[HIGH COURT OF AUSTRALIA.]

MESSER . . . . . APPELLANT;

AND

THE DEPUTY FEDERAL COMMISSIONER OF TAXATION . . . . . RESPONDENT.

H. C. OF A. 1934.

PERTH, *Sept.* 11, 12, 13.

Rich, Dixon and McTiernan JJ.

Income Tax—Assessment—Business—Pastoral property—Converted into a company—Shares in lieu of cash for assets—Shares instead of money taken as consideration—Companies Act 1893 (*W.A.*) (*No.* 7 *of* 1893), *sec.* 26—*Income Tax Assessment Act* 1922-1930 (*No.* 37 *of* 1922—*No.* 50 *of* 1930), *sec.* 16 (*d*)*.

The appellant was assessed by the respondent for income tax in respect of the value of certain shares allotted to him in a company which had been formed to take over certain pastoral properties held on lease by a partnership of which appellant was a member. On the day of allotment, the partners gave a cheque to the company in payment for the shares, and the company gave a cheque for precisely the same amount to the partners in part payment for the lease taken over. Against this assessment appellant appealed to the High Court.

Held, that the transaction was one in which shares and not money were received by way of consideration for the assignment of the lease, and that an amount representing the value of appellant's shares should not be included in his income for purposes of taxation.

* The *Income Tax Assessment Act* 1922-1930 by sec. 16 provides: "The assessable income of any person shall include—(*d*) money derived . . . by way of consideration for the assignment or transfer of a lease, . . . and shall also include, where that amount or any part of that amount is paid by a company in the form of shares in that company to a person who has a controlling interest in that company and where those shares are sold or transferred by that person during the unexpired period of the lease . . . or within a period of two years after that date, whichever period is the lesser—the amount for which the shares were so sold or transferred."

CASE STATED.

The appellant, Kenneth Durward Messer, objected to his assessment for income tax made by the respondent, and asked that such objection be treated as an appeal to the High Court. The appeal came on to be heard before *Dixon* J., who agreed to state a case for the opinion of the Court as provided by sec. 51A of the *Income Tax Assessment Act* 1922-1930. The facts appear from the case stated, which was substantially as follows :—

1. The appellant and Hilda Maud Messer and Laura Georgiana Lee Steere under the firm name of " Minnie Creek Station " carried on the business of pastoralists from 10th June 1919 until 13th September 1929. The interests of the partners were :—

Appellant	One-fifth
Hilda Maud Messer	Two-fifths
Laura Georgiana Lee Steere	Two-fifths

The property owned and used in the business of the partnership in the production of its income consisted of (*inter alia*) :—

(*a*) Pastoral Lease Number 1875/96 the subject of Crown Lease Number 1906/1922 which was held from the Government of Western Australia for a term expiring in 1948 granted under *The Land Act* 1898 and amendments.

(*b*) Improvements on the lease.

(*c*) The live-stock, plant, goods, chattels and effects upon the lease.

2. Minnie Creek Pastoral Co. (hereinafter called " the company ") was formed and registered under the *Companies Act* 1893 (W.A.) on 13th September 1929. The subscribers to the memorandum and articles of association were :—

Hilda Maud Messer	1 share
Laura Georgiana Lee Steere	1 ,,
Kenneth Durward Messer ..	1 ,,
Aileen Lee Steere	1 ,,
Hilda Lee Steere	1 ,,
Harold James Hamilton ..	1 ,,
H. H. Wilson	1 ,,

3. By letter dated 13th September 1929 the partners offered to sell to the company the whole of their assets on the terms therein stated.

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4. The offer contained in the said letter was accepted by the company as appears by the memorandum at the foot thereof.

5. On the 13th September 1929 the appellant and his co-partners applied for the following shares in the company :—

Appellant	5,799 shares
Hilda Maud Messer	11,597 ,,
Laura Georgiana Lee Steere	11,597 ,,
	28,993 shares

The applications were accompanied by the partnership cheque for £29,000 dated 13th September 1929 in payment for the said shares and the 7 shares of the subscribers to the company's memorandum and articles of association, and such cheque was paid to the credit of the company's banking account. On the same day a cheque for £29,000 was drawn by the company and handed to the partnership in payment of the purchase price of the station pursuant to the terms of the agreement referred to in pars. 4 and 5 hereof, and such cheque was paid to the credit of the partnership banking account. On 13th September 1929 shares were duly allotted to such applicants in conformity with their respective applications.

6. The total number of shares issued by the company was 29,000 allocated as follows :—

Hilda Maud Messer	11,598 shares	£11,598
Laura Georgiana Lee Steere	11,598 ,,	11,598
Kenneth Durward Messer ..	5,800 ,,	5,800
Aileen Lee Steere	1 share	1
Hilda Lee Steere	1 ,,	1
Harold James Hamilton ..	1 ,,	1
H. H. Wilson	1 ,,	1
	29,000 shares	£29,000

These shares are still retained by the respective shareholders except the share of H. H. Wilson now deceased, which has been transferred to Hilda Maud Messer.

7. Pursuant to the *Income Tax Assessment Act* as amended by Act No. 50 of 1930, the Deputy Commissioner of Taxation, Perth, called upon the partnership to furnish a return showing the disposal

of the partnership assets to the company. On receipt of this return he caused assessments to be made and issued to the partners, and in the aggregate imposed income tax based on the following figures :—

Subject.	Income from property.	Income from personal exertion.
The purchase price of the pastoral leases	£5,000	
Price of wool of sheep (breeders) ..		£301
Profit on sale of live-stock		403
	£5,000	£704

8. The appellant was assessed for tax in respect of the said sums of £5,000 and £704 on the following basis :—

Income from Property—one-fifth of £5,000 .. £1,000

Income from Personal Exertion—one-fifth of £704 £141

9. The appellant, being dissatisfied with the said assessment, objected thereto by letter dated 7th November 1931, and by letter dated 10th December 1931 the Deputy Commissioner disallowed the said objection, whereupon by a further letter dated 23rd December 1931 the appellant requested the Deputy Commissioner to treat his objection as an appeal in accordance with the provisions of sec. 50 (4) of the *Income Tax Assessment Act* 1922-1931, and forward it to the High Court of Australia.

10. For the appellant it was contended (1) that the sum of £1,000 included in his assessable income on account of the consideration for the pastoral leases is capital and not income : (2) that the transaction does not fall within par. (*d*) of sec. 16 of the said Act : and (3) that if it does, such paragraph introduces into the Act another subject of taxation in contravention of sec. 55 of the Commonwealth Constitution.

For the Commissioner it was contended that par. (*d*) of sec. 16 validly operates to authorize the inclusion of such sum in the appellant's assessable income, and that the third contention of the appellant is not open under his notice of objection.

The questions for the opinion of the Court are :—

1. Whether the assessment should be reduced by excluding from the assessable income the whole or any part of the

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sum of £1,000 referable to the consideration for the said pastoral leases.

2. If not, whether it should be taxed as income from property, or as income from personal exertion.

Negus, for the appellant. The appellant contends (*a*) that the sum of £1,000 included in his assessable income was part of the consideration paid for the pastoral lease, and was therefore capital and not income; (*b*) that the transaction did not fall within par. (*d*) of sec. 16 of the *Income Tax Assessment Act* 1922-1930; (3) if it did, the paragraph introduced into the Act another subject of taxation in contravention of sec. 55 of the Commonwealth Constitution, and by reason of the incorporation of the *Assessment Act* in the *Income Tax Act* 1930, the latter Act is either invalid or ineffective to impose the tax on the sum of £1,000. As to the second contention, sec. 16 (*d*) taxes (*a*) amounts received as consideration for the assignment or transfer of leases, and (*b*) amounts received on the sale of shares as consideration for the assignment or transfer of leases. The latter provision only applies when the shares are sold within two years. One of the provisos to the section indicates that it was not the intention of the Legislature to tax share considerations in any circumstances, but only the proceeds of sale of shares in some circumstances. In revenue cases it is a well recognized rule that the substance of a transaction must be regarded, and the form may be disregarded. In substance this transaction was the formation of a company by three partners who had owned a station in the shares one-fifth, two-fifths, and two-fifths respectively. By forming the company they were taking advantage of the Western Australian legislation enabling them to limit their liability. There was really no sale of the assets whatsoever. If there was a sale, no amount of cash was received by the vendors as consideration for the assignment of the lease. "Received" means the same as "derived," namely, "obtained for the benefit and use of the recipient." In this case cheques were exchanged in accordance with a very common practice in Western Australia and in other parts of Australia in order to avoid registering an agreement with the Registrar of Companies

under sec. 26 of the *Companies Act* 1893. (See *Spargo's Case* (1).) The essential part of the transaction when applying for shares is a cheque accompanying the application. The vendors were obliged to apply for shares from a practical point of view. If they made default the sale of the station could not have been completed. It was not intended that they should obtain any beneficial use of the money represented by the cheque paid to the partnership by the company. The only consideration which the vendors received in substance was a number of shares in the company. The shares were received and held by the vendors in the same proportions as they owned shares in the partnership. The shares are still retained by the shareholders, and the two years mentioned in the section has long since expired.

Downing K.C. and *Gibson*, for the respondent. The offer by the partnership to the company was to accept payment of the purchase price in cash; part of the price, namely £6,000, was to be satisfied by the company paying certain liabilities. The individual partners made separate applications for shares, totalling 29,000, and in payment handed to the company the partnership cheque. The company then gave its cheque for the same amount. The transaction was therefore carried through on a cash basis. Sec. 26 of the *Companies Act* 1893 (W.A.) declares that every share in the company shall be deemed to have been issued subject to the payment of the whole amount thereof in cash, unless otherwise determined by the memorandum or articles of association or by a filed contract. The word "cash" has a well defined meaning (*Spargo's Case* (1)).

[RICH J. referred to *Australian Mercantile Land and Finance Co.* v. *Federal Commissioner of Taxation* (2) and *J. C. Williamson's Tivoli Vaudeville Pty. Ltd.* v. *Federal Commissioner of Taxation* (3).]

Williamson's Case bears out respondent's contention. Sec. 16 (*d*) of the *Income Tax Assessment Act* declares that "any amount received" by way of consideration for the assignment of a lease shall be assessable income. Special provision is, however, made where the consideration or part thereof is paid by a company in

(1) (1873) 8 Ch. App. 407.
(2) (1929) 42 C.L.R. 145.
(3) (1929) 42 C.L.R. 452.

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the form of shares in that company. It was open to the appellant to have stipulated for a payment in shares, and the transaction could then have been carried out in that form by a special provision in the memorandum or articles, or by a filed contract. If property and not cash was paid for the shares, such shares have not been paid for within the meaning of sec. 26 of the *Companies Act*, and the appellant still remains liable to the company for the amount, or at any rate would do so in the event of a winding up and the assets being insufficient to pay the creditors. (See *Inland Revenue Commissioners* v. *Blott* (1).) The position resulting from the exchange of cheques was recently considered by the High Court in *Joseph* v. *Campbell* (2). Both in form and substance, the transaction was carried through as if cash had been paid by each of the parties.

Negus, in reply. I concede the point raised by respondent's counsel that unless the appellant succeeded on the third contention six thirty-fifths of the sum of £1,000, would be taxable, as the amount thus obtained represented that proportion of the consideration for the assignment of the lease which was actually paid in cash under the arrangement that the company should take over and pay partnership debts aggregating £6,000. The appellant would abandon the third contention if the second question were answered in favour of the taxpayer except as to the six thirty-fifths of the £1,000.

Cur. adv. vult.

Sept. 13. The following written judgment was delivered :—

RICH, DIXON AND MCTIERNAN JJ. When the proprietor of a business desires to register a company for the purpose of taking it over so that he will exchange his character of owner for that of shareholder in the company, which becomes the proprietor of the business and carries it on, the transaction is conducted according to well recognized forms. Shares are allotted as fully paid up to the owner of the business who promotes the company. The amount of the shares thus issued corresponds with the value placed upon the assets after the deduction of the liabilities which are assumed by the company.

(1) (1921) 2 A.C. 171, at p. 213. (2) (1933) 50 C.L.R. 317 ; 7 A.L.J. 210.

The value so placed upon the assets, which are transferred to the company, supplies the means of paying up the shares. In jurisdictions where the provisions enacted by sec. 25 of the *Companies Act* 1867 of Great Britain are not in force, the assets may be transferred in satisfaction of the amount of the share capital issued, so that the shares are in this manner fully paid up. In *Ooregum Gold Mining Co. of India Ltd.* v. *Roper* (1) Lord *Watson* said :—" A company is free to contract with an applicant for its shares ; and when he pays in cash the nominal amount of the shares allotted to him, the company may at once return the money in satisfaction of its legal indebtedness for goods supplied or services rendered by him. That circuitous process is not essential. It has been decided that, under the Act of 1862, shares may be lawfully issued as fully paid up, for considerations which the company has agreed to accept as representing in money's worth the nominal value of the shares. I do not think any other decision could have been given in the case of a genuine transaction of that nature where the consideration was the substantial equivalent of full payment of the shares in cash." But, under the provisions enacted in Great Britain by sec. 25 of the statute of 1867, the liability upon the shares cannot be satisfied otherwise than by a payment in cash, unless an agreement between the allottee and the company is drawn up in writing and filed at or before the issue of the shares. Those who form companies to undertake their businesses naturally desire to avoid filing such a full statement of the transaction. Accordingly, wherever possible steps are taken to allow of a payment in cash to the company in respect of the shares issued. It was soon found that no difficulty existed in carrying through the transaction in a form which would leave the shares paid for in cash. If the company incurred a liability to pay a money sum equal to the face value of the shares in consideration of the transfer of assets, this liability might be used as the source of a payment in discharge of the liability imposed upon the allottee by the issue of the shares to him. In *Spargo's Case* (2), in a familiar passage, *James* L.J. said :—" In *Fothergill's Case* (3) the bargain in effect was to give paid-up shares in satisfaction of the money which was to be paid for other

(1) (1892) A.C. 125, at p. 136.
(2) (1873) 8 Ch. App. at p. 412.
(3) (1873) 8 Ch. App. 270.

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shares. But if a transaction resulted in this, that there was on the one side a bona fide debt payable in money at once for the purchase of property, and on the other side a bona fide liability to pay money at once on shares, so that if bank notes had been handed from one side of the table to the other in payment of calls, they might legitimately have been handed back in payment for the property, it did appear to me in *Fothergill's Case* (1), and does appear to me now, that this Act of Parliament did not make it necessary that the formality should be gone through of the money being handed over and taken back again; but that if the two demands are set off against each other the shares have been paid for in cash. If it came to this, that there was a debt in money payable immediately by the company to the shareholders, and an equal debt payable immediately by the shareholders to the company, and that each was accepted in full payment of the other, the company could have pleaded payment in an action brought against them, and the shareholder could have pleaded payment in cash in a corresponding action brought by the company against him for calls."

Under the operation of sec. 25 of the Act of 1867, it became the practice so to frame the transaction that the company bought the assets comprised in the business for a price expressed as a money sum. Shares to the amount of this sum were issued contemporaneously to the transferor: the cross-demands were then extinguished. Whether, because a set-off, such as that described in *Spargo's Case* (2), was thought to require some formal evidence or record, or because of a fear that, unless the capital in the shares was immediately called up so as to be then payable, the set-off would be ineffectual, it became usual to extinguish the cross-demands by an exchange of cheques which operated as counter-payments. In three States of the Commonwealth the provisions of sec. 25 remain in force. (See sec. 55 of the *Companies Act* 1899 (N.S.W.), sec. 25 of the *Companies Act* 1892 (S.A.), and sec. 26 of the *Companies Act* 1893 (W.A.), which contains an immaterial variation from the English model.) It is not uncommon in Australia for those engaged in pastoral pursuits to incorporate companies to take over in this manner their stations, often consisting of Crown leases. In this

(1) (1873) 8 Ch. App. 270.

(2) (1873) 8 Ch. App. 407.

condition of State law and practice under it, the Commonwealth Parliament enacted sec. 16 (*d*) of the *Income Tax Assessment Act* 1922-1930, which deals, *inter alia*, with the taxation of the consideration obtained on the assignment of leases. The material part of this paragraph provides that the assessable income of any person shall include " (*d*) money derived . . . by way of consideration for the assignment or transfer of a lease . . . and shall also include, where that amount or any part of that amount is paid by a company in the form of shares in that company to a person who has a controlling interest in that company and where those shares are sold or transferred by that person during the unexpired period of the lease . . . or within a period of two years after that date, whichever period is the lesser—the amount for which the shares were so sold or transferred." A proviso is made upon the paragraph that it should not apply to an amount paid by a company in the form of shares in that company, except to the extent provided in the paragraph. Another proviso made it clear that the assignment of Crown leases is included.

It is apparent that in the transaction we have described, no payment of money takes place if the shares are allotted in respect of the transfer of assets, and no cross-payment or set-off is effected in respect of an agreed purchase price equal to the amount of the shares and the liability on the shares. Accordingly, in those States where the provisions of sec. 25 of the British Act of 1867 are not in force, the form which the transfer usually takes would not expose the transferor to liability to tax under sec. 16 (*d*), unless before the end of the lease, or within two years, whichever is the earlier, he transfers the shares. In States where the provisions are in force there is a point in the transaction at which undeniably the shares are in point of law considered to be paid for in cash. The entire transaction, however, produces exactly the same result, viz., allotment of shares in the company in exchange for the assets transferred. Does the fact that one step in the transaction involves a payment of money by the company take it out of the proviso and the second limb of par. (*d*) of sec. 16 and expose a transferor to an unconditional liability under the first limb ?

The facts of the present case raise this question exactly.

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Three partners in a pastoral enterprise formed a company with which, on the day of its incorporation, they made an agreement to transfer the assets of the business for a purchase price of £35,000. A term of the agreement was that the company should satisfy the price by taking over the liabilities of the business amounting to £6,000 and paying immediately in cash the balance of the purchase price, viz., £29,000. On the same day, the partners applied for fully paid up shares of the total amount of £29,000, and, on the same day, the shares were allotted to them in proportion to their interests. On the same day a cheque for £29,000 was paid by the partners to the company, and another cheque of £29,000 was paid by the company to the partners. One of the partners, the appellant, who has not a controlling interest in the company, and who has not sold or transferred his shares, now complains of an assessment upon him which includes in his assessable income an amount representing his proportion of that part of the total consideration of £35,000 which is referable to the leases. The question is whether this proportion constituted money derived by him by way of consideration for the assignment or transfer of the lease, or constituted an amount paid by the company in the form of shares in the company within the meaning of those respective descriptions in par. (*d*) of sec. 16.

The question depends rather upon the true interpretation of the enactment than upon the character of the transaction. For it appears to us to be indisputable upon the one hand, that in point of law a payment was made in the course of the transaction by the company in respect of the lease, and, on the other hand, that as a result of the entire transaction when carried to its completion, the taxpayer obtained not money but shares in exchange for his interest in the lease. The general policy disclosed by the provision upon the question material to the case appears to us to be to distinguish between, on the one hand, assignments of leases which result in the receipt by the taxpayer of money, whether by direct payment or indirectly by the subsequent disposal within a limited period of shares forming the consideration for the assignment, and, on the other hand, assignments which result in the taxpayer receiving no more than a new form of right, viz., shares enabling him to continue in the economic enjoyment of the property assigned. In carrying

out that policy, the legislature has adopted expressions, not of a technical, but of a business character. The description "amount paid by the company in the form of shares" is the language of commerce rather than of company law. It is not incapable of describing the result produced by transactions carried out in the ordinary way determined by the operation of the provisions of sec. 25 of the British *Companies Act* of 1867. It is not the only place in the statutes in which the word "paid" is used in an elastic sense. (Cf. per *Rich* J. in *J. C. Williamson's Tivoli Vaudeville Pty. Ltd.* v. *Federal Commissioner of Taxation* (1).) The governing words, however, of par. (*d*) are those with which it opens: "Money derived." In the context of the provision, as it now stands, this expression appears to us to describe a receipt of money into the actual control or disposition of the taxpayer so that he may enjoy it, or deal with it as he chooses, in its character of money. It serves to mark the opposition to the other case dealt with by the paragraph, in which the taxpayer obtains shares, a case described as a payment to him of an amount in the form of shares. In the one case the lease is transmuted into money, in the other, into shares. The state of the law in the various States and the common course of practice must be taken into account in construing and applying the section. Upon its face, it is directed to transactions the nature of which is determined by that law and practice. Where, to meet the requirements of the provisions of the Act of 1867, cross-cheques are given or cross-demands are set-off, this process forms an essential part of the entire transaction. It is a thing which the parties contemplate, not as one which they may do, but one which they must do to carry it through. The transferor receives no money payment which in good faith he can retain; indeed, the cross-payments are concurrent conditions of the transaction simultaneously performed. Such is the practice which was conformed to in the present case.

For these reasons we are of opinion that the case is one in which shares and not money were derived by way of consideration for the assignment of the lease. Owing to the fact that, of the consideration of £35,000, £6,000 were satisfied by taking over liabilities and £29,000 by payment in the form of shares, it is not to the whole

(1) (1929) 42 C.L.R., at p. 479.

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but only a proportion of the consideration referable to the lease that was paid in the form of shares. This proportion is twenty-nine thirty-fifths.

We answer the first question in the case stated as follows :—

The assessment should be reduced by excluding from the assessable income twenty-nine thirty-fifth parts of the sum of £1,000 referable to the consideration for the pastoral lease.

It is unnecessary to answer the second question.

Costs in the appeal.

First question in the case stated answered that the assessment should be reduced by excluding from the assessable income twenty-nine thirty-fifth parts of the sum of £1,000 *referable to the consideration for the pastoral lease. Costs of the case stated, costs in the appeal.*

Solicitors for the appellant, *Parker & Parker.*

Solicitor for the respondent, *Wolff*, Assistant Crown Solicitor.