

[HIGH COURT OF AUSTRALIA.]

W. THOMAS AND COMPANY LIMITED . APPELLANT ;
PLAINTIFF,

AND

THE COMMISSIONER OF TAXATION }
(WESTERN AUSTRALIA) . . . } RESPONDENT.
DEFENDANT,

ON APPEAL FROM THE SUPREME COURT OF
WESTERN AUSTRALIA.

Dividend Duties—Taxation—Profits—Realization of assets—Whether profits liable to dividend duties—Dividend Duties Act 1902-1924 (W.A.) (No. 32 of 1902—No. 35 of 1924), secs. 5, 6. H. C. OF A.
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Secs. 5 and 6 of the *Dividend Duties Act 1902-1924* (W.A.) impose a duty upon the profits made in every year by a company carrying on business in Western Australia.

Held, that when the Act uses the words all profits made by a company carrying on business, it is referring to profits arising from the trading or business operations of the company, and not to profits of any description, such as increments arising from the appreciation in the value or the realization of capital assets of the company, and, consequently, that profits arising on a realization of part of the company's assets were not liable to taxation under that Act.

Decision of the Supreme of Court Western Australia (Full Court) : *Thomas & Co. v. Commissioner of Taxation (State)*, (1930) 33 W.A.L.R. 54, reversed.

MELBOURNE,
Feb 24.
—
SYDNEY,
April 4.

Starke, Evatt
and McTiernan
JJ.

APPEAL from the Supreme Court of Western Australia.

The facts stated by the Court were as follows :—"The appellant, W. Thomas & Co. Ltd., is a company incorporated in South Australia, and carried on there and in Western Australia the business of flour millers and grain merchants. In 1927 an agreement was entered into between the Company and a trustee or agent for a

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Company about to be formed, whereby the business in Western Australia and the assets, plant and goodwill connected therewith were to be sold to the new Company for £190,000, whereof the sum of £160,000 was to be paid in cash, and the balance, £30,000, in three equal annual payments, either to the vendor Company or to H. V. Piesse, who had sold part of its business and assets to the latter Company. The vendor Company agreed, however, to apply for 160,000 ordinary shares in the new Company and pay the price in cash. The new Company was to have a nominal capital of £500,000, divided into 500,000 shares of £1 each, of which 200,000 shares were to be 8 per cent cumulative preference shares. The new Company was incorporated, and the agreement for sale and purchase duly completed. The substance of the transaction was that the appellant Company transferred its business and assets in Western Australia to the new Company for 160,000 shares at the face value of £1 each; also £30,000 in cash, which was required to pay off the vendor (H. V. Piesse) to the old Company. The Commissioner of Taxation, purporting to act under the *Dividend Duties Act* 1902-1924, assessed the profits made by the Company in Western Australia during the year ending on 31st October 1928 at the sum of £63,346. Included in this balance is the sum of £160,000, which the Commissioner treated as proceeds of sale under the agreement of 1927 already mentioned."

In respect of the profits so assessed the appellant Company objected to the assessment on the ground that the sum assessed was not a profit within the meaning of the *Dividend Duties Act* 1902-1924, and so was not chargeable with duty under the Act. The Commissioner disallowed the objection and the appellant Company took out an originating summons, which was referred by *Draper J.* to the Full Court, which held that the amount on which the dividend duty had been assessed was profit realized on the sale of capital assets; that in so far as such profit was distributable as dividend it was profit within the meaning of the *Dividend Duties Act* 1902; and that such profit was distributable as dividend if upon such distribution the paid-up capital of the Company was left intact: *Thomas & Co. v. Commissioner of Taxation (State)* (1).

The Full Court referred the originating summons back to *Draper J.* to determine what portion of the amount was profit within the meaning of the *Dividend Duties Act 1902*.

A deed of settlement which constituted the memorandum and articles of the appellant Company provided:—"Dividends. Clause 95.—The directors may, whenever they shall think fit, declare out of the profits of the Company such dividends as such profits shall permit after making all proper allowances for bad and doubtful debts, depreciation in stock and plant, and providing for all proper contingencies, and such profits shall be divisible amongst the members of the Company in proportion to the amount paid upon the shares held by them respectively. Clause 96.—No dividend shall be payable except out of the profits arising from the business of the Company."

From the decision of the Full Court the appellant Company now appealed to the High Court.

Robert Menzies K.C. and *Frisby-Smith*, for the appellant. The profit on realization was an accretion to capital and was not taxable as a profit taxable under the *Dividend Duties Act*. The tax appears to have been first imposed on dividends but later it was imposed on profits as at their source. In the case of shipping companies the tax is on receipts and in the case of insurance companies it is imposed on premiums. *McMillan C.J.* considered that the only question he had to consider was whether this sum could have been distributed as a dividend, and treated the matter as a question of company law unaffected by any articles. This completely ignores the character of the legislation that imposes the tax. The Act imposes a tax only on profits and not on dividends and profits. It is clear from the terms of the Act that the profits that are taxed are the annual profits which are made during the financial year and are represented by the balance of revenue over expenditure. They are trading profits calculated on a profit and loss basis. The capital asset in question has been earned and improved over a period of twenty-two years, and it would be fantastic to assume that it first got its value on 1st September 1927. As to the meaning of "profits" and "income," see *Webb v. Australian Deposit and*

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Mortgage Bank Ltd. (1). If a tax of a recurring nature is imposed requiring a return from year to year, prima facie the profits referred to are to be treated as being of a recurring nature. In *Hickman v. Federal Commissioner of Taxation* (2) the Court considered the question of profits arising from the sale of a business as a whole. In *Tebrau (Johore) Rubber Syndicate Ltd. v. Farmer* (3) it was held that a profit was not assessable to income tax but was an accretion to capital. For the purpose of recovering tax the subject matter of this Act is "profits." (See *Buckley's Companies Acts*, 10th ed., p. 662.)

[STARKE J. referred to *Ruhamah Property Co. v. Federal Commissioner of Taxation* (4).]

In *The Crown v. D. & W. Murray Ltd.* (5) the actual point decided was that a company, to determine its profits in any year for purposes of assessment to dividends duty, is not entitled to deduct the amount of dividend duty paid for any preceding year. (See also *Colonial Treasurer v. Lake View and Oroya Exploration Ltd.* (6).) The whole of the Act is pointed to taxing annual profits of a business, and therefore is not applicable to an accretion of capital which is in its nature not attributable to any particular year. Unless the appellant comes within sec. 6, it is not taxable, and that section contemplates annual profits.

[STARKE J. referred to the *Bawra Case* (*Commissioner of Taxes v. British Australian Wool Realization Association Ltd.*) (7).]

It was after *Colonial Treasurer v. Lake View and Oroya Exploration Ltd.* (8) that the 1918 Act was passed. That Act reiterates the word "profits" and also uses the words "during the year" (*Harris Scarfe Ltd. v. Commissioner of Taxation (State)* (9); *Commissioner of Taxation (W.A.) v. D. & W. Murray Ltd.* (10), which treats the determination of "profit" as a problem similar to the ascertainment of income tax profit; and also *Lawless v. Sullivan* (11)).

J. L. Walker, for the respondent. The main question involved in this appeal depends almost entirely on an examination of the

(1) (1910) 11 C.L.R. 223, at pp. 227, 233, 241.

(2) (1922) 31 C.L.R. 232.

(3) (1910) 5 Tax Cas. 658.

(4) (1928) 41 C.L.R. 148.

(5) (1909) 11 W.A.L.R. 92.

(6) (1916) 18 W.A.L.R. 83, at p. 85.

(7) (1931) A.C. 224; 47 T.L.R. 57.

(8) (1916) 18 W.A.L.R. 83.

(9) (1923) 26 W.A.L.R. 96.

(10) (1929) 42 C.L.R. 332, at p. 345.

(11) (1881) 6 App. Cas. 373.

Act in order to ascertain what is the intention and scope of the Act. In making that examination, considerable assistance will be obtained by an examination of the legislation commencing with the earliest Act, the *Companies Duty Act* 1899. Sec. 2 of that Act defines "dividend" as including every sum of money, &c. Sec. 4 deals with a company carrying on business in Western Australia. Sec. 5 deals with companies carrying on business both within and without Western Australia. "Dividend" includes both profits and also other sums intended to be distributed among members of the company. The definition of dividend is enlarged by the Act of 1902. In sec. 6 (1) of the Act of 1902 (now sec. 7 of the consolidated Act) is inserted the word "all" before the word "profits." In the 1902 Act as in the 1899 Act in the case of a company carrying on a business in Western Australia only, it was the declaration of the dividend that was the basis of the assessment and it was immaterial from what source the company got the funds from which it declared the dividend; and the same principle must apply with regard to companies carrying on business elsewhere as well. In the case of a company carrying on business both within and without Western Australia its profits would be those declared both within and without Western Australia, being the amount it would have to distribute among its shareholders. Sec. 14 of the Act of 1902 was amended and is now sec. 17 of the Consolidation. That section is intended to cover the case of a winding up where profits from capital and trading have been appropriated to reserve in circumstances which rendered them not available for dividend. Only those profits that are distributable are dutiable. There is no question of winding up, because the business of the Company is being carried on in South Australia and the assets are being taken over by the South Australian Company. The Court will assume that the assessment is correct unless the taxpayer shows the contrary. The duty is imposed on all profits made in Western Australia which the Company has power to distribute. The title of the Act and the provisions defining "dividend" show that the Act never purported to impose a duty on income but on profits. The *Companies Act* 1893, based almost entirely on the English *Companies Act* of 1862, shows that the Company had power to distribute these profits as dividends. Clause

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95 of the articles of the Company enables the directors to declare a dividend out of profits. On the authorities there is no doubt that, though a dividend could not be paid out of capital, that rule does not apply to a realization of a capital asset (*Lubbock v. British Bank of South America* (1); *Foster v. New Trinidad Lake Asphalt Co.* (2); *Cross v. Imperial Continental Gas Association* (3); *In re Bates*; *Mountain v. Bates* (4); *Bond v. Barrow Haematite Steel Co.* (5)). If profits beyond mere income profits are included, then the judgment of the Supreme Court is justified.

Frisby-Smith, in reply. *Stone v. Federal Commissioner of Taxation* (6) turns on the construction of sec. 32 (b) of the *Income Tax Assessment Act*, and no such section exists in this particular Act. The onus is on the Crown to show that the appellant falls within the Act and that this is a profit within the Act. The cases relied upon do not draw a distinction between payment of a dividend out of capital and payment of a dividend out of the realization of a capital asset (*Buckley's Companies Acts*, 10th ed., p. 666). The articles of this Company contemplate payment out of the profits arising out of the business of the Company only (*Buckley's Companies Acts*, 7th ed. (1897), p. 554). If this is a fund available for distribution as a dividend, it is in the hands of the shareholders to protect it. Article 95 leaves it open to the directors to determine whether such sum shall be profit or capital, and, if they have done so, it is not for the Court but for the shareholders or directors to determine (*Burland v. Earle* (7)). The amount in this case was left as an accretion to the capital account. [Counsel also referred to *Lawless v. Sullivan* (8).]

Cur. adv. vult.

April 4.

THE COURT delivered the following written judgment :—

STARKE, EVATT AND McTIERNAN JJ. [The facts as above set out were here stated, and the judgment continued :—] If the assets transferred were not worth £190,000, then the shares were not worth their face value, and the inclusion of the sum of £160,000 as a cash receipt

- (1) (1892) 2 Ch. 198.
- (2) (1901) 1 Ch. 208.
- (3) (1923) 2 Ch. 553.
- (4) (1928) Ch. 682, at p. 686.

- (5) (1902) 1 Ch. 353.
- (6) (1918) 25 C.L.R. 389.
- (7) (1902) A.C. 83, at p. 95.
- (8) (1881) 6 App. Cas., at p. 383.

might, in such circumstances, be open to some question in point of fact. (Compare *Doughty v. Commissioner of Taxes* (1).) But both parties to this appeal assumed a cash receipt by the Company of £160,000 under the 1927 agreement, and rested their respective contentions upon the construction of the *Dividend Duties Act* 1902-1924. Now, under this Act, secs. 5 and 6, a duty or tax is imposed upon all profits made by a company carrying on business in Western Australia, for a calendar year, or the balancing period of the company. That Act, as it originally stood, imposed a duty upon dividends declared by a company carrying on business in Western Australia (see *Swan Brewery Co. v. The King* (2); *Inland Revenue Commissioners v. Blott* (3)); but this provision was repealed by the Act 1915, No. 24, sec. 2, and, except as an aid to construction, is not now of any importance.

The question is whether the words "all profits" upon which the tax is imposed include not only the balance of trading profits over trading expenses, but also realized accretions or enhancements in value of capital or fixed assets. The income tax cases are not of much assistance, for there the tax is on income and not on profits (*Ruhamah Case* (4); *Bawra Case* in the Privy Council (5)). The Commissioner's contention is that "if a company acquires assets and with them carries on business, every increment of value, whether by way of appreciation of the assets or by way of profit earned in employing them," is a profit. In some sense it is a profit (*Buckley on Companies Acts*, 11th ed., p. 757; *In re Spanish Prospecting Co.* (6)). But in every case the question is what is the true meaning of the words "net profits," "profits," or, as in the present instance, "all profits," in the document to be construed. (Compare *Patent Castings Syndicate Ltd. v. Etherington* (7); *Vulcan Motor and Engineering Co. v. Hampson* (8).) The subject is not, of course, to be taxed unless the Act clearly imposes the obligation. The profits here taxed are profits made or earned during a calendar year, or the balancing period of the Company, and by a company carrying on business in Western Australia. Now, that indicates profits arising

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(1) (1927) A.C. 327, at p. 332.

(2) (1914) A.C. 231.

(3) (1921) 2 A.C. 171.

(4) (1928) 41 C.L.R., at p. 151

(5) (1931) A.C. 224; 47 T.L.R. 57

(6) (1911) 1 Ch. 92.

(7) (1919) 2 Ch. 254.

(8) (1921) 3 K.B. 597.

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from the business of the Company, and not profits of *any* description. They are the profits resulting from the trading operations of that year. But the Act formerly taxed dividends declared by a company carrying on business in Western Australia. That predicated profits of some kind, and, subject to any internal regulations of a company, accretions in value of capital assets might, when realized at all events, be brought into profit and loss and declared as a dividend (*Lubbock v. British Bank of South America* (1)). Consequently it is said that when the Act taxes "all profits" made by a company carrying on business in Western Australia, then profits available for dividends necessarily fall within the meaning of those words. This, we think, is the view at the basis of the judgment appealed from. But it is one thing to tax realized or ascertained profits declared and paid as a dividend, and quite another to tax profits calculated on a basis of comparison in the value of assets of a company at the end of a calendar year or the balancing period of the company—mere estimated profits: such a method might theoretically be possible, and yet practically difficult or impossible.

There is, as *Farwell J.* said in *Bond v. Barrow & Co.* (2), no single definition of the word "profits" which will fit all cases. One must return to the particular document to be construed, to its subject matter, and the context in which the word is found. The present Act is dealing with the profits of companies engaged in business, in commercial activities, and with the usual methods of drawing up accounts and ascertaining the profits of a business at the close of the calendar year or the annual balancing period of the business. It is quite unusual, and contrary to all commercial practice, to include under profits "gains and losses arising from causes not directly connected with the business of the company, such, for instance, as a rise in the market value of land occupied by the company." (See *Spanish Prospecting Co.'s Case* (3).) In the Act under consideration, the Legislature is dealing with commercial ventures, and must be taken to legislate with regard to the usual methods of ascertaining profits therein. Consequently, when the Act uses the words all profits made by a company carrying on business, it is

(1) (1892) 2 Ch. 198.

(2) (1902) 1 Ch., at p. 366.

(3) (1911) 1 Ch., at p. 99.

referring to profits arising from the trading or business operations of a company, and not to profits of any description, such as increments arising from the appreciation in the value or the realization of capital assets of a company.

In our opinion, therefore, the judgment of the Full Court should be reversed.

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Appeal allowed. Order of Full Court set aside.

Declare that the amount upon which the duty of £4,552 19s. 11d. has been assessed is not profit within the meaning of the Dividend Duties Act 1902-1924, and is not chargeable with duty under the said Act. Order that the respondent the Commissioner of Taxation pay the costs of the appeal to the Full Court and of this appeal. Remit case to the Supreme Court of Western Australia with the foregoing declaration.

Solicitors for the appellant, *Downing & Downing.*

Solicitor for the respondent, *J. L. Walker*, Crown Solicitor for Western Australia.

H. D. W.