

[HIGH COURT OF AUSTRALIA.]

THE FEDERAL COMMISSIONER OF TAXATION . APPELLANT ;

AND

THE STANDARD TRUST LIMITED . . RESPONDENT.

ON APPEAL FROM THE SUPREME COURT OF  
VICTORIA.

*Income Tax (Cth.)—Assessment—Assets company—Realization of assets—Profits—In what year profits earned—Income Tax Assessment Act 1922-1930 (No. 37 of 1922—No. 60 of 1930), sec. 13.*

A company was formed to take over, manage, nurse and realize the assets of three other companies and for other purposes. It credited to a reserve account a balance on revaluation and surpluses on realization of assets, profits arising from the purchase at a discount of debenture stock, and other items. By the end of the year 1925 and at the end of the year 1926 this reserve account amounted to £150,000. In 1927 the company appropriated this amount in substantially equal proportions between a general reserve account and a capital reserve account. The Federal Commissioner of Taxation assessed the company to income tax, in respect of so much of the sum of £150,000 as was derived from sources within Australia, on the basis that the sum was income of the year 1927.

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MELBOURNE,  
March 6-9.  
SYDNEY,  
April 24.  
Rich, Starke,  
Evatt and  
McTiernan JJ.

*Held* that the company was wrongly so assessed : The amount in the reserve account could not be regarded as having been held in suspense until 1927, and the appropriation in 1927 did not operate to make the amount income derived in that year.

*Commissioner of Taxes v. Melbourne Trust Ltd.*, (1914) A.C. 1001 ; 18 C.L.R. 413, distinguished.

Decision of the Supreme Court of Victoria (*Cussen* A.C.J.) affirmed.

H. C. OF A. APPEAL from the Supreme Court of Victoria.

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The Standard Trust Limited appealed to the Supreme Court of Victoria against an assessment to Federal income tax for the financial year 1928-1929 in respect of income alleged to have been derived by it during the year ended 31st December 1927. For the purpose of the proceedings the parties made admissions of fact which, so far as they are material to this report, were substantially as follows:—

1. The appellant company (hereinafter called “the appellant”) under the name of “Melbourne Trust Limited” was incorporated in England on 13th July 1903, and registered under and pursuant to the provisions of the *Companies Acts* of the State of Victoria as a company formed outside Victoria but carrying on business within that State, and in April 1927 its name was changed to “The Standard Trust Limited.”

2. Three banking companies incorporated in the State of Victoria, the English and Australian Mortgage Bank Ltd., the Federal Bank of Australia Ltd., and the City of Melbourne Bank Ltd., being unable to pay their debts, were ordered to be wound up prior to the year 1897. In that year three several schemes of arrangement were entered into between the banks severally and their respective creditors, the shareholders in none of the banks having any interest in the assets thereof, which were avowedly insufficient to pay the respective creditors. Under these schemes of arrangement the whole of the then existing assets of each of the banks was transferred to a separate assets company, and the creditors of the respective banks received in respect, and in full satisfaction, of their debts so much debenture stock and so many fully paid up shares in the respective assets companies. In pursuance of these schemes, three several companies were incorporated in December 1897. The objects in the case of each of the said companies were to acquire, take over and carry on the undertaking, property and assets of the respective liquidating bank for debenture stock and fully paid shares, to carry on the business of an assets company in all its branches and to nurse, use, employ, manage, develop, liquidate, for such time and to realize at such time or times as might be deemed expedient all property at any time coming into its possession.



3. The respective assets companies then proceeded gradually to realize the assets so transferred to them, and with the proceeds to pay off their respective debenture stock, which was by the terms of its creation redeemable stock. By the year 1903 the whole of the debenture stock of each assets company had been redeemed. During the whole of the life of the said assets companies both their shares and debenture stock were transferable and some of the shares and of the stock were in fact transferred.

4. The said three assets companies carried on their respective activities until the year 1903, when the appellant, under the name of "Melbourne Trust Limited," was incorporated, and under three several agreements made respectively with the three assets companies the appellant acquired the undertakings, including the unrealized assets, of the three assets companies, at a valuation, and as consideration therefor (*inter alia*) issued fully paid up shares and debenture stock which were distributed amongst the shareholders of the three assets companies.

5. The number of fully paid up shares and the amount of debenture stock issued by the appellant and distributed amongst the shareholders of the said three assets companies as aforesaid were as follows:—Shares: 1,366,659 of 4s. each, £273,331 16s. Debenture stock: £392,485 10s.

6. The assets acquired by the appellant from the three assets companies (hereinafter called "original assets") included (*inter alia*) five pastoral properties in Australia and one in New Zealand and certain city, suburban, and country lands, houses and shops in Australia and the Penang Sugar Estate in Fiji. The original assets were taken over by the appellant at a valuation amounting in the aggregate to the sum of £686,522 4s. 8d., which reproduced a valuation of such assets made by the assets companies respectively about four years prior to the date of such acquisition, and the appellant entered the original assets in its books at such values, totalling £686,522 4s. 8d. as aforesaid.

7. After its incorporation the appellant was engaged in carrying out certain of the objects for which it was formed and from time to time realized the original assets at such times and in such manner as its board of directors considered expedient. The appellant also,

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from time to time, purchased other assets and properties (hereinafter called "new assets") as part of its undertaking, and from time to time disposed of part of such new assets and up to and including the year ending 31st December 1925 included the surplus or deficit, as the case might be, resulting from such realizations of new assets each year in its profit and loss account for that year, and such profit or loss has been taken into account each year since 1920 in the assessment of the appellant for Federal income tax, but the appellant did not in any year include the surplus or deficit resulting from the realization of original assets in its annual profit and loss account nor did it include the same in its returns for the purposes of Federal income tax for any year.

8. The appellant from time to time from 1903 to 1909 applied moneys received, including portion of the moneys received from the realization of the original assets, in paying off its own debenture stock, partly by purchasing (sometimes at a discount) such stock by tender or in the market, and partly by redeeming the same at par. By 15th October 1909 the whole of the original debenture stock had been so paid off.

9. In the books of the appellant each year the surplus of the amount realized for the original assets disposed of during that year over the amount for which such original assets were entered in the books of the appellant was carried to an account which, until 31st December 1909, was called "Realization reserve account," to which was also carried any discount upon the purchase of debenture stock. On 31st December 1909 the net amount standing to the credit of the realization reserve account was £148,708 15s. 2d., made up of: (a) the surplus shown by the realization of original assets—£144,765 9s. 8d. (being the difference between the proceeds of such assets realized up to 31st December 1909, £477,490 0s. 9d., and the amount of £332,724 11s. 1d., the value at which the same had been acquired by the appellant); and (b) the amount of discount on purchases and cancellation of debenture stock by the appellant as aforesaid—£3,943 5s. 6d.

10. In or before the month of August 1910 the assets of another company, The Mercantile Bank Assets Co. Ltd., were acquired by the appellant, and in conjunction with this transaction and in order



that the book value of the appellant's original assets then unrealized might more accurately reflect their true value, the original assets were revalued and the book values thereof were increased by the sum of £121,033 11s. 2d. In the month of May 1910, a bonus of 6d. per share, amounting in all to £34,166 13s., and, in the month of August 1910, a distribution of debenture stock or cash in lieu thereof to shareholders at the rate of 3s. 4d. per share, amounting to £246,559 3s. 4d., were made.

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11. The following statement shows how in 1910 the said increase on revaluation and the then existing realization reserve account were appropriated :—

Realization reserve account as at 31st December 1909 .. .. .	£148,708 15 2
Surplus on absorption of The Mercantile Bank Assets Co. Ltd. .. .. .	28,782 7 8
Increase on revaluation of assets .. .. .	121,033 11 2
Revenue received and surplus shown by the realization of original assets between date of sale (1st January 1903) and date (31st October 1903) when the assets were transferred to the appellant .. .. .	24,171 15 8
	<hr/>
	£322,696 9 8
Distribution to shareholders of 6d. per share in cash in May 1910 .. .. .	£34,166 13 0
Distribution of 3s. 4d. per share in debenture stock in August 1910, or cash .. .. .	246,559 3 4
	<hr/>
	£280,725 16 4
	<hr/>
Balance carried to reserve account .. .. .	£41,970 13 4
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The item "Surplus on absorption of The Mercantile Bank Assets Co. Ltd., £28,782 7s. 8d." represents an increase on revaluation by the appellant of the assets acquired from such bank immediately after such assets were brought into its account.



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12. In each year from 1910 to 1925 inclusive, subject to the exception hereinafter mentioned, the difference between the amount realized for the original assets disposed of during that year and the amount for which such assets were respectively entered in the books of the appellant after such revaluation as aforesaid was carried, if a surplus, to the credit of the reserve account, and, if a deficiency, to the debit thereof. The exception was that in the year 1912 one of the original assets, a station property in New South Wales called "Coan Downs," was sold at a price which made a surplus on realization of £18,695 2s., of which only £5,000 was carried to the credit of the reserve account; and the balance of £13,695 2s. was applied in that year in the books of the appellant in writing down the then book value of the Penang Sugar Estate in Fiji, another of the original assets.

13. In each year from 1910 to 1914 inclusive an amount by way of discount on the purchase by the appellant below par of its debenture stock was credited to the reserve account, which amounts in the aggregate totalled £3,992 0s. 4d.

14. In the year 1910 a sum of £2,500, being the balance of a dividend equalization reserve created in 1907 out of profits earned prior to 1st January 1907, was transferred to the credit of the reserve account. In the year 1911 an amount was transferred from the balance to the credit of the appellant's profit appropriation account at 31st December 1910 to the credit of the reserve account, and later in the year 1911 a further amount was transferred to the credit of the reserve account from the profit appropriation account for that year, and thereafter in each of the years 1912 to 1925 inclusive, other than the year 1915, an amount was transferred from the appellant's profit appropriation account for the particular year to the credit of the reserve account. The aggregate of the transfers from 1911 to 1925 inclusive amounted to £61,896 13s. 7d.

15. In the year 1914 the sum of £1,032 5s., being premiums received on the issue of new shares by the appellant, and in the years 1919, 1920, 1921, and 1922 interest received on war loans, amounting in the aggregate to the sum of £10,313 3s. 6d., was credited to the reserve account.



16. In the year 1915 the sum of £18,721 2s. 4d. was debited to the reserve account. Such sum was made up of the items set out below, being moneys paid as a result of a judgment of the Judicial Committee of the Privy Council in certain litigation with respect to the liability of the appellant to income tax under the law of the State of Victoria, which had been the subject of proceedings in the Supreme Court of Victoria, and then in the High Court of Australia, and which came before the Judicial Committee of the Privy Council on appeal from the High Court of Australia (1).

17. In the year 1924 the sum of £25,482 1s. 10d., being brokerage expenses amounting to £1,026 1s. 10d. and discount of 15 per cent amounting to £24,456 in respect of the issue by the appellant in that year of debenture stock of a face value of £163,040 issued at a price of £85 for every £100 of stock, and in the year 1925 the sum of £9,112 7s. 6d., being an average discount of £14 3s. 10½d. per cent in respect of the issue by the appellant in that year of debenture stock of a face value of £64,200 issued at an average price of £85 16s. 1½d. for every £100 of stock, was debited to the reserve account. All such expenses were incurred and paid in London.

18. On 18th January 1926 the appellant was asked on behalf of the respondent, the Federal Commissioner of Taxation, to state why no part of the surplus arising from the realization of the original assets had been included in its Federal income tax returns for any year. The appellant replied on 23rd January 1926 in a letter from which the following is an extract:—"The company under the authority of the judgment of the Privy Council in *Commissioner of Taxation v. Melbourne Trust Ltd.* considered that these profits were not liable to taxation, having in view the decision of the Privy Council that profits on the realization of the old assets and securities were not liable to taxation until they had been treated by the company as profits available for distribution."

20. The respondent, in assessing the appellant to income tax for the financial year 1925-1926 in respect of income derived by the appellant during the year ended 31st December 1924, included in the assessment as assessable income an amount of £13,451, being the sum arrived at by dividing the sum of £25,482 1s. 10d., debited

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during that year to the reserve account as mentioned in admission No. 17, proportionately as shown in the statement, marked "P," mentioned in admission No. 40. The appellant objected to the inclusion of the amount of £13,451 in the assessment on the grounds set out in the notice of objection lodged by it. The respondent disallowed the objection, and the appellant requested the respondent to treat the objection as an appeal and to forward it to the High Court of Australia for hearing and determination. The appeal is now pending.

21. The respondent, in assessing the appellant to income tax for the financial year 1926-1927, in respect of income derived by the appellant during the year ended 31st December 1925, included in the assessment as assessable income an amount of £4,601, being the sum arrived at by dividing the sum of £9,112 7s. 6d., debited during that year to the reserve account as mentioned in admission No. 17, proportionately as shown in the statement, marked "P," mentioned in admission No. 40. The respondent also included in the assessment as assessable income an amount of £13,896, as being that part of the sum of £33,451 16s. 7d. mentioned in admission No. 32 which he considered was the profit from the sale of live stock sold with the "Strathdarr" station in 1925. The appellant lodged an objection in writing to the assessment. The respondent, subsequent to the lodging of the objection, caused a letter dated 1st December 1930 to be sent to the appellant, a copy of which letter is attached hereto, marked with the letter "F," and forms part of this admission. The respondent amended the assessment to the extent and in the manner indicated in the letter.

22. On 31st December 1924 the then unrealized original assets, together with amounts expended on development, stood in the books and balance-sheet of the appellant at the sum of £211,640 1s. 5d. In the following year (1925) the "Strathdarr" station, one of the original assets, was sold to Strathdarr Pastoral Co. Ltd. as a going concern on a walk-in walk-out basis, together with certain shares in other companies, which in part represented portion of the original assets and in part new assets for the sum of £110,000, which was satisfied by the allotment of 50,000 fully paid up seven per cent cumulative preference shares of £1 each in the Strathdarr Pastoral



Co. Ltd. (thereafter shown in the accounts of the appellant under the heading "other investments"), and 60,000 fully paid up ordinary shares of £1 each, which were promptly sold by the appellant at par for cash. By reason of the realization of original assets, including "Strathdarr" station, made during the year 1925, the book value of the unrealized original assets held by the appellant had by 31st December 1925 been reduced to £114,863 6s., which was shown in the balance-sheet as at that date as "Investments, acquired from the assets companies, taken on basis of revaluation by the local board in March 1910, with amount expended on development, less realizations, £114,863 6s.," the next item in the balance-sheet being "Other investments at or under cost, £603,771 2s." Such unrealized original assets consisted almost entirely of certain shares in the Penang Sugar Co. The appellant had in the year 1920 sold the Penang Sugar Estate to this company and the appellant owned the whole of its capital.

23. In the year 1926 the Penang Sugar Co. sold the Sugar Estate and thereupon went into liquidation. The appellant in that year received the sum of £100,000 as dividend in the liquidation, and in the report submitted to the shareholders with the balance-sheet as at 31st December 1926 the directors of the appellant stated that "the amount of the acquired assets standing in the books being reduced to £14,496 16s., and as it is no longer considered necessary to state this balance separately, it is included in the figure 'Investments at or under cost,' appearing in the balance-sheet." By 31st December 1927 the balance of £14,496 16s. had been reduced to the sum of £1,990 10s. which was made up of £3, being the book value of certain debenture stock and shares, and £1,987 10s. being the amount of a promissory note given to the appellant by one Browne as part payment of the purchase money for the sale to him in 1925 of certain assets forming part of the "Strathdarr" station. In the balance-sheet as at 31st December 1926 the only description of investment assets was "Investments at or under cost, £791,366 6s. 8d."

24. In the year 1926 the appellant carried the balance of the net surplus on realizations to a fund to meet contingencies.

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25. In the year 1927 in pursuance of certain amendments of its articles of association made in April of that year, the directors of the appellant divided the reserve account, which at the beginning of the year stood at the sum of £150,000, into “ capital reserve fund ” £75,290 2s. 11d. and “ general reserve ” £74,709 17s. 1d. The directors transferred the sum of £290 2s. 11d. from the year’s profits to the general reserve, making it up to £75,000, at which figure it appeared in the balance-sheet at 31st December 1927. The capital reserve fund of £75,290 2s. 11d. was dealt with as appears in the balance-sheets and accounts and the directors’ reports for the year 1927, and subsequent years.

26. From time to time the appellant increased its authorized capital and also its paid up capital by the issue of new shares as shown by the following statement of its share capital :—

		Authorized.			Paid Up.		
		£	s.	d.	£	s.	d.
1904 Original	..	320,000	0	0	273,333	4	0
					(not for cash)		
1910 Increased to	..	320,000	0	0	295,871	0	0
					(not for cash)		
1914	..	500,000	0	0	300,000	0	0
1926	..	500,000	0	0	500,000	0	0
1928	..	750,000	0	0	675,000	0	0
1929	..	1,000,000	0	0	750,000	0	0
1930	..	1,000,000	0	0	1,000,000	0	0

Except where otherwise specified the new shares were issued for cash. In the year 1910 and from time to time thereafter the appellant issued new debenture stock and on 31st December 1927 there was £430,000 of such debenture stock issued and outstanding.

27. Before the “ Strathdarr ” station was realized as stated in admission No. 22, it had been carried on as a going concern by the appellant, local accounts being opened for the use of the manager of the station, but the results of all station transactions were entered in other accounts kept by the appellant in Melbourne where the local directors controlled all matters connected with the carrying on of the station such as improvements, additions to plant, purchases and sales of stock and the moneys arising from all such sales were received by the appellant in Melbourne.



28. The pastoral station "Strathdarr" was acquired by the appellant as part of the assets taken over from the three assets companies in the year 1903 for £49,270 9s. 3d.

29. "Strathdarr," at the time it was taken over by the appellant, was being conducted as a pastoral property, and the appellant thereafter continued to conduct it as such until its sale in 1925. The property, including the improvements and live stock thereon (less depreciation written off in the books of the appellant annually), was included each year, until sold, in the appellant's balance-sheet under the heading "Investments acquired from the assets companies."

30. The property "Swanvale" was purchased by the appellant in the year 1923 for £1,800. The property was thereafter, until sold with "Strathdarr" in 1925, conducted in conjunction with "Strathdarr."

31. Under an agreement dated 15th July 1925 the appellant sold, as on and from 1st March 1925, "Strathdarr" and "Swanvale" stations as going concerns on a walk-in walk-out basis, together with all live stock, improvements, plant, wool, produce, stores, furniture, chattels and effects thereon, for the sum of £80,000.

32. Under date 1st March 1925 the appellant opened a separate realization account in connection with "Strathdarr" in its books, which account showed a balance of £33,451 16s. 7d. as the surplus on such realization. The amount of £33,451 16s. 7d. formed part of the amount of £43,725 6s. credited to reserve account in the year 1925 as the surplus on realizations of original assets during that year and formed part of the £150,000 which was standing to the credit of that account at 31st December 1926.

33. None of the live stock acquired with "Strathdarr" in the year 1903 was on the station or on "Swanvale" when sold in 1925, but "Strathdarr" had been kept stocked with the live stock required for the purposes of the pastoral business carried on thereon by natural increase, purchases and sales from time to time.

34. The live stock on "Strathdarr" and "Swanvale" on 1st March 1925 consisted of 30,802 sheep, 2,157 cattle, and 199 horses.

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35. During the period 1903-1925 depreciation of leasehold, improvements, wire netting and plant from time to time on "Strathdarr" was entered from time to time in the books of the appellant and charged against general profits of the respective years and during such period disposals of assets were effected.

36. Additions to assets of "Strathdarr" during the period 1903-1925 were made up as follows:—Improvements, £10,972. Plant, £7,461.

37. During the period 1923-1925 depreciation amounting to £359 11s. 6d. of the leasehold, improvements and plant on "Swanvale" was entered in the books of the appellant and charged against general profits of the respective years.

38. The deductions allowed for depreciation by the respondent for Federal income tax purposes were made.

39. The value of the live stock on "Strathdarr" as at the end of the income year ended 31st October 1924 which was taken into account in the assessment for Commonwealth income tax for the financial year 1925-1926 was £23,814, and the value in the appellant's books at that time was £23,481 15s.

40. In assessing the appellant to income tax for the financial year 1928-1929 in respect of income derived by the appellant during the year ended 31st December 1927, the respondent included an amount of £92,143 as being assessable income of the appellant for that financial year. The amount was made up as set out in the statement of the respondent attached hereto and marked with the letter "P."

41. Copies of the notice of the assessment for the financial year 1928-1929, dated 31st October 1929, and of the notice of amended assessment for that year, dated 1st December 1930, given by the respondent to the appellant together with the statements referred to in or accompanying the said notices are attached hereto, marked with the letter "Q," and form part of these admissions.

42. The appellant lodged with the respondent on 12th December 1929 notice of objection to the assessment, and, on 24th December 1930, notice of objection to the amended assessment. The respondent disallowed both the objections and the appellant requested him to treat the objections as an appeal and forward them to the Supreme Court.



The Commissioner's letter dated 1st December 1930, referred to in admission No. 21 and marked "F," in substance intimated that the amount of £13,896 was included in error in the assessment for the financial year 1926-1927 and stated: "The amount of £13,896 has been transferred to the assessment for the financial year 1928-1929 to restore the amount realized on the sale of 'Strathdarr' station to £33,451 16s. 7d., which amount was carried to reserve account as surplus on the sale of an 'old' asset, and formed part of the amount of £150,000 which was appropriated as profit during the year ended 31/12/1927."

The statement of the Commissioner, referred to in admission No. 40 and marked "P," consisted of the Commissioner's analysis of the reserve account from the year 1904 to 31st December 1925.

The notice of assessment for the financial year 1928-1929, referred to in admission No. 40 and marked "Q," assessed The Standard Trust Ltd. to taxation amounting to £3,905 12s. on income assessed at £78,112. The amended assessment for this year added the above-mentioned figure of £13,896, making a total assessable income of £92,008 and a total tax for that year of £4,600 8s.

Article 128 of the company's articles of association, as amended in 1927, provided:—"The directors may from time to time reserve or set aside out of the profits of the company (including therein premiums obtained on the issue of shares, but excluding profits to be carried to the capital reserve fund pursuant to the next following article) and carry to reserve or reserves (other than the capital reserve fund hereinafter mentioned) such sums as they think proper, which shall at the discretion of the directors be applicable for meeting claims on or liabilities of the company or contingencies, or for paying off any debenture capital or for equalizing dividends or for any other purpose of the company for which profits are properly applicable, including (with the sanction of the company in general meeting, but not otherwise) the distribution thereof by way of bonus amongst the members or any class of them. Pending such application, all sums carried to such reserve or reserves may at the discretion of the directors be employed in the business of the company, or be invested in such investments as the directors may think fit, and so that it shall not be necessary to keep any investments constituting

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the said reserves separate or distinct from any investments of the capital reserve fund or any other investments of the company.” Article 128 (a) provided: “The directors shall establish a special reserve to be called ‘The capital reserve fund.’ Any capital appreciation realized upon sales of the company’s investments shall be applied to capital purposes only, and unless appropriated to meet losses or to write down investments or debts due to the company shall be carried direct to the capital reserve fund. There may also be carried to the capital reserve fund any sums which at the date of the adoption of this article stand to the credit of any reserve in the books of the company and which in the opinion of the directors represent appreciation realized on the sale of investments by the company. The directors may apply all sums so set aside to the capital reserve fund to meet depreciation or contingencies or for repairing, improving, or maintaining any property of the company, or subject as hereafter mentioned for such other purposes of the company as the directors shall in their absolute discretion think conducive to the interests of the company, and they may invest the sums standing to capital reserve fund in such investments as they think fit, other than shares or stock of the company and from time to time deal with or vary such investments and dispose of all or any part thereof with full power to employ the capital reserve fund in the business of the company and that without keeping it separate from the other assets and may divide the said fund into separate accounts if they think fit. The capital reserve fund shall not be available for payment of dividends or bonuses on the shares or stocks of the company.” Article 131 provided: “No dividend shall be paid except out of the profits derived from the revenue of the company, until such time as the debenture stock to be issued under the agreements mentioned in article 3 hereof shall be redeemed, and no dividends shall be paid thereafter except out of profits. No dividend shall carry interest as against the company.”

The appeal was heard by *Cussen A.C.J.*, who sustained the taxpayer’s objection, set the assessment aside and remitted the matter of the assessment for the financial year 1928-1929 to the Commissioner for reconsideration.

From that decision the Commissioner now appealed to the High Court.



Sir *Edward Mitchell* K.C. and *Tait*, for the appellant. The company is a trading company and the surplus realized by selling the assets at enhanced prices is a taxable profit (*Commissioner of Taxes v. Melbourne Trust Ltd.* (1) ). Up to the year 1927 the surplus on realization was treated as being in suspense. In April 1927 art. 128 of the articles of association dealing with the reserve fund was amended and in that year the reserve fund was divided. This was a recognition by the company that part of the reserve fund was proved surplus. By that time all but an infinitesimal part of the original assets had been realized, and there was no possibility of a loss occurring which would depreciate the surplus which until then had been held in suspense. The Commissioner was entitled to hold the respondent to its own accounts and rely upon its action in severing the proved surplus from the reserve fund (*Federal Commissioner of Taxation v. Thorogood* (2) ; *Commissioner of Taxes (Q.) v. Burke* (3) ). The fact that no distribution was made to shareholders does not matter (*Commissioner of Income Tax (Q.) v. Brisbane Gas Co.* (4) ); the material thing is that in 1928 the company first recognized and dealt with the excess realization as a proved profit. June 1914 was a critical time. At that time the company learnt that the Privy Council had decided that the question of tax depended upon the totality of the transactions. It then discarded the term “realization reserve” which had formerly appeared in its accounts and made a reserve fund simply. There was no year before 1927 when it could be said that there was a realized profit nor had any of the excess realization been treated as such until then. In that year the company paid half the sum in general reserve to capital reserve and used part of the capital reserve to write down “new investments.” This is the definitive act which impressed the surplus realizations with the stamp of profit. *Cussen* A.C.J. was wrong in holding that the original purchase price of the assets had been recovered by 1914. The 3s. 4d. given to shareholders was not a return of capital but a bonus distribution of profit gained from so much of the original assets as had then been realized and paid for. The surplus was given away, but the shareholders were still owed the whole of the

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(1) (1914) A.C. 1001 ; 18 C.L.R. 413. (3) (1926) 38 C.L.R. 314.  
(2) (1927) 40 C.L.R. 454, at p. 458. (4) (1907) 5 C.L.R. 96.



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issued share capital. In any event the Commissioner was misled by the statement of the company's accountant that there was no profit until all the assets had been realized. The company should not now be allowed to assert that this statement was wrong, since the Commissioner has acted upon it. It cannot matter whether the moneys that are in suspense are kept in a separate account or put into a mixed account as long as these amounts from realization can be traced.

*Wilbur Ham* K.C. (with him *Russell Martin*), for the respondent. The only balance-sheet and report of the company before the Privy Council in 1914 was that of April 1910 (see *Melbourne Trust Ltd. v. Commissioner of Taxes* (Vict.) (1) ) and the opinion delivered by Lord *Dunedin* must be considered with this fact in mind. *R. v. Anderson Logging Co.* (2) shows that a purely estimated profit is not taxable if the estimate is made conditional on the eventual repayment of the purchase moneys paid by the company. In the earlier appeal of the company the question as to which was the particular period of twelve months in which profits were earned was not material (see question 1 in *Melbourne Trust Ltd. v. Commissioner of Taxes* (Vict.) (3) ). In this case time is all important, since the appellant's main objection is that the income on which it has been assessed was not derived in the year 1927. It is admitted that profits have been made, but they were made year by year from 1912 onwards and cannot be taxed *in globo* as if all were derived in the year 1927. The alteration of the articles of association and the division of the reserve fund has nothing to do with the derivation of income. If no resolution had been passed to alter the articles, the company could not have said in 1927 that the realizations were still held in suspense because nothing had been done. Art. 131 of the articles of association prohibited the company from paying dividends until the whole of the original debenture stock had been paid off and this was the reason for keeping surplus realizations apart from ordinary profits in the company's accounts. After 1910, when all the debenture stock had been redeemed, it was no longer

(1) (1912) 15 C.L.R. 274, at p. 284.

(2) (1926) A.C. 140.

(3) (1912) 15 C.L.R., at p. 284.



necessary to keep the profits in suspense and so the old realizations reserve became simply an ordinary reserve account. It was dealt with as such for income tax purposes and other outgoings were debited to it. If the Judicial Committee meant that the profits of this company were not taxable until distributed to shareholders, there has been no distribution, but, if it meant that profits were not taxable until dealt with as a profit, they have been so dealt with from 1910 onwards. The new art. 128 (a) takes nothing from a suspense fund. On the contrary it puts in suspense half of the reserve fund which after 1910 was free to be used for any purpose ordinarily met from a company's reserve. The Penang Sugar Estate was sold to a new company in 1923. The totality of the transaction occurred at one or other of the dates, 31st December 1913, 31st December 1923, or, at latest, 31st December 1925. When the totality was reached it could be definitely stated that the surplus was profit. Profits are not made in the year in which they are ascertained to be profits without doubt, but in the respective years when the component parts of such profit comes in.

[EVATT J. referred to *Westminster Bank Ltd. v. Osler* (1).]

The manner in which money is dealt with after receipt is by no means conclusive. The character of the transaction and not the disposal of the proceeds determines whether receipts are income or capital (*Commissioner of Income Tax (Q.) v. Bank of New South Wales* (2); *Forrest v. Federal Commissioner of Taxation* (3)). The respondent was not misled by any returns or representations of fact into thinking that the company was holding this money in suspense after 1925. The only representation made was by an accountant as to his view of the effect of the former decision of the Privy Council. No doubt this was an honest representation of his opinion, and in any event the Commissioner cannot say that the accountant's reading of the law estops the company. The savings made by the company's purchasing its own debenture stock at a discount are not income profits (*Commissioner of Taxes v. British Australian Wool Realization Association* (4)).

*Cur. adv. vult.*

(1) (1932) 1 K.B. 668; (1933) A.C. 139.

(2) (1913) 16 C.L.R. 504, at p. 511.

(3) (1921) 29 C.L.R. 441.

(4) (1931) A.C. 224.



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The following written judgments were delivered :—

RICH J. This is an appeal from the judgment of *Cussen A.C.J.* allowing an appeal from an assessment for Federal income tax for the financial year 1928-1929, based on income derived in the calendar year ended 31st December 1927. By the order appealed from, his Honor set aside the assessment and remitted it to the Commissioner for reconsideration. The appellant company, which was formerly called the Melbourne Trust Ltd., when it was constituted in 1903, acquired from three other companies a mass of assets in consideration of debenture stock and shares. The primary purpose of the company was to dispose of these assets to advantage, and it was held that in doing so it was carrying on business as a trading company and that "the surplus realized by it by selling the assets at enhanced prices is a surplus which is taxable as profit" (*Commissioner of Taxes v. Melbourne Trust Ltd.* (1)). The reports of this case (2) provide a full statement of the circumstances affecting the formation of the company and its method of operations until 1909. The assessment appealed from in the present proceedings assesses the company upon a net income of £92,008 derived from sources in Australia during the twelve months ended 31st December 1927. This figure is ascertained by a dissection of a sum of £150,000 which, pursuant to alterations of the articles of association, adopted during the year, the directors appropriated substantially in equal proportions to a capital reserve fund and a general reserve fund. The assessment proceeds upon the view that the appropriation amounted to an unequivocal acknowledgment that the sum appropriated was profit and to a detachment of the sum from the general funds of the company so that it should be considered income derived during the year in which this was done. The ultimate conclusion of the judgment appealed from is that the amount so dealt with by the company, in so far as it comprised assessable income, was derived, not during the year ended 31st December 1927, but during a period which did not extend into that year. It is not disputed that the sum included in the assessment was, before the opening of the year 1927, contained in the funds of the company and that the operations

(1) (1914) A.C., at p. 1010; 18 C.L.R.,  
at p. 421.

(2) (1914) A.C. 1001; 18 C.L.R. 413;  
(1912) 15 C.L.R. 274; (1913) V.L.R. 196.



of the company which brought it into its hands were performed before that date and had caused its receipt. The contention of the Commissioner is that the sum had not the clear characteristics of income until it was, so to speak, severed from the receipts or funds of the company and diverted from them in a manner which impliedly acknowledged that it was income. The sum of £92,008 represents the proportion obtained from Australian sources of amounts credited to the company's realization reserve account. This account contained a record of the results of the company's dealings with the assets acquired at its inception in consideration of shares and debenture stock. The entire basis of the assertion that the sum in question standing at the credit of that account bore an equivocal character until it was appropriated, as income only could be, is a supposed analogy which the Commissioner has found between the condition of the company and its financial operations in 1927 and that of 1909, dealt with in the Privy Council (*Commissioner of Taxes v. Melbourne Trust Ltd.* (1)). At that date the company had not realized by the disposal of its original assets a sufficient amount to cover the value at which they were acquired or the value at which they were taken into the account. Its debenture stock had not been paid off and, by an article of association, the company was prohibited from paying any dividend out of such realizations until the debenture stock was redeemed. The proceeds of realization were accordingly carried to a realization account, and, so far as concerned the question whether the contents of the account constituted profit or a fund available for dividend, it was necessarily true that the account might properly be considered a suspense account. Until enough was recovered by the realization of the assets to cover the amount treated as expended in their acquisition there could be no logical certainty that any sum at its credit represented profit on the entire transaction. Until the debenture stock was paid off none of the moneys contained in the account was available for dividend. The Privy Council had before them this state of affairs obtaining in 1909. The facts, however, showed that by 15th October 1909 the whole of the debenture stock had been paid off and that out of the moneys to the credit of the realization account

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the directors resolved to distribute 6d. a share as a bonus to the members of the company and further proposed a distribution of new debenture stock to the shareholders, paid up out of the same source. Their Lordships, whose opinion was delivered by Lord *Dunedin*, after holding that the initial figure at which the original assets were taken into the company's account represented real value and should be adopted said:—"But it is possible that other investments on realization may show loss instead of profit; and it is obvious that it is in the totality of the transactions that the question of profit comes to be fixed. Their Lordships are, however, of opinion that the company may well be held bound by its own actions. In distributing a bonus of 6d. per share it affirmed that to that extent at least there was profit realized. In the same way in making a distribution of debenture stock on and after August 10, 1910, they may be held to have distributed profit. . . . As regards the question of when a profit is earned their Lordships' view is that a profit can be said to be earned when it is dealt with as a profit. In ordinary cases this synchronizes with the realization of the sums which swell the assets of the person or company, and which entering the account (whether on the creditor or debtor side will depend on the particular account in view) go to bring out the balance which is deemed profit. But for the reasons already given their Lordships think that in a case like this the company are entitled to hold at least a part of their realizations in suspense—as indeed they have done in their accounts—and that it is only when finally the same is given to the shareholders that the final impress of profit is, so to speak, stamped upon it, and that therefore, for the purposes of the Act, that is the time at which it is earned" (1). Among the declarations made by their Lordships was the following:—"Declare that as regards the bonus of 6d. per share referred to in par. 7 of the directors' report of April 9, 1910, there is evidence sufficient to show that this is taxable as profit so far as it was earned in or derived from Victoria; and that *pari ratione* the distribution of debenture stock to shareholders calculated as justified by the state of the realization reserve account should be properly held to be taxable as profit according to the pecuniary value thereof" (2). Now, to my mind, it is obvious

(1) (1914) A.C., at pp. 1011, 1012; 18 C.L.R., at pp. 421, 422.  
(2) (1914) A.C., at p. 1012; 18 C.L.R., at pp. 422, 423.



that the whole foundation of these observations and of their Lordships' decision upon this point is the condition of the company's affairs at that time when the result of the "totality of the transactions" was not known, although it is upon that totality that "the question of profit comes to be fixed." If in these circumstances a corporation exercising a trade in carrying out such transactions chooses to detach from the moneys so far recovered a sum which it forthwith treats as profit it avows that by the exercise of trade it has, when it does so, earned that profit. But when it has become clear that a profit has been earned on the "totality of the transactions" and it continues to trade with the assets remaining in its hands quite different considerations arise. It needs no exercise of judgment on the part of the directors, no determination to appropriate funds, and no distribution, to establish the character of the moneys derived. The ascertainment of their character depends upon nothing but the construction of the correct account. In the present case *Cussen A.C.J.* has made a close examination of the company's condition and of its accounts, and, to my mind, has shown conclusively that the realization account was not considered and could not be considered a suspense account in any relevant sense, that a clear profit had arisen on "the totality of the transactions," and that the moneys out of which £92,008 came were accumulations in the hands of the company which bore no equivocal character. I cannot agree with the contention on the part of the Commissioner that, because large sums had already been distributed to the shareholders, and because losses might have been incurred in dealings by the company with other assets, or deficiencies in the book values of such original assets as might be considered still in the company's hands at any relevant date might appear on realization, therefore the contents of the realization account must be still considered as held in suspense awaiting determination whether they represented profits or not. This argument departs from the issue. In every trading concern valuations may be falsified by the event, and net profits ascertained on the trading account at a particular date may be lost in subsequent operations. The issue is, whether, apart from severance or detachment from the company's funds, it could be said that in the disposal of the items of a mass of assets a profit had been made. Once the

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expenditure in acquiring the entire mass has been recovered the particular difficulty, in my judgment, vanishes. I entirely agree with the judgment of *Cussen* A.C.J. and think the appeal should be dismissed.

STARKE J. The Melbourne Trust Ltd. was incorporated in England in the year 1903, and in 1927 changed its name to The Standard Trust Ltd. It was formed to take over, nurse, develop and realize the assets of three other companies, and for other purposes. The Commissioner of Taxes for the State of Victoria assessed the company to income tax in respect of the year 1910, and the Judicial Committee held in 1914 that the surplus realized by the company over the purchase price paid for the assets sold, after making all just deductions, was profit taxable as income in the following year (*Commissioner of Taxes v. Melbourne Trust Ltd.* (1) ). The Federal Commissioner of Taxation has now assessed the company under the *Federal Income Tax Assessment Act* for the financial year 1928-1929 in respect of a sum of £92,008, based, as he asserts, upon the taxable income of the company derived directly or indirectly from sources in Australia during the year 1927, its accounting period (*Income Tax Assessment Acts* 1922-1928, 1922-1930, sec. 13). The sum of £92,008 is part of a sum of £150,000 standing to the credit of the company's "reserve account" in 1927, and which in that year the directors, in accordance with its articles of association, divided, and transferred to "capital reserve fund" and "general reserve." The parties, in view of the decision of the Judicial Committee, have not contested that the sum of £92,008, or the greater part of it, is assessable income, but the question is whether that sum is assessable income for the year in respect of which it was assessed, namely, the financial year 1928-1929. The determination of that question involves an examination of the reserve accounts of the company and how they were built up.

The consideration for the assets taken over by the company was :—

Debenture stock 4%	..	..	..	£392,485	10	0
Shares, 1,366,659 of 4/-	..	..	..	273,331	16	0
Cash	..	..	..	20,704	18	8
				<hr/>		
				£686,522	4	8
				<hr/>		

(1) (1914) A.C. 1001 ; 18 C.L.R. 413.



By the end of 1909 this debenture stock had been redeemed, and, before the end of 1910, assets of another realizing company, the Mercantile Bank Assets Co., had been acquired. The directors reported at a meeting held on 8th May 1910 as follows:—"During the past year the shareholders have received a 4 per cent debenture stock" (this, I interpolate, is a new issue) "in the proportion of three shillings and fourpence per share under the arrangement for the absorption of the Mercantile Bank Assets Company Limited, following upon a revaluation of the assets of both companies. In lieu of debenture stock there was paid in cash in respect of small share-holdings £20,168 16s. 8d., and of the debenture stock created the sum of £32,437 6s. 8d. was redeemed previous to the close of the accounts, leaving then outstanding £193,953. The revaluation based on an appreciation in value of the assets originally acquired from the liquidating banks showed an estimated surplus of over £300,000 over all liabilities and capital and justified the Trust in allotting nine of its fully paid up 4s. shares in exchange for each £1 share of the Mercantile Bank Assets Company. The following statement shows how the increase on revaluation and the hitherto existing realization reserve account have been appropriated:—

Realization reserve as at 31st December 1909	£148,708	15	2
Surplus on absorption of the Mercantile Bank Assets Co. Ltd.	28,782	7	8

Increase on revaluation of assets of Melbourne Trust (including the surplus of £24,171 15s. 8d. accrued prior to date of transfer of assets of Melbourne Trust in 1903, as explained in previous reports)	145,205	6	10
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£322,696 9 8

Distribution to shareholders of 6d. per share in cash in May 1910	£34,166	13	0
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Distribution of 3s. 4d. per share, August 1910, in debenture stock or cash in lieu thereof	246,559	3	4
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280,725 16 4

Balance of revaluation as shown in balance-sheet	£41,970	13	4"
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The realization reserve account spoken of in this report consisted of the net surplus on realizations and the profit arising from the purchase of the debenture stock. In the balance-sheet as at 31st December 1910, realization reserve account disappears, and a new account appears, "Reserve account." To it are credited the balance on revaluation above mentioned, £41,970 13s. 4d., further surpluses on realization, and profits on purchase of debenture stock from the dividend equalization account, making a total of £47,998. In the next balance-sheet, 31st December 1911, and in all future balance-sheets, to and inclusive of that as at 31st December 1926, the account appears as reserve account, and to its credit are placed surpluses on realization, profits on purchase of debenture stock, appropriations from profit and loss, premiums on shares issued, war loan interest, and against it have been debited losses on realizations and discount and brokerage expenses of debenture stock issue. On 31st December 1925, and on 31st December 1926, the reserve account stood in credit £150,000. But was that sum a realized profit before the end of 1926, as the company now asserts, and so definitely ascertained that it could be treated as income earned or derived by the company at or before that time? It is a question of fact, upon which the actions of the company may well throw light.

It will be remembered that, before the end of 1909, the company had paid off its original debenture-stock issue of £392,485, and had distributed to the shareholders 6d. per share in cash and 3s. 4d. per share in debenture stock or cash in lieu thereof. As to this, the Judicial Committee observed that in distributing a bonus of 6d. per share the company affirmed that to that extent at least there was a profit realized. In the same way, in making a distribution of debenture stock on and after 10th August 1910, they may be held to have distributed profit. It may be open to doubt whether their Lordships would have reached the latter conclusion if they had known, as they did not, that the distribution of 3s. 4d. per share in debenture stock was based largely upon a revaluation of assets and not upon profits actually realized and placed to the credit of the realization reserve. The debenture stock issued about August 1910 was redeemed as the



realization of the assets taken over proceeded. The balance-sheets give the history of the matter :—

As at 31st December 1910 :—

Liabilities.		Assets.
Debenture Stock 4%	£193,953	Properties in Australia
Reserve accounts	47,998	as revalued by local Board in March 1910
		Purchasers' balances
		£446,118
		124,069.

Before 31st December 1914, the whole of the 4 per cent debenture stock issued about August 1910 had been redeemed (see directors' report submitted to a meeting on 29th April 1915).

As at 31st December 1925 :—

Liabilities.		Assets.
Reserve account ..	£150,000	Investments acquired from the assets companies taken on basis of revaluation by local board in March 1910, with amount expended on development less realizations .. ..
		£114,863.

These entries are explained in the directors' report submitted to a meeting on 23rd June 1926 :—" During the year the directors have dealt with the investments acquired from the assets companies as follows: The Trust's interest in Strathdarr station and certain shares in Australian pastoral companies (some of which shares formed part of 'Other investments' of the Trust) were conveyed to a new company called the Strathdarr Pastoral Co. Ltd. (Australia) for a sum of £110,000, satisfied by the allotment of £50,000 7 per cent cumulative participating preference shares and £60,000 ordinary shares. The £60,000 ordinary shares were sold by the Trust at par for cash, and the Trust's interest in these pastoral properties is now limited to the £50,000 participating preference shares in the new company, which are now included in 'Other investments.' The balance of the acquired investments (other than the Penang Sugar Co., and one or two small investments) were sold for cash. As

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regards the Penang Sugar Co., the Trust still holds the whole capital of this company, which, with one or two small investments, makes up the amount of the 'Acquired investments,' as now standing in the balance-sheet, namely £114,863 6s." On presenting the balance-sheet as at 31st December 1926 the directors reported to a meeting on 12th April 1927 that "the Penang Sugar Estates having been sold, the Penang Sugar Co. Ltd. has been placed in liquidation, and before the close of the accounts the sum of £100,000 was received as dividend in the liquidation. This has resulted in the amount of acquired assets standing in the books being reduced to £14,496 16s., and as it is no longer considered necessary to state this balance separately, it is included in the figure 'Investments at or under cost' appearing in the balance-sheet."

It thus appears that, by the end of 1926, practically the whole of the assets acquired by the company had been realized, and that the company had redeemed the debenture stock originally issued as part of the purchase price (£392,495) and had distributed in cash 6d. per share in May 1910 (£34,166), and the sum of 3s. 4d. per share (£246,559) resolved upon about August of 1910, either by payments in cash or redemption of debenture stock then issued, and still held £50,000 7 per cent cumulative preference shares received on account of Strathdarr, or the proceeds thereof, and unrealized assets valued at £14,496; in addition, there was the sum of £150,000 in reserve account as already mentioned.

Despite these outstanding facts, the Commissioner insists that the sum of £150,000, or the part thereof derived from Australian sources, can and should be treated as taxable income of the company derived directly or indirectly by it during the year 1927. The argument depends upon the reasons assigned by the Judicial Committee for their advice in the *Melbourne Trust Case* (1):—"It is obvious that it is in the totality of the transactions that the question of profit comes to be fixed. Their Lordships are, however, of opinion that the company may well be held bound by its own actions. In distributing a bonus of 6d. per share it affirmed that to that extent at least there was profit realized. In the same way in making a distribution of debenture stock on and after August 10, 1910, they may be held

(1) (1914) A.C., at pp. 1011, 1012; 18 C.L.R., at pp. 421, 422.



to have distributed profit. . . . As regards the question of when a profit is earned their Lordships' view is that a profit can be said to be earned when it is dealt with as a profit. In ordinary cases this synchronizes with the realization of the sums which swell the assets of the person or company, and which entering the account (whether on the creditor or debtor side will depend on the particular account in view) go to bring out the balance which is deemed profit. But for the reasons already given their Lordships think that in a case like this the company are entitled to hold at least a part of their realizations in suspense—as indeed they have done in their accounts—and that it is only when finally the same is given to the shareholders that the final impress of profit is, so to speak, stamped upon it, and that therefore, for the purposes of the Act, that is the time at which it is earned."

Now, the facts in the present case establish that the company never made any return to the Commissioner before or after 1926 setting forth that the sum of £150,000 or any part of it was income or profit of the company. The company, through its taxation expert, informed the Commissioner that the reason why the profits on realization of assets and securities were not included in the Federal income tax return was because the company considered that, in view of the decision of the Judicial Committee in the *Melbourne Trust Case* (1), profits on the realization of old assets and securities were not liable to taxation until they had been treated by the company as profits available for distribution. But I agree with *Cussen A.C.J.* that this cannot affect the company's rights. It was a question of law, and a mistake as to the meaning and effect of the reasons of the Judicial Committee would not convert income derived in law and in fact during a preceding year into income derived by the company during the year 1927. The directors, however, in a report submitted to a meeting on 12th April 1927, announced that it was proposed that the articles of association be altered so as to provide that the balance of profits arising from the realization of securities should be applied in writing down investments—that is, its "other investments"—or carried to a capital reserve fund, and not used to pay dividends. The articles were altered accordingly.

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By the articles as altered the directors were empowered to reserve or set aside out of profits and to carry to reserve or reserves, other than the capital reserve fund, such sums as they thought proper. And they were also authorized to establish a special reserve, to be called the capital reserve fund. Into this fund capital appreciation realized on sales was to be carried, including any sums then standing to the credit of any reserve in the books of the company and which in the opinion of the directors represented appreciations realized on the sale of investments by the company. Before 31st December 1927, the directors, in accordance with the altered articles of association, divided the reserve fund, which at the beginning of the year stood at £150,000, into capital reserve fund £75,290 2s. 11d., and general reserve £74,709 17s. 1d. (which, with a sum transferred from revenue, brought the latter to £75,000). The balance-sheet at 31st December 1927 records the transaction as follows :—

Liabilities.		Assets.
General reserve ..	£75,000	Investments at or under cost (less capital reserve fund) .. .. £1,039,804.

In my opinion, it is quite impossible on these facts to conclude that the company thus affirmed, or that in fact, the sum of £150,000 remained, until 1927, in suspense awaiting the final result of the realization before the profit on the totality of the transactions was ascertained. Everything points to the conclusion that it was, long before that time, a reserve of ascertained profits available for application by the company in any manner allowed by its memorandum and articles of association. A company does not escape taxation because it leaves profits in, or carries them to, reserve account. The passage relied upon in the *Melbourne Trust Case* (1) deals with the company at a time when realization had not proceeded far, when the result of the totality of the transactions could not be predicated. In such circumstances, their Lordships declined to treat all receipts from realizations and carried to reserve as ascertained profits ; they must remain in suspense until the company affirmed by its acts how much represented profit, or, as I think, until the fact could be otherwise established. And in my opinion it is clearly established

(1) (1914) A.C. 1001 ; 18 C.L.R. 413.



in the present case that the sum of £150,000 in the reserve account was a realized and ascertained profit of the company before the end of the year 1926, and consequently not assessable to income tax for the financial year 1928-1929.

The appeal is simply against an assessment for that year, and we have no authority to determine, nor would it be desirable to express any opinion upon, the years in which the sum of £150,000 is assessable, or the amount assessable in any particular year. All that is or can be decided is that an assessment for the financial year 1928-1929 is wrong, and that the appeal from the decision of *Cussen* A.C.J. should be dismissed.

EVATT J. This is an appeal from the decision of the Supreme Court of Victoria (*Cussen* A.C.J.) which held that the appellant Commissioner had wrongly assessed the respondent company for the financial year 1928-1929 in respect of income derived by the company during the year ending December 31st, 1927.

The respondent company is identical with the Melbourne Trust Ltd., which in 1914 was held by the Privy Council to have been so constituted and to have so carried on its affairs

“that any surplus ascertained and realized of the proceeds of the assets of the assets companies over the consideration paid by way of purchase money for them, after making all just deductions, would be profits taxable as income in the following year; this being over and above any annual surplus of incomings over outgoings of the concern” (*Commissioner of Taxes v. Melbourne Trust Ltd.* (1) ).

The Commissioner included an amount of £92,143 as part of the income derived by the company from its realization business during 1927. The sole question upon the present appeal is whether this sum of money should be regarded as attributable to the activities conducted by the company within Australia during the year in question.

Par. 40 of the admissions of fact and annexure “P” therein referred to show at the very first glance that the sum of £92,143 is a composite or resultant figure representing realization activities spread over many years. Annexure “P” also shows that the sum of £92,143 was, according to the Commissioner’s own analysis of the reserve account

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(1) (1914) A.C., at p. 1012; 18 C.L.R., at p. 422.



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of the company, referable to profits or income which had been actually realized on or before December 31st, 1925. How is this sum of money capable of being referred to the income year 1927 and treated as income solely derived during that year ?

The Commissioner says that the Privy Council decision already referred to is binding and arms him with authority to make this hypothetical or arbitrary allocation of income. That the decision binds us is obvious, the proved facts being identical.

Moreover, it is true that Lord *Dunedin* in his judgment pointed out that there was ample evidence that the company was a trading company, that the surplus realized by it in selling the assets at enhanced prices was taxable as a profit and that it was “ in the totality of the transactions that the question of profit comes to be fixed ” (1).

His Lordship also said that

“ in a case like this the company are entitled to hold at least a part of their realizations in suspense . . . and . . . it is only when finally the same is given to the shareholders that the final impress of profit is, so to speak, stamped upon it, and . . . therefore, for the purposes of the Act, that is the time at which it is earned ” (2).

It is argued that these expressions mean that the Commissioner is entitled to treat the year in which the company proceeds to deal with its accumulated profits from realization as the year in which the whole of such profits are earned, although the period of accumulation has extended over many years.

It may be pointed out that the Victorian Act under consideration by the Privy Council in *Commissioner of Taxes v. Melbourne Trust Ltd.* (3) did not, as do the Commonwealth Acts now before us, provide for a graduated system of taxation with the rate of tax increasing with the increase of income. This distinction would, of course, result in a considerable increase in the amount of tax if it were held that the operations of (say) ten years can be attributed to the activities of the tenth year only.

Assuming for the moment that Lord *Dunedin's* words have been correctly interpreted by the Commissioner, the question arises whether the company did, during the year 1927, in any relevant

(1) (1914) A.C., at pp. 1010, 1011; (2) (1914) A.C., at pp. 1011, 1012;  
18 C.L.R., at p. 421. 18 C.L.R., at p. 422.

(3) (1914) A.C. 1001; 18 C.L.R. 413.



sense "deal with" the amount of £92,143 upon the footing of profit. Certainly it did not distribute such sum or any of it to its shareholders. In the report submitted with the balance-sheet and profit and loss account for the year ending December 31st, 1926, the following paragraph appeared:—

"It is also proposed that the articles of association be altered so as to provide that the balance of profits arising from the realization of securities should be applied in writing down investments, or carried to a capital reserve fund, and not used to pay dividends. It is further proposed to submit to the shareholders a resolution that the name of the company be altered to 'The Standard Trust Limited.' The Penang Sugar Estates having been sold, the Penang Sugar Co. Ltd. has been placed in liquidation, and, before the close of the accounts, the sum of £100,000 was received as dividend in the liquidation."

During the year 1927, the articles of association having been altered as proposed, there was a division by the company of its then reserve fund into two almost equal sums, one being put into the capital reserve fund, and the other into general reserve; and it is correct to say that, included in the total reserve fund of £150,000 thus divided, there was included the sum of £92,143 which the Commissioner now seeks to bring into charge against the company.

If Lord *Dunedin's* observations are to be regarded as requiring the attribution of the accumulated profits to the year during which the company dealt with them as such, the only act to which the Commissioner can point as occurring in 1927 is the division of the reserve fund I have just mentioned. In my opinion this act is quite insufficient to warrant any inference that the accumulated profit of £92,413 was derived during the year 1927.

But I do not accept the theory that Lord *Dunedin's* judgment was ever directed to such a state of affairs as has been proved in the present case. When the matter was before the Privy Council in 1914, the outstanding feature was that the company had distributed to its shareholders a bonus of 6d. per share and had also distributed considerable debenture stock to its shareholders. Each of these distributions of money or money's worth, the company had considered to be warranted by the then state of its realization reserve account. The statement of the history of the company which is now presented to us, and which is necessarily fuller and more accurate, shows clearly that in making these distributions to its shareholders the

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company was anticipating the coming in of large sums of money and was relying upon the correctness of its valuations of assets not disposed of. Its confidence was justified, but only after four or five years had elapsed.

It seems to me that the gist of Lord *Dunedin's* finding is contained in the sentence: "As regards the question of when a profit is earned their Lordships' view is that a profit can be said to be earned when it is dealt with as a profit" (1). The company had itself elected to treat as profits the moneys sought to be charged against it by the Victorian Commissioner, and this course of conduct was deemed sufficient to justify the Commissioner in following the company's example.

In my opinion the decision of the Privy Council is not to be regarded as addressing itself to the very different state of affairs here, where the company, having made profits from its operations during a series of years, has refrained from making any distribution to its shareholders. A very good illustration of the established principle that profits made by a company from a realization business may be treated as income, irrespective of any question of distribution of the profit among shareholders, is provided by the recent decision of the House of Lords in *Westminster Bank Ltd. v. Osler* (2).

So far as the facts of the present case are concerned, it is clear that, during the year 1926, for all practical purposes the company wound up its realization business, the last receipt being the £100,000 received in 1926 as dividend in the liquidation of the Penang Sugar Co. Ltd. This receipt was mentioned in the report from which I have already quoted. In the circumstances the Privy Council decision does not compel us to hold that the Commissioner was correct in treating the sum of £92,413 as part of the company's income derived during the year 1927, and for the reasons given I think that the judgment of *Cussen A.C.J.* should be affirmed.

But the Commissioner had some reason for his action in delaying and finally making his assessment referable to 1927. On June 18th, 1926, the company was asked to state why no part of the surpluses arising from the realization of the original assets had been included

(1) (1914) A.C., at p. 1011; 18 C.L.R., at p. 422.

(2) (1933) A.C. 139.



in its Federal income tax returns for any year. The company's reply, dated June 23rd, 1926, included the following statement:—

"The company, under the authority of the judgment of the Privy Council in *Commissioner of Taxation v. Melbourne Trust Ltd.* . . . considered that these profits were not liable to taxation, having in view the decision of the Privy Council that profits on the realization of the old assets and securities were not liable to taxation until they had been treated by the company as profits available for distribution."

I have already pointed out that in my opinion the Privy Council did not lay down the rule suggested. But, not unnaturally, Sir *Edward Mitchell* relied strongly upon this express statement of the company and urged that it was not unjust to treat the company upon the legal basis suggested. Even upon such assumption, I do not think that any action taken by the company in 1927 satisfies the test stated in the letter. However, the question for our determination must turn upon the ascertained and admitted facts rather than upon any supposed reason or excuse for the company's failure to make adequate returns of income.

So far, I have expressed no opinion as to how the accumulated income should have been allocated amongst the various income years prior to 1927. The matter has not been fully gone into, but it seems to me that, once the final amount of the accumulated profit is established, there should be no great difficulty in going back and distributing it throughout the years prior to December 31st, 1926.

For such purpose it is better that the accounts should not be made up upon the analogy of ordinary profit and loss accounts with the assets valued at the beginning and end of each trading year. I can see no logical difficulty in adopting such method, but it seems to be excluded by a portion of the reasoning of the Privy Council in the case already discussed.

Perhaps that case would authorize the Commissioner in fixing the year 1926 as the main, if not the sole, year of profit. It must be remembered, however, that the £100,000 received by the company during 1926 was received as a dividend in the liquidation of a separate company, which had been brought into existence some years earlier by the respondent.

Interesting questions arise whichever system of division of the profit amongst the years may be finally adopted, and I have no desire to prejudice their full investigation and final solution.

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I should not leave the case without the observation that it was practically undisputed before us that the company had become liable to pay taxation to the Commissioner in respect of its accumulated profits from realization, and that it has only succeeded in excluding 1927 as the true income year. It is desirable in the interest both of the Commissioner and the company that an agreement should be reached by them as to the quantum of tax owing, otherwise further proceedings may be necessary to determine it.

The appeal should be dismissed.

McTIERNAN J. I have read the judgment of my brother *Rich*, and entirely agree with it.

*Appeal dismissed with costs.*

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

Solicitors for the respondent, *Blake & Riggall*.

H. D. W.