[HIGH COURT OF AUSTRALIA.]

THE COMMISSIONER OF TAXATION (NEW SOUTH WALES) . . . . . } APPELLANT;
RESPONDENT,

AND

STEVENSON . . . . . RESPONDENT.
APPELLANT,

ON APPEAL FROM THE SUPREME COURT OF NEW SOUTH WALES.

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SYDNEY, *Aug.* 5, 6, 9; *Dec.* 14.

Latham C.J., Rich, Starke, Dixon, Evatt and McTiernan JJ.

Income Tax (*N.S.W.*)—*Company*—*Accumulated profits and capital assets*—*Distribution to shareholders*—*Irregularity*—*Subsequent voluntary liquidation*—*Profits*—*Liability to tax*—"*Dividends*"—*Income Tax* (*Management*) *Act* 1928 (*N.S.W.*) (*No.* 35 *of* 1928), *secs.* 4, 11 (*b*)*—*Companies Act* 1899 (*N.S.W.*) (*No.* 40 *of* 1899), *sec.* 260 (4).

The assets of a company consisted of the goodwill and freehold of an hotel and certain undistributed profits. The property was sold, and, after payment of debts, one of the directors, with the approval of the others, distributed the whole of the company's assets amongst all the shareholders except two, who held single shares and whose proportion he retained on their behalf. Thereafter, at meetings of all the shareholders, except the two abovementioned, neither of whom was served with notices thereof, a resolution for the voluntary liquidation of the company was passed and confirmed and a liquidator was appointed.

* The *Income Tax* (*Management*) *Act* 1928 (N.S.W.) provides:—Sec. 4: "In this Act, unless the context requires another meaning . . . 'Dividend' includes profit and bonus and bonus share, whether declared or dealt with by the company issuing the bonus share as capital or not, except to the extent to which a bonus share represents a writing-up or revaluation of assets without disposal thereof, or the capitalization of profits derived from the sale of capital assets, if such profits were not liable to income tax under this or the previous Act." Sec. 11: "The assessable income of any person shall (without in any way limiting the meaning of the words) include . . . (*b*) in the case of a member or shareholder (other than a company) of—(i) a company which derives income from a source in the State . . . all dividends (but not including a reversionary bonus issued on a policy of life assurance) credited, paid, or distributed to the member or shareholder from any profit derived from any source by the company."

A shareholder was assessed under sec. 11 (*b*) of the *Income Tax* (*Management*) *Act* 1928 (N.S.W.) for tax in respect of that proportion of the distribution received by her alleged to represent undistributed profits.

Held, by *Rich*, *Dixon*, *Evatt* and *McTiernan* JJ. (*Latham* C.J. and *Starke* J. dissenting), that no part of the money received by the shareholder was a dividend, profit or bonus paid by the company within the meaning of sec. 11 (*b*) (when read with the definition of dividend contained in sec. 4) of the *Income Tax* (*Management*) *Act* 1928 (N.S.W.).

Per Rich, *Dixon*, *Evatt* and *McTiernan* JJ. : Sec. 11 (*b*) of the *Income Tax* (*Management*) *Act* 1928 (N.S.W.) is intended to bring into the assessable income of a taxpayer all distributions or detachments of profit by a company as a going concern, but not distributions in retirement or extinguishment of shares.

Decision of the Supreme Court of New South Wales (Full Court) : *Stevenson* v. *Commissioner of Taxation*, (1936) 37 S.R. (N.S.W.) 84 ; 54 W.N. (N.S.W.) 3, affirmed.

APPEAL from the Supreme Court of New South Wales.

On the hearing of an appeal by Mary Stevenson from an assessment of her to income tax by the Commissioner of Taxation for New South Wales, his Honour Judge *White*, District Court judge, sitting as a Court of Review, stated, under the provisions of sec. 51 (8) of the *Income Tax* (*Management*) *Act* 1928 (N.S.W.), a special case, substantially as follows, for the determination of the Supreme Court :—

1. The taxpayer was a shareholder in a family company, in which she, her husband and her daughter held the bulk of the shares, each of them holding a large number of shares and there being four other shareholders who held one share each. The company was formed and registered in 1922 under the *Companies Act* 1899 (N.S.W.) as a company limited by shares and under the name of Angel Hotel Ltd., and its sole business was the carrying on of the Angel Hotel, situate in Pitt Street, Sydney. This business, with the goodwill and other assets thereof and the freehold of the hotel, were the only assets of the company. It carried on business profitably for some years, but the whole of the profits were not distributed to the shareholders.

2. In June 1928 it was decided to sell the hotel property and business. The sale was completed in January 1929, and the proceeds of the sale were applied in the first place in discharge of the liabilities. Those shareholders who had received loans from the

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company, as permitted by its articles of association, were debited with the amounts outstanding against them, and the balance of the proceeds and the other moneys of the company were distributed amongst the shareholders in proportion to their share holdings. This distribution was carried out by Mr. C. E. Lewis, a director of the company, with the knowledge and approval of the other directors, and was completed during March 1929. It was made with the approval at the time of Mr. J. H. Mitchell, as manager of the hotel, and he did not at any time disapprove of it.

Portion of the moneys so distributed to the shareholders consisted of undistributed trading profits of the company amounting in all to approximately £16,000, and the taxpayer received her due proportion of such previously undistributed trading profits, such proportion amounting to the sum of £5,387, or thereabouts.

3. By a notice of amended assessment, dated 25th July 1933, the taxpayer was assessed by the commissioner under the *Income Tax (Management) Act* 1928-1929 (N.S.W.) on her proportion of the abovementioned sum of £16,000 as being assessable income derived by her during the year ended 30th June 1929.

4. On 8th August 1933 the taxpayer gave notice of objection to the assessment on the following grounds :—(*a*) That the inclusion in the assessable income of the amount of £5,387, received by the taxpayer from the liquidator of the Angel Hotel Ltd., was incorrect and contrary to law ; (*b*) that the taxpayer was not liable to taxation under the provisions of the New South Wales *Income Tax (Management) Act* 1928 upon any portion of such amount of £5,387 distributed by the liquidator of the Angel Hotel Ltd. ; (*c*) that the tax was excessive ; (*d*) that any amount distributed by the liquidator of the Angel Hotel Ltd. was a distribution of capital, and as such was not liable to New South Wales income tax.

5. The objection was disallowed by the commissioner. Thereupon, on 7th May 1934, the taxpayer requested the commissioner in writing to treat the objection as an appeal. The appeal was duly instituted in the Court of Review and heard before me as aforesaid.

6. No resolution was ever proposed or passed by the company sanctioning the distribution above referred to, nor was any application ever made for reduction of capital.

7. In order that the company should go into voluntary liquidation, a special resolution was required. By the articles of the company not less than seven clear days notice of any general meeting (exclusive both of the day on which the notice is served or deemed to be served and of the day of the meeting) is required.

8. On 28th May 1929, at a meeting at which all the shareholders of the company were present except two, each of whom held only one share and neither of whom was served with any notice of the meeting, those present purported to pass a resolution for the voluntary liquidation of the company. The two members who were not present were Mr. O'Keefe and Mr. Watts. At a second meeting, on 12th June 1929, those present purported to pass a resolution confirming the above resolution and to appoint the aforesaid J. H. Mitchell as liquidator; the same two members were also absent from this meeting. The method of calling the meetings was by sending out notices by post.

9. With regard to the two members who were not present at the meetings, Mr. C. E. Lewis, who acted in the matter of calling the meetings, gave evidence that no notice was given to either of them of either of the above meetings, and that no attempt was made to give either of them any notice of either meeting. One of them, Mr. Watts, was at the time out of the State; the whereabouts of the other, Mr. O'Keefe, were then unknown to the company; they have not since been communicated with in any way. They had not at any time named an address for service within the State of New South Wales under art. 135 of the company, but in the case of Mr. O'Keefe the evidence did not show that he was ever residing out of the State of New South Wales.

10. On behalf of the taxpayer it was contended, with reference to the non-service of notices on the two members aforesaid, that this deficiency was covered by certain provisions contained in the articles of the company. These are as follows:—Art. 134: "A notice may be served by the company upon any member either personally or by advertisement or by posting it in a prepaid letter to such member at his registered address." Art. 135: "Any member residing out of the State of New South Wales may name an address within the State of New South Wales at which all notices shall be

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served upon him, and all notices served at such address shall be deemed to be well served." Art. 136: "Any notice given by advertisement shall be advertised once at least in two Sydney daily newspapers." Art. 137: "Any notice, if served by post shall be deemed to have been served on the day following that on which the envelope or wrapper containing the same is posted, and in proving such service it shall be sufficient to prove that the notice was properly addressed and posted." Art. 140: "No member who shall have omitted to give his address for registration shall be entitled to receive any notice from the company." In my judgment I held that art. 140 aforesaid applies only to the case where there is no registered address attached to the name of the shareholder in the register, and not to the case where a registered shareholder residing out of the State has failed to name an address in the State for service of notices under art. 135. There was no evidence that satisfied my mind on the point whether there was or was not a registered address against the name of Mr. Watts or Mr. O'Keefe in the register of shareholders. I was of the opinion that, in this matter, the onus of proof was on the taxpayer, and that, accordingly, such onus had not been discharged.

11. Accordingly, on the evidence I found that the aforesaid meetings of the company had not been duly summoned or held, and that the resolutions which the persons present at such meetings purported to pass had not been duly passed, and I therefore held that the company had not gone into liquidation and that there had been no valid or effective appointment of a liquidator. I therefore held that the taxpayer was not entitled to rely upon the effect of the so-called liquidation and that she had not sustained her objections.

12. There were addresses of Mr. Watts and Mr. O'Keefe given with their respective signatures to the memorandum of association and to the articles of association of the company dated 11th September 1922, the address so given of Mr. Watts being Mylor, South Australia, and the address so given of Mr. O'Keefe being 125 Pitt Street, Sydney.

13. In the course of my judgment, there appear the following words: "Assuming, though it was by no means clearly established, that the notices sent out by the secretary of the company were in the

proper form and were sent out in due time and order, it does seem to me that there was a failure to establish that the shareholders to whom notices were not sent were covered by the exception in the articles."

14. I found that the taxpayer had in fact received in the distribution, whether in due form of law or not, an amount which was in fact income within the meaning of the *Income Tax (Management) Act* 1928, and taxable as such, and that what happened afterwards did not have the effect of altering the character of that amount.

15. I dismissed the taxpayer's appeal. As the parties had agreed that the proportion of the sum of £16,000 of previously undistributed trading profits received by the taxpayer might not have been £5,387, and that the ascertainment of the actual amount of such undistributed trading profits received by her in the distribution should be the subject of adjustment between the parties, I so directed.

The questions of law reserved for the determination of the court were as follows :—

(1) Whether, upon distribution in a winding up of assets some of which represent undistributed profits of the company, any portion thereof, and if so what, is assessable income in the hands of the shareholders within the meaning of the *Income Tax (Management) Act* 1928.

(2) Whether when assets of a company are distributed *in globo* to shareholders in the circumstances hereinbefore set out, any portion thereof, and if so what, is assessable income in the hands of the shareholders within the meaning of the Act.

(3) Whether art. 140 is applicable when a shareholder residing out of the State has failed to name an address pursuant to art. 135 but his address is in the register of members or he has given his address for registration in such register.

(4) Whether in the circumstances hereinbefore stated I ought to have held that Mr. Watts had given his address for registration within the meaning of art. 140.

(5) Whether in the circumstances hereinbefore stated I ought to have held that Mr. O'Keefe had given his address for registration within the meaning of art. 140.

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(6) Whether, there being no evidence that satisfied my mind on the point whether there was or was not a registered address of Mr. Watts or Mr. O'Keefe in the share register, I was right in proceeding upon the basis that the company was not in liquidation, upon the ground that notice of the meetings in question had not been proved to have been served upon Mr. Watts and Mr. O'Keefe in accordance with the articles of association, the onus being upon the taxpayer to prove liquidation.

(7) Whether I was right in holding that the sum of £5,387 or thereabouts so distributed to and received by the taxpayer, as mentioned in par. 2 of this case, was assessable income of the taxpayer within the meaning of the Act.

(8) Whether it would be correct so to hold if the resolution for voluntary winding up mentioned in par. 8 of this case was validly passed as a special resolution.

The Full Court of the Supreme Court answered the questions as follows :—1. In the case of the winding up of a company bona fide, upon distribution of the assets some of which represent undistributed profits, no portion of such assets is assessable income in the hands of the shareholders. 2. No portion of the assets of a company, distributed in the circumstances set out in this special case, is assessable income in the hands of the shareholders, within the meaning of the Act. 3, 4, 5, 6. No answer is necessary to these questions, as the winding-up resolution was valid for reasons other than those pertaining to the meaning of the articles. 7. No. 8. Yes, in the circumstances set out: *Stevenson* v. *Commissioner of Taxation* (1).

From that decision the commissioner, by special leave, appealed to the High Court.

Maughan K.C. (with him *Hooton*), for the appellant. The sum of £5,387 was trading profits distributed by the company and was received by the respondent *qua* shareholder; it, therefore, by the operation of sec. 11 (*b*) (i) of the *Income Tax* (*Management*) *Act* 1928, became assessable income in the hands of the respondent. All moneys of a company not in liquidation received by a shareholder *qua*

(1) (1936) 37 S.R. (N.S.W.) 84; 54 W.N. (N.S.W.) 3.

shareholder, whether described as dividend or bonus, or not described, are income in the hands of the recipient, except only moneys returned as the result of an irregular deduction of capital (*Bouch* v. *Sproule* (1); *In re Piercy*; *Whitwham* v. *Piercy* (2); *Pool* v. *Guardian Investment Trust Co.* (3); *Hill* v. *Permanent Trustee Co. of New South Wales* (4)). In *Hill's Case* (5) the Privy Council disapproved *Knowles and Haslem* v. *Ballarat Trustees, Executors and Agency Co. Ltd.*, (6) and *Fisher* v. *Fisher* (7). The moneys thus paid by the company and received by the respondent were profits within the meaning of the Act. For the purpose of determining the question whether moneys received by a shareholder are capital or income it is prima facie irrelevant that the distribution may be irregular and that certain steps should have been taken prior to distribution which have not been taken. Having been received in fact, for the purposes of taxation the proper course is to treat the moneys as being within the category of profits. The mere fact that moneys reach the shareholders without the necessary formalities having been taken does not relieve those shareholders from paying tax thereon if the moneys were retained by them. Irregularities and illegalities in connection with the receipt of money do not affect the taxability of the money (*Minister of Finance* v. *Smith* (8); *Mann* v. *Nash* (9); *S. Southern* v. *A.B.* (10)). Such irregularities and illegalities only become relevant if advantage be taken thereof to recover back the moneys from the shareholder. In view of the non-observance of necessary formalities there was no liquidation of the company (*Mount Oxide Mines Ltd.* v. *Gould* (11); *In re Sanders Ltd.* (12); *In re Allison, Johnson & Foster Ltd.*; *Ex parte Birkenshaw* (13)). That non-observance is not cured by the provisions of sec. 260 (4) of the *Companies Act* 1899 (N.S.W.). Those provisions have no relation to the validity or otherwise of a special resolution directed to a winding up. Even if notionally the money had been distributed in the liquidation, it is taxable under

(1) (1887) 12 App. Cas. 385.
(2) (1907) 1 Ch. 289, at p. 294.
(3) (1922) 1 K.B. 347.
(4) (1930) A.C. 720; 31 S.R. (N.S.W.) 32; 48 W.N. (N.S.W.) 13.
(5) (1930) A.C., at pp. 730, 731; 31 S.R. (N.S.W.), at pp. 39, 40.
(6) (1916) 22 C.L.R. 212.
(7) (1917) 23 C.L.R. 337.
(8) (1927) A.C. 193.
(9) (1932) 1 K.B. 752.
(10) (1933) 1 K.B. 713.
(11) (1915) 15 S.R. (N.S.W.) 290, at p. 294; 32 W.N. (N.S.W.) 95.
(12) (1932) 49 W.N. (N.S.W.) 220.
(13) (1904) 2 K.B. 327.

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the provisions of sec. 11 (*b*) (i) of the *Income Tax (Management) Act*. *Inland Revenue Commissioners* v. *Burrell* (1) does not apply.

[DIXON J. referred to *Inland Revenue Commissioners* v. *Wright* (2); *Halsbury's Laws of England*, 2nd ed., vol. 17, p. 254, par. 517; *Stamp Duties Commissioner* v. *Broken Hill South Extended Ltd.* (3); *Webb* v. *Federal Commissioner of Taxation* (4); *James* v. *Federal Commissioner of Taxation* (5).]

By sec. 4 of the *Income Tax (Management) Act* the word "dividend" is defined as including, *inter alia*, profit and bonus; thus it includes undistributed profits in the possession of the company at the date of liquidation (See *Clarke* v. *Federal Commissioner of Taxation* (6)). A liquidator is not allowed to recover moneys simply to pay them back to the same people (*In re Exchange Banking Co.*; *Flitcroft's Case* (7); *In re National Bank of Wales Ltd.* (8)).

Teece K.C. (with him *Shannon*), for the respondent. The moneys received by the respondent were not a dividend paid by the company; there had not been a declaration of a dividend, and so no debt arose as between the company and the respondent; therefore the moneys do not come within the provisions of sec. 11 (*b*) (i) of the *Income Tax (Management) Act*. A dividend which is taxable must be a dividend which is paid in discharge of a debt, which, in the normal case, arises out of a declaration of dividend (*Webb* v. *Federal Commissioner of Taxation* (9)). The undistributed profits were not detached from the capital assets and were not paid separately therefrom. The moneys were received by the respondent as a distribution of assets in a *de facto*, though not in a *de jure*, winding up; therefore those moneys were not income. As against the respondent there was subsequently a valid winding up. If the moneys were wrongfully received by the respondent she became a constructive trustee thereof (*Russell* v. *Wakefield Waterworks Co.* (10); see sec. 4, *Income Tax (Management) Act*), and therefore not liable to tax in respect thereof. The word "distributed" in sec. 11 (*b*) applies only to bonus

(1) (1924) 2 K.B. 52.
(2) (1926) 2 K.B. 246; (1927) 1 K.B. 333.
(3) (1911) A.C. 439.
(4) (1922) 30 C.L.R. 450.
(5) (1924) 34 C.L.R. 404.
(6) (1932) 48 C.L.R. 56.
(7) (1882) 21 Ch. D. 519, at p. 536.
(8) (1899) 2 Ch. 629, at p. 678.
(9) (1922) 30 C.L.R., at pp. 463, 473, 477.
(10) (1875) L.R. 20 Eq. 474, at p. 479.

shares. Dividends can only be credited or paid and bonus shares distributed in pursuance of a legal obligation.

[LATHAM C.J. referred to *James* v. *Federal Commissioner of Taxation* (1).]

Here, there was a distribution in a *de facto* winding up. It was a distribution of the surplus assets of the company after payment of all the liabilities. It was not income, nor was it a dividend credited, paid or distributed within the meaning of sec. 11 (*b*).

[LATHAM C.J. referred to *Inland Revenue Commissioners* v. *Burrell* (2).]

If there had been a regular liquidation here *Burrell's Case* (3) would have applied notwithstanding the provisions of sec. 11 (*b*) (i). All the shareholders have in fact received and retained their proportion of the surplus assets, so that there is an acquiescence by the shareholders in the irregular winding up (*Ho Tung* v. *Man On Insurance Co.* (4)). When an act, *intra vires* the company, but performed irregularly, is acquiesced in by all the shareholders, it becomes an act of the company (*Parker and Cooper Ltd.* v. *Reading* (5)).

Maughan K.C., in reply. The respondent was not a trustee of the moneys received by her, as all persons interested, all of whom were *sui juris*, assented to what was done. In any event, a recipient of moneys of a company wrongfully paid away does not become a constructive trustee of those moneys. The fact that all the shareholders accepted and retained the moneys of the company said to have been wrongfully paid away made the paying away of those moneys, including the trade profits, an act of the company. Sec. 11 does not require that the dividends or profits shall be credited or paid by the company. Profits in the hands of the shareholders are taxable irrespective of whether the acts of the directors were irregular or *ultra vires* (*Webb* v. *England* (6)). The accumulated profits were detached from the capital assets and were paid as a dividend by the company. " Detached " means the handing out

(1) (1924) 34 C.L.R., at pp. 418, 419.
(2) (1924) 2 K.B., at p. 63.
(3) (1924) 2 K.B. 52.
(4) (1902) A.C. 232.
(5) (1926) Ch. 975.
(6) (1897) 23 V.L.R. 260, at p. 272; 19 A.L.T. 103, at p. 104.

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to the shareholders of the profits in specie representing money values (*Webb* v. *Federal Commissioner of Taxation* (1)). The mere fact that there was no antecedent debt does not make the income or profit free from tax. Payment to shareholders out of profits is income of the shares and cannot be changed into corpus (*Hill* v. *Permanent Trustee Co. of New South Wales* (2)).

Cur. adv. vult.

Dec. 14.

The following written judgments were delivered :—

LATHAM C.J. The respondent Mary Stevenson was assessed by the Commissioner of Taxation for the State of New South Wales to income tax under the *Income Tax* (*Management*) *Act* 1928 in respect of a sum of £5,387, or thereabouts, claimed to be taxable under sec. 11 (*b*) of the Act. That section provides that " the assessable income of any person shall (without in any way limiting the meaning of the words) include— . . . (*b*) in the case of a member or shareholder (other than a company) of—(i) a company which derives income from a source in the State . . . . all dividends (but not including a reversionary bonus issued on a policy of life assurance) credited, paid, or distributed to the member or shareholder from any profit derived from any source by the company."

The respondent was a shareholder of a company known as Angel Hotel Ltd. That company derived income from sources in the State. The commissioner contends that the respondent received a dividend which was paid or distributed to her from profits derived by the company. The taxpayer appealed to a Court of Review and the Court of Review upheld the assessment but stated a case for the decision of the Full Court. The Full Court answered the questions in the case in favour of the taxpayer. An appeal from the decision of the Full Court is now brought to this court.

The Full Court answered the first question in the case as follows :— " In the case of the winding up of a company bona fide, upon distribution of the assets some of which represent undistributed profits, no portion of such assets is assessable income in the hands of the shareholders."

(1) (1922) 30 C.L.R. 450.

(2) (1930) A.C., at p. 734.

The second question was answered by stating that no portion of the assets of the company distributed in the circumstances set out in the special case was assessable income in the hands of the shareholders. It will be seen that the Full Court thus treated the case as substantially involving a distribution of assets as upon the winding up of the company. The payment made to the taxpayer was held by the Full Court not to be a payment of profits within the meaning of the Act,

The principal argument for the respondent rests upon the contention that the section which I have quoted does not apply to moneys received in the liquidation of a company, and that the company was, in effect, in liquidation at the time of payment, or, if this was not the case, that the company subsequently went into liquidation so that in the circumstances of the case the distribution of moneys should be treated as a distribution of assets in a liquidation.

The facts stated in the case show that the company carried on the Angel Hotel in Pitt Street, Sydney, and made profits, and that the whole of the profits were not distributed to the shareholders. In June 1928 it was decided to sell the hotel and the business. The sale was completed in January 1929 and the proceeds of the sale were applied in payment of the liabilities of the company. Shareholders who had received loans from the company were debited with the amounts outstanding, and the balance of the proceeds of the sale and the other moneys of the company were distributed among the shareholders in proportion to their shareholdings. This distribution was made by a director of the company with the knowledge and approval of the other directors. There is no evidence that any dividend was formally declared, and it is clear that at this time the company did not go into liquidation. Portion of the moneys distributed among the shareholders consisted of undistributed trading profits of the company amounting in all to about £16,000. The share in such profits which the appellant received amounted to £5,387 or thereabouts. Thus the whole of the assets of the company were distributed as if the company were being wound up, and the company no longer carried on business. Nothing, however, was done before the distribution of the money to put the

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company into liquidation under the provisions of the *Companies Act* 1899 (N.S.W.), and the company was plainly not in liquidation when the respondent received the amount in question. Thus, upon the basis of the facts as so far stated the taxpayer cannot found any argument upon a regular and lawful liquidation of the company.

It is contended, however, that the company did go into liquidation in 1929, and that, accordingly, what had previously been done became as effective as if it had been done in a regular liquidation. In May 1929 an endeavour was made to put things in order. Meetings of shareholders were held at which a resolution for voluntary liquidation was passed and subsequently confirmed by the majorities necessary for the passing of a special resolution. No notice of these meetings, however, was given to two out of the seven shareholders. These two shareholders held only one share each. Thus all the persons who owned the substantial interest in the company approved of what was done, but it does not follow that the company actually went into liquidation. The articles of association of the company provided that a notice might be served upon any member either personally or by advertisement or by posting the notice in a prepaid letter to the member at his registered address. The articles also provided that "no member who shall have omitted to give his address for registration shall be entitled to receive any notices from the company." There is no finding that the two shareholders in question had omitted to give addresses for registration. Thus the case must be treated upon the basis that no notices of these meetings were given to two of the shareholders. There is no evidence that these shareholders waived any of the requirements of the articles, as in *In re Oxted Motor Co. Ltd.* (1). The *Companies Act* 1899 provides for voluntary liquidation in sec. 130. The special resolution (upon which reliance is placed in this case) must be passed at a meeting which has been summoned in accordance with the Act. This appears from sec. 247, which sets out the requirements for a special resolution. It must be passed at a "general meeting of which notice specifying the intention to propose such resolution has been duly given" and it must be confirmed "at a subsequent general meeting of which notice has been duly given." Sec. 247 (3) provides

(1) (1921) 3 K.B. 32.

that notice of any meeting shall for the purposes of the section be deemed to be duly given and the meeting to be duly held whenever the notice is given and the meeting held in manner prescribed by the rules or regulations of the company. As I have already stated, the articles of association required that notices should be served in a particular manner upon the shareholders, unless they had omitted to leave addresses for service. Notices of the meetings at which the special resolution was passed and confirmed were not served in any manner upon two of the shareholders, and, accordingly, they were not meetings of which notice was duly given, and the meetings were thus not duly held. The result is, therefore, that the company was not put into liquidation at any time and even now is not in liquidation.

Even if the company were in liquidation, or were treated as being in liquidation, it is not by any means clear that profits distributed in the liquidation would not be taxable under the New South Wales Act. In *Inland Revenue Commissioners* v. *Burrell* (1), it was held by the Court of Appeal that where, on the winding up of a limited company, undivided profits of the company were distributed among the shareholders, super-tax was not payable in respect of such profits, because the company was not paying profits to the shareholders, but was dividing its whole property among shareholders. This result, however, depended upon what *Atkin* L.J. described as " the legal results of the winding up " (2). It is not possible to apply the principle involved in *Burrell's Case* to a case where there has been no legal winding up under the *Companies Act*. Even if there had been a legal winding up in the present case, it is not established that the principle of *Burrell's Case* would have been applicable. The New South Wales Act under consideration contains in the part of sec. 11 which has been quoted (and the Commonwealth *Income Tax Assessment Act* also contains) provisions which may possibly deprive the decision in *Burrell's Case* of any relevance in relation to these statutes. It may be that income tax is payable under these Acts upon profits which are distributed in the course of the liquidation of a company (See *Clarke* v. *Federal Commissioner of Taxation* (3)).

(1) (1924) 2 K.B. 52. (2) (1924) 2 K.B., at p. 66.
(3) (1932) 48 C.L.R., at p. 76.

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As there was no legal winding up in the present case it is not necessary to decide this question upon this occasion.

It has been urged for the taxpayer that what was done when the moneys were paid to the shareholders was intended to be a distribution of capital assets in anticipation of liquidation, and that, therefore, the distribution should be regarded as a distribution of capital. It may be conceded that it is for the company to determine whether a particular distribution shall be a distribution of profits or a distribution of capital (*Thomas* v. *Richard Evans & Co. Ltd.*; *James* v. *South-West Lancashire Coal Owners' Association* (1)). But in order to bring about a distribution of capital a company must in some way actually create or have created the capital alleged to have been distributed and must distribute it to shareholders as an interest in the capital of the company. While it is true that the company may determine the character of a distribution which it makes, it can only do so "provided that the company violates no statute and also keeps within its articles" (*Inland Revenue Commissioners* v. *Fisher's Executors* (2)). In the present case, however, the company had violated a statute, and it did not keep within its articles. In *Knowles and Haslem* v. *Ballarat Trustees, Executors and Agency Co. Ltd.* (3), a company paid moneys to its shareholders, each sum consisting of "dividend of 6d. per share, bonus of 6d. per share and distribution of assets 10s. per share." It was held that the company had acted in anticipation of winding up and that the distribution of assets should be treated as a distribution of capital, the character of capital having been impressed upon the moneys by the company. The decision in this case, however, has been disapproved by the Privy Council in *Hill* v. *Permanent Trustee Co. of New South Wales Ltd.* (4), where their Lordships said: "If payment to the shareholders is made out of profits it is income of the shares, and no statement of the company or its directors can change it from income into corpus." A distribution of assets not made in a liquidation cannot, in relation to third parties at least, be treated as if it were a distribution of assets made in a liquidation.

(1) (1927) 1 K.B. 33.
(2) (1926) A.C. 395, at p. 408.
(3) (1916) 22 C.L.R. 212.
(4) (1930) A.C., at p. 734.

In the present case there has been no reduction of capital of the company with a return of capital to the shareholders. Nor is it a case of increasing the capital of a company by capitalization of profits by the issue of bonus shares involving the application of a dividend, declared out of profits, in payment for the shares. The company parted with the moneys paid to its shareholders and did not keep them in its hands in any form. Thus it is not necessary in the present case to consider the law as laid down in *Bouch* v. *Sproule* (1), *Inland Revenue Commissioners* v. *Blott and Greenwood* (2) and other similar decisions.

No question is raised as to any moneys received by the shareholders other than sums representing accumulated profits. In *Hill's Case* (3) it was said that " a limited company not in liquidation can make no payment by way of return of capital to its shareholders except as a step in an authorized reduction of capital. Any other payment made by it by means of which it parts with moneys to its shareholders must and can only be made by way of dividing profits. Whether the payment is called ' dividend ' or ' bonus ' or any other name, it still must remain a payment on division of profits." Here, however, the company has in fact done what the Privy Council in *Hill's Case* stated that it cannot (that is, cannot lawfully) do. It is not claimed by the commissioner that the moneys representing capital of the company are taxable, and it is, therefore, unnecessary to consider whether, in relation at least to revenue laws, the absolute proposition laid down in *Hill's Case* may require some qualification. In the present case there was a distribution of profits in fact—an irregular distribution, but an actual distribution. The moneys were detached from the assets of the company and were put into the pockets of the shareholders. They were actually " paid " to the shareholders. They were clearly " distributed " to the shareholders. Therefore the questions which arose in *Webb* v. *Federal Commissioner of Taxation* (4) as to detachment or release of profits and as to payment of profits do not arise in this case. It may be observed that the word " distributed " was not present in the corresponding section which was under consideration in *Webb's Case*.

(1) (1887) 12 App. Cas. 385.
(2) (1921) 2 A.C. 171.
(3) (1930) A.C., at p. 731.
(4) (1922) 30 C.L.R. 450.

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In the present case there is no doubt that a payment was made to a shareholder and that the moneys paid were profits. Therefore, in my opinion, as all questions relating to the liquidation of the company may be put on one side for the reason that the company was not in liquidation, the moneys received by the taxpayer fall within the words of the relevant portion of sec. 11 and are, therefore, taxable.

This conclusion is not, in my opinion, affected by the other argument submitted on behalf of the taxpayer. It was argued that, as the distribution was irregular, the liquidator would be entitled to recover from the shareholders the payments made to them, and that the moneys received must be regarded as held in trust for the company by the shareholders. In my opinion there are two answers to this argument. In the first place a liquidator will not be allowed to institute proceedings to recover moneys from shareholders simply for the purpose of repaying the same moneys at a later stage to the same shareholders (*In re Exchange Banking Co.*; *Flitcroft's Case* (1); *In re National Bank of Wales Ltd.* (2)). In the second place, the court must deal with the facts as they are, and the actual state of facts is that, at the time when the assessment was made, and at the present time, the shareholders are in the position of having received moneys which in fact are the profits of the company and which must be regarded as being paid to the shareholders as profits.

For these reasons I am of opinion that the assessment of the commissioner was right and that the appeal should be allowed.

RICH, DIXON AND MCTIERNAN JJ. For reasons which we shall attempt later to explain, we find it necessary in order to dispose of this appeal to decide whether, upon its proper interpretation, the *Income Tax (Management) Act* 1928 (N.S.W.) included in the assessable income of a shareholder of a company not only the amount or value of what the company might distribute as a going concern in respect of his shares, but also so much of any distribution to shareholders in a winding up as might upon a dissection be found to represent accumulated profits or surplus assets after the discharge of liabilities and the repayment of paid-up capital. This question

(1) (1882) 21 Ch. D., at p. 536. (2) (1899) 2 Ch., at p. 678.

of interpretation arises upon the special language of sec. 11 (*b*) and the definition of " dividend " contained in sec. 4. Sec. 4 says that, unless the context requires another meaning, " dividend " includes profit and bonus and bonus share, whether declared or dealt with by the company issuing the bonus share as capital or not, except to the extent to which a bonus share represents a writing-up or revaluation of assets without disposal thereof, or the capitalization of profits derived from the sale of capital assets, if such profits were not liable to income tax. Sec. 11 (*b*) provides, so far as material, that, in the case of a member or shareholder (other than a company) of a company, the assessable income shall include all dividends credited, paid or distributed to the member or shareholder from any profit derived from any source by the company.

In all income tax legislation a difficulty has been found in determining the occasion when and the extent to which shareholders shall be taxed in respect of the profits of a company.

The difference between capital and income depends upon the relation of the recipient to the source of the receipt. A share in a company is a piece of property the alienation of which is subject to few or no restrictions. Its value is a value in exchange and is ascertained by reference to the sum obtainable upon sale. That sum represents the influence of two factors, namely, the amount of the accumulated funds or assets of the company and the expectation of future dividends annually or periodically distributed. Distributions by a company of profits earned during the period in respect of which the distribution is made clearly fall within any conception of income, at all events for those who acquired the shares before the beginning of the period. But a distribution of profit earned at some antecedent date, and accumulated so as to form part of the capital value of the undertaking of the company, reflected in the value of the shares, necessarily stands upon a different footing. To a shareholder who bought his shares at a value ascertained by reference to the accumulated funds the distribution wears very much the appearance of a return of capital. To a shareholder who acquired his shares before the profits were earned, the distribution may appear as a deferred payment of income properly referable to a past period or as a return of capital originally created by the capitalization of income.

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In systems of taxation which are not content with taxing the profits at the source in the hands of the company that earns them, but tax the shareholder in respect of the income which he derives from the share, it has not been found possible to discriminate among the various shareholders according to the relation in which the individual stood to the particular profit distributed. Apart from special exemptions of dividends declared out of capital profits, all dividends are in such systems made taxable in the hands of the shareholder for the time being. No attention is paid to the fact that to one shareholder the distribution may be but a return of capital invested when he bought the share; that to another it may be a payment of profits earned while he was a shareholder but long ago capitalized and treated by him as part of the capital value of the investment he holds; and that in a third case a dividend may be but a distribution of current earnings. The criterion adopted is usually that of the company law, namely, that without a return of the share capital of the company there has been a declaration of dividend and a payment accordingly. The special problem which arises when the declaration of dividend is nothing but a step in converting accumulated profits into share capital or debenture capital is dealt with differently under different systems (Cf., e.g., *Inland Revenue Commissioners* v. *Blott*; *Inland Revenue Commissioners* v. *Greenwood* (1); *Inland Revenue Commissioners* v. *Fisher's Executors* (2); *Swan Brewery Co. Ltd.* v. *The King* (3); *James* v. *Federal Commissioner of Taxation* (4); *Eisner* v. *Macomber* (5)). The difference depends on the greater weight placed, in one system, upon the fact that in the end the shareholder obtains nothing but a different paper title to a share in the same assets, and, in another system, upon the fact that to effectuate the payment for the new issue of share capital or debentures a dividend out of profits must be credited to the shareholder. This difference of view is reflected in both the judicial and legislative treatment of the problem. But, whether profits be distributed in cash or, as in *Pool* v. *Guardian Investment Trust Co.* (6), in specific assets, or be appropriated to

(1) (1921) 2 A.C. 171.
(2) (1926) A.C. 395.
(3) (1914) A.C. 231.
(4) (1924) 34 C.L.R. 404.
(5) (1920) 252 U.S. 189; 64 Law. Ed. 521.
(6) (1922) 1 K.B. 347.

answer a new issue of share capital or debenture capital, the transaction leaves the shareholder still a member of the company, holding the same title to participate in future distributions of profit and possessing, in the event of winding up, the same status as a contributory entitled to share in the surplus assets or liable to contribute towards a deficiency. It is for this reason that such a distribution of profit is described by expressions like "detachment," "release" and "liberation." The title to them is treated, it may be said, as a *jus re fruendi salvâ rei substantiâ*. The share is the substance of the property which remains, and the distribution the *fructus*. But an entirely different set of considerations arises when accumulated profits exist in a company which winds up. In the liquidation the excess of its assets over its external liabilities is distributed among the shareholders in extinguishment of their shares. The shareholders, in other words, as contributories receive nothing but the ultimate capital value of the intangible property constituted by the shares. The *res* itself ceases to exist. The profits are not detached, released or liberated, leaving the share intact as a piece of property. There is no dividend upon the share. There is no distribution of profits because they are profits. The shareholder simply receives his proper proportion of a total net fund without distinction in respect of the source of its components and he receives it in replacement for his share. Both in the British and American systems of taxation such a transaction is acknowledged to be of a capital nature and to involve no receipt of income. In the United States the distinction has been described as follows:—"Loosely speaking, the distribution to the stockholders of a corporation's assets, upon liquidation, might be termed a dividend; but this is not what is generally meant and understood by that word. As generally understood and used, a dividend is a return upon the stock of its stockholders, paid to them by a going corporation without reducing their stockholdings, leaving them in a position to enjoy future returns upon the same stock. . . . In other words, it is earnings paid to him by the corporation upon his invested capital therein, without wiping out his capital. On the other hand, when a solvent corporation dissolves and liquidates, it distributes to its stockholders, not only any earnings it may have on hand, but it also pays to them

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their invested capital, namely, the amount which they had paid in for their stock, thus wiping out their interest in the company" (*Langstaff* v. *Lucas* (1), quoted in *Montgomery, Income Tax Procedure*, p. 655; cf. *Lynch* v. *Turrish* (2); *Lynch* v. *Hornby* (3); *Brushaber* v. *Union Pacific Railway Co.* (4)).

In England it has been held that the total income of an individual from all sources does not include any part of the amount received by him as a shareholder in the distribution of the surplus assets of a liquidating company, although composed in part of accumulated profits (*Inland Revenue Commissioner* v. *Burrell* (5)). The decision of this court in *Webb* v. *Federal Commissioner of Taxation* (6) may be taken, in effect, to mean that no part of a distribution in a liquidation answers the description "dividends, interest, profits, or bonus credited or paid to any . . . shareholder . . . of a company." These are the expressions of sec. 14 (*b*) of the *Income Tax Assessment Act* 1915-1918. Whether the introduction of the word "distributed" in the corresponding sec. 16 (*b*) (i) of the *Income Tax Assessment Act* 1922-1930 produced a different result is a matter "susceptible of argument" (See *Clarke* v. *Federal Commissioner of Taxation* (7)).

Under sec. 47 of the Commonwealth *Income Tax Assessment Act* 1936 distributions in a liquidation have been expressly dealt with. Such distributions are taxable in the hands of the shareholder to the extent to which they represent income derived by the company other than income which has been properly applied to replace a loss of paid-up capital. The enactment says that the distributions shall for the purposes of the Act be deemed to be dividends paid to the shareholders by the company out of profits derived by it.

The first question in the present case is whether the provisions of the *Income Tax (Management) Act* 1928 (N.S.W.) produced the same effect as this express provision. When the definition of dividend is combined with sec. 11 (*b*), it is possible to extract a direction that profit distributed to a shareholder from any profit derived from any source by the company shall be included in the assessable income of the shareholder. It is said that this direction is sufficient

(1) (1925) 9 Federal Reporter (2nd S.) 691, at p. 694.
(2) (1918) 247 U.S. 221; 62 Law. Ed. 1087.
(3) (1918) 247 U.S. 339; 62 Law. Ed. 1149.
(4) (1916) 240 U.S. 1; 60 Law. Ed. 493.
(5) (1924) 2 K.B. 52.
(6) (1922) 30 C.L.R. 450.
(7) (1932) 48 C.L.R., at p. 76.

to include accumulated profits contained in or represented by a distribution of assets in a liquidation. The considerations which we have already discussed are, we think, sufficient to show that some clear expression of intention to include amounts received in a liquidation in the income of the taxpayer should be required before a court holds that such amounts are liable to taxation as income. In truth no part of such distributions are income of the shareholder and, if legislation includes them in his taxable income, the reasons for doing so must depend not on their true nature but upon the desire to effectuate the policy behind a graduated income tax. For, unless they are taxed, it is possible for a company to withhold distributions of profit and then wind up for the purpose of bringing them into the hands of the shareholders without exposing them to additional tax thereon. The danger to the revenue of this device is much lessened by the provisions enabling the Commissioner of Taxation to treat undistributed income as distributed where the failure to declare a dividend is unreasonable. In any case, companies must seldom be ready to wind up merely for the purpose of effecting a distribution of profit. Whether the legislature will regard the danger as sufficiently serious to warrant the imposition of a tax upon distributions in a winding up must be uncertain. In the absence of express provision, general words should not be given any extended application in order to meet the case.

On the whole, we think sec. 11 (*b*) should not receive an application which would bring into tax any distributions except those made by a company as a going concern. Obviously the word " dividend " in its natural meaning means a distribution of profit in respect of a share which continues to exist as a piece of property. In the definition " bonus share " is included to meet the special difficulty of the declaration of dividends for the purpose of answering liability upon share capital. The word " distributed " covers distributions in specie such as those in *Pool's Case* (1), while the words " credited " or " paid " are appropriate only to distributions expressed in terms of money.

The definition includes the words " profits or bonus " in order to prevent any evasion on the part of a company which might avoid

(1) (1922) 1 K.B. 347.

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he use of the expression "dividend" or of the exact machinery customary in declaring one.

In our opinion the *Income Tax (Management) Act* 1928 does not bring into the assessable income of a shareholder any part of the proceeds of a liquidation.

The facts of the present case are unusual. The distribution of assets which has occasioned the controversy was not made in a winding up under the *Companies Act*. The taxpayer, who is the respondent in the appeal to this court, was one of three substantial shareholders in a family company consisting of seven members. The other four shareholders held only one share each. The company was called the "Angel Hotel Ltd.", and its only business was to conduct an hotel of that name situated in Pitt Street, Sydney. Its assets consisted of the freehold of the hotel, the goodwill of the business and what are called with more brevity than particularity "the other assets thereof", i.e., of the business of conducting the hotel. It appeared that the shareholders had loan accounts with the company and, no doubt, these debts are included in the expression "assets thereof." Over a period of years the company accumulated profits which it did not distribute to its shareholders. It follows from what has been said that these accumulated profits were either invested in the business or standing on loan to the shareholders. During the financial year ending 30th June 1929 the company sold the whole of its business. It discharged all its liabilities, that is, as we understand the case stated, its external liabilities. Then the directors distributed the balance of the proceeds of the sale and the other moneys of the company amongst the shareholders in proportion to their shares, debiting shareholders who had received loans with the amount of the loans. The entire assets of the company were distributed in this manner. As a matter of account they necessarily included the assets which would be required to answer the accumulations of trading profits. The taxpayer was assessed to income tax upon the footing that so much of the amounts she received in the distribution as represented ratably a proportion of trading profits formed part of her assessable income. The question for decision is whether this amount is rightly so included in the assessable income. The directors had no lawful authority for making the distribution.

They simply ignored the requirements of the *Companies Act*. Treating the three substantial shareholders as the only persons interested, they simply divided the assets of the company amongst them. Doubtless they provided the proportionate amounts for the remaining four shares, but these were negligible. After the distribution had been completely made and actually before the end of the financial year, the directors took steps to set the matter right legally by a voluntary winding up. Unfortunately two of the shareholders holding one share only were not notified of the meeting, with the result, it is said, that the resolutions for winding up are invalid.

Upon these facts the taxpayer's liability in respect of so much of the distribution as could be traced to accumulated trading profits would have been clear if sec. 11 (*b*), interpreted by means of the definition of "dividend," were construed to cover all distributions in a liquidation. For, if, contrary to the opinion we have expressed, the provisions bore the meaning that every distribution containing components traceable to profit should form part of the shareholder's assessable income, notwithstanding that the distribution extinguished the share and replaced it by payment of its capital value or equivalent in assets, then it would necessarily extend to such a case as the present.

On the other hand, if it means, as we think it does, to include all distributions or detachments of profit by a company as a going concern, but not distributions in retirement or extinguishment of the shares, it is difficult to bring the facts of this case within its operation. It is for this reason that we stated at the beginning of this judgment that the decision appeared to us to depend upon the interpretation of the statute.

In our opinion the fact that the distributions were not authorized by law does not operate to make any part of the sum distributed taxable. The prima facie liability of the shareholders to account for the assets of the company received in an unauthorized distribution tends rather against their taxability as income. But we think that, as the shareholders retain the assets thus received, the liability to include their value or any part thereof in the assessable income of a shareholder must depend upon an examination of the true nature or character of the receipt. Such an examination shows, we think,

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that the amount distributed to each shareholder represented the full capital value of the share. Considered apart from the liability of the shareholder to replace the amount received, the payment to her was made in extinguishment of her share interest. No part of it was a detachment of the profit from the funds of the company paid as the income earned by the share. None of it was a dividend, profit or bonus, paid by the company as a going concern in respect of the shares as continuing, although intangible, pieces of property. In *Burrell's Case* (1) *Atkin* L.J., as he then was, said that upon a liquidation the shape taken by the inquiry is "not what does the liquidator intend to give the shareholder, but what does the shareholder in fact receive? In fact he receives his share of the joint stock, as *Scrutton* L.J. said in *Blott's Case* (2), not income of the property, but the property itself."

This, in our opinion, precisely expresses the situation of the taxpayer in the present case. It follows that the process of dissecting the amount received in the distribution, discovering how much of the total distribution can be traced to the accumulation of profits and treating the taxpayer's proportion as a dividend forming part of her assessable income is erroneous.

We think the taxpayer is not liable and the appeal should be dismissed with costs.

STARKE J. This is an appeal from the decision of the Supreme Court of New South Wales upon a case stated pursuant to the provisions of sec. 51 (8) of the *Income Tax (Management) Act* of New South Wales. Angel Hotel Ltd. was incorporated in New South Wales under the *Companies Acts* and its sole business was carrying on the Angel Hotel situate in Pitt Street, Sydney. The case states that "this business with the goodwill and other assets thereof and the freehold of the hotel were the only assets of the company." The whole of the profits of the company were not distributed to its shareholders, but whether these profits were invested in the business or in some other manner is not certainly stated in the case.

About 1929 the hotel property and business were sold, the proceeds applied in discharge of the liabilities of the company and "the

(1) (1924) 2 K.B., at p. 68. (2) (1920) 2 K.B. 657, at p. 675.

balance of the proceeds and the other moneys of the company were distributed amongst the shareholders in proportion to their share holdings." "Portion of the moneys so distributed to the shareholders consisted of undistributed trading profits of the company amounting in all to approximately £16,000." The respondent, who was a shareholder in the company, received, subject to adjustment between the parties, her proportion of these profits, namely, a sum of £5,387, during the year which ended on 30th June 1929. The appellant, the Commissioner of Taxation, assessed the respondent to income tax in respect of this sum for the income year 1929. The questions of law stated for the determination of the Supreme Court were eight in number, but, in substance, the matter for decision is whether the assessment of the respondent was contrary to the provisions of the *Income Tax (Management) Act* 1928. The Supreme Court answered several questions but in effect its determination was that the respondent was not assessable to income tax in respect of the sum mentioned. Hence an appeal to this court on the part of the Commissioner of Taxation. The question depends upon the construction of the Act which provides in sec. 11 : "The assessable income of any person shall . . . include . . . (*b*) in the case of a member or shareholder . . . of (i) a company which derives income from a source in the State . . . all dividends . . . credited, paid or distributed to the member or shareholder from any profit derived from any source by the company." "Dividend" by force of sec. 4 includes, unless the context requires another meaning, profit and bonus and bonus share, whether declared or dealt with by the company issuing the bonus share as capital or not, except to the extent to which a bonus share represents a writing-up or revaluation of assets without disposal thereof, or the capitalization of profits derived from the sale of capital assets, if such profits were not liable to income tax under that or the previous Act.

And there is a proviso to sec. 11 as follows : "Provided further that notwithstanding any other provision of this Act where a dividend is paid wholly and exclusively out of profits derived from the sale of capital assets, the member or shareholder shall not, if the company was not liable to income tax in respect of such profits under this or a previous Act, be liable to tax on that dividend."

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The distribution made to the shareholders in the present case was wholly irregular. " A limited company not in liquidation can make no payment by way of return of capital to its shareholders except as a step in an authorized reduction of capital " (*Hill* v. *Permanent Trustee Co. of New South Wales Ltd.* (1)).

But in the present case the company realized all its assets and, after discharging the company's liabilities, distributed the proceeds amongst its shareholders whether representing capital or undistributed profits without winding up or even the declaration of a dividend. Steps were taken to wind up the company after the distribution had been made. They have therefore no bearing upon the case and in any case were ineffective, for the provisions of the *Companies Act* and the articles of association in relation to notices of meeting to two shareholders were not observed. The shareholders nevertheless received the moneys distributed to them, and the question remains whether the proportion of the undistributed profits received by the respondent is assessable to tax. *Inland Revenue Commissioners* v. *Burrell* (2) affords no direct assistance in this case, for there the company was in liquidation : here it is not. Nor do such cases as *Inland Revenue Commissioners* v. *Fisher's Executors* (3) and *Inland Revenue Commissioners* v. *Wright* (4), for there there was a capitalization by the company of accumulated profits : here there is not.

In *Webb* v. *Federal Commissioner of Taxation* (5) the business assets of the company were transferred to a new company consisting of substantially the same shareholders with a view to the business being continued by the new company. It was what is commercially called a reconstruction. And it was held that shares of the new company allotted to a member of the company were not profits " credited or paid " by the old company to its members. It was in truth what might be called a change in the form of investment or holding and not a distribution, release or liberation of any profits to the shareholders. The case does not, I think, touch the present case.

But it is argued that the Angel Hotel Co. simply divided its assets or property amongst its shareholders and cannot be said to have

(1) (1930) A.C., at p. 731.
(2) (1924) 2 K.B. 52.
(3) (1926) A.C. 395.
(4) (1927) 1 K.B. 333.
(5) (1922) 30 C.L.R. 450.

liberated or released any profit in the form of income to its shareholders. But I cannot agree with the argument on the facts of this case and in the face of the provisions of the *Income Tax (Management) Act* itself. The company had capital and undistributed profits of known amount invested in the business or in some other assets. It actually realized its business and all its assets. The result was a sum of money the capital of the company and undistributed profits. It paid and distributed to its shareholders this sum, its undistributed profits. The Act explicitly provides that all dividends credited, paid or distributed by a company to its members or shareholders from any profit derived from any source by the company shall be assessable. And dividends, as already mentioned, include profit whether declared or not. The case is not, I think, attended with much doubt. In my opinion the words of the Act in their ordinary English signification precisely cover the facts stated in the case and render the respondent liable to assessment in respect of the sum mentioned in the case which was paid or distributed to her by the company.

The appeal should be allowed. Question 7 of the case should be answered in the affirmative : the other questions do not, I think, require a formal answer.

EVATT J. This appeal involves the question whether the New South Wales *Income Tax (Management) Act* 1928 operates so as to bring within the sweep of " assessable income " money received by shareholders of a company as and for their *aliquot* share of the aggregate net assets of a company which is in liquidation.

In my opinion the statute does not operate so as to include in the shareholder's assessable income any portion of such distributions. The question is one of construction, but the reasoning of such authorities as *Webb's Case* (1) in Australia, and *Burrell's Case* (2) in England runs strongly against the construction of the New South Wales Act contended for by the commissioner.

The precise point in issue is whether the words used in sec. 11 (*b*) of the *Income Tax (Management) Act*, viz., " all dividends . . . paid or distributed to the member or shareholder from any profit derived from any source by the company," are apt to include

(1) (1922) 30 C.L.R. 450.

(2) (1924) 2 K.B. 52.

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liquidation receipts. Sec. 4 of the Act prima facie defines "dividend" as including "profit and bonus and bonus share." The New South Wales legislature was at liberty to follow the method of the Commonwealth Act and deal expressly with liquidation distributions, but it refrained from so doing. It is obvious that the "income" which has its source in a company share does not include what the shareholder receives in final replacement of the rights represented by the share itself. If the share is regarded as the fund, the income from the share is the flow or product of the fund. But what is received at the time of the liquidation in exchange for the fund itself cannot be regarded as flowing from, or produced by, the fund. The commissioner's contention that liquidation distributions or some portion thereof may always be regarded as income derived from the shares cannot be supported, so that the main question is: To what extent has the statute altered the general statement of principle which I have outlined? In my opinion, the words employed in sec. 11 (*b*) are singularly ill adapted for the purpose of dragging in a shareholder's liquidation receipts. The special reference in sec. 4 to "bonus share" rather supports the view that the "dividends" to be brought into charge as the assessable income of the shareholder are confined to distributions made upon the footing that the company is still a going concern. The word "distributed" is used in sec. 11 (*b*) and it is undoubtedly of wide import. But, like its neighbours, "credited" and "paid," it is concerned with the manner in which the shareholder receives the benefit of the dividend, emphasizing that, in whatever manner the "dividend" reaches the shareholder, portion of it is to be regarded as assessable income. Of course the word of greatest significance is "dividend" itself, and in my view it does not aptly relate to the very special kind of transaction which takes place upon a liquidation or to the special character of the receipt constituted by a shareholder's obtaining once and for all his *aliquot* share of the net assets of the company. The words of the section are not to be extended as against the taxpayer, for the legislature is quite capable of making its intention very clear. As Lord *Tomlin* said in *Munro* v. *Commissioner of Stamp Duties* (1), "it is not always sufficiently appreciated

(1) (1934) A.C. 61, at p. 68; 34 S.R. (N.S.W.) 1, at p. 7.

that it is for the taxing authority to bring each case within the taxing Act, and that the subject ought not to be taxed upon refinements or otherwise than by clear words."

The next question is whether certain irregularities which took place in the course of the *de facto* liquidation of the company of which the appellant was a shareholder have so altered the character of her receipt as to create liability to tax under sec. 11 (*b*). The company was a family company, its sole business being the carrying on of an hotel business at the Angel Hotel in Sydney, and its sole property being directly associated with such business. In June 1928 it was decided to sell the hotel property and business and the sale was completed in January 1929. The company parted with every stick of its property. All debts to outsiders were paid, and the final distribution of assets to shareholders took place. There was no separate distribution of trading profit, but one payment to each shareholder. Unfortunately the distribution was not preceded by the necessary resolutions for winding up, and even in May 1929, when the laymen concerned set out to regularize what had been done, two shareholders were not present at the meeting. It has been contended for the commissioner that the absence from the meeting of the two shareholders necessarily invalidated the resolutions. Each absent shareholder held only one share, and it is certain, not only that their absence made no difference to the decisions of the company, but that, if present, they would both have approved such decisions. In the circumstances, it is somewhat extraordinary that the officers of the Taxation Department so closely pursued their investigations into the funeral rites of the private family company. If an investigation takes place into every company winding up, doubtless a number of irregularities as to serving notices of resolutions &c. will be discovered. But where, as here, there is no doubt whatever as to the genuineness of a *de facto* liquidation, it hardly seems to be within the normal function of taxation officers to examine the internal concerns of a company, not to detect and expose fraud and impropriety, but merely to establish a technical non-compliance with legal requirements so as to convert a regular liquidation into an irregular or void liquidation. If, because of such discoveries, a small additional tax is gathered, it is merely as a result of the

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ignorance of laymen, and in all fairness and honesty such tax is not recoverable. No case has been cited to us where the taxation authorities have acted in a similar way before, and I feel sure that, if every liquidation of the past twenty years were investigated by the commissioner, quite a number of legal flaws in the process of formal winding up would reveal themselves. In those cases where no shareholder has disputed for a moment the legality of the past transactions, and there is no suggestion of wrongdoing, taxation officers might well be expected to refrain from rushing in.

As it is, however, the commissioner's discoveries do not assist his attempt to make the shareholder's receipt taxable under sec. 11 (*b*). The New South Wales Act is not framed so as merely to exempt from tax distributions in the case of a valid liquidation; for the reasons already suggested such distributions are not hit at by the words used in the sub-section. And the reason why such distributions are not included as "dividends" applies equally to the *de facto* distributions received by the present shareholder. She too received her *aliquot* share of the aggregation of the company's net assets in the same way as she would have received such *aliquot* share in case of an ordinary winding up. It cannot fairly be said that she received a "dividend" within the meaning of sec. 11 (*b*). All the company's assets had been parted with, the business had been sold, and the company was no longer a going concern. In my opinion the construction of sec. 11 (*b*) as a result of which it is not possible to include distributions to a shareholder in a valid liquidation applies equally to exclude the distributions made to the respondent.

I think the appeal should be dismissed.

Appeal dismissed with costs. Order varied by striking out answer to question 8.

Solicitor for the appellant, *J. E. Clark*, Crown Solicitor for New South Wales.

Solicitors for the respondent, *John A. K. Shaw, Lewis & Co.*

J. B.