[HIGH COURT OF AUSTRALIA.]

ROBERT G. NALL LIMITED . . . . APPELLANT;
APPELLANT,

AND

THE FEDERAL COMMISSIONER OF TAXATION RESPONDENT.
RESPONDENT,

H. C. OF A 1936-1937.

SYDNEY, 1936, *Dec.* 11, 12.

Rich J.

SYDNEY, 1937, *July* 29, 30; *Aug.* 17.

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

Income Tax (Cth.)—Assessable income—Deduction—Governing director—Remuneration—Disproportionate to value of services rendered—Extrinsic reasons—"Money not wholly and exclusively laid out or expended for the production of assessable income"—Income Tax Assessment Act 1922-1934 (*No.* 37 *of* 1922—*No.* 18 *of* 1934), *secs.* 23 (1) (*a*), 25 (*e*).

The taxpayer company was formed in 1920, and then purchased the business of another company, the shares in which were controlled by N. The consideration for the sale was in the form of shares in the taxpayer company. These shares were, by direction of N., distributed among members of his family. He himself held only one share. The articles of association of the taxpayer company provided that N. should be the governing director of the company until he resigned or died, and that his salary as such governing director should be at the rate of £2,500 per annum or such greater sum as the company should from time to time determine. N. drew this salary in all the relevant years. In 1928 the taxpayer company, which had carried on an extensive business of printing and manufacturing boxes, gave up that business, and thereafter its activities were limited to the management of its assets. The work of N. became very small after 1928, being limited to collections of rent and interest and to looking after some debts owing to the company. An accountant acted as secretary of the company and did most of the actual work. In its return of income for each financial year subsequent to 1928 the taxpayer company deducted the sum of £2,500 paid to N., but this deduction was disallowed by the commissioner to the extent of £2,000 in each year.

Held, by *Rich* J., that the question did not depend on bona fides, but in each year the question was: What was the reason or occasion of the payment? Was it laid out for the production of income or for some other reason?, and

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that when the company disposed of its business the services justifying the remuneration were no longer needed, and in reality the governing director's remuneration ceased to be a reward for services performed on behalf of the company in gaining its income and became an annual payment out of the company's income enjoyed by him as an office holder as opposed to a capacity of shareholder.

Held, by the Full Court, that the decision of *Rich* J. was supported by the evidence; therefore an appeal from that decision should be dismissed.

APPEAL from *Rich* J.

Robert G. Nall Ltd. lodged objections against amended assessments made by the Federal Commissioner of Taxation in respect of that company's income for the five financial years ended 31st July 1931, 31st July 1932, 31st July 1933, 31st July 1934 and 31st July 1935. The subject of each objection was the sum of £2,000, portion of director's fees totalling the sum of £2,500 paid to the governing director of the company, claimed by it as deductible under sec. 23 (1) (*a*) of the *Income Tax Assessment Act*, but disallowed by the commissioner who considered that the money so paid in excess of the sum of £500 was an expense not necessarily incurred in the production of the company's assessable income.

The objections were disallowed by the commissioner who, at the request of the taxpayer, treated them as appeals and forwarded them to the High Court for hearing.

The appeals were heard by *Rich* J.

Further facts appear in the judgments hereunder.

Bowie Wilson, for the appellant.

Roper, for the respondent.

Cur. adv. vult.

1936, Dec. 12.

RICH J. delivered the following written judgment:—

These are five appeals from amended assessments, in respect of the financial years 1930-1931, 1931-1932, 1932-1933, 1933-1934 and 1934-1935. The subject of each appeal is a sum of £2,000, portion of director's fees totalling £2,500, claimed by the taxpayer, but disallowed by the commissioner, who considered the balance over £500 an expense not necessarily incurred in the production of the company's

assessable income. The appeals depend upon the well-known provisions of the *Income Tax Assessment Act* which govern deductions for business expense, viz., secs. 23 (1) (*a*) and 25 (*e*). Sec. 23 (1) (*a*) is as follows: "(1) In calculating the taxable income of a taxpayer the total assessable income derived by the taxpayer shall be taken as a basis, and from it there shall be deducted—(*a*) all losses and outgoings (including commission, discount, travelling expenses, interest and expenses, and not being in the nature of losses and outgoings of capital) actually incurred in gaining or producing the assessable income." Sec. 25 provides: "A deduction shall not, in any case, be made in respect of any of the following matters . . . (*e*) money not wholly and exclusively laid out or expended for the production of assessable income."

It has been determined by the decisions of the English courts and this court that the question whether a certain sum should be deducted from the taxpayer's profits as being wholly and exclusively expended for the purpose of that taxpayer's business is primarily a matter of fact in each case. The decisions are collected in *Maryborough Newspaper Co. Ltd.* v. *Federal Commissioner of Taxation* (1) and *Federal Commissioner of Taxation* v. *Gordon* (2). The taxpayer is a company which was incorporated at the end of 1920. It acquired its business from an earlier limited company the capital of which was held by Mr. R. G. Nall. The consideration for the sale appears to have been shares, the allotment of which Mr. R. G. Nall controlled. They appear to have been allotted to or for the benefit of members of his family. They were issued as fully paid up. One share only was issued to Mr. R. G. Nall. But by the articles of association of the appellant company it was provided that Mr. R. G. Nall should be the governing director of the company until resignation or death. The fullest powers of management and control were vested in him. His remuneration was provided for by a clause in the articles in the following terms: "The salary of the said Robert Greaves Nall as such governing director shall be at the rate of £2,500 per annum or such greater sum as the company in general meeting may from time to time determine. The salary of the governing director shall be payable weekly."

(1) (1929) 43 C.L.R. 450.

(2) (1930) 43 C.L.R. 456.

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The business of the company was extensive and probably the company would have little difficulty in justifying the salary as a remuneration if the business had been continued. I do not understand the commissioner as attacking the bona fides of the article of association viewed as at the time of its adoption. At the same time the fact cannot be overlooked that it was open to Mr. Nall to take the income he derived from the business either in the form of profit distributable on shares or as remuneration for services. Possibly his intention to distribute the shares amongst the members of his family influenced his choice between the alternatives, but it is likely that the effect upon income tax of the distribution between income from property and income from personal exertion was not overlooked. However, the company did not continue its business. On the contrary it disposed of its business in 1928 and thereafter the activities of the company were limited to the receipt of rent, interest on Commonwealth bonds, interest on mortgages, the getting in of sundry debts and attention to such matters as arose out of its position as landlord and the holder of investments. Its investments were limited, and the company's affairs called for little more than general supervision on the part of its governing director. During the relevant periods the company possessed an experienced and efficient accountant and auditor who was its public officer. The company's accounts were made up for the twelve-monthly periods ending 31st July and the commissioner assessed the company for each financial year on the figures made up to the 31st July in that financial year instead of up to the previous 30th June. No change was made in the company's articles of association until 15th November 1933, when a resolution was confirmed substituting £1,000 for the sum of £2,500 payable to Mr. R. G. Nall. He died in 1935. In the five accounting periods beginning 1st August 1929 and ending 31st July 1934 the commissioner refused to allow a deduction from the appellant company's assessable income in respect of Mr. Nall's remuneration under the articles of more than £500. The company appeals from the five assessments based on these accounting periods. The last appeal admittedly cannot succeed because by sec. 31H of Act No. 18 of 1934 the quantum becomes a matter within the discretion of the commissioner. The appeal for that year was not pressed. It was

in the course of the accounting period for that year that the remuneration was reduced to £1,000. The substantial question which I am called upon to decide is whether in the circumstances prevailing during the four prior financial years the commissioner was wrong in holding that no more than £500 of the governing director's remuneration was money wholly and exclusively laid out for the production of assessable income. This case differs from *Aspro Ltd.* v. *Commissioner of Taxes* (1) because the challenge to the remuneration arises out of the changed condition of the affairs of the company. A contention of the taxpayer's counsel is that as the remuneration when originally fixed was bona fide it was not possible to hold that in whole or in part it had ceased to be expenditure laid out for the production of assessable income. I cannot agree in this contention. The articles of association conferred no contractual right on Mr. R. G. Nall to retain the office until he died at the remuneration which it specified. The articles did not constitute a contract between the company and Mr. Nall and, so far as appears, no contract entitling him to hold the office fixed by the articles was made between him and the company. It was, therefore, open to the company in each year to alter its articles and fix an appropriate remuneration. When the company disposed of its business the services justifying the remuneration were no longer needed, and, in reality, the governing director's remuneration ceased to be a reward for services performed on behalf of the company in gaining its income and became an annual payment out of the company's income enjoyed by an office holder as opposed to a shareholder. I do not think that it is correct to treat the matter as one altogether depending on bona fides. In each year of income in respect of which the deduction is claimed the question must be, What was the reason or occasion for the payment? Was it laid out for the production of income or was it made for some other reason ? If the company were guided solely by business considerations and in deciding whether the articles should stand or be altered had nothing in view but the profitable conduct of the company's affairs, it is to my mind quite clear that the article would have been altered at the time when the business was sold. A salary of £2,500 a year is out of all proportion to the demands made by

(1) (1932) A.C. 683.

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the company's transactions upon the time and capacity of the person directing its affairs. I have no hesitation in attributing the continuance of the remuneration to other motives than those of business. It may be that the commissioner took too favourable a course in apportioning the £2,500 and allowing £500 as remuneration. I am not called upon to express an opinion whether the total remuneration can be dissected and if so whether the amount allowed is not too liberal.

The appeals will be dismissed with costs.

From that decision the taxpayer appealed to the Full Court.

By an order made on 12th February 1937 the appeals were consolidated.

Abrahams K.C. (with him *Bowie Wilson*), for the appellant. The nature and extent of the evidence required from an appellant to discharge the onus of showing that the remuneration paid was, in whole or in part, a proper deduction, was dealt with in *Aspro Ltd.* v. *Commissioner of Taxes* (1). The appellant had, by its articles of association, contracted, in effect, to pay to the governing director, as remuneration for his services, the amount challenged by the respondent. The shareholders of the company had no knowledge of the law as to their power to alter the articles of association. In all probability they were of opinion that it would be a breach of contract to alter the particular article (*Shuttleworth* v. *Cox Brothers & Co. (Maidenhead)* (2)). The obligation to pay the full amount stipulated in the article of association subsisted despite the alteration in, and the diminution of, the appellant's business (*Maryborough Newspaper Co. Ltd.* v. *Federal Commissioner of Taxation* (3)).

[DIXON J. referred to *W. Nevill & Co. Ltd.* v. *Federal Commissioner of Taxation* (4).]

The obligation subsisted during the time that the income was produced and thus the remuneration so paid was an expense wholly incurred in the production of assessable income (*Californian Oil Products Ltd.* v. *Federal Commissioner of Taxation* (5)). The

(1) (1932) A.C., at pp. 687-689.
(2) (1927) 2 K.B. 9.
(3) (1929) 43 C.L.R. 450.
(4) (1937) 56 C.L.R. 290.
(5) (1934) 52 C.L.R. 28.

question whether full value was obtained for the remuneration so paid is immaterial. It is not necessary that an expense incurred in the carrying on of a current business should have actually or directly produced income (*Amalgamated Zinc (De Bavay's) Ltd.* v. *Federal Commissioner of Taxation* (1)). Here there was no evidence which showed, or from which it could be inferred, that the remuneration paid to the governing director was so paid for any reason or motive other than that of business. The mere fact that the company was a "family" company does not justify such an inference. *Johnson Brothers & Co.* v. *Inland Revenue Commissioners* (2) is distinguishable on the facts.

Hooton, for the respondent. The fact that the remuneration was paid to the governing director does not conclude the matter. It still remains open to the commissioner to inquire whether the expenditure was wholly and exclusively incurred for the production of income, and if, on inquiry, it is found that, having regard to the services performed, it cannot reasonably be said that the *quantum* of remuneration was fixed or paid on a commercial basis, it may be disallowed, either in whole or in part, as a deduction. Up to the time of the sale of the appellant's business the remuneration of the governing director was, perhaps, commensurate with the services rendered by him, but after the sale the remuneration paid to him was ludicrous when considered only in relation to the services required to be rendered. The reasonableness or otherwise of remuneration paid during any particular income year depends upon the nature and extent of the services rendered by the recipient in that particular year. The matter is unaffected by the fact that originally the business was owned by the governing director, and that in consideration, *inter alia*, of the *quantum* of remuneration fixed in the articles of association, he transferred his interest in the business to the shareholders of the appellant company.

[DIXON J. referred to *Egerton-Warburton* v. *Deputy Federal Commissioner of Taxation* (3).]

There was nothing in law to prevent the alteration of the article relating to the governing director's remuneration. Notwithstanding

(1) (1935) 54 C.L.R. 295, at pp. 303, 304.

(2) (1919) 2 K.B. 717.

(3) (1934) 51 C.L.R. 568.

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that the remuneration may have been payable under a contract, an inquiry may be held under sec. 25 (*e*) of the *Income Tax Assessment Act* to ascertain how far the expenditure has been incurred in producing the assessable income (*Johnson Brothers & Co.* v. *Inland Revenue Commissioners* (1); *Stott and Ingham* v. *Trehearne* (2)). The remuneration paid to the governing director was not "money wholly and exclusively laid out or expended for the production of assessable income." The onus of establishing that it was so expended is upon the appellant. At most, it was only in part paid to the governing director for services rendered, and the balance was paid to him for the purpose of providing him with an income.

[DIXON J. referred to *C. M. Legg & Son Ltd.* v. *Commissioners of Inland Revenue* (3) and *Eyres* v. *Finnieston Engineering Co. Ltd.* (4).]

The remuneration paid was altogether disproportionate to the value of the services for which it was purported to be paid, and, in this connection, regard should be had to the close relationship between the governing director and the shareholders. If the shareholders were influenced by that relationship, or by the fear that non-payment would constitute a breach of contract, it would tend to show that in making the payment they were not actuated wholly by business considerations. The question of an alteration of articles was considered in *Swabey* v. *Port Darwen Gold Mining Co.* (5) and *Shuttleworth* v. *Cox Brothers & Co. (Maidenhead)* (6). So far as the governing director was concerned there was no enforceable contract: it was not to be performed within the space of one year.

Abrahams K.C., in reply. The appellant is not required to show that each item of expenditure in fact resulted in the production of assessable income (*Amalgamated Zinc (De Bavay's) Ltd.* v. *Federal Commissioner of Taxation* (7)).

Cur. adv. vult.

(1) (1919) 2 K.B. 717.
(2) (1924) 9 Tax Cas. 69.
(3) (1920) 12 Tax Cas. 391.
(4) (1916) 7 Tax Cas. 74.
(5) (1889) 1 Meg. 385.
(6) (1927) 2 K.B., at pp. 16, 21.
(7) (1935) 54 C.L.R. at pp. 307, 309.

The following written judgments were delivered :—

LATHAM C.J. These are appeals (which have been consolidated) from judgments of *Rich* J. upholding amended assessments of the appellant company, Robert G. Nall Ltd., to income tax under the Commonwealth *Income Tax Assessment Act* 1922-1934. The company claimed as a deduction in each of the relevant years a sum of £2,500 paid to R. G. Nall, since deceased, as governing director of the company. The Commissioner of Taxation disallowed the deductions and decided that sec. 25 (*e*) of the Act prevented the deduction of any amount over £500 in each year. Sec. 25 provides that "a deduction shall not, in any case, be made in respect of any of the following matters . . . (*e*) money not wholly and exclusively laid out or expended for the production of assessable income."

The appellant company was formed in 1920 and then purchased the business of another company, Fuerth & Nall Ltd., the shares in which were controlled by R. G. Nall. The consideration for the sale was in the form of shares in the appellant company. These shares were, by direction of R. G. Nall, distributed among members of his family. He himself held only one share. The articles of association of the company provided that R. G. Nall should be the governing director of the company until he resigned the office or died, and that "the salary of the said Robert Greaves Nall as such governing director shall be at the rate of £2,500 per annum or such greater sum as the company in general meeting may from time to time determine." R. G. Nall drew this salary in all the relevant years. (Later the articles of association were altered by a special resolution which was confirmed on 15th November 1933 and which reduced the salary to £1,000 per annum). In 1928 the appellant company, which had carried on an extensive business of printing and manufacturing boxes, gave up that business, and thereafter its activities were limited to the management of its assets. These assets consisted of freehold premises which were let to a tenant, Commonwealth bonds, mortgages, and some debts owing to the company. The work of the governing director after 1928 became very small, being limited to collections of rent and interest and to looking after the debts mentioned. An accountant acted as secretary of the company and did most of the actual work. The commissioner took

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the view that £2,500 was an extravagant payment for the services rendered and that it could not be regarded as an expenditure "wholly and exclusively laid out or expended for the production of assessable income." The deduction was therefore disallowed to the extent of £2,000 in each year, leaving only the balance of £500 in each year as a deduction. The company appealed and *Rich* J. dismissed the appeals, holding that the continuance of the remuneration on the old scale during the period after 1928, when the company was carrying on business only upon a greatly reduced scale, was to be attributed to other motives than those of business. He held that if the company had been guided solely by business considerations the articles of association would have been altered at an earlier date. The learned judge determined the matter as a question of fact (*Maryborough Newspaper Co. Ltd.* v. *Federal Commissioner of Taxation* (1); *Federal Commissioner of Taxation* v. *Gordon* (2)). The taxpayer has appealed.

It has not been suggested that the remuneration of £2,500 was not a permissible annual deduction during the period when the company was carrying on the business of printing and box manufacturing. It is contended for the appellant that the diminution in the volume of the business of the company cannot bring about the result that an originally permissible deduction can no longer be allowed.

The question arises in relation to the income tax of the company, and not in relation to any income tax payable by the shareholders who received the shares from R. G. Nall. The question must, therefore, be determined in relation to the income of the company which it is sought to tax. The question is whether £2,500 in each of the years in question was "wholly and exclusively laid out or expended for the production of assessable income" of the company. In my opinion it is not necessary to consider whether R. G. Nall had a contract with the company under which the company was bound to keep him in office for his life or until he resigned. The fact is that the sum of £2,500 was paid to R. G. Nall for his services as governing director in each of the relevant years. The question whether it was paid under a contract of which the company could

(1) (1929) 43 C.L.R. 450.

(2) (1930) 43 C.L.R. 456.

not relieve itself does not answer the question which is raised. In *Aspro Ltd.* v. *Commissioner of Taxes* (1) the Privy Council plainly held that the fact that a remuneration was paid to directors for their services in accordance with a valid resolution of the company was not sufficient to exclude inquiry by the Commissioner of Taxation whether the moneys were in fact laid out wholly and exclusively for the production of assessable income. Thus the existence of a legal obligation to make a payment is not in itself sufficient to authorize such a deduction for purposes of assessment to income tax.

The words of sec. 25 (*e*) are "money not wholly and exclusively laid out or expended for the production of assessable income." The word "for" suggests that regard should be had to the purpose for which the expenditure is made. The existence of a purpose in the mind of some person cannot always be taken as the test in the application of this provision. The provision must be applied in the case of corporations, and it is impossible to limit the ascertainment of purpose in the case of a corporation to the ascertainment of the actual mental state of some natural person. The words, therefore, must, I think, be given an interpretation which does not necessarily depend upon the object which some person or persons desire to achieve, though, in a case where natural persons are concerned, the object which they naturally have in their minds may properly be taken into consideration in determining whether a particular expenditure is made for the production of assessable income. If, for example, (to take a simple case) B was an employee of A working for a salary and A made a gift to him which was not connected in any way with the business and which was shown to be made for purely personal reasons, those facts would prevent the view being taken that the expenditure was made for the purpose of producing assessable income.

The provision in question is directed to the relation between the expenditure of the taxpayer and the income produced in the course of the income-earning enterprise of the taxpayer. The section contemplates a test which may be applied objectively and independently of subjective states of mind, even though there may be room for differences of opinion in applying any objective criterion and

(1) (1932) A.C., at pp. 687, 688.

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though the application even of an objective criterion may be affected in the case of natural persons, who are capable of having states of mind, by consideration of those states of mind.

The question is, in my opinion, whether there was a real connection between the expenditure and the income produced. In the case of a company carrying on a business and existing for the purpose of making profits, the question is whether the expenditure has a real relation to the profits sought to be gained. If the expenditure, in the circumstances of a particular case, is not shown to be wholly and exclusively connected with the production of income, then the expenditure cannot be said to have been wholly and exclusively laid out or expended for the production of the income. Where, therefore, in the case of the director of a company, there is evidence from which the conclusion may be drawn, and the conclusion is drawn, that there is a great disproportion between the expenditure and the services rendered in the business of the company, the expenditure cannot be regarded as being so made. This, in my opinion, is the effect of the decision in *Aspro Ltd.* v. *Commissioner of Taxes* (1). In that case the Privy Council examined the payment made to the directors in the light of all the circumstances and not merely in the light of the fact that the company had bound itself to make the payments in question. The governing director in the present case was responsible for the management of assets of large value, but, when all the circumstances are considered, there was evidence to support the conclusion that the sum of £2,500 per year was disproportionate to the services rendered by him in looking after the relatively small amount of business which the company transacted in the relevant years. Thus there was evidence upon which the learned judge was reasonably "entitled . . . . to decline to hold it proved that the assessment was excessive"—to use the words of their Lordships in *Aspro Ltd.* v. *Commissioner of Taxes* (2).

This conclusion in no way challenges the propriety of the payment made by the company to R. G. Nall. The fact that he had in effect provided all the assets of the company and had gratuitously given the shares to members of his family provided abundant reason for the payment made and indeed shows that it would have

(1) (1932) A.C. 683.

(3) (1932) A.C., at p. 688.

been dishonourable to alter those payments without his consent; but these considerations do not affect the answer to the question whether, in determining the liability of the company to taxation upon its income, these sums should be allowed as a deduction as being wholly and exclusively laid out or expended for the production of income.

For the reasons I have given I am of opinion that the appeals should be dismissed.

STARKE J. These are four appeals from decisions of *Rich* J. which have been consolidated by an order of 12th February 1937. The subject of each appeal is the disallowance of a sum of £2,000 as a deduction from assessable income for each of the years 1930-1931, 1931-1932, 1932-1933, 1933-1934. This sum is portion of a sum of £2,500 purporting to have been paid by the appellant, the taxpayer, to its governing director, Robert Greaves Nall, as a remuneration for his services. The commissioner has allowed a deduction of £500 in each of the years mentioned, and no question arises as to that allowance. But the further allowance of £2,000 is claimed under secs. 23 and 25 (*e*) of the *Income Tax Assessment Act* 1922-1934, which provide that in calculating the taxable income of a taxpayer the total assessable income derived by the taxpayer shall be taken as a basis, and from it there shall be deducted all losses and outgoings not being in the nature of losses and outgoings of capital actually incurred in gaining or producing the assessable income; but a deduction shall not in any case be made in respect of money not wholly or exclusively laid out or expended for the production of assessable income.

The taxpayer is a company which was incorporated in 1920. It carried on the business of general printers, stationers, paper-box manufacturers, and general importers. Its articles of association provided that Robert Greaves Nall should be the governing director of the company until he resigned the office or died, and that the salary of Nall as such governing director should be at the rate of £2,500 a year, or such greater sum as the company in general meeting might determine.

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It is not disputed that Nall acted as the governing director of the company and received the sum of £2,500 a year to the close of the year 1933. The business of the company was extensive and the duties of the governing director responsible and onerous. Down to the year 1928 the deduction of the sum of £2,500 a year appears to have been an outgoing of a company in gaining or producing assessable income. But in 1928 the company disposed of its printing business, and thereafter its activities were limited to the receipt of rent from freehold land and buildings, interest on government bonds and mortgages, and the getting in of sundry debts and matters connected therewith.

Rich J. held that the sum of £2,500 paid to Nall in the years of assessment in contest in these appeals was so disproportionate to the value of the services rendered by him that the outgoing as to the sum of £2,000—portion of the sum of £2,500—was not an outgoing actually incurred in gaining or producing the assessable income.

Aspro Ltd. v. *Commissioner of Taxes* (1) is authority for the proposition that the amount of remuneration paid by a company or fixed by its articles of association is not conclusive of the question whether expenditure is incurred in gaining or producing the assessable income, but is a matter which can be inquired into by the taxing authority, or by an appellate tribunal upon appeal from him. But the taxpayer contends that a payment to the governing director originally made for the purpose of gaining or producing the assessable income did not change its character merely because the company reduced its business activities, or was over-generous in its payments to the governing director. This appears to me a rather forcible argument, and I also think that the responsibilities of guarding and investing the capital assets and investments of the taxpayer, which were in the neighbourhood of £150,000, and collecting the income therefrom, have been somewhat underestimated. The learned judge, however, had other facts before him than the mere disproportion in the value of the services rendered by the governing director. It appears from evidence that the taxpayer was a company which took over a business controlled and substantially owned by

(1) (1932) A.C. 683.

the governing director, and that he arranged the distribution of its share capital amongst his family and relations, but stipulated that he should be remunerated at the rate of £2,500 a year for managing the company. Moreover it appears that in October and November 1933 the articles of the company were altered, the governing director's remuneration being reduced from £2,500 to £1,000.

Under these circumstances it appears to me that, since 1928 at all events, the payment to the governing director was open to two interpretations: one that it was an outgoing, even if over-generous, actually incurred in gaining or producing the assessable income; the other that it was made (to some extent at all events) as a provision for the founder of the business and the company, and was not wholly and exclusively laid out and expended for the production of assessable income.

Rich J. adopted the latter interpretation of the facts, and even though I may have more hesitation in reaching this conclusion of fact than he, still I am unable to affirm that it is not a view which the learned judge, viewing the evidence reasonably, could not have reached.

The conclusion is one of fact, and this court should not lightly disturb such conclusions. Consequently the appeal should be dismissed.

DIXON J. The question in this appeal is whether the taxpayer, an incorporated company, is entitled to a deduction from its assessable income of the full amount of the remuneration paid to its governing director.

Sec. 31H of the *Income Tax Assessment Act* 1922-1934 came into operation after the termination of the years in respect of which the question arises, and does not apply. The matter is governed by the general provisions contained in secs. 23 (1) (*a*) and 25 (*e*). The former of these provisions directs that, in the calculation of the taxable income of a taxpayer, the total assessable income shall be taken as a basis and from it there shall be deducted all losses and outgoings actually incurred in gaining or producing the assessable income. The latter forbids the making of any deduction in respect of money

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not wholly and exclusively laid out or expended for the production of assessable income.

The amount of the governing director's remuneration was £2,500 per annum, and the company sought to deduct the whole of it. The commissioner refused to allow a deduction of more than £500 for the years in dispute and, on appeal from his assessment, *Rich* J. decided that he was not wrong in disallowing the excess. The company was formed in 1920 by way of reconstruction to take over the business of a prior company. The business is described as that of printing, box making and paper and board converting. It seems to have been extensive and profitable. The consideration given by the company upon acquiring the undertaking of its predecessor was 92,664 shares of £1 each fully paid. The governing director in respect of whose remuneration the deduction is claimed was the chief shareholder in the earlier company; but upon reconstruction he appears to have caused the shares issued by the new company to be allotted to members of his family. He took none himself except as trustee. But by the articles of association he was appointed governing director for life and given complete control of the affairs of the company. The articles provided that as such governing director his salary should be at the rate of £2,500 per annum or such greater sum as the company in general meeting might from time to time determine. From 1920 to 1928 he conducted the company's manufacturing and trading business. But in that year the business was sold as a going concern to another undertaking. Land and buildings producing rent were retained and the purchase money was invested upon mortgage or in government securities. Since 1928 the business of the company has been confined to collecting rent and interest and dealing with such financial matters as might arise. The gross annual income of the company was a little more than £9,000.

Rich J. says in his judgment:—"Its investments were limited, and the company's affairs called for little more than general supervision on the part of its governing director. During the relevant periods the company possessed an experienced and efficient accountant and auditor who was its public officer."

When the company gave up its business no change was made in the article of association fixing the governing director's remuneration. No doubt that was natural. For, apart from the influence of family relationship, he was the founder of the company and the source whence the members obtained their shares. But no one can doubt that the *quantum* of remuneration had no longer any relation to the nature of the responsibility or work demanded by the company's affairs. Whatever may have been the motive in 1920 in fixing it at £2,500, the amount was not an excessive reward for the management and direction of a business of the nature and extent of that carried on by the company. The commissioner conceded that £500 a year might be allowed, but apparently *Rich* J. thought this allowance was excessive. Any difficulty which may be felt in the present case arises, I think, from the continuing character of the article of association fixing the rate of remuneration. As the purpose of the payment may be supposed originally to have been to provide a proper reward for services necessary in order to gain assessable income, it may seem difficult to treat the altered circumstances of the company as a sufficient reason for denying that a like purpose attached to subsequent payments made under the article of association adopted in the first instance. But this consideration does not appear to me to have much weight in favour of allowing the deduction. It is true that no narrow application should be given to the words in sec. 25 (*e*), "laid out or expended for the production of assessable income." At the same time an outgoing or expense cannot be brought within them unless it is connected with the earning or derivation of income by the taxpayer. The nature of the connection is vaguely stated by the word "for," and this is commonly paraphrased by means of words expressing purpose. But, in matters of income tax, purpose is an elusive and indefinite criterion. The purpose of a payment when a deduction is claimed for it becomes an attribute of the transaction rather than a state of mind in some actual person. In his dissenting opinion in *Inland Revenue Commissioners* v. *Blott* (1) Lord *Sumner* has something to say upon the intention or purpose to capitalize profits as affecting both a remainderman's title to bonus shares and the right of the revenue to tax them. He says :

(1) (1921) 2 A.C. 171, at p. 218.

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"In any literal sense of the word intention had nothing to do with the matter." He goes on to exclude the testator, the trustee and the company's directors and shareholders, the tenant for life and the remaindermen as persons entertaining on the question any actual mental intention, and says :—"The company, in so far as intention is a mental act, was incapable of having any intention at all. . . . The intention, which the final decision assumed, was one of those so-called intentions which the law imputes ; it is the legal construction put on something done in fact."

In the same way, when it is said that gaining or producing assessable income must be the purpose of the expenditure if its deduction is to be allowed, no more can be meant than that the circumstances of the transaction must give it the complexion of money laid out in furtherance of a purpose of gaining income. If in the common course of affairs the expenditure is considered to conduce to or to be required by the purpose, to be referable or attributable to it, the condition prescribed by sec. 25 (*e*) will be presumptively satisfied. Courts cannot ascribe to legislative provisions a more exact and logical meaning than is to be found in them and it is dangerous to attempt to do so. For indefiniteness in a statutory criterion is not always unintentional. It is, therefore, unwise to undertake to say what in every case shall be and what shall not be enough to bring a payment within the general scope of the provision to qualify it as an allowable deduction. The case of *Aspro Ltd.* v. *Commissioner of Taxes* (1) makes it sufficiently plain that a company does not become entitled to deduct a sum as exclusively incurred in the production of assessable income simply because it is a payment of directors' fees lawfully fixed under the articles of association. There must be a further connection between the payment and the production of the company's revenue.

In the present case there is, I think, no sufficient relation, at any rate between the full sum of £2,500 and the production of income. As the company's affairs stood in the years after 1928 for which the deduction is claimed, it is plain that the emoluments attached to the office of governing director had ceased to have any connection with the services performed. The amount had been fixed as

(8) (1932) A.C. 683 ; (1930) N.Z.L.R. 935

remuneration for managing a business. The business had been transferred and the work for which it was fixed had gone. Comparatively speaking, an onerous office had become a sinecure, but the remuneration continued. The expenditure could no longer be considered to conduce to obtaining the revenue, to be called for or required for the purpose of supervising the company's investments. The circumstances no longer gave it the complexion of an expenditure incurred in order to gain income, but, on the contrary, stamped it for the greater part as a distribution of income gained. The right to remuneration depended wholly on the articles of association. There was no contract entitling the governing director to the same remuneration throughout his life. Probably in view of our decision in *Amalgamated Zinc (De Bavay's) Ltd.* v. *Federal Commissioner of Taxation* (1) it would have mattered little if there had been such a contract. It is not the nature of the director's right to payment but the insufficiency of the connection between the outlay on his remuneration and production of income that makes the claim to the deduction unsustainable.

In my opinion the decision of *Rich* J. is right and the appeal should be dismissed.

EVATT J. The question is whether the director's fees of £2,500 per annum paid by the appellant company in respect of the five years under review were moneys incurred in producing, not partly, but wholly and exclusively, the company's assessable income. In my view the appellant fails. It is true that there is no direct evidence of any decision by the company in respect of the years in question. But, in my opinion, the evidence leads irresistibly to the conclusion that the purpose of continuing such large payments of fees at a time when the company had for all practical purposes gone out of business, is that no business, trading or income-getting purpose characterized the expenditure and that it was continued for purely family or personal reasons.

The cases bearing on the question need not be discussed. They were all considered and analyzed in *Herald & Weekly Times Ltd.* v. *Federal Commissioner of Taxation* (2).

In my opinion, the judgment appealed from should be affirmed and the appeal dismissed.

(1) (1935) 54 C.L.R. 295.

(2) (1932) 48 C.L.R. 113.

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McTIERNAN J. The form of the expenditure which the appellant sought to deduct was a payment of salary to its managing director. The form, however, is not conclusive of the question whether the money paid was an outlay wholly and exclusively for producing assessable income (*Aspro Ltd.* v. *Commissioner of Taxes* (1)). The question is one of fact (*J. P. Sennitt & Son Pty. Ltd.* v. *Federal Commissioner of Taxation* (2)). The question of fact in this case is whether the money paid in the form of salary was really remuneration or reward paid wholly and exclusively for work, services or attendances done by its recipient for the appellant. *Rich* J. went fully into all the circumstances and decided this question of fact adversely to the appellant. In my opinion his Honour's finding was correct. I agree that the appeal should be dismissed.

Appeal dismissed with costs.

Solicitors for the appellant, *Harold T. Morgan & Sons.*

Solicitor for the respondent, *H. F. E. Whitlam*, Commonwealth Crown Solicitor.

J. B.

(1) (1932) A.C. 683.

(2) (1932) 1 A.T.D. 387.