g., on wharf) without being placed in a store of the Company. The cost of the parcel purchased was, on delivery, charged at once to the Company by the manufacturer or importer, and each member participating was thereupon debited by the Company with a sum ascertained as follows:—The price which the Company charged each member participating was the full purchase price of his share of the parcel less the trade and cash discounts (other than the special discount) granted by the manufacturer or importer to the Company, plus any costs of handling incurred by the Company in Sydney or elsewhere, and plus also $\frac{1}{2}$ per cent of the price so ascertained as aforesaid. The amount due for the whole parcel was paid by the Company and the amount charged by the Company to each member was paid by such member to the Company.

12. During each of the years ended 31st December 1924 and 31st December 1925 the requirements from time to time of the members

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of the Company in respect of certain commodities (specified in schedule B) were met in the following manner :—It was agreed by and between the Company and the manufacturers or importers of the said commodities that a special discount in addition to the usual trade and cash discounts should be allowed to the Company in respect of the commodities supplied as hereinafter stated. The quantity of such commodities which was required was ascertained and the commodities supplied in the manner described in par. 11 hereof, except that the Company did not give an order for immediate delivery but gave an order for a specific quantity of each commodity for delivery as required over a period of months. Deliveries were made in some instances on the directions of the Company as arranged with its members and in other instances on the directions of the members. The commodities as supplied were charged by the manufacturer or selling agent to the Company, and the Company thereupon debited its members in the manner described in par. 11 hereof, and the commodities were paid for in the manner described in the said paragraph.

13. In each of the years ended 31st December 1924 and 31st December 1925 the requirements of the members of the Company in respect of certain commodities (specified in schedule C) were met in the following manner :—The manufacturers or importers of the said commodities agreed with the Company to give to the Company a special discount in addition to the usual trade and cash discounts on all commodities supplied to its members by such manufacturers or importers and that the cost of such goods should be debited to the Company. In some instances the Company, acting on instructions communicated by members, including the appellant, placed orders with the manufacturers or importers for deliveries to be made to members. In other instances members, including the appellant, for their convenience or on account of the frequency of their requirements sent orders direct to the manufacturers or importers and instructed the said manufacturers or importers to debit the Company with the price. In all instances the manufacturers or importers charged the Company, and the Company then debited each member with, the price of the goods actually delivered to such member.

The method of calculating the price so charged by the Company to each member was the same as that stated in par. 11 hereof, and the commodities were paid for in the manner described in the said paragraph.

14. In each of the years ended 31st December 1924 and 31st December 1925 the Company purchased abroad a quantity of kerosene sufficient to supply what it estimated to be the annual requirements of its members. The Company imported the said kerosene and on arrival in New South Wales the same was stored by the Company at the expense of the Company in Sydney and in various country towns in New South Wales. Any member of the Company requiring kerosene ordered the same from the Company, and the same was supplied at the most convenient store on the member's order. A member so ordering kerosene was charged by the Company the ruling market-price of the same and, in addition, $\frac{1}{2}$ per cent thereof together with the cost of delivering to the town of supply and less an agreed trade and cash discount.

15. The amount of $\frac{1}{2}$ per cent in the preceding paragraphs mentioned was fixed by the Company as a charge which the Company estimated would produce a sum sufficient to pay the working expenses of the Company and a dividend of 8 per cent on the paid-up capital of the Company.

16. During each of the years ended 31st December 1924 and 31st December 1925 the Company arranged with the manufacturers or selling agents of certain commodities (specified in schedule D) to supply the said commodities to its members on special terms, and the appellant purchased the said commodities and paid the said manufacturers or selling agents for the same and the price of the said commodities did not pass through the books of the Company. The Company received from the said manufacturers or selling agents the sum of £26 11s. 3d. by way of commission in respect of the appellant's said purchases during the year ended on 31st December 1925. On 25th March 1925, as part of the said sum of £971 3s. 9d. mentioned in par. 19 hereof, the Company paid to the appellant the said sum of £26 11s. 3d. The appellant now admits that the said sum of £26 11s. 3d. formed part of his assessable income.

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17. During each of the years ended on 31st December 1924 and 31st December 1925 the appellant purchased in the manners hereinbefore described commodities of the several kinds mentioned in the schedules above referred to and kerosene.

18. In the years ended on 31st December 1924 and 31st December 1924 and 31st December 1925 respectively the Company made profits. In the months of March 1925 and March 1926 respectively the Company declared a dividend of 8 per cent per annum on its paid-up share capital for the years ended on 31st December 1924 and 31st December 1925 respectively. Of the balance of the profit remaining after payment of such dividend, part was in the months of March 1925 and March 1926 divided between the members of the Company. The amount so divided was calculated separately in respect of each commodity in the manner hereinafter stated. That part of the amount so divided which was paid to each member in respect of each commodity (other than kerosene) was that part of the special discount allowed to the Company in respect of that commodity which the Company considered was attributable to that part of such commodity which such member had purchased (subject to such variations as might be made as described in pars. 20 and 21 hereof). That part of the amount so divided in respect of kerosene which was paid to each member was calculated in the manner stated in par. 21 hereof.

19. On or about 25th March 1926 the appellant received from the Company the sum of £971 3s. 9d. together with a circular letter from the secretary of the Company which, omitting formal parts and parts not material hereto, was as follows:—"I attach hereto statement of the amounts due to you for rebates bonuses commissions &c. for the year ended 31st December 1925. From this you will see that a deduction has been made for loss sustained on the purchase of dates in the year 1925 which has been charged against you in accordance with the decision of the directors and based on your turnover in dates." Attached thereto was a statement which was headed "Sydney, 31st December 1925. —In account with Distributors' Commercial Company Ltd.— Harry Shelley Esq.—Commissions, Bonuses, &c., earned for the year." The account then set out a list of goods (including kerosene,

£242 12s.) amounting to £1,201 4s. 4d.; less amounts paid (£31 13s. 6d.), less loss on dates (£94 16s. 9d.), less other deductions (£103 10s. 4d.), £230 0s. 7d.: £971 3s. 9d.

20. In the years ending 31st December 1924 and 31st December 1925 the amount received by the Company in respect of the ½ per cent in par. 15 and preceding paragraphs hereof mentioned was more than sufficient to pay the working expenses of the Company and the dividend mentioned in par. 18 hereof. The balance of the said amount of ½ per cent was placed to the credit of the reserve fund of the Company, and the amount paid by the Company to the appellant on 25th March 1926 in respect of the commodities (other than kerosene) purchased by the appellant was equal to the amount of the special discount granted by the manufacturers or importers in respect of such commodities.

21. In some years in the case of some commodities (other than kerosene) the amount of ½ per cent above-mentioned was less than what the Company estimated to be a fair charge for the expenses incurred by it in respect of such commodities, and in such cases the Company did not divide the full amount of the special discount paid to it among the purchasers of such commodities but divided only the part thereof remaining after the further expenses attributed to the said commodities had been deducted. In respect of kerosene the amount paid by the Company to members was in all years determined by dividing the difference between the receipts and the estimated costs of the Company of and in connection with kerosene among the members of the Company in proportion to their purchases of kerosene.

22. During the year ended 31st December 1925 the Company ascertained by correspondence with all its members the aggregate of their requirements in respect of dates. The quantity so ascertained was purchased by the Company through agents in Sydney at a special discount in addition to the usual trade and cash discounts. On arrival in Sydney the dates were placed in bond, and the amounts required by each member were delivered to him from time to time, the price which the Company charged each member being ascertained in the manner described in par. 11. During the month of June 1925 the stock of dates in bond was inspected by the Company and it was

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found that portion thereof had deteriorated and that portion was unsalable. The price charged to members, after such inspection, was reduced by an amount agreed upon at a meeting of the Company. The Company made a loss in respect of its purchase of dates owing to the said deterioration, and in March 1926 the loss was apportioned between the members in proportion to their original estimates of their requirements, and each member's proportion of the said loss so ascertained was deducted from the amount payable to him as aforesaid in March 1926.

23. The sum of £971 3s. 9d. mentioned in par. 19 hereof was made up as follows:—(1) Amount payable to the appellant in respect of his purchases of goods comprised in schedule A as set forth in par. 11 hereof £2 16s. 8d.; (2) amount payable to the appellant in respect of his purchases of goods comprised in schedule B hereof as set forth in par. 12 hereof £204 17s. 3d.; (3) amount payable to the appellant in respect of his purchases of goods comprised in schedule C hereof as set forth in par. 13 hereof £692 13s. 8d.; (4) amount payable to the appellant in respect of his purchases of kerosene as set forth in par. 14 hereof £242 12s.; (5) amount payable to the appellant as stated in par. 15 hereof £26 11s. 3d.: £1,169 10s. 10d. Appellant's proportion of loss on purchase of dates £94 16s. 9d.; amount due by the appellant to the Company in respect of other transactions £103 10s. 4d.; by cheque 25th March 1926 £971 3s. 9d.: £1,169 10s. 10d. Of the said sum of £1,142 19s. 7d. (total items numbered 1, 2, 3, 4, above) the sum of £44 12s. 1d. was the sum payable to the appellant by the Company in respect of his transactions with the Company in the year ended on 31st December 1924. No part of the said sum of £971 3s. 9d. was paid to the appellant by way of dividend on shares.

24. The appellant made a return of his income derived by him in his business during the year ended 30th June 1926. For the purpose of arriving at the amount of the net profits earned by him in the said business in the said year the appellant did not include the said sum of £971 3s. 9d. as a receipt of the said business, but he deducted the said sum of £971 3s. 9d. from the amount of the purchases made by him for the purpose of his said business.

25. The respondent made an assessment of the taxable income of the appellant derived by him during the year ended 30th June 1926. In making such assessment the respondent did not allow the said deduction of the sum of £971 3s. 9d. and disallowed the said claim of the appellant.

26. The appellant paid the tax claimed in the notice of assessment, and by notice of objection dated 29th March 1927 objected to the assessment.

27. The respondent disallowed the objection.

The questions stated by *Knox* C.J. for the opinion of the Full Court were as follows:—

(1) Is the appellant entitled for the purposes of the *Income Tax Assessment Act* 1922-1925 to make the deduction of the said sum of £971 3s. 9d. or any part thereof, and, if so, what part thereof as claimed in the return of income of the appellant derived by him during the year ended on 30th June 1926 ?

(2) Is the appellant liable to pay income tax under the *Income Tax Assessment Act* 1922-1925 in respect of the said sum of £971 3s. 9d. or any and, if so, what part thereof ?

The notice of objection above referred to set out (1) that the assessment was excessive and contrary to law; and/or (2) that the assessment should be reduced for the following reasons: (i.) that an amount of £971 representing rebates received from the Distributors' Commercial Co. Ltd. has been wrongly included in arriving at the taxable income on which the assessment is based; (ii.) that the Distributors' Commercial Co. Ltd. is a co-operative company and at least ninety per cent of its sales was made to its own members; (iii.) that the taxpayer is a member of the Distributors' Commercial Co. Ltd. and the amount of £971 represents rebates received by him on purchases made from the Company; (iv.) that the amount of £971 is not taxable under the *Income Tax Assessment Act* in accordance with the definition of "income" in sec. 4 of such Act; (v.) that the definition referred to specifically exempts the amount of £971 from taxation; (vi.) that the said amount of £971 is not taxable and the taxable income should be reduced accordingly.

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By reason of the appellant's admission in par. 16 of the case stated, the amount actually in dispute was reduced from £971 3s. 9d. to £944 12s. 6d.

Other material facts appear in the judgments hereunder.

W. J. V. Windeyer, for the appellant. The money is a rebate and therefore the appellant is entitled to the deduction; otherwise he would be paying income tax on something which the Act says is not income.

[*Alroy Cohen.* Sec. 4 of the Act as to "income" does not apply to such a company as the Distributors' Commercial Co.]

[KNOX C.J. A further question arises: Whether on the facts stated the Distributors' Commercial Co. is a co-operative company within the meaning of sec. 4 of the *Income Tax Assessment Act* 1922-1925.]

The definition of "co-operative company" as appearing in sec. 20 (1A) of the *Income Tax Assessment Act* 1922-1925 is only for the purpose of that section, and was introduced by the 1925 Act. Whether the Distributors' Commercial Co. is a co-operative company is a question of fact which must be determined by an examination of its memorandum and articles of association. The objects of the Company show that it was formed to promote economical buying of certain commodities on the co-operative principle and to sell such commodities to its members to the mutual advantage of such members. An organization which sells goods to members and divides profits amongst its members in proportion to purchases is a co-operative society. Although the Company does not directly satisfy the requirement of sec. 20 of the Act in respect of the limitation of the number of shares held by or on behalf of each member, if it be material, it does so indirectly as by art. 42 a transferee of shares must be approved by the Company.

[ISAACS J. Art. 137 describes the payments as a "bonus," not a "rebate."]

The mere fact that by art. 137 provision is made for the distribution amongst members of certain profits as bonus will not make the money so received taxable under the Act. Although designated "bonus" it should be regarded as rebate. "Bonus" in the Act

means a payment in proportion to the value of shares held, not in proportion to the amount of purchases made. It might be suggested that in all the transactions disclosed in par. 11 of the case stated the Company was an agent only. The test is whether a manufacturer who supplied goods could look to the members or to the Company to pay for them.

The appellant is entitled to a share of the rebate as a purchasing member. All the members of the Company are merchants interested in one particular phase of business and they formed the Company to promote their interests. The provision in art. 137 that surplus profits shall be divided between the members for the time being in proportion to the amount of their respective purchases from or through the agency of the Company is an indication that the Company is a co-operative one. If a company such as the Distributors' Commercial Co. engages with non-members, it should have a separate account, which is then income of the Company (*New York Life Insurance Co.* v. *Styles* (1)). Apart from the definition in the Act the position is dealt with in *Jones* v. *South-West Lancashire Coal Owners' Association* (2). (See also *Last* v. *London Assurance Corporation* (3).) Those cases decide that moneys received from a purely mutual association are not income ; the Act allows the " purely mutual " feature to be modified by 10 per cent. Art. 149—which provides that in the event of the Company being wound up the surplus assets are to be distributed to members, firstly, in payment of paid-up capital ; secondly, in payment of a dividend of 8 per cent on paid-up capital, and, thirdly, in proportion to the purchases of each respective member from or through the agency of the Company—points to the Company being a co-operative company. As to whether it is or is not, should be tested by the nature of the business it actually carries on. Some of the objects of the Company are definitely stated to be co-operative ; all the others can be carried out in a co-operative way. The payment of a dividend by a company does not make it any the less a co-operative company (see *Co-operation, Community Settlement, and Credit Act* 1923 (N.S.W.), sec. 47 (14)). There is nothing to suggest that the Company is to carry on

(1) (1889) 14 App. Cas. 381. (2) (1927) A.C. 827, at p. 832.
(3) (1885) 10 App. Cas. 438.

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in any other than a co-operative way. Among its objects as stated in the memorandum of association are those indicated in *Palmer's Company Precedents*, 13th ed., Part I., p. 532, as proper for a co-operative company.

Alroy Cohen, for the respondent. The Distributors' Commercial Co. is not a co-operative company. The onus is on the appellant of showing that it is. Its objects are as wide as those of an ordinary company, but in addition it has certain objects which suggest certain privileges to its members. After payment thereout of a dividend the balance of profits is distributed as a bonus in proportion to the purchases of members. A co-operative company is one which must, not may, carry on a co-operative business: it is not what a company does, but what it must do. It may sell to non-members only to further its own objects to remain co-operative. The Company does not come within the definition contained in sec. 20 (1A) of the *Income Tax Assessment Act* 1922-1925 as its rules make no provision for the prohibition of the quotation of its shares on the Stock Exchange, nor for the limitation of the number of shares which may be held by or on behalf of any one member. One only of the objects of the Company refers to the carrying on of a co-operative store, and by the same clause the Company is empowered to carry on "all kinds of agency business." The object "to promote economical buying on the co-operative principle" is the strongest reference to the co-operative system, but not to a co-operative company (*Halsbury's Laws of England*, vol. XVII., p. 4; *Encyclopædia of Forms and Precedents*, vol. X., p. 203). The Company is really a partnership between a number of persons by whom an individual is appointed to buy for, and sell to, them on better terms than anyone else. Collective buying is one only of many features requisite to evidence a co-operative society; when ascertaining how much was paid for goods purchased, prima facie "paid" means "paid out-and-out" or "finally paid" (*D. & W. Murray Ltd.* v. *Federal Commissioner of Taxation* (1); *O'Sullivan* v. *Thomas* (2)). The amount so paid here was the total amount of the invoice prices less certain proper credits and the sum of £971 now being dealt with (*Doughty* v. *Commissioner*

(1) (1927) 40 C.L.R. 148, at p. 152.

(2) (1895) 1 Q.B. 698.

of Taxes (1)). Sec. 23 of the Act shows how the taxable income is to be calculated.

W. J. V. Windeyer, in reply. The money cannot be regarded as a discount on the purchase-money paid by the trader for goods during the year of income, for the rebate is calculated in respect of the Company's trading year, which is a different period from the year of income. [He also referred to *Tennant* v. *Smith* (2) and to *Third Report of the Royal Commission on Taxation*, 1921, Fed. Parl. Papers 1922, vol. II., p. 1145.]

Cur. adv. vult.

Nov. 4.

The following written judgments were delivered :—

KNOX C.J. I have had the advantage of reading the reasons about to be published by my brother *Dixon*, and agree with him in thinking that the constitution of the Distributors' Commercial Co. Ltd. is lacking in distinctive features essential to the constitution of a "co-operative" company properly so called. I agree also that clause 137 of the articles of association is not sufficient to render the Company "co-operative." Indeed, it seems to me that in its present form that clause amounts to a negation of the co-operative principle. It is not necessary in this case to decide whether a company formed for the sole purpose of benefiting middlemen, who are neither producers nor consumers, and whose benefit is only attainable at the expense of either the producer or the consumer, can properly be classified as a "co-operative" company, and I desire to reserve my opinion on this question.

In my opinion the question should be answered : (1) No ; (2) Yes.

ISAACS J. The appellant is a merchant and importer, and is taxable in respect of his business income. As to the amount of his actual gross income from his business, there is no question. But he claims to have that income reduced by a sum of £971 3s. 9d., received from the Distributors' Commercial Company Ltd.

The claim is rested on the provision in sec. 4 of the *Income Tax Assessment Act* that in that Act "income" does not include "any

(1) (1927) A.C. 327. (2) (1892) A.C. 150, at p. 154, per Lord *Halsbury* L.C.

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Isaacs J.

rebate received by a member of a co-operative company based on his purchases from that company, where the Commissioner is satisfied that ninety per centum of its sales is made to its own members." I shall assume for present purposes that the sum in question answers the description in that provision.

It is plain that wherever the word " income " is found in the Act, it must, in the absence of a contrary intention appearing, be read so as to exclude the sum of £971 3s. 9d. Consequently, that sum does not form part of the taxpayer's gross income, although in the absence of that provision it might be included by virtue of sec. 16 (*b*). If, therefore, the Commissioner had proceeded to add it to the gross proceeds of the business, which do not include it, and would remain the same even if the rebate had never been received, the taxpayer could rightfully have insisted on its excision. But could he also have insisted, as he is doing here, not only on its absence from the gross income side of the computation, but also on its addition to the deductions from the rectified gross income ? To do so would require some provision in the Act allowing it. " Taxable income "—which, of course, excludes this rebate—" means the amount of income remaining after all deductions allowed by this Act have been made." The deductions allowed by the Act include losses and outgoings actually incurred in producing income. When a rebate is made to a purchaser of goods based on his purchase, it means that his purchase price is by so much the less. To support the claim, therefore, the deduction of the rebate from the nominal price must be excused, or its deduction from the gross income allowed, by some express provision. No such provision exists. It comes to this, that the provision relied on is irrelevant, because the Commissioner is not seeking to tax it ; and there is no other provision enabling the taxpayer to ignore it in arriving at his actual cost of purchases, nor can one see why there should be.

The notice of objections and the case stated treat the sum of £971 3s. 9d. as entire in relevant characteristics and legal result. Sec. 39 of the Act makes the assessment prima facie evidence that the amount and all the particulars of the assessment are correct, and there is nothing to show the contrary in respect of time. The case may therefore be determined on this point alone. Still, as

co-operative companies are considered by the Legislature sufficiently important to receive special attention, I think I ought to express my opinion on this part also.

It is true that sub-sec. 1A of sec. 20 says that the definition of "co-operative company" is "for the purposes of the last preceding sub-section." But it does not say for that sub-section only. It is therefore open as a matter of construction of the Act as a whole to see whether any other meaning is intended in sec. 4. It is highly improbable that Parliament intended by "co-operative company" two different kinds of company. It is still more improbable that the "rebates based on purchases by shareholders from the Company" in sub-sec. 1 meant anything different from "rebate received by a member of a co-operative company based on his purchases from that company" in sec. 4. Again, the language in sec. 20 as to commodities and animals is so strikingly like that in sec. 4 that I cannot doubt they were fashioned in the same mould of thought and were meant to be worked together. But, adopting that view, I cannot find in the rules of the Company any limitation of the number of shares which may be held by or by and on behalf of any one member, or which prohibits the quotation of the shares at the Stock Exchange.

For this reason also I think the first question should be answered in the negative, and the second in the affirmative.

DIXON J. The taxpayer complains that his taxable income derived during the twelve months ending 30th June 1926 has been assessed for the succeeding financial year at an amount too large by the sum of £944 12s. 6d. This sum is the balance of an amount which he received on 24th March 1926 from a company of which he was a member, called formerly "Distributors' Co-operative Company Limited" but now "Distributors' Commercial Company Limited." The amount which he so received was composed of two sums.

The first, a comparatively small sum, was calculated upon the purchase price of goods supplied to him by or through the Company during the twelve months ending 31st December 1924. The second, the larger sum, was calculated upon the purchase price of goods supplied to him during the twelve months ending 31st December

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1925. The taxpayer contends that these sums should be excluded in the ascertainment of his taxable income because of par. (*c*) of the definition of "income" in sec. 4 of the *Income Tax Assessment Act* 1922-1927. That paragraph provides: "'Income' . . . does not include (*c*) any rebate received by a member of a co-operative company based on his purchases from that company where the Commissioner is satisfied that ninety per centum of its sales is made to its own members." The Commissioner was in fact satisfied that ninety per cent of the Company's sales were made to its own members, but he denies that it was a co-operative company. He further maintains that even if the Company were co-operative, the taxable income should not be reduced by these sums. He says that par. (*c*) of the definition of "income" does no more than forbid the inclusion of rebates from a co-operative company in the assessable income as revenue; that properly understood the sums in question are not receipts or revenue, but mere reductions or diminutions of the amounts which otherwise the taxpayer would expend in acquiring his goods. Sec. 23 (1) provides that "in calculating the taxable income of a taxpayer the total assessable income derived by the taxpayer . . . shall be taken as a basis, and from it there shall be deducted (*a*) all . . . outgoings . . . including . . . expenses actually incurred in gaining or producing the assessable income." The Commissioner concedes that when he is satisfied that ninety per cent of the sales of a co-operative company are made to its own members, rebates received by a member based on his purchases from that company are not to be included in the member's total assessable income, but he contends that if these purchases are made in the way of trade or business, and the sums laid out in them are therefore to be deducted as outgoings or expenses incurred in gaining the assessable income, then it is not the gross amount charged in the first instance which is to be deducted from the assessable income but the net amount actually expended, arrived at by diminishing the gross amounts by the rebates. It is to be observed that this argument leaves little or no operation to par. (*c*). For if a rebate, based upon purchases, is a mere reduction of expenditure, it could not be a receipt or constitute revenue, whether the expenditure was made in order to produce income, or for some other reason.

It would thus be needless to provide that income should not include such rebates.

It is further to be remarked that the contention does not give a consistent application to the provisions of sec. 23 (1) (*a*) upon which it depends. It is based upon the view that sec. 23 (1) (*a*) prescribes the method of ascertaining the profits of a business. This view was expressed by *Higgins* J. in *Webster* v. *Deputy Federal Commissioner of Taxation* (1) as follows:—"To determine the 'profits' of the business is not—I say it with all respect—'the first step' to be taken. Under the definition in sec. 4 of 'income from personal exertion,' the first step is to ascertain the 'proceeds'—the gross proceeds—of the business carried on by the taxpayer. These proceeds (including all the moneys realized from the sale of trading stock or wool) become the 'assessable income'; from the assessable income have to be deducted (*inter alia*) 'all losses and outgoings (*not being in the nature of losses and outgoings of capital*)' (sec. 23 (1) (*a*)). What remains after the deductions is the 'taxable income' (sec. 4; sec. 23)." But this view necessitates a comparison between the sum of actual gross receipts and the sum of actual gross expenditure incurred in gaining income. The taxpayer actually expended the full purchase price of the goods, and actually received the sums said to be rebates. But instead of applying sec. 23 (1) (*a*) by first getting the total gross revenue, the assessable income which (but for par. (*c*) of the definition of "income") would include the rebates received and then ascertaining the total "outgoings" or "expenses" which would include the full price paid over for the goods, this full price is first diminished by deducting the rebate, and not until it is so diminished is it included in the outgoings.

But apart from these considerations this contention of the Commissioner is misconceived. For, upon the facts of this case, it does not operate to support the assessment. The rebates in question were not allowances made in respect of the price of the goods bought or paid for in the twelve months in which the income under assessment was derived, but in respect of purchases made in two consecutive periods of twelve months the last of which ended in the middle of this year of income. Thus the sums in dispute are not discounts or

(1) (1926) 39 C.L.R. 130, at p. 135.

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reductions of expenditure which otherwise would be allowed in full as a deduction in the year of income. It is true that there is a period of six months common to the year of income and to the last year for which the rebate was paid. It may therefore be that some part of the last rebate was in fact attributable to purchases made or paid for within the year of income, but the special case does not state that this is so. On the contrary it deals with rebates as entire sums. It follows that if Distributors' Commercial Co. Ltd. is a co-operative company within the meaning of par. (*c*) of the definition of "income," the two sums which compose the amount of £945 17s. 6d. ought not to be included in the assessment. The question whether it is a co-operative company must therefore be considered.

This does not depend upon the artificial definition of co-operative company introduced into sec. 20 as sub-sec. 1A by the *Income Tax Assessment Act* 1925 (No. 28 of 1925). That definition is confined in its application to sec. 20 (1), and can only be of indirect assistance in determining the connotation of the expression used in the definition of "income" in sec. 4. To discover that connotation is no easy matter. The word "company" is defined to include all bodies or associations corporate or unincorporate. But what attributes must such a body or association possess in order to answer the description "co-operative"? "Co-operation" is defined by the *Oxford New English Dictionary* to mean, when used in political economy, "the combination of a number of persons, or of a community, for purposes of economic production or distribution, so as to save, for the benefit of the whole body of producers or customers, that which otherwise becomes the profit of the individual capitalist." But it appears from a survey of the long history of the "Co-operative Movement," and a perusal of some of the works which describe the many applications of its principles, that the means by which this general purpose is worked out vary almost without limit. Indeed, the opening statement of the supplementary article on Co-operation in the 12th edition of the *Encyclopædia Britannica* does not go too far in saying that the term covers a large number of forms of economic organization which have little resemblance except that of name. The author (Mr. *Leonard Woolf*) simply resorts to classification. "Co-operative organizations may," he says, "be conveniently

classified under four main heads :—Consumers Co-operation, Industrial Producers Co-operation, Co-operative Credit and Banking, Agricultural Co-operation." This or some similar classification is generally adopted, but usually without much attempt to discern and define the common characteristics which the word " co-operation " is intended to express. The late Mr. *Aneurin Williams*, who contributed the article upon Co-operation to the 11th edition of the *Encyclopædia Britannica*, was alive to the lack of a clear conception of what the term " co-operative " exactly connotes when thus used, and he made some endeavour to supply the want. In effect, he considered that there must be a voluntary association or working together for the production or distribution of wealth, but so that the shares of those concerned were not determined by competition (i.e., a struggle and the relative ability of each to secure a large share) and so that all concerned had an opportunity to share in the ultimate control. But he found it necessary to add :—" We speak of co-operative societies for agriculture, for manufacturing, for retail, or wholesale distribution, for building or house-owning, for raising capital and so forth ; while the great Friendly Societies though a part of co-operation as a theory of life, are not part of the co-operative movement. The line is somewhat hard to draw, and consequently is drawn somewhat arbitrarily. Thus while a society for building, or for the collective ownership of houses, is counted a co-operative society, a building society (as we ordinarily understand the term), though it be purely mutual in its basis, is not so counted in Great Britain, but is in the United States." This attempted analysis leaves out of account an element which some writers, who perhaps discuss co-operation rather as a means of social, economic or industrial amelioration, describe as essential to the conception. This element is the free or unrestricted admission to membership of the co-operative association. Thus Mr. *C. R. Fay* in his *Co-operation at Home and Abroad* (2nd ed., 1920, pp. 4-5) says :—" The ultimate criterion is this : are the members prepared to admit to the benefits of their society on proportionately equal terms all those who, being of suitable character, are commercially as weak as or weaker than themselves ? If so, the society is co-operative. We have, therefore, as our final definition of the co-operative society : ' An association for the

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purposes of joint trading, originating among the weak and conducted always in an unselfish spirit, on such terms that all who are prepared to assume the duties of membership share in its rewards in proportion to the degree in which they make use of their association.' Any narrower definition runs the risk of excluding much that claims, and is recognized, to be co-operative." (See, too, *Webb, Consumers' Co-operative Movement*, at p. 9.) The capacity of such an association to enlarge its membership is almost necessarily inconsistent with a distribution of dividend upon share capital, and with the existence of a fixed capital divided into shares. To multiply shares would tend to reduce dividends, if what the rules of the co-operative union describe as " the fund commonly called profit," was distributed as a dividend upon share capital. But additional members could not be admitted indefinitely without indefinite multiplication of shares.

Those who regard co-operation from a business point of view find that the thing which distinguishes it from all other forms of organization for trading or production, is that the surplus remaining after the capital invested has been rewarded by a fixed percentage and all expenses have been met, is distributed or allocated among the members in proportion to their dealings. Thus in the Co-operative Wholesale Societies' Bank, the surplus, which remains after a period of business, is appropriated to increase interest upon deposits, and to reduce the charge for overdrafts. (*Webb, Consumers' Co-operative Movement*, p. 99). In Ireland the provision usually made by the co-operative agricultural and dairying societies is, or was, (1) that the surplus arising from general business should be appropriated first in payment of a fixed percentage on share capital, next in a subvention to reserve, and then in a distribution of the balance among members in proportion to their sales through, and purchases from the society; (2) that the surplus arising from the dairying business, after providing for a fixed percentage on share capital should be appropriated in paying to employees an additional remuneration of a specified percentage on wages, and in distributing the balance amongst those who supplied milk, cream or other produce to the society, in proportion to the value of their supplies. (See *Industrial Co-operation*, 3rd ed., p. 153, by *Catherine Webb*). In consumers' co-operation, although an equal division of profits is recognized (see *Walker*,

Political Economy, sec. 433), a division according to the value of purchases is required by what is called "the Consumers' Theory of Co-operation." "This," says Mr. *Aneurin Williams* in his *Co-partnership and Profit Sharing*, at p. 215, "is, that all profit is due to the consumer, that, in fact, the value of everything is caused by him, seeing that if there were no consumers desiring to purchase, even the rarest thing, and the thing produced with the most labour and capital would be valueless. If the consumer, says this theory, be charged 7d. for what costs the producer 6½d. to produce—including cost of materials, wages, and all necessary expenses—then he is overcharged a ½d., and he has a claim to have that ½d. returned to him. If the ½d. is retained by the producer it is a profit on the price for which he sells the article, and profit on price is the forbidden fruit in the eyes of this school. They claim that a society which pays out its so-called profits to its customers as a dividend on their purchases, does not really make any profit; it merely retains, temporarily, a balance belonging to the consumer and ultimately returned to him."

The British Legislature took account of these features in co-operation, and by the *Industrial and Provident Societies Acts* 1852, 1862 and 1876 (now consolidated in that of 1893) provision was made for the incorporation and regulation of societies with limited liability but without a specified nominal capital and therefore capable of admitting an indefinite number of members. A limit was placed upon the number of shares which one person might hold. In partial recognition of the theory of profit, or absence of profit, held by co-operators, it was provided that a registered society should not be chargeable under Sched. C of the Income Tax Acts (profits arising from interest, annuities, dividends and shares of annuities payable out of any public revenue) or Sched. D (balance of profits or gains from trade, vocation, &c.) unless it sells to persons not members thereof, and the number of shares of the society is limited either by its rules or its practice. (See sec. 24 of the *Industrial and Provident Societies Act* 1893 (56 & 57 Vict. c. 39) and sec. 39 (4) and 7th Sched. of the *Income Tax Act* 1918 (8 & 9 Geo. V. c. 40)). The profits or surpluses of such societies were, however, subjected to excess profit duty (see *Finance Act* (*No.* 2) 1915, 4th Sched.,

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Part. I., cl. 10, and *Finance Act* 1917, sec. 26 (8)). And corporation profit tax was imposed upon any profit not paid out by way of bonus, discount, or dividend on purchases. (See sec. 53 (2) (*h*) of *Finance Act* 1920 (10 & 11 Geo. V. c. 18); see too *Webb, Consumers' Co-operative Movement*, pp. 259 *et seq.* and 263 (n).)

The various forms of co-operation described above were all known in Australia and many of them were practised (see "*Co-operation in Australia*," contributed to the *Commonwealth Year Book* No. 17 (1924), at pp. 581 *et seqq.*, by Mr. *H. Heaton*, lecturer in economics, University of Adelaide). But it was not until the *Income Tax Assessment Act* 1918 that any special provision was made in the Federal income tax law in respect of co-operative companies. That Act inserted in the definition of "income" a provision that it should include "(*b*) in the case of a co-operative company or society—all sums received from members in payment for commodities supplied or animals or land sold to them or received in respect of commodities animals or land sold by the company or society whether on its own account or on account of its members." This provision is necessarily confined, on the one hand, to what may in spite of the mention of land be called "consumers' or consumptive co-operation," and on the other, to co-operation for the disposal of vendible things. But in spite of the restriction in the application of the term co-operation which this involves, it remains possible to contend that a company is not co-operative (1) if its membership is limited; (2) if its control is not vested in members equally, or according to dealings, but according to investment or subscriptions of capital; (3) if its constitution does not require the division of "the fund commonly called profit" among the members who deal with it in proportion to their dealings; or (4) if its purpose or primary purpose is not to serve the "consumer" or the user as such, or the "producer" as such, as the case might be. Possibly the enactment was necessary only by way of precaution and did not in fact alter the law. For it might be supposed that the sums derived by such co-operative companies from transactions would fall within *Last* v. *London Assurance Corporation* (1) rather than within the *New York Life Insurance Co.* v.

(1) (1885) 10 App. Cas. 438.

Styles (1) and *Jones* v. *South-West Lancashire Coal Owners' Association* (2). But, however this may be, it was followed by the enactment in the *Income Tax Assessment Act* 1921 of the provision that income should not include "(*c*) any rebate received by a member of a co-operative company based on his purchases from that company where the company is one which usually sells goods only to its own members." This was enacted probably because it was thought to be the logical consequence of par. (*b*). But it extends only to co-operation for the supply of goods, commonly called consumers' or consumptive co-operation. When in the Act of 1922 the provision was re-enacted in its present form, it was still confined in effect to this form of co-operation, although ten per cent of the society's sales may now be made to non-members and although sales of land may perhaps be included now that the word "goods" is dropped.

It is evident that the meaning of co-operative company in par. (*c*) can be no wider than in par. (*b*) and the contentions open as to the requirements of the term in the one case are open in the other. But whatever characteristics may be required in order to bring a company within that expression, it seems reasonably clear that the company must possess them by virtue of its constitution. It is not enough that a company may in fact conduct a series of transactions or a business upon principles which justify the title "co-operative." The company itself must be a union for "co-operation." To render the company co-operative by its constitution it is at least necessary that the contract *inter socios* shall be "co-operative."

Distributors Commercial Co. Ltd. was incorporated in 1916 under the *Companies Act* 1899 of New South Wales by the name Distributors Co-operative Co. Ltd. Its members were and are merchants. Amongst the objects of its memorandum were the following: "(9) To carry on the business of a co-operative store and general supply society in all its branches and to transact all kinds of agency business; (11) to promote economical buying on the co-operative principle; (15) to control, conduct and organize the trade of the members of the Company and promote their mutual benefit; (16) to disseminate trading intelligence amongst the

(1) (1889) 14 App. Cas. 381. (2) (1927) A.C. 827.

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members of the Company and mitigate bad debts." But its objects were 62 in number, and enabled the Company to do almost anything, and to do it on ordinary commercial or capitalist principles. The Company was limited by shares, and its nominal capital is £100,000 divided into 1,000 shares of £100 each. The transfer of shares is restricted to persons approved by an extraordinary resolution of the Company. No limit is placed upon the number of shares a member may hold.

It is not easy to interpret the articles which relate to the votes of members (69-75), but probably their effect with sec. 248 of the *Companies Act* 1899 (N.S.W.) is to give to each member one vote, whether upon a poll or otherwise, irrespective of his shareholding. Arts. 137, 138 and 149 are as follows :—" (137) Subject to the provisions as to reserve fund and to any extraordinary resolution of the Company with respect to the same the profits of the Company which it shall from time to time determine to divide shall be divisible amongst the members by way of dividend at a rate not to exceed 8 per cent per annum on the share capital paid up from time to time and any balance remaining over after such payment of such dividend shall be divided between the members for the time being as a bonus in proportion to the amount of their purchases respectively from or through the agency of the Company as determined by the Company in general meeting." " (138) Subject to the foregoing clause the Company in general meeting may declare a dividend or bonus to be paid to the members according to their rights and interests in the profits and may fix the time of payment." " (149) If the Company shall be wound up the surplus assets shall subject to the rights of the holders of the shares issued upon special conditions be distributed amongst the members of the Company in the first place in paying to them the amount of capital paid up on their respective shares and in the second place in paying to them a cumulative dividend of 8 per cent per annum upon the amounts paid up on their shares respectively calculated from the date of registration of the Company but less all sums theretofore paid to such members by way of dividend and in the third place any surplus then remaining shall be distributed amongst the members of the Company in proportion to the amount of their purchases respectively from or through

the agency of the Company during the twenty-four calendar months next before the winding up of the Company."

The Company in fact has acquired and supplied to its members commodities in which they trade. It charged a price calculated by adding to the net cost price charged to it (but without deducting a special discount arranged for with the supplier) the costs of handling, &c., and ½ per cent to cover expenses and dividend of 8 per cent on its capital. The price so obtained was paid to it by its members, and was sufficient to meet the items of expenditure for which it was required. But in fact the Company obtained from its suppliers a special discount, with the result that a balance of profit remained to it and this was divided amongst the members. The special case says :—" The amount so divided was calculated separately in respect of each commodity in the manner hereinafter stated. That part of the amount so divided which was paid to each member in respect of each commodity (other than kerosene) was that part of the special discount allowed to the Company in respect of that commodity which the Company considered was attributable to that part of such commodity which such member had purchased." The distribution is not precisely in conformity with art. 137 because it discriminates among the various classes of commodities bought. The article contemplates a distribution of a lump sum of profit in proportion to all purchases. The principle of division is nevertheless co-operative in its general character. But the Company does not employ this principle of division for the purpose of supplying consumers or users of the commodities. The members whom it supplies are indeed traders, who deal in the commodity for profit. They are employing the co-operative principle to facilitate the very method of distribution which the originators of " The Co-operative Movement " desired to replace. But if by its constitution the Company had other attributes which would entitle it to the description co-operative, this fact might not be enough perhaps to take it outside the description. For instances are given of co-operative societies, one of which has even gone into production for exchange, and another accommodates shopkeepers with the use of its refrigerating store. (*Webb, Consumers' Co-operative Movement*, pp. 76, 80.) Indeed the Wholesale Co-operative Society which supplies retail societies is said to be

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no more than "practically" open only to co-operative societies (p. 96). Moreover, the definition in sec. 20 (1A) does not include such a requirement.

Desirable as it might be to formulate a definition of "co-operative company," the conclusion seems to be unavoidable that there is no one characteristic, the presence or absence of which is essential to the description co-operative. It is a term used to describe bodies which differ in character and purpose but possess enough of the features commonly associated with the description to bring them within one of the categories recognized as deserving the title.

But in the case of this Company most of the features are absent which are relied upon, whether alone or in combination, as a justification of the title Co-operative. It does not serve the consumer or user. Its membership is not open to all who may desire its services. Its capital is fixed. There is no limitation upon the number of shares to be held by one person. Its trade is not restricted to its members. It is not concerned with social, economic, industrial, or other amelioration. The facts upon which it depends for the title are that it distributes "the fund commonly called profit" among its members in proportion to their dealings, and that it is controlled by members who vote without reference to share capital. Perhaps these characteristics would be enough if the articles of association bound the Company absolutely to this course of distribution and this method of voting. But art. 137 is expressed to be subject to an extraordinary resolution. It does not prescribe what may be called "co-operative distribution" of profit. It merely requires it unless and until a three-fourths majority of those present at a meeting resolve otherwise pursuant to notice. Having regard to the absence of all other attributes of co-operation, such a provision in the contract *inter socios* is not enough to render the Company co-operative in its constitution.

For these reasons the first question in the special case should be answered No and the second Yes.

Question 1 *answered No*; *question* 2, *Yes. Costs, costs in the appeal.*

Solicitors for the appellant, *W. A. Windeyer, Fawl & Co.*

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

J. B.