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Hughes v Federal Commissioner of Taxation (1958) 98 CLR 345

Appl
Lonsdale Sand & Metal Pty Ltd v FCT (1998) 162 ALR 220

[HIGH COURT OF AUSTRALIA.]

JOLLY . . . . APPELLANT;

AND

FEDERAL COMMISSIONER OF TAXATION . RESPONDENT.

ON APPEAL FROM DIXON J.

H. C. OF A.
1933-1934.
1933.
MELBOURNE,
Oct. 23, 24, 25;
Nov. 10.
Dixon J.
1934.
MELBOURNE,
Mar. 5.
Gavan Duffy C.J., Rich, Starke, Evatt and McTiernan JJ.

Income Tax (Cth.)—Assessment—Failure to include assessable income—Subsequent voluntary disclosure—Liability for additional tax—Deduction—Payment of interest—Whether money exclusively expended for production of income—Sale of shares at profit—Whether business of dealing in shares conducted—Profit liable to assessment—Dividends from stock—Profits of company liable to British income tax—Some dividends declared free of British income tax; other dividends not—Whether tax payable on amount before deducting British tax or only on net amount received—Income Tax Assessment Act 1915-1921 (*No.* 34 *of* 1915—*No.* 31 *of* 1921), *secs.* 12A, 14 (*b*), 18 (1) (*a*), 20 (*e*)—*Finance Act* 1920 (10 & 11 *Geo. V. c.* 18), *sec.* 27 (5).

The taxpayer was assessed to income tax in respect of income received during the four years 1917 to 1921. In 1927 the taxpayer voluntarily furnished amended returns of income for the years in question. In 1931 the Commissioner altered the original assessment upon the basis of the amended return submitted by the taxpayer. The amended assessment included a penalty for omitted income under sec. 59 (1) (*b*) of the *Income Tax Assessment Act* 1915-1921 imposed upon the ground that the taxpayer had failed to include assessable income in his returns.

Held, by *Dixon* J. and on appeal by the Full Court, that the taxpayer came within the description of a " person who fails to include any assessable income in any return " in sec. 59 (1) (*b*) and was liable to the penalty imposed by that section, and that the Court could not review the discretion of the Commissioner who had not remitted any additional tax, as he had power to do.

In the assessable income derived during the year ending 30th June 1920 the Commissioner included a profit made by the taxpayer on the sale of shares in a company. The taxpayer objected on the ground that the profit was not income but was of a capital nature.

Held, by *Dixon* J. and on appeal by the Full Court, that the taxpayer had not discharged the onus of showing that the profit obtained on the sale of the

shares in question was not the result of carrying out a scheme of profit-making consisting of taking up shares for the purpose of resale at a profit in pursuance of a general course of conduct; and that the profit so received was taxable.

During the year ended 30th June 1921 the taxpayer received dividends upon the ordinary stock and also upon the preference stock which he held in a company. The profits of the company were liable to British income tax. The dividends upon the ordinary shares were declared free of British income tax, but the dividends upon the preference shares were not. The sum received from the preference stock was the residue of dividends from which deductions had been made on account of tax. The Commissioner claimed that the dividends upon the ordinary stock should, for the purpose of assessment, be increased by an amount equal to the British taxation paid on them, and that the dividends on the preference stock should be included at the full amount without deduction.

Held, by *Dixon* J., that no more than the net amount paid to the taxpayer by the company in respect of dividends on preference or on ordinary stock was credited or paid to him, and that he was not liable to the inclusion in his assessment of any greater amount of dividend.

Decision of *Dixon* J. affirmed.

APPEAL from *Dixon* J.

These were four consolidated appeals by the taxpayer, John Jolly, against alterations made in assessments to income tax under the *Income Tax Assessment Act* 1915-1921.

The parties agreed upon the following facts:—

1. Pursuant to the provisions of the relevant *Income Tax Assessment Acts* the taxpayer furnished returns of income derived by him during the years ended 30th June 1918, 1919, 1920 and 1921 respectively.

2. The Commissioner made and issued assessments on such returns.

3. Afterwards, namely, on or about 3rd March 1927, the taxpayer lodged with the Commissioner documents bearing the description "Amended returns" in respect of the said years containing amounts or items as income which were not included in the returns mentioned in par. 1 hereof. These documents were not lodged in response to any requirement of or notice given by the Commissioner.

4. Afterwards, namely, on 27th July 1931, amended assessments in respect of the said years were made and issued by the Commissioner, which (*inter alia*) included as assessable income in each of the said years certain amounts which were not included in the returns mentioned in par. 1 hereof, but which were included as income in

the documents mentioned in par. 3 hereof. The said amounts consisted of additional fees and commission and certain other items or amounts.

5. In such amended assessments additional tax under sec. 59 of the *Income Tax Assessment Act* 1915-1921 was assessed and charged in respect of each of the said years.

6. A notice of objection dated 21st August 1931 was lodged against each amended assessment on the following ground (*inter alia*) :— " A correct and complete return of all fees and commissions and interest collected during the year having been spontaneously lodged by the taxpayer immediately errors in the original return were discovered by him, and information of the errors and correction having been given by him, it is submitted that a penalty should not be imposed in respect of the earlier return and that, as requested by the taxpayer at the time, the later return should be accepted and treated as cancelling and superseding the earlier return. In the circumstances, penalties should not be imposed in respect of errors in the earlier return which were corrected by himself in the later return."

7. In the said amended assessment for the year ended 30th June 1920 the Commissioner included as assessable income the item of £99 5s. 6d., being the profit made or realized by the taxpayer during the said year by or upon the sale of shares in a company called George Pizzey & Sons Ltd.

8. In the notice of objections lodged thereto a further ground of objection was as follows : " The gain arising from the sale of shares in George Pizzey & Sons Ltd. acquired as an investment is an accretion of capital resulting from realization of a capital asset and is not taxable as income."

The appeals were heard by *Dixon* J., in whose judgment hereunder the facts are fully set out.

Fullagar K.C., for the appellant.

Wilbur Ham K.C. and *Tait*, for the respondent.

Cur. adv. vult.

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Dixon J. delivered the following written judgment :—

These are four consolidated appeals by a taxpayer against alterations made in assessments to income tax under the *Income Tax Assessment Act* 1915-1921. The assessments in question are for the four financial years extending from 1st July 1918 to 30th June 1922 based upon the four respective years of income beginning 1st July 1917 and ending 30th June 1921. Towards the end of the first half of each of the four financial years, the taxpayer furnished returns of his income pursuant to sec. 28 of the *Income Tax Assessment Act* and in due course assessments were made upon him based upon these returns. In the beginning of the year 1927 he reconsidered the ascertainment of his assessable and taxable income for a period of time which includes the years with which these proceedings are concerned. Why he did so, is not, in my opinion, a material issue. As a result of a re-examination and reconstruction of his accounts, on 3rd March 1927 he furnished to the Commissioner, in respect of each of the four years of income, statements in the same form as returns of income headed "Amended return of income." After some investigation had been made by his officers, the Commissioner, by notices of amended assessment dated 27th August 1931, notified the taxpayer that the assessment for each of the four years had been altered in the manner appearing in the notice and accompanying sheets. The alteration in each case apparently proceeded upon the basis of or followed the amended returns submitted by the taxpayer, although it did not entirely accept them. In each case the amended assessment included a so-called penalty for omitted income, that is, additional tax under sec. 59 (1) (*b*) imposed upon the ground that the taxpayer had failed to include assessable income in his returns. The Commissioner did not remit any of the additional tax, as he has power to do under the proviso to that section, and his discretion cannot be reviewed upon these appeals. (Compare *Richardson* v. *Federal Commissioner of Taxation* (1).)

The amount of additional tax adopted by each amended assessment is double the sum by which the total tax ascertained under the amended assessment exceeded the total tax ascertained by the

(1) (1932) 48 C.L.R. 192, at p. 205.

assessment based upon the taxpayer's primary return. The amounts are as follows :—

Financial Year.	Increase in Tax.	Additional Tax under sec. 59.
1918-1919	£15 19 1	£31 18 2
1919-1920	£21 12 9	£43 5 6
1920-1921	£183 6 11	£366 13 10
1921-1922	£378 1 5	£756 2 10

It is not surprising that the taxpayer should resist payment of this large penal sum. He does so on the ground that the condition described by sec. 59 (1) (*b*) has not occurred : that he could not be described as a " person who fails to include any assessable income in any return." His contention is that the documents of 3rd March 1927 bearing the description " Amended return " should be considered a part of his returns, and that, except for some unimportant items, they contained in each case his assessable income for the relevant twelve months. This contention is or may be supported by giving either of two interpretations to the expression " fails to include any assessable income in any return." First, the word " return " may be given a meaning which includes the plural " returns " ; and, second, the word " any " may be given that meaning, which has the effect of " every," so that the phrase is equivalent to " omits some of his assessable income from every return." I do not think either of these two meanings can be adopted. The word " fails " implies that what is not included ought to be included. The words " any return " refer to the document in which it ought to be included. In my opinion, any single document, which answers the description " return," is within these words, if it professes to include all the assessable, or perhaps all the relevant part of the assessable, income. If a return is furnished which purports to include the assessable income and some of the assessable income is in fact omitted, the taxpayer, I think, comes within the description " person who fails to include any assessable income in any return." The taxpayer for each of the four years did furnish a return purporting to include all his assessable income, and in fact assessable income was omitted from it. For these reasons I am of opinion that the objections to the assessment of additional tax under sec. 59 cannot be sustained.

From a pecuniary point of view the question of penal tax is the most important in the appeals. But the taxpayer contested the

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correctness of the Commissioner's disallowance of other objections upon which he relied, and in respect of two of these matters I think he is entitled to succeed. The amended assessment for the financial year ended 30th June 1921 based upon income derived in the year ended 30th June 1920 attributed to the taxpayer the receipt in that period of a sum of £315 14s. 3d. fees for professional services. The taxpayer maintains that neither in cash nor in account did he receive that sum in the twelve months ended 30th June 1920, and that in truth its receipt occurred in 1917. I am satisfied upon the evidence that this sum was neither earned nor received during the period with which these appeals are concerned.

The second of the questions upon which I think the taxpayer should succeed, although in this case involving but a small amount of tax, is said to be of general importance, and it is convenient to deal with other objections before discussing it.

In respect of the two financial years ending 30th June 1921 and 1922, the assessments for which are based on the income derived during the years ending 30th June 1920 and 1921, the taxpayer seeks to include among the deductions sums of £66 11s. 1d. and £70 18s. 1d. respectively for interest. He says these sums were incurred in respect of an advance by the executors of one John Widdis, who died on 12th February 1918. Before his death he had become one of several joint purchasers of a pastoral property, and had paid £1,500 on account of his share of the purchase-money. The taxpayer says that he arranged with the executors of John Widdis and with the surviving co-purchasers to take the deceased's place in the transaction. The amount already paid by the late John Widdis was to become a loan to the taxpayer bearing interest at 6½ per cent per annum. The interest was not actually paid during these two years, and it was not claimed as a deduction until objections were lodged to the amended assessments of 27th July 1931. But in his original return for the financial year ending 30th June 1919, the taxpayer did claim as a deduction from his income from property "interest to Widdis Exors. John £74 12s. 9d.," an admittedly erroneous amount. As of 30th June 1930 an entry was made in his books narrating the transaction with Widdis' executors including the interest accruing during all prior years. The calculation of the amounts shown in this account, including those claimed as deductions,

was not explained. The account shows a credit to the executors of £1,500 for principal and £724 9s. 4d. for interest; but the taxpayer in his evidence said that his indebtedness had now been reduced to £69 by payments in cash and by charges for services rendered. Although he paid nothing for interest during the two years in question, the taxpayer claims that a deduction should be allowed under sec. 18 (1) (*a*) of the *Income Tax Assessment Act* 1915-1921, and that it should be considered money wholly and exclusively laid out or expended for the production of income within sec. 20 (*e*). Whatever arrangement was made by the taxpayer with the executors of Widdis, I am not satisfied that it imposed upon him a liability to pay interest within either of the two years ending 30th June 1920 or 1921. I am not prepared to find that the taxpayer incurred an obligation which in those two years resulted in a debt for interest then due and payable. I do not think a deduction can be obtained unless an immediate liability accrued within the accounting period, there being no actual expenditure. Upon that ground I disallow the claim. It is unnecessary to deal with the Commissioner's contention that this complaint by the taxpayer is not against the alterations to the assessments, and, therefore, that the objection is not competent to the taxpayer.

In the assessable income derived during the year ending 30th June 1920 upon which the taxpayer was assessed for the financial year ending 30th June 1921, the Commissioner, by his amended assessment, included a profit of £99 5s. 6d. made by the taxpayer on the sale of some shares in a company called "George Pizzey & Co. Ltd." The taxpayer objects that the profit is not income but is of a capital nature. The taxpayer is a public accountant and conducts a practice in Melbourne. Until 1916 he was also secretary of the Woolbrokers Association. After 1916 he engaged exclusively in private practice, but he had pastoral interests and, as he said, "a good deal of money on investment—stock and shares." On 4th February 1920 he bought 450 preference shares and 300 ordinary shares in the company, George Pizzey & Co. Ltd., which was then floated. On 29th March 1920 he sold the preference shares and on 21st April 1920 he sold the ordinary shares. He said that in buying the shares his immediate object was not to make a profit but to

hold as an investment from which he hoped to obtain dividends; that he was not working for a turn in the market, but that manifestly he looked for an advance, he never bought without looking for an advance, although he would not sell unless he required the money for something else; that his impression was that during the four years under consideration these were the only shares he sold, but that he was buying frequently. A list was put in evidence showing his losses and gains resulting from the realization and abandonment of shares in industrial, mining and oil companies from the years 1920 to 1931 inclusive. I think that the taxpayer was in the habit of buying and taking up shares, that he often did so by way of pure speculation, and that, on the other hand, sometimes his main object was to obtain and hold an investment of capital in a revenue-producing security, which, however, if he so desired, he could sell to advantage or at least without loss. He was not a market operator and there was no high degree of frequency in his transactions, but continually he laid out available money in stocks and shares because they appeared likely to rise in value, or, in the case of oil shares, perhaps, because, if the company's venture succeeded, the rise in the value of its shares appeared likely to be very great. The evidence as to his transactions in and about the year 1920 is scanty and unsatisfactory, but I think it probable that his course of conduct then was as I have described it. The burden of proof lies upon him and I am not satisfied that the facts were more favourable to him than I have stated. I do not think that at this distance of time reliance can be placed upon his evidence of the circumstances in which he sold the shares in George Pizzey & Co. Ltd., or of the motives by which he was actuated in buying them. Having regard to the short time he held the shares, to the fact that he applied for them as a member of the public when the company was floated and to the general character of his transactions, I do not think that it should be found that early resale upon a favourable market was not within his contemplation when he acquired the shares, and did not form the main reason for taking them up.

The criterion for distinguishing between capital and income is flexible, if not vague, and for that reason appears to me to be

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unsatisfactory. It is stated and discussed in *Blockey* v. *Federal Commissioner of Taxation* (1), *Federal Commissioner of Taxation* v. *Clarke* (2) and *Coglan* v. *Federal Commissioner of Taxation* (3), which are cases of individuals. Decisions in company cases must be used with care when the taxpayer is an individual, but the criterion is the same. It is stated in *Ruhamah Property Co.* v. *Federal Commissioner of Taxation* (4). The principal English authorities are referred to in these cases, but I wish to refer, in addition, to *Cooper* v. *Stubbs* (5), *Pickford* v. *Quirke* (6), *Commissioners of Inland Revenue* v. *Livingston* (7), *Jones* v. *Leeming* (8) and *Westminster Bank* v. *Osler* (9).

I am not satisfied that the profit obtained on the sale of shares in question was not the result of carrying out a scheme of profit-making consisting of taking up the shares for the purpose of resale at a profit in pursuance of some general course of conduct which the taxpayer had adopted of acquiring speculative as well as other securities. The taxpayer has not established that the profit upon the shares in George Pizzey & Co. Ltd. was of a capital nature. Accordingly I disallow the objection to the inclusion of this item in the assessable income derived in the year ending 30th June 1920.

During the year ended 30th June 1921 the taxpayer received from the New Zealand Loan and Mercantile Agency Co. the sum of £143 16s. 6d. by way of dividend upon £2,397 ordinary stock and the sum of £1 3s. 10d. by way of dividend upon £32 10s. preference stock, which he held in that company. Although part of the company's income is derived from sources in Australia, its profits, or some of them, are liable to British income tax, presumably because it is " resident " in the United Kingdom. The dividends upon the ordinary shares were declared and paid " free of English income tax." The dividends upon the preference shares were not declared free of British income tax and the sum of £1 3s. 10d. received by the taxpayer was the residue of two dividends of 2½ per cent or 16s. 3d. each, from which deductions had been made on account of tax ; a

(1) (1923) 31 C.L.R. 503.
(2) (1927) 40 C.L.R. 246.
(3) (1932) 47 C.L.R. 109.
(4) (1928) 41 C.L.R. 148, at pp. 151, 152.
(5) (1925) 2 K.B. 753, per *Atkin* L.J. at pp. 774-776.
(6) (1927) 13 Tax Cas. 251.
(7) (1926) 11 Tax Cas. 538.
(8) (1930) A.C. 415.
(9) (1933) A.C. 139.

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deduction at the rate of 4s. 6d. in the £ from one and 6s. in the £ from the other. The amount of 4s. 6d. in the £ represents British tax at 6s. 4d. reduced by the rate of relief obtained by the company under sec. 27 of the British *Finance Act* 1920 in consequence of the payment of Dominion income tax. Sub-sec. 5 of that section requires that the amount of the deduction from dividends shall be so reduced, but, in consequence of the adoption in the Chancery Division of a construction of sub-sec. 5 now held to be erroneous, the full amount of 6s. was deducted from the next dividend. (See *Wakefield* v. *Whiteaway, Laidlaw & Co.* (1), overruled by *Sheldrick* v. *South African Breweries Ltd.* (2).)

If, instead of declaring upon the ordinary shares tax free dividends, the company had declared dividends of such amounts as would, after the deduction of British tax reduced by Dominion relief, give the shareholder the same net return, it would apparently have been necessary to increase one of these dividends by 3s. 4½d. in the £ and another of them by 3s. 3d. in the £. (See schedule A of Ex. E.)

The Commissioner claims that, for the purpose of ascertaining the taxpayer's assessable income under the *Income Tax Assessment Act* 1915-1921, the dividends upon the ordinary stock must be so increased in order to arrive at the amount to be included and those upon the preference stock must be included at the full amount without deduction. The amended assessment gave effect to this claim although, apparently, the figures actually adopted were erroneous. The taxpayer objects that no greater amount than the net dividends he received should be included in his assessable income. The ground of the Commissioner's claim is that the amount representing British income tax forms part of the dividends, not only of the dividend upon the preference share but also of the dividend upon the ordinary shares, and that for this reason it was assessable income of the taxpayer.

A governing principle of British income tax law is taxation at the source, and, in accordance with this principle, the profits and gains of a body of persons, an expression which includes a joint stock company, are brought into charge before they are divided, and the body of persons paying a dividend is entitled to deduct the tax

(1) (1922) 1 Ch. 200.

(2) (1923) 1 K.B. 173.

appropriate thereto (rule 20 of the *All Schedules Rules, Income Tax Act* 1918). When a company declares a tax free dividend, it is regarded, at any rate for many purposes, as dividing profits sufficient in amount to pay a gross dividend which, after deduction of tax, will leave the net amount at which the dividend is expressly declared. In *Gold Fields American Development Co.* v. *Consolidated Gold Fields of South Africa*, *Tomlin* J. said (1) :—" It remains to consider what is the effect of payment of a dividend free of tax. I think that such a dividend is one of such an amount as after the deduction of the proper rate of tax leaves the rate of interest specified available for the shareholder. Where the shareholder is liable to super-tax he must return the gross amount of the dividend, and that amount will vary with the amount in respect of tax, which has not been received by the shareholder from the company. The amount not so received is the amount of the tax on the gross dividend, and is in my opinion in substance and in fact deducted by the company within the meaning of rule 20." (See, too, *Attorney-General* v. *Ashton Gas Co.* (2), per *Buckley* J. ; affirmed, *Ashton Gas Co.* v. *Attorney-General* (3).) The question whether the amounts representing British tax deductible in respect of the dividends forms part of the assessable income of the taxpayer derived during the year ending 30th June 1921 is governed by the provisions of sec. 14 (*b*) of the Commonwealth *Income Tax Assessment Act* 1915-1921. These provisions direct that the income of any person shall include dividends, profits, or bonus, credited or paid to any member or shareholder of a company which derives income from a source in Australia. If the company also derives income from a source outside Australia, a proportionate part of the dividend is excluded from the Commonwealth assessment. No provision allows a deduction from the assessable income of any tax paid or borne in Great Britain, but sec. 12A provides for a rebate of tax of a character similar to the relief allowable in Great Britain when Dominion tax is paid in respect of profits there brought into charge. The taxpayer has made no objection to the manner in which the Commissioner has proportioned the dividends or applied sec. 12A. The question is whether upon a

(1) (1926) Ch. 338, at p. 356.
(2) (1904) 2 Ch. 621, at p. 623.
(3) (1906) A.C. 10.

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proper understanding of the legal effect under the British income tax legislation of what the company has done, the additional sums representing British tax answer the description—dividends, profits or bonus credited or paid to the taxpayer as a member of the company. The meaning and effect of this description were considered in this Court in the two cases of *Webb* v. *Federal Commissioner of Taxation* (1) and *James* v. *Federal Commissioner of Taxation* (2). In effect, the view adopted in those cases by *Knox* C.J., *Gavan Duffy* and *Starke* JJ. was that the description was satisfied if the shareholder received a specific sum of money in currency or obtained the benefit of such a sum by way of credit entry, set-off or other statement of account (3). *Isaacs* J. considered that profits were not credited or paid within the meaning of the statutory expression unless in some way, including the declaration of dividend, a debt has been incurred by the company to the shareholder (4). Whatever else the provision includes, I think it extends to all profits which a company allocates as such to all or some class of its members severally, and, under lawful authority, appropriates in discharge of claims to which they are individually liable. But it is not any uncertainty as to the meaning or operation of sec. 14 (*b*) of the Australian statute that makes difficult the question whether the sums representing British tax are dividends, profits or bonus credited or paid by the company to the taxpayer. The difficulty arises rather in the nature of the British legislation. In *Hamilton* v. *Commissioners of Inland Revenue* (5), *Rowlatt* J. said :—" I do not think anybody has ever sat down to really tackle exhaustively, so as to work out a complete system, the problems which arise in relating the taxpayer's individual income to the income of the company. Those problems, of course, were very much in the background in 1842, but they came into some prominence as soon as you got the growth of the joint stock commercial companies, and their consideration has been one of the esoteric joys of the select company of income tax lawyers for a long time." Under Schedule D (1) (*b*) of the *Income Tax Act* 1918, tax is charged in respect of all

(1) (1922) 30 C.L.R. 450.
(2) (1924) 34 C.L.R. 404.
(3) (1922) 30 C.L.R., at p. 461; (1924) 34 C.L.R., at p. 418.
(4) (1922) 30 C.L.R., at p. 479; (1924) 34 C.L.R., at p. 414.
(5) (1931) 16 Tax Cas. 213, at pp. 222, 223.

interest of money annuities and other annual profits or gains not charged under Schedules A, B, C or E and not specially exempt from tax. Schedule D (2) provides : " Tax under this Schedule shall be charged under the following cases respectively ; that is to say, . . . Case VI.—Tax in respect of any annual profits or gains not falling under any of the foregoing cases, and not charged by virtue of any other Schedule ; and subject to and in accordance with the rules applicable to the said cases respectively."

No other provision warrants a direct assessment upon a shareholder in respect of the receipt by him of dividends or profits distributed by a company. But Case VI. of Schedule D sweeps into charge all annual profits or gains not elsewhere included, and it appears probable that, if dividends and profits were not otherwise dealt with for the purposes of taxation, the shareholder would be liable under this case to assessment thereon. The system, however, of taxation at the source involves a treatment of corporate profits which is not compatible with any general inclusion of dividends in the shareholder's own assessment to income tax. The profits and gains are assessed in the hands of the company prior to distribution. They are taxed collectively. Upon distribution the company is authorized, but not required, to deduct from the dividend the tax which would be payable upon the dividend. The company does not account to the Crown for the amount deducted : for the profits distributed have already borne tax in its hands. But, for the purposes of reliefs allowed to taxpayers, the shareholder is entitled to treat himself as having paid by deduction the amount which the company has withheld in paying his dividend ; and in assessing his liability to super-tax or surtax, which is levied on his total income from all sources, the amount so withheld as well as the dividend must be included. In the case of yearly interest of money, annuities or other annual payments of a like character, a sum representing the amount of tax thereon at the rate or rates in force during the period through which the payments were accruing due may be deducted by the person liable to make such payment if it is payable wholly out of profits or gains brought into charge to tax, and, if it is not so payable, a deduction must be made by him of a sum representing the amount of tax thereon at the rate of tax in force

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at the time of payment. In the first case, the recipient is not to be assessed but the profits are to be assessed in the hands of the payer and he may retain the deduction. In the second case, the payer must account to the Crown for the deduction. These provisions, which are contained in rules 19 and 21 of the *All Schedules Rules*, differ in many particulars from those governing company dividends, which are contained chiefly in rule 20, but the interpretation of rule 20 has not always escaped confusion with them. Rule 20 is as follows : " The profits or gains to be charged on any body of persons shall be computed in accordance with the provisions of this Act on the full amount of the same before any dividend thereof is made in respect of any share, right or title thereto, and the body of persons paying such dividend shall be entitled to deduct the tax appropriate thereto." It is to be noticed that the rule, like sec. 54 of the *Income Tax Act* 1842 upon which it is founded, includes much more than incorporated companies. " Body of persons " means " any body politic, corporate, or collegiate, and any company, fraternity, fellowship and society of persons, whether corporate or not corporate " (sec. 237 of the Act of 1918). The principle adopted is that a fund of income owned collectively should be taxed independently of its division among its collective owners. In ascertaining their several rights in or against the fund, it may have been considered important to authorize a deduction in respect of tax from the dividends. Sec. 54 of the Act of 1842 required that all persons having a share, right or title in or to the profits and gains should allow out of such dividends a proportionate deduction in respect of the duty charged on the profits and gains. This enactment probably contemplated a deduction of a proportion of the actual sum which the profits distributed in dividends had borne. But it was always the practice to deduct from the dividend whatever tax would be exigible upon it. Until 1927 a company's assessment was based upon the average of its profits for the three preceding years. Since that date the assessment has been upon the profits of one preceding year. (Sec. 29 of the *Finance Act* 1926.) A good account of the practice is given in the opinion of the Commissioners contained in the case stated in *Hamilton* v. *Inland Revenue Commissioners* (1) :—

(1) (1931) 2 K.B. 495, at pp. 502, 503; 16 Tax Cas. 213, at p. 219.

" As a consequence of the system of measuring assessments by the results of a previous period, the assessments on a company seldom correspond in amount, even approximately, to the profits of the year of assessment which are taxed by those assessments, and it is not uncommon for the profits available for distribution by way of dividend to exceed the amount of the assessments (or of the proportions of such assessments if the company's accounting period does not coincide with the income tax year) for the period in which the profits were made. Nevertheless, it is, and always has been, the almost universal practice to deduct from the gross amount of the dividend the tax appropriate to that amount, or, if the dividend is declared to be 'free of tax,' to treat it, for the purposes of computing total income, as equivalent to the gross amount which, after deduction of the appropriate tax, corresponds to the net amount actually paid, without any reference to the amount of the company's 'statutory' income. This method of dealing with dividends is one of the accepted conventions under which the Income Tax Acts are regularly administered, and it is consistent with the actual words of the Acts." (See, too, per *Sargant J.*, *Johnson* v. *Chestergate Hat Manufacturing Co.* (1).)

The change in language made in rule 20 has gone far to confirm this practice. The rule enables the body of persons to deduct, not a proportion of the duty charged on the profits or gains, but the tax appropriate to the dividend. This expression means the tax at the standard rate on the gross amount of the dividend paid by the company and not a proportionate part of the tax paid by the company in the year in which the dividend is distributed (*Hamilton* v. *Inland Revenue Commissioners* (2)). The liability of the company to assessment upon its profits is not that of a representative or agent but of a principal. Its legal personality is as separate from that of its members for the purpose of the income tax as for any other purpose. Notwithstanding earlier judicial statements to the contrary, it is now clear that it does not pay the tax on behalf of its shareholders, that the description "agent" is inappropriate, and that it is an independent taxpayer. (See *Inland Revenue*

(1) (1915) 2 Ch. 338, at pp. 343-344.
(2) (1931) 2 K.B. 495; 16 Tax Cas. 213.

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Commissioners v. *Blott* (1), per Viscount *Cave* ; *Scottish Union and National Insurance Co.* v. *New Zealand and Australian Land Co.* (2), per Viscount *Finlay* ; *Sheldrick* v. *South African Breweries Ltd.* (3), per *Younger* L.J. ; *Bradbury* v. *English Sewing Cotton Co.* (4), per *Younger* L.J. ; *Inland Revenue Commissioners* v. *Burrell* (5), per *Pollock* M.R. ; *Inland Revenue Commissioners* v. *Dalgety & Co.* (6), per Lord *Hanworth* M.R. ; *Neumann* v. *Inland Revenue Commissioners* (7).) The company is enabled to recoup itself by the deduction (*Bradbury's Case* (8), per Lord *Shaw of Dunfermline*); but it need not do so (per Lord *Sumner* (9)). Because what it is authorized to deduct is the standard rate of tax upon the dividend and not the tax which it has paid upon the profits divided, the company does not recoup itself exactly. Although the tax paid by the company and the tax deducted from its shareholders may not be equivalent, the system is employed even if at times it yields some profit to the company. The shareholder is not paying by deduction an aliquot part of the taxation imposed upon the company (*Hamilton's Case* (10), per Lord *Hanworth* M.R.). Accordingly the shareholder cannot treat himself as having paid tax in the amount of the deduction, subtract the tax which would have been payable by him on his income if the dividends had been included in an individual assessment upon him and obtain a refund of the excess by way of relief (*Ritson* v. *Phillips* (11) ; compare *Inland Revenue Commissioners* v. *Blott* (12), per *Rowlatt* J.). The reason why the receipt of dividends by a shareholder exposes him to no liability to direct assessment to income tax thereon is that the profits divided have already borne tax. " The operation of declaring a dividend is not an operation which gives birth to a profit or gain ; it is only the division of profits or gains earned by the trading operation, and the company is assessed in respect of the trading operation, which is the only source of profit or gain, and the declaration of the

(1) (1921) 2 A.C. 171, at p. 201 ; 8 Tax Cas. 101, at p. 136.
(2) (1921) 1 A.C. 172, at p. 182.
(3) (1923) 1 K.B., at pp. 190-194.
(4) (1922) 2 K.B. 569, at p. 589 ; (1923) A.C. 744, at p. 757 per Lord *Shaw of Dunfermline*, at p. 763 per Lord *Sumner*, at pp. 765, 766 per Lord *Wrenbury*, at pp. 769, 770 per Lord *Phillimore*.
(5) (1924) 2 K.B. 52, at p. 65.
(6) (1930) 1 K.B. 1, at pp. 26, 28.
(7) (1933) 1 K.B. 728, at p. 737 per Lord *Hanworth* M.R., at p. 742 per *Slesser* L.J., at p. 744 per *Romer* L.J.
(8) (1923) A.C., at p. 757.
(9) (1923) A.C., at p. 763.
(10) (1931) 2 K.B., at pp. 515, 517.
(11) (1924) 9 Tax Cas. 10.
(12) (1920) 1 K.B. 114, at pp. 132, 133.

dividend is merely the division, without any income accruing, of the profits and gains realized" (per *Rowlatt* J., *Hamilton's Case* (1)). "The dividends or drawings of corporators, shareholders, partners, joint tenants and the like were not again taxable as a new subject matter" (*Blott's Case* (2), per *Rowlatt* J.; compare *Bradbury's Case* (3)). But the result is to relieve the shareholder of a liability to tax in respect of the dividend, which, otherwise, would fall upon him and this relief, or more correctly the price of it consisting in the deduction which he suffers, must be reckoned in for the purpose of super-tax or surtax, which is based upon total income including dividends received. The immunity is to be treated as in the nature of a receipt or deemed to be a receipt by the shareholder (*Hartland* v. *Diggines* (4), per *Pollock* M.R.). "The tax is paid by one person, but the sum which is paid over tax free is larger by reason of the fact that before it has been paid over the tax has been paid upon it and it has been handed over without any deduction having been made from it. For the purposes of super-tax the person who receives the dividend must return not merely the sum that he has actually received, but also the amount which he did not receive but which eased his position by reason of the fact that somebody else paid the income tax upon the sum which he did receive. The totality therefore of the dividend plus the income tax is the sum which is to be returned for super-tax purposes to the revenue" (per Lord *Hanworth* M.R., *Sutton* v. *Commissioners of Inland Revenue* (5)). What conditions must be fulfilled in order to give a dividend immunity from income tax in the individual assessment of the shareholder is a question upon which much difference of opinion appears to exist. The view held by *Rowlatt* J. is that profits and gains of a company bear income tax at the source or not at all, and that no subsequent distribution exposes the shareholder to income tax. Thus dividends would not be taxable although paid out of profits which were not subject to charge in the company's hands because they were of a capital nature, or for some other reason. (See *Gimson* v. *Commissioners of Inland Revenue* (6); *Hamilton's Case* (7); *Purdie* v. *The*

(1) (1931) 16 Tax Cas., at p. 221.
(2) (1920) 1 K.B., at p. 130.
(3) (1923) A.C., per Lord *Phillimore* at p. 769, and per Lord *Sumner* at pp. 760, 763, 764, and per *Younger* L.J. s.c. (1922) 2 K.B., at p. 589.
(4) (1924) 10 Tax Cas. 247, at p. 253.
(5) (1929) 14 Tax Cas. 662, at p. 682.
(6) (1930) 15 Tax Cas. 595, at p. 601.
(7) (1931) 16 Tax Cas., at p. 221.

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King (1).) But there are many expressions of a contrary view or views. Sometimes it appears to be considered that the immunity attaches only to dividends representing or attributable to profits or gains which have borne full tax before distribution. Sometimes deduction of tax from the dividend seems to be regarded as an essential condition of the shareholder's freedom from direct assessment in respect of the dividend. As it is well established that a tax free dividend should be treated as a dividend of a larger amount reduced by deduction of tax, it is not easy to see why express deduction should be material to the shareholder's liability to direct assessment in respect of the dividend ; compliance by the company with the requirement, now statutory, that it should exhibit upon the dividend warrant the gross and net amounts can scarcely be the criterion. Be this as it may, in *Scottish Union and National Insurance Co.* v. *New Zealand and Australian Land Co.* (2), Viscount *Cave* expressed the view that if preference shareholders did not bear the full deduction of tax but received the benefit of Dominion relief obtained by the company, they would probably be liable to direct assessment for the difference in tax. In *Hamilton's Case* (3), *Romer* L.J. says : "If a company should declare a dividend without deducting tax then it seems to me that the shareholder would himself be assessable to tax in respect of the dividend he had received." (Cf. per *Lawrence* L.J. (4), per Lord *Hanworth* M.R. (5), and per *Scrutton* L.J. (dissenting) in *Bradbury's Case* (6) ; per *Romer* L.J. in *Neumann's Case* (7).) Possibly these views have been influenced by rules 19 and 21. At any rate, when *Atkin* J. in *Brooke* v. *Commissioners of Inland Revenue* (8) said : "If the payee has not paid income tax by allowing the deductions, as by the appropriate sections he is compelled to do, it is difficult to see how he escapes paying income tax on the net sum that comes into his hands," he had actually before him a case arising under the provisions now contained in those rules. The question whether the shareholder obtains immunity from taxation by direct assessment if, and only if, he suffers a deduction in respect of tax from the dividend, appears to me to be of some importance in

(1) (1914) 3 K.B. 112, at pp. 116, 117.
(2) (1921) 1 A.C., at p. 185.
(3) (1931) 2 K.B., at p. 521.
(4) (1931) 2 K.B., at p. 506.
(5) (1931) 2 K.B., at p. 517.
(6) (1922) 2 K.B., at p. 583.
(7) (1933) 1 K.B., at p. 746.
(8) (1917) 1 K.B. 61, at p. 71.

relation to the question whether the actual or imputed deduction made should be considered dividend or profit credited or paid to the shareholder within the meaning of sec. 14 (*b*) of the Commonwealth *Income Tax Assessment Act* 1915-1921. Unless this be so, I think the remaining incidents of the relation of the shareholder to the gross amount, actual or notional, of the dividend are against the view that the excess over the amount he receives is credited or paid to him. That excess the company is by law entitled to withhold whether it is included within, or excluded from, the amount of the dividend expressly declared. When the company retains such a sum, it forms part of its general funds and is applicable accordingly. The fact that it specifies in its declaration of dividend a larger sum or rate than it in fact pays, does not seem of importance. In point of law it incurs no liability to the shareholder by doing so for any amount except the net sum after the deduction. Whether it be correct or not, that before sec. 7 of the *Finance Act* 1931 the company was authorized to make a deduction from dividends out of profits on which the company paid no tax (see per *Romer* L.J. in *Neumann's Case* (1)), it is clear that deduction of tax did not operate by way of set-off or otherwise to discharge any liability for any sum paid by the company for tax. There is no appropriation to or for the use of the shareholder ; nothing done by the company on his account or for his use. If it be true that the shareholder's immunity from direct assessment depends upon his suffering a deduction from dividend, all that can be said is that, by making the deduction, the company *ipso facto* discharges or absolves the shareholder from a direct liability to the Crown for tax in respect of the dividend. I do not think that in the peculiar situation in which the shareholder stands this would be enough to constitute a credit to him of the profits within sec. 14 (*b*) as construed in *Webb's Case* (2) and *James's Case* (3). The destruction or prevention of the shareholder's liability to tax would be a consequence ensuing from the deduction as a result of an express provision of positive law, a statutory phenomenon, and not a discharge by payment or appropriation of money for the purpose. The money would not be credited to the

(1) (1933) 1 K.B., at pp. 747, 749. (2) (1922) 30 C.L.R. 450.
(3) (1924) 34 C.L.R. 404.

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taxpayer and applied by the company in discharge of his liabilities. But in any event, my opinion is, if I may venture to express it upon such a matter, that under the British *Income Tax Acts* the deduction from dividend of the standard rate of tax thereon is not the cause or the occasion of the shareholder's immunity from income tax. His immunity arises from the imposition of income tax upon the profits in the hands of the company and from the principle, which, in *Bradbury's Case* (1), Lord *Sumner* accepted as " now well recognized, that the various taxing Acts with which we are concerned nowhere authorize the Crown to take income tax twice over in respect of the same source for the same period of time " ; or from the principle, which Lord *Phillimore* in the same case (2) attributed to the legislation, " that for revenue purposes a joint stock company should be treated as a large partnership, so that the payment of income tax by a company would discharge the quasi-partners. The reason," he said, " for their discharge may be the avoidance of double taxation, or to speak accurately, the avoidance of increased taxation. But the law is not founded upon the introduction of some equitable principle as modifying the statute ; it is founded upon the provisions of the statute itself."

In my opinion no more than the net amount paid to the taxpayer by the company in respect of dividends on preference or on ordinary stock was credited or paid to him. He is not liable to the inclusion in his assessment of any greater amount of dividend.

In respect of an objection to the amended assessment for the financial year ending 30th June 1919 and an objection to that for the financial year ending 30th June 1921, the parties agreed upon amounts to be adopted in the assessment. To give effect to the objections that I have upheld and to this agreement, the appeals in respect of the three financial years 1918-1919, 1920-1921 and 1921-1922 will be allowed. I think my discretion as to costs will in all the circumstances be best exercised by making no order.

The order will be as follows :—Declare that the sum of £315 14s. 3d. described as " fees from S. Kidman," which, in the amended assessment for the financial year ending 30th June 1921, is included in the assessable income of the taxpayer derived during the year ending

(1) (1923) A.C., at p. 760.

(2) (1923) A.C., at pp. 769, 770.

30th June 1920 does not form part of such assessable income. Declare that the dividends upon the stock or shares, whether ordinary or preferred, of the New Zealand Loan and Mercantile Agency Co. Ltd. included in the taxpayer's assessable income derived during the year ended 30th June 1921 ought to be so included at the net amounts actually paid by the said company to the taxpayer and not at amounts increased by an addition thereto in respect of British income tax, whether the payment of such dividends was made expressly subject to a deduction in respect of British income tax or free of such tax. Allow appeals in respect of the financial years ending 30th June 1919, 30th June 1921 and 30th June 1922, and remit the amended assessments for such years to the Commissioner of Taxation to give effect to this order and the agreement of the parties in respect of an item of the assessment for the financial year ending 30th June 1919 and an item of the assessment for the financial year ending 30th June 1921.

No order as to costs.

The order will state that these appeals were consolidated by consent.

The taxpayer appealed to the Full Court from so much of this decision as declared that he was liable to pay additional tax under sec. 59 of the *Income Tax Assessment Act* 1915-1921 for failing to include assessable income in his return, and also so much of the decision as declared that the sum of £99 5s. 6d. made during the year ending 30th June 1920 on the sale of the shares of George Pizzey & Sons Ltd. was assessable to income tax.

Fullagar K.C. (with him *Herring*), for the appellant. This case does not fall at all within sec. 59 of the *Income Tax Assessment Act*, as the taxpayer first put in his return and then put in an amended return. He was assessed on the original return and later on the amended return, and he based his amended assessment on his original return. The original assessment was based on the original return, and the appellant at no time committed an offence against the section. The question is whether the two documents together constitute a return or only the one. It is only by assessing the taxpayer that sec. 59

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applies, and here he put in the additions before he was assessed on the second occasion. The two documents together constitute the taxpayer's return, and these two documents contain the whole assessable income of the taxpayer (*Attorney-General* v. *Till* (1); *Penrose* v. *Federal Commissioner of Taxation* (2)). The taxpayer can at any time put himself right by making an amended return. No section expressly enables the taxpayer to make any corrections in his returns. A return only means a statement of income and deductions. If the assessment were made before the taxpayer put in the amended return, he would be too late. Sec. 59 occurs in the part of the Act which deals with penalties, and other sections of the Act amply provide for fraud and evasion. The profit made on the sale of Pizzey's shares was an accretion to capital and was not income. None of the shares invested in by the appellant were speculative. He was not trading in shares. Though buying shares frequently during the four years in question, this was the only sale made. The investment cannot be regarded as a profit-making scheme (*Commissioners of Inland Revenue* v. *Livingston* (3)). This was the only sale until 1924. Even if this was a speculation, it was a casual speculation (*Jones* v. *Leeming* (4)). The mere hope and expectation that the shares would rise in value would not make the increase taxable unless the purchaser were engaged in a profit-making scheme.

Herring. In sec. 59 (1) (*b*) of the Act the words " any return " should be read as meaning " some return." It should be open to the taxpayer to correct omissions or mistakes in his return. This is a penal section involving very heavy penalties on taxpayers. If the word " any " means " some " in sec. 59 (1) (*b*) it would not impose a penalty on the taxpayer. When the taxpayer comes forward with his information the position then is that the Commissioner may or may not treat the statement contained in it as a return. " Fails " to furnish a return may amount to a conscious failure (*Attorney-General* v. *Till* (5)). Sec. 59 should not be so construed as to apply to a person who has innocently made a mistake. The

(1) (1910) A.C. 50, at p. 52.
(2) (1931) 45 C.L.R. 263.
(3) (1926) 11 Tax Cas. 538.
(4) (1930) A.C., at pp. 423, 425.
(5) (1910) A.C., at pp. 54, 61, 62, 70.

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Court should regard some element of guilt as being essential to a breach of sec. 59. The failure must be either conscious or due to culpable carelessness. As to the profit on Pizzey's shares, his Honor erroneously treated the Act in force at the relevant time (1918-1920) as containing a definition of income that the Act of 1930 now contains. There must be more than the mere acquisition for the purpose of profit-making. The motive which actuates the purchaser in buying the shares is immaterial (*Commissioners of Inland Revenue* v. *Livingston* (1)). The Act has been altered by the Act of 1930 which effects a real change in the test to be applied (*Blockey* v. *Federal Commissioner of Taxation* (2)).

Wilbur Ham K.C. (with him *Tait*), for the respondent. Secs. 28, 59, 60 and 61 of the 1915-1918 Act should be read together. "Failure" is the omission to do what ought to be done. The Act merely induces the making of accurate returns. Secs. 60 and 61 deal with fraudulent evasions, and sec. 59 does not imply anything in the nature of conscious failure. The determination of the Commissioner is subject to the Board of Review. The word "evade" in this collocation means "avoid." The appellant has not discharged the onus of proving that he had not bought Pizzey's shares as part of a profit-making scheme (*Ruhamah Property Co.* v. *Federal Commissioner of Taxation* (3)). The test is whether the taxpayer is engaged in any profit-making scheme.

[EVATT J. referred to *Foreman* v. *Commissioners of Taxation* (4).]

Mar. 5, 1934.

The following judgments were delivered :—

GAVAN DUFFY C.J. In this case the appeal will be dismissed. In my opinion the judgment of my brother *Dixon* is correct.

RICH, STARKE, EVATT and MCTIERNAN JJ. concurred.

Appeal dismissed with costs.

Solicitors for the appellant, *Hedderwick, Fookes & Alston.*

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

H. D. W.

(1) (1926) 11 Tax Cas. 538.
(2) (1923) 31 C.L.R. 503.
(3) (1928) 41 C.L.R. 148, at p. 151.
(4) (1898) 19 N.S.W.L.R. 197; 15 N.S.W. W.N. 81.