[HIGH COURT OF AUSTRALIA.]

THE COMMISSIONER OF TAXES (VICTORIA) APPELLANT

AND

NICHOLAS . . . . . RESPONDENT.

ON APPEAL FROM THE SUPREME COURT OF VICTORIA.

H. C. OF A. 1938.

MELBOURNE, *Feb.* 17, 18, 21; *Mar.* 25.

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

*Income Tax (Vict.)—Special tax—Unemployment-relief tax—Company—Bonus shares — Capitalization of profits — Assessable income of shareholder — "Profit or bonus"—"Credited paid or distributed"—Shareholder liable to taxation to extent of paid-up value of shares—Unemployment Relief Tax (Assessment) Act* 1933 *(Vict.)* (*No.* 4171), *sec.* 4—*Income Tax Act* 1935 *(Vict.)* (*No.* 4309), *sec.* 2 (1) (*g*).

A capitalization of reserves derived from the profits of a company carried out by means of an issue to shareholders of fully-paid-up bonus shares constitutes a "profit or bonus credited" to the shareholders within the meaning of sec. 4 (*a*) of the *Unemployment Relief Tax (Assessment) Act* 1933 and sec. 2 (1) (*g*) of the *Income Tax Act* 1935 (Vict.). A shareholder who receives such bonus shares is, accordingly, liable to unemployment-relief tax and special income tax under those provisions to the extent of the paid-up value of the shares.

So *held* by *Latham* C.J., *Rich*, *Starke* and *McTiernan* JJ. (*Evatt* J. dissenting).

*James* v. *Federal Commissioner of Taxation*, (1924) 34 C.L.R. 404, applied.

*Inland Revenue Commissioners* v. *Blott*, (1921) 2 A.C. 171, distinguished.

Decision of the Supreme Court of Victoria (Full Court): *Commissioner of Taxes* v. *Nicholas*, (1937) V.L.R. 331, reversed.

CASE STATED.

On an objection by George Richard Nicholas to an assessment for Victorian income tax (special tax) and unemployment-relief tax made for the financial year 1935-1936 a judge of county courts, to

whom the objection was transmitted, stated a special case which was substantially as follows for the opinion of the Supreme Court of Victoria :—

1. The taxpayer, George Richard Nicholas, is a person ordinarily resident in Victoria, and was at all relevant times and is a shareholder of Lorraine Investments Pty. Ltd. (hereinafter called " the company "), a company incorporated in Victoria on 3rd March 1926 under the *Companies Acts* (Vict.) and carrying on business in Victoria.

2. The taxpayer made a return pursuant to and for the purposes of the *Income Tax Acts* and the *Unemployment Relief Tax (Assessment) Acts* (Vict.) of his income for the year ended 30th June 1935.

3. The commissioner caused to be prepared an assessment for the purpose of ascertaining the amount upon which Victorian income tax, special tax and unemployment-relief tax should be levied upon the taxpayer for the financial year 1935-1936 and gave notice of such assessment to the taxpayer on 24th February 1936. The notice showed taxable income assessed as follows :—

| | |
|---|---|
| For Victorian income tax .. | £1,785 |
| For special tax .. .. | £238,685 |
| For unemployment relief tax | £238,685 |

4. The sum of £238,685 assessed as taxable income for special tax and unemployment-relief tax included a sum of £210,000 which was the face value of bonus shares issued during the year ended 30th June 1935 to the taxpayer by the company in respect of the shares in the company held by the taxpayer.

5. On 7th March 1936 the taxpayer gave notice of objection to the assessment to special tax and to unemployment-relief tax on the ground " that the distribution of bonus shares to the extent of £210,000 from Lorraine Investments Pty. Ltd. does not come within the provisions of the *Unemployment Relief Tax (Assessment) Act*, and is not subject to State special income tax."

6. The commissioner disallowed the objection. The taxpayer requested the commissioner to transmit the objection to be heard and determined by a judge of county courts in accordance with the provisions of the Acts, and the objection was transmitted accordingly.

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7. The company at the time of its incorporation had a nominal share capital of £100,000, divided into 100,000 shares of £1 each. The nominal capital was on or about 22nd August 1932 increased to £500,000 by the creation of 400,000 new shares of £1 each.

8. Prior to 29th August 1934 the company issued 50,000 of the shares, and the same had been paid for in cash, and on 29th August 1934 the shares of the company were held as follows :—

| | |
|---|---|
| George R. Nicholas (the taxpayer) .. | 29,995 shares |
| The trustees of Betty, Lindsay, Nola and Hilton Nicholas .. .. .. | 20,000 shares |
| F. J. Davey .. .. .. .. | 5 shares |

9. On 22nd August 1932 the company in general meeting passed the following resolution : " Resolved to transfer £122,505 from profit and loss appropriation account ex profits accumulated prior to 30th June 1932."

10. On 29th August 1934 the company in general meeting passed the following resolution : " Resolved to transfer the amount of £150,000 to reserve account and to distribute bonus shares out of reserve account to the full amount to credit of this account, viz., £350,000."

11. On 25th September 1934 the directors of the company passed the following resolution : " Resolved to allot the following shares in furtherance to resolution of shareholders : 50,001-260,000 to G. R. Nicholas ; 260,001-400,000 to the trustees of Betty, Lindsay, Nola and Hilton."

12. Each of the above resolutions was carried in the presence of, and with the consent of, all the shareholders of the company.

13. In the books of the company, journal entries and ledger account entries giving effect to the resolutions referred to in pars. 9, 10 and 11 hereof were made.

14. The sum of £350,000 was undistributed profits of the company from the carrying on of its business, earned from the date of its incorporation.

15. The shares mentioned in the resolution of directors of 25th September 1934 were duly allotted as aforesaid and issued by the company, 210,000 of such shares to the taxpayer and 140,000 to the trustees of Betty, Lindsay, Nola and Hilton Nicholas.

16. Share certificates for the 210,000 shares were made out by the company in the name of and given to, the taxpayer, and a share register was kept in the form of butts of the company's share-certificate book, in which it was recorded that such certificates for the shares had been issued.

17. The 210,000 shares were at all material times of a value of £210,000.

The question asked by the special case was :

Should the assessment of taxable income for the purpose of (1) special tax and (2) unemployment-relief tax have included the amount of £210,000 ?

The Full Court of the Supreme Court answered the question by saying that the assessment of the taxpayer for special tax and unemployment-relief tax should not have included the sum of £210,000 : *Commissioner of Taxes* v. *Nicholas* (1).

From that decision the Commissioner of Taxes appealed to the High Court.

*O'Bryan* K.C. (with him *Tait*), for the appellant. The facts of this case bring the taxpayer within the taxing provisions of par. *a* or par. *b* of sec. 4 of the *Unemployment Relief Tax (Assessment) Act* 1933 and sec. 2 (*g*) of the *Income Tax Act* 1935 (Vict.), imposing unemployment-relief tax and special tax respectively. Accumulated profits can only be turned into share capital by observing the rules that a company cannot issue its own shares for nothing and cannot pay for its own shares (*Palmer, Company Precedents*, 15th ed. (1937), Part I., pp. 967, 968). The Act asks if the taxpayer has been credited with any bonus that has come out of the company's profits. If what was credited to the shareholder was a bonus or dividend, that is the end of the matter. In this case the respondent has been credited with money, not with shares. It does not matter whether this is a capital gain, provided that in the process of getting it the taxpayer has been credited with a bonus or dividend. The word " bonus " is wide enough to include a capital gain. By his assent to this transaction the respondent has assented to a profit credited to him by the

(1) (1937) V.L.R. 331.

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company. The respondent does not owe the company any money, because he has been credited with money by the company. 210,000 shares were issued to the respondent, and the company gave him a credit that destroyed his liability. The shares which were issued had to be paid for (*Inland Revenue Commissioners* v. *Blott* (1)). The issue of bonus shares was an advantage to the shareholder (*Swan Brewery Co. Ltd.* v. *The King* (2)). In *James* v. *Federal Commissioner of Taxation* (3) there was a profit credited to the shareholder. The entries made in the books of the company in *James' Case* (3) were parallel to those in this one. *Blott's Case* (1) turned on the specific provisions of the super-tax Act in England. That Act only attracted income received by the taxpayer as such, and it was only what was received that was taxed. The *Swan Brewery Case* (2) is not distinguishable from the present case, and there it was held that the taxpayer had obtained an advantage (4).

*Fullagar* K.C. (with him *Ashkanasy*), for the respondent. By sec. 3 the tax is described as a tax on income as defined. The words used in the section are referable to income and not to a return of capital. The giving of the shares was not a bonus or profit, and the shareholder has parted with any right he had to get money out of the company. The shareholder discharged his obligation to pay for the shares by becoming a party to a resolution which withdrew from distribution a fund of profits in the distribution of which he might have shared. [He referred to *Hill* v. *Permanent Trustee Co. of New South Wales* (5); *Blott's Case* (6); *Inland Revenue Commissioners* v. *Fisher's Executors* (7); *Commissioner of Income Tax, Bengal* v. *Mercantile Bank of India Ltd.* (8).] The *Swan Brewery Case* (2) must be based on the word "advantage" in the Act; it is based on so narrow a ground that it is not an authority except in such a case as is on all fours with it. The real object of sec. 4 of the *Unemployment Relief Tax (Assessment) Act* 1933 is to deal with the source of profits. The rule that a company cannot

(1) (1921) 2 A.C. 171, at pp. 184, 212-213.
(2) (1914) A.C. 231.
(3) (1924) 34 C.L.R. 404.
(4) (1914) A.C., at pp. 235, 236.
(5) (1930) A.C. 720, at pp. 730-732.
(6) (1921) 2 A.C., at pp. 187-189, 195-199, 200, 202.
(7) (1926) A.C. 395, at pp. 400-404, 406-407.
(8) (1936) A.C. 478, at pp. 491, 494-495.

pay for its own shares is for the purpose of protecting creditors. The Victorian Parliament had before it in 1933 a Federal Act which used practically the same words as the Victorian legislature chose. The Victorian legislature must be taken to have known the history of the previous legislation and the controversy about it. If bonus shares were to be taxed, the legislature should have said so expressly (*Eisner* v. *Macomber* (1) ). Both the House of Lords and the Privy Council have said that the *Swan Brewery Case* (2) cannot be supported except on the use of the word "advantage." *James' Case* (3) is distinguishable. What the company in the present case did was to tie up in the share-capital account money which was formerly in the reserve fund and thereby to turn what was formerly fluid into something fixed (*Executor Trustee and Agency Co. of South Australia Ltd.* v. *Deputy Federal Commissioner of Taxation* (*S.A.*) (4) ). The judgment of the Supreme Court is correct (*Commissioner of Taxation* (*N.S.W.*) v. *Stevenson* (5) ). There has been a surrender of rights or of potential rights in payment for the shares. The shareholder is not credited with anything that he is entitled to get from the company, and it is the crediting of something due from the company to the shareholder that makes it taxable. At no stage does this company credit the shareholder with anything. There is a mere satisfaction of liability (*In re Bridgewater Navigation Co.* (6) ). *James' Case* (3) is based on very narrow grounds; otherwise it can no longer be regarded as law, in view of the decisions of the House of Lords and of the Privy Council.

*O'Bryan* K.C., in reply. The entry on the butt of the share certificates is a credit entry. The result of the transaction should be regarded, and not the means whereby it is carried out. If this is done, it will appear that the taxpayer has been credited with the amount in question. The resolution effects a distribution of money out of the reserve account and an issue of shares in respect thereof. To satisfy the Act you do not have to find an entry in any books. As between the shareholder and the company, you

(1) (1920) 252 U.S. 189, at pp. 202, 203, 208-211; 64 Law. Ed. 521, at pp. 526, 527, 529, 530.
(2) (1914) A.C. 231.
(3) (1924) 34 C.L.R. 404.
(4) (1928) 41 C.L.R. 299.
(5) *Ante*, p. 80.
(6) (1891) 2 Ch. 317, at p. 327.

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can find that the shareholder is given credit for a sum of money, which the company has given as a dividend or profit. There was no consideration moving from the shareholder in purporting to relinquish a right in the reserve fund, which was the property of the company and over which the shareholder as such had no control. At every capitalization of profits there must have been a crediting of a bonus or dividend. The taxpayer is credited with his proportion of accumulated profits. You look to see what the taxpayer received, and you do not look to see how he received it. In *Blott's Case* (1) it was considered whether the allotment to the taxpayer was capital; that case was concerned only with what was paid to the taxpayer. In *Fisher's Case* (2) it was held that the bonus paid in debenture stock was not income. The provision in *James' Case* (3) was not identical with that in the Victorian Act (*Executor Trustee and Agency Co. of South Australia Ltd.* v. *Deputy Federal Commissioner of Taxation* (*S.A.*) (4) ). What has been handed to the taxpayer is a valuable thing.

*Cur. adv. vult.*

Mar. 25.

The following written judgments were delivered :—

LATHAM C.J. This is an appeal from a decision of the Full Court of the Supreme Court of Victoria relating to the liability of the respondent to pay tax under the *Unemployed Relief Tax* (*Assessment*) *Act* 1933 and the *Income Tax Act* 1935 of Victoria. The former Act, sec. 4, provides that for the purposes of the Act " (*a*) in the case of any person who is a member or shareholder of a company registered in Victoria—any dividend interest profit or bonus credited paid or distributed to him by the company from any profit derived in or from Victoria or elsewhere by it . . . shall be deemed to form part of the assessable income of that person."

The *Income Tax Act* of 1935, sec. 2 (*g*), contains a similar provision for the purposes of that Act, under which a special tax on income is imposed. The question is whether the taxpayer became liable to

(1) (1921) 2 A.C., at pp. 178, 179, 180, 190, 194, 195, 199, 203, 204, 207, 208; (1920) 2 K.B. 657, at p. 668.

(2) (1936) A.C. 395, at p. 405.

(3) (1924) 34 C.L.R., at pp. 413, 416, 417, 418, 419.

(4) (1928) 41 C.L.R., at p. 312.

taxation under these Acts by reason of the issue to him of certain shares by a company—Lorraine Investments Pty. Ltd.—in which he is a shareholder. The company had transferred profits from the profit and loss account to a reserve fund, and it was decided to capitalize £350,000 of the reserve fund. The nominal capital of the company was increased by the creation of 400,000 new shares of £1 each. On 29th August 1934 the company in general meeting passed the following resolution : " Resolved to transfer the amount of £150,000 to reserve account and to distribute bonus shares out of reserve account to the full amount to credit of this account, viz., £350,000."

On 25th September the directors of the company passed the following resolution : " Resolved to allot the following shares in furtherance to resolution of shareholders : 50,001-260,000 to G. R. Nicholas ; 260,001-400,000 to the trustees of Betty, Lindsay, Nola and Hilton."

The resolutions were carried in the presence of and with the consent of all the shareholders, and journal entries and ledger account entries were made in the books of the company to give effect to the resolutions mentioned. Shares were allotted in accordance with the resolutions, and share certificates for 210,000 fully-paid-up shares were made out in the name of, and given to, the taxpayer. No separate share register was kept, except in the form of butts of the company's share-certificate book. Upon these butts it was recorded that the certificates for the fully-paid-up shares had been issued. It is agreed that the 210,000 shares were at all material times of a value of £210,000.

The question which the learned County-Court judge stated for the opinion of the Supreme Court is as follows : " Should the assessment of taxable income for the purposes of (1) special tax and (2) unemployment relief tax have included the said amount of £210,000 ? "

The Full Court of the Supreme Court, by a majority (*Mann* C.J. and *Macfarlan* J., *Gavan Duffy* J. dissenting), answered this question in the negative.

The relevant sections of the statutes deal with dividends, interest, profits or bonuses. Unless that in respect of which the taxation is

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sought to be imposed falls within one or other of these categories, the sections do not apply. Next, the dividends &c. must be either credited, paid or distributed to the shareholder. It is not necessary that money should be paid. If anything which otherwise falls within the terms of the sections is credited or distributed, the sections will apply. Finally, the sections provide that what is credited, paid or distributed must come from profits derived in or from Victoria or elsewhere by the company.

The term " payment " plainly covers a payment of money by the company to a shareholder. In this case, however, there was no actual payment of any sum of money. The term " distribution," whether or not it includes the payment of money, is wide enough to cover other benefits received from the company by a shareholder, for example, a distribution of assets other than money. The term " crediting " relates to something of which the shareholder receives the benefit in account with the company, even if there is no actual payment or distribution of anything to him. The question which arises in this case is whether, when profits are first capitalized and are then appropriated to meet the liability on shares which are distributed to the shareholders in proportion to their holdings, the special statutory provisions operate to impose a liability upon the shareholders.

The leading case in this branch of the law is *Inland Revenue Commissioners* v. *Blott* (1). There it was held that in such circumstances the shares were not " income " of the shareholder who received them. In that case a bonus was declared out of current annual profits. Shares credited as fully paid up were issued in satisfaction of the bonus. It was held that the distribution was a distribution of capital and not of income. The profits were converted into capital and were not paid away to the shareholders. They were retained by the company and applied " in paying up the capital sums which shareholders electing to take up unissued shares would otherwise have to contribute " (2). The shareholders were given " shares instead of a bonus " (3). If the question in the present case were whether the shares were income in the ordinary sense and independently of

(1) (1921) 2 A.C. 171.
(2) (1921) 2 A.C., at p. 184.
(3) (1921) 2 A.C., at p. 195.

any special statutory extension of the definition of income, *Blott's Case* (1), in my opinion, would compel an answer in the negative.

But the statutes under which the question arises provide that any dividend or bonus or profit credited to a shareholder from the profits of a company are taxable. The shares in this case were issued as fully paid up. They were treated as fully paid up. The shareholder received the benefit in account of a credit of the amount of the liability on the shares. Unless there were such a credit and that credit were effective, the shareholder would be liable for the full amount of £1 per share. The operation of capitalization of profits and issue of shares which was intended by the shareholders is possible only if the shareholders are credited with the full amount of the original liability on the shares. In *Blott's Case* (1) the shareholders equally received a credit, but the statute did not purport to tax such a credit.

The distinction between a statute such as that considered in *Blott's Case* (1) (" total income from all sources ") and the statutes now before the court (" profits or bonuses paid credited or distributed from the profits of the company ") was explained by this court in *James* v. *Federal Commissioner of Taxation* (2). The procedure followed by the company in that case does not appear to me to be distinguishable in any material particular from what was done in the present case. It was resolved in *James' Case* (2) that profits be distributed among the shareholders by allotting shares in satisfaction of a bonus declared. The share register showed the shares issued to the taxpayer as paid up to 10s. per share. It was unanimously held that the amount of 10s. was taxable as being a dividend, bonus or profit credited to the taxpayer. *Isaacs* J. quoted what he had said in *Webb* v. *Federal Commissioner of Taxation* (3): " The legislature, as it appears to me, has by the word ' credited ' sought to reach cases where, through a member or shareholder *who* has not been ' paid ' the dividend or bonus, there has been credit in the company's books imputed to the share he holds " (4). *Isaacs* J., after referring to the process of capitalizing profits, declaring a dividend or bonus, and issuing shares in satisfaction of the bonus, said:

(1) (1921) 2 A.C. 171.
(2) (1924) 34 C.L.R. 404.
(3) (1922) 30 C.L.R. 450, at pp. 478, 479.
(4) (1924) 34 C.L.R., at pp. 413, 414.

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"The Australian Act, unlike the English Act, does not always wait till the end of the process: it also sometimes seizes an intermediate operation" (1), that is, the operation of crediting the shareholder with the amount which he would otherwise be liable to pay upon his new shares. In *James' Case* (2) the credit was made in the share register (3). So, in the present case there is a crediting (as a matter of book-keeping) by the insertion of the entry upon the butt of the share certificates which shows that the shares are fully paid up, and there is a crediting (as between creditor and debtor) in the transaction which that entry records. Shares issued by a company must be paid up in money or in money's worth. Either these shares are fully paid up or they are not paid up at all. The taxpayer contests the matter upon the basis that he is the holder of the shares as fully paid up. He has not paid for them in money or money's worth unless the operation of entering his name as the holder of fully-paid-up shares represents a crediting to him of the amount for which he would otherwise be liable.

In my opinion *James' Case* (2) is in this court conclusive authority in favour of the appellant, and therefore, in my opinion, the appeal should be allowed, the order of the Supreme Court should be set aside and the question asked in the case should be answered in the affirmative in relation to both statutes.

RICH J. The short question in the case is whether the capitalization of reserves of profit makes a shareholder liable to Victorian income tax (special tax) and Victorian unemployment relief tax upon so much of the profits capitalized as is represented by the shares he receives. For the purposes of these taxes the assessable income of a taxpayer includes, in the case of any person who is a member or shareholder of a company registered in Victoria—any dividend, interest, profit or bonus credited, paid or distributed to him by the company from any profit derived in or from Victoria or elsewhere by it (*Income Tax Act* 1935 (special tax), sec. 2 (1) (*g*) and proviso; *Unemployment Relief Tax* (*Assessment*) *Act* 1933, sec. 4). If the question were whether the shares themselves, issued

(1) (1924) 34 C.L.R., at p. 417. (2) (1924) 34 C.L.R. 404.
(3) (1924) 34 C.L.R., at p. 407.

as they are as fully paid up, constituted income arising in the hands of the taxpayer, the answer would be in the negative. For that answer is both authorized and required by *Blott's Case* (1) and *Commissioner of Income Tax, Bengal* v. *Mercantile Bank of India Ltd.* (2). The reason for that conclusion is summarized by a short passage in the opinion of Lord *Haldane* in *Blott's Case* (1), which Lord *Cave* treated in *Inland Revenue Commissioners* v. *Fisher's Executors* (3) and Lord *Thankerton* in the *Bengal Case* (4) as stating the principle. Lord *Haldane* said: "My Lords, for the reasons I have given I think that it is, as matter of principle, within the power of an ordinary joint-stock company with articles such as those in the case before us to determine conclusively against the whole world whether it will withhold profits it has accumulated from distribution to its shareholders as income, and as an alternative not distribute them at all, but apply them in paying up the capital sums which shareholders electing to take up unissued shares would otherwise have to contribute. If this is done the money so applied is capital and never becomes profits in the hands of the shareholders at all. What the latter gets is no doubt a valuable thing. But it is a thing in the nature of an extra share certificate in the company" (5). It is to be noticed that Lord *Haldane* describes the operation of the company as applying the profits in paying up the capital sum which shareholders electing to take up unissued shares would otherwise have to contribute. To my mind the question on the Victorian statutes is whether this operation does not involve or connote the crediting of a profit to the shareholder. Now, the words I have quoted from the Victorian statutes have much history behind them in Australia. They are taken from the Federal income-tax legislation which preceded the consolidation of 1936, a consolidation now, I think, adopted in the same form by the various States. In the Federal legislation the provision took its beginning in sec. 14 (*b*) of the *Income Tax Assessment Acts* 1915, which provided that the income of any person should include "dividends, interest, profits, or bonus credited or paid to any member, shareholder, or debenture holder of a company which derives income from a source in Australia

(1) (1921) 2 A.C. 171.
(2) (1936) A.C. 478.
(3) (1926) A.C. 395.
(4) (1936) A.C., at pp. 493, 494.
(5) (1921) 2 A.C., at p. 184.

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or of a company which is a shareholder in a company which derives income from a source in Australia, but not including a reversionary bonus issued on a policy of life insurance." Whilst the provision was substantially in this form it was interpreted by this court in *James* v. *Commissioner of Taxation* (1). The case was decided in 1924 by this court with *Blott's Case* (2) before it. It was an ordinary case of capitalization out of profits. After examining *Blott's Case* (2), *Isaacs* J., as he then was, said :—" It appears to me that the point of divergence between the majority and the minority in that case is found in this consideration :—Both agreed that the declaration of dividend entitled the shareholder to his proportion of the profits in some way. Both agreed that he was entitled to have that proportion applied by the company so as to impute payment of his liability in respect of the capital represented by the new shares to be issued " (3). In describing the particular procedure followed by the company there in question his Honour said that " the declaration of dividend created a debt, there can be no doubt " (3) ; then he went on :—" But it was a debt which from its birth was conditioned to be satisfied, not by payment over, but by a credit in discharge of a liability on shares in a process which the law says is, in the result, the creation of capital. The Australian Act, unlike the English Act, does not always wait to the end of the process : it also sometimes seizes an intermediate operation " (4). This represented the view of *Knox* C.J., who said that the sum appropriated answered the description of profits or bonus credited to a shareholder of a company (5). It represented also, I think, the view of *Gavan Duffy* and *Starke* JJ., who said : " Such a transaction could not be carried out, in point of fact or of law, unless the profits had been allocated to the shareholders and treated, in account between the company and the shareholders, as at the ' credit ' of the shareholders " (6). And I may add that I expressed the view myself that it was incontestable on the facts stated that the sum in question was credited to the shareholder out of the profits of the company in respect of the shares (6). This unanimous decision settled, so far as we are concerned the question, if any question there could be, that

(1) (1924) 34 C.L.R. 404.
(2) (1921) 2 A.C. 171.
(3) (1924) 34 C.L.R., at p. 416.
(4) (1924) 34 C.L.R., at pp. 416, 417.
(5) (1924) 34 C.L.R., at p. 411.
(6) (1924) 34 C.L.R., at p. 419.

an appropriation by a company of a fund consisting of profits reserved to answer an allottee's prima-facie liability upon the amount of the shares is a crediting of profits within the meaning of the crucial words as they stood in the Federal Act. In the Federal consolidation of 1922, sec. 16 (*b*) (i), the word "distributed" was added to the words "credited and paid." A special provision was made for bonus shares (sec. 16 (*b*) (ii)), and to it a proviso was added excluding the application of *James*' *Case* (1) beyond that provision. It is needless to go into the subsequent history of the matter in the Federal Acts. It is enough to say that the legislation has proceeded on the basis of *James*' *Case* (1) and the Acts have been modified or qualified from time to time according to the policy which for the time being appealed to the parliament. But the Victorian legislature took the very words upon which *James*' *Case* (1) was decided and applied them to the purposes of the Victorian income tax, special tax and unemployment-relief tax. The notoriety of *James*' *Case* (1) makes it certain that the legislature took them as words involving all the consequences of that decision. But in *James*' *Case* (1) the procedure of the company in capitalizing was less direct than in the present case. Here art. 95 of the articles of association provides that "when declaring a dividend the directors may direct payment of the same wholly or in part by the distribution of specific assets and in particular of shares debentures or debenture stock of the company or of any other company or of war-loan bonds or stock at face value or in any one or more of such ways and when any difficulty arises in regard to the distribution they may settle the same as they think expedient and in particular may issue fractional certificates or sell shares not divisible by reason of fractions and may fix the value for distribution of such specific assets or any part thereof and may determine that cash payments shall be made to or by any members upon the footing of the value so fixed in order to adjust the rights of all parties. Where requisite a proper contract shall be filed in accordance with sec. 96 of the *Companies Act* 1915 and the directors may appoint any person to sign such contract on behalf of the persons entitled to the dividend and such appointment shall be effective." In *James*' *Case* (1) an extraordinary resolution of the company authorized the directors to

(1) (1924) 34 C.L.R. 404.

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capitalize profits and to that end to distribute the amount to be capitalized as a bonus in proportion to the shares held by the members and to distribute in like proportions unissued shares paid up to the predetermined amount. It is said that the difference justifies the conclusion that profits were not credited in the present case, notwithstanding that they were in *James' Case* (1). As a matter of company law the direct method of capitalization pursued in the present case represents a comparatively recent practice. Its growth may be perhaps best evidenced by a reference to the polemics of anonymous controversialists in the *Law Quarterly Review*, vol. 33, pp. 208 and 297, and the note in reply, vol. 34, p. 7; see vol. 46, p. 336. Since then it has become common practice to adopt articles of association authorizing the direct issue of paid-up shares. But the shares must be paid up out of something and that something must be susceptible of application or appropriation to answer what would otherwise be a liability to the face value of the shares. Unless the prima-facie liability is extinguished by the application of money or money's worth available for that purpose, the shares are unpaid, and that means the shareholder is liable for their amount and upon the capital being called up would owe a debt *in praesenti* (*In re Eddystone Marine Insurance Co.* (2)). When a company appropriates or applies its profits to satisfy or extinguish this liability, it appears to me quite clear that it credits them to the shareholder. It applies them to his use. When the Act of Parliament speaks of " crediting " it is not discussing bookkeeping, but the appropriation of profits to answer the purposes of the shareholder. If the shareholder obtains shares, stock, debentures, bonds or any other negotiable or transferable form of obligation of the company or interest in its assets, and the consideration which otherwise must be supplied by him consists in an appropriation by the company of profits to that end it would seem to me to be the very thing meant by " crediting " the profits. At all events, this is what *James' Case* (1) means, and we are bound by that decision. Perhaps it may be added that after all the water that has flowed under the statutory bridge it seems to me rather late in the day to ask us to say that a

(1) (1924) 34 C.L.R. 404.

(2) (1893) 3 Ch. 9; (1894) W.N. 30.

capitalization of profits does not involve a "crediting" of them within the meaning of Australian legislation.

In my opinion the question in the special case should be answered in the affirmative.

STARKE J. Special case stated by a judge of the County Court at Melbourne pursuant to the *Income Tax Act* and the Unemployment Tax Relief Acts. The facts are stated in the case.

Lorraine Investments Pty. Ltd. was a company registered in Victoria, and the taxpayer is one of its shareholders. The company had accumulated profits amounting to a sum of £350,000 which it had not distributed to its shareholders. In 1934 the directors of the company allotted 350,000 unissued shares in the capital of the company to its shareholders. To the taxpayer 210,000 shares were so allotted. All the shares were issued to the shareholders as fully paid up, and the sum of £350,000—the undistributed profits of the company—was appropriated by the company to satisfaction of the liability on the shares. The Commissioner of Taxes included in his assessment of the taxpayer to special income tax and unemployment-relief tax for the year ending on 30th June 1935 the sum of £210,000, the face and the real value of the 210,000 shares already mentioned.

The question stated for the opinion of the Supreme Court was: Should the said assessment of taxable income for the purposes of (1) special tax and (2) unemployment-relief tax have included the said amount of £210,000? The Supreme Court answered this question in the negative, and the commissioner has now appealed to this court.

Under the English Finance Acts it is settled that in cases in which a limited company transfers or transmutes its undivided profits into paid-up capital and does not distribute them amongst its shareholders as income, then the profits so dealt with are not chargeable to income tax (*Inland Revenue Commissioners* v. *Blott* (1); *Inland Revenue Commissioners* v. *Fisher's Executors* (2); *Commissioner of Income Tax, Bengal* v. *Mercantile Bank of India Ltd.* (3); *Inland Revenue Commissioners* v. *Wright* (4)). Consequently, it follows in this case that

(1) (1921) 2 A.C. 171.
(2) (1926) A.C. 395.
(3) (1936) A.C. 478.
(4) (1927) 1 K.B. 333.

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the company, if the English cases govern the matter, did not liberate or distribute any profits to its shareholders as income, but capitalized them. But we have in this case to consider the Victorian *Income Tax Act* 1928, the *Income Tax Act* 1935 (No. 4309), sec. 2 (1) (*g*) (special tax), and the *Unemployment Relief Tax (Assessment) Act* 1933 (No. 4171), sec. 4. Under the Act of 1928 a company is chargeable to income tax in respect of its profits, and shareholders were exempt from tax in respect of dividends from companies (See secs. 42 and 21). But companies are not chargeable to special tax or unemployment-relief tax (Act 4309, sec. 2 (*g*); Act 4171, sec. 3 (5)). Special provision was made in these Acts rendering shareholders or members of companies assessable to tax in respect of the special tax and the unemployment-relief tax. It was as follows :—" In the case of any person who is a member or shareholder of a company registered in Victoria—any dividend interest profit or bonus credited paid or distributed to him by the company from any profit derived in or from Victoria or elsewhere by it " " is to " (Act 4309), " shall " (Act 4171), " be deemed to form part of the assessable income of that person."

The Federal *Income Tax Assessment Act* 1915-1921, sec. 14 (*b*), in much the same words, was the subject of consideration in this court in *Webb* v. *Federal Commissioner of Taxation* (1) and *James* v. *Federal Commissioner of Taxation* (2). But under the Federal Act 1915-1921 a company was not chargeable to income tax in respect of so much of its assessable income as was available for distribution and was distributed to its shareholders (sec. 16 (1)), and shareholders were by force of sec. 14 (*b*) chargeable in respect of dividends, bonuses or profits credited, paid or distributed to them from any profit derived by the company from a source in Australia. The Federal Act 1922-1925, on which was decided the case of *Executor Trustee and Agency Co. of South Australia Ltd.* v. *Deputy Federal Commissioner of Taxation* (*S.A.*) (3), contained other provisions. The Federal law is now governed by the provisions of the *Income Tax Assessment Act* 1936, secs. 44; 19; 6, " Dividend," " Paid." Under this Act shareholders are now chargeable in respect of the paid-up value

(1) (1922) 30 C.L.R. 450.
(2) (1924) 34 C.L.R. 404.
(3) (1928) 41 C.L.R. 299, at p. 302.

of shares distributed by a company to its shareholders to the extent to which the paid-up value represents the capitalization of profits.

The case before us falls, however, for decision under the Victorian Acts already mentioned. On the part of the taxpayer it is contended that the taxes imposed by these Acts are taxes on income and that it is not meant to tax anything else (*London County Council* v. *Attorney-General* (1)). Nothing, it is argued, has been liberated or released to the shareholders as income; the company has capitalized its profits. On the other hand, the commissioner contends that the Victorian Acts tax not only dividends &c. credited, paid or distributed in the ordinary course by a company to its shareholders, but seize also upon the intermediate operations of a company in the course of capitalizing its profits; intercept those profits and tax them if credited, paid, or distributed to its shareholders.

Constitutionally it is quite competent for Parliament so to legislate, and the question first and last is: What is the proper construction of the Act? It does not depend on the English *Finance Act* or directly on any English case. The Victorian Acts and the Federal Income Tax Acts are different in structure from the English Acts.

Under the Federal Acts companies pay income tax at a flat rate, whilst shareholders pay on a steeply graduated scale. The taxation of companies and shareholders under these Acts is complementary in its nature. Perhaps that aids the construction of the Act which commended itself to this court in *James' Case* (2) that profits credited, paid, or distributed to shareholders in the operation of capitalizing profits were chargeable under that Act to income tax. *Executor Trustee and Agency Co. of South Australia Ltd.* v. *Federal Commissioner of Taxation (S.A.)* (3) is consistent with the decision in *James' Case* (2), if the passage in the judgment of *Knox* C.J. and *Gavan Duffy* J. (4) is read with the light thrown upon it by *Higgins* J. (5).

But it is the construction of the Victorian Acts which govern this case. Under these Acts the companies do not pay special or unemployment-relief tax, but only shareholders. It might perhaps be expected in these circumstances that the profits of a company made available to shareholders, whether capitalized or not, would be

(1) (1901) A.C. 26.
(2) (1924) 34 C.L.R. 404.
(3) (1928) 41 C.L.R. 299.
(4) (1928) 41 C.L.R., at p. 309.
(5) (1928) 41 C.L.R., at pp. 312, 313.

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chargeable to the special tax and unemployment-relief tax imposed by those Acts. But it depends upon the construction of the Acts, and in my opinion the words of the Acts are explicit. Any dividend, interest, profit or bonus credited, paid or distributed to a shareholder from any profit derived by a company shall be deemed to form part of his assessable income. If profits of a company are credited, paid or distributed to shareholders, they are chargeable to income tax. It may be true, but it is nothing to the point to say, that they have not been liberated or released to the shareholders as income but have been capitalized. The critical matter is whether they have been credited or paid or distributed to shareholders. Even the case of *Swan Brewery Co. Ltd.* v. *The King* (1), much as it has been criticised and limited, allows that accumulated profits transmuted into shares in the capital of a company were chargeable to tax under the *Dividend Duties Act* 1902-1906 of Western Australia. The Victorian Acts, though income-tax Acts, are equally explicit. It appears to me a fallacious method of solving the problem involved in this case to start with the proposition that capitalized profits are not income on the basis of the English decisions and cannot therefore be assessable income under the Victorian Acts. It depends on the language of those Acts, and, to adopt the words of *Higgins* J. in the *Executor Trustee Co.'s Case* (2), probably most people would have thought it sufficiently clear that the profits appropriated to the shares issued to the taxpayer as fully paid up had been credited to him under and by virtue of the words of those Acts.

But it is necessary to consider those words more closely. It is clear, and was, I think, conceded that the taxpayer in the issue of shares to him did participate in the profits of the company. "Paid" prima facie implies payment of money and not satisfaction in shares or other assets (*Webb's Case* (3), per *Higgins* J.). "Distributed" means divided. In the present case I should not think that the profits had been paid or distributed to the shareholders. But there is the other word, "credited." It is rather indefinite in meaning. It is a commercial or, rather, a book-keeping term. A person is "credited"

(1) (1914) A.C. 231.
(2) (1928) 41 C.L.R., at p. 310.
(3) (1922) 30 C.L.R. 450, at p. 487.

with an amount if it is entered on the credit side of his account. But special tax or unemployment-relief tax could not be evaded simply by refusing or omitting to make entries customary in accountancy which the transaction involved " in business as in contemplation of law."

In the present case the company has avoided so far as possible the entry in any book of a credit to the account of the taxpayer in respect of its accumulated profits. But shares have been issued to the taxpayer and accepted by him, and the only share register used by the company records that the shares are fully paid up, and the shares, no doubt, contain the same statement upon their face. It is commonplace of company law that " paid-up shares cannot be issued unless they are paid up by someone other than the company " (*Palmer, Company Precedents*, 14th ed. (1931), Part I., p. 957).

The taxpayer did not pay for the shares in cash. But the company appropriated accumulated profits from its reserve to unallotted capital, " being bonus shares allotted from reserve," to discharge the taxpayer's liability on the shares. What is such an appropriation but the crediting of the taxpayer with the amount of accumulated profits of the company ? It resulted, no doubt, in a capitalization of the profits, but in the course of that operation the taxpayer is necessarily both as a matter of business and as a matter of law given credit for and " credited " with the amount paid up on his shares. Otherwise, the shares are not paid up at all.

In *James' Case* (1) the entries made in the books of the company were not the same as in the present case, but the governing principle is the same, and it ought to be followed in this court.

The appeal should be allowed and the question stated answered in the affirmative.

EVATT J. Since the judgments of the House of Lords in *Inland Revenue Commissioners* v. *Blott* (2) and *Inland Revenue Commissioner* v. *Fisher's Executors* (3), as explained by the Privy Council in *Commissioner of Income Tax, Bengal* v. *Mercantile Bank of India Ltd.* (4), it must be taken that the *Swan Brewery Case* (5), is to be

(1) (1924) 34 C.L.R. 404.
(2) (1921) 2 A.C. 171.
(3) (1926) A.C. 395.
(4) (1936) A.C. 478.
(5) (1914) A.C. 231.

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regarded " as having been primarily based on the distribution of the new shares being ' advantages ' within the meaning of the particular Act under consideration " (1). In *Blott's Case* (2) Lord *Sumner* had said that the *Swan Brewery Case* (3) " did not turn on the special definition of dividend in the taxing statute of Western Australia " (4); but, so far as it did not turn on such definition, so far as it " regarded the transaction as involving, in substance, a distribution of accumulated profits among shareholders and a repayment by them to the company " (5), it cannot be treated as a correct or permissible analysis of the whole transaction of capitalizing profits with a view to the issue of bonus shares.

From the final interpretation of the *Swan Brewery Case* (3) as resting on the single word " advantage," certain conclusions inevitably follow. The definition of " dividend " in the West Australian Act included " every profit, advantage or gain intended to be paid or credited to or distributed among the members of the company." Having regard to such definition, it is a necessary inference from the *Swan Brewery* decision, as authoritatively explained, that from the mere capitalization of profits and the proportionate allocation to shareholders of the increased capital no " profit " or " gain " is " paid " or " credited " or " distributed " to any shareholder of the company.

It is equally clear that, in such circumstances, it is not possible to postulate *a priori* that any " dividend " is " paid " or " credited " or " distributed." A shareholder, as Viscount *Haldane* said, " is not entitled to claim that the company should apply its undivided profits in payment to him of dividend. He cannot sue for such a dividend until he has been given a special title by its declaration " (6). In such a capitalization, to use Viscount *Finlay's* words describing the Blott transaction, " instead of his getting any dividend, or anything in the nature of a dividend, the fund which might have been divided was impounded to increase the capital of the business " (7). Or, as Lord *Russell of Killowen* has said, " moneys which had been capable of division by the company as profits among its share-

(1) (1936) A.C., at p. 495.
(2) (1921) 2 A.C. 171.
(3) (1914) A.C. 231.
(4) (1921) 2 A.C., at p. 217.
(5) (1936) A.C., at p. 495.
(6) (1921) 2 A.C., at p. 182.
(7) (1921) 2 A.C., at p. 196.

holders have ceased for all time to be so divisible, and can never be paid to the shareholders except upon a reduction of capital or in a winding up " (*Hill's Case* (1) ).

These considerations are of decisive relevance in the construction of sec. 4 of the *Unemployment Relief Act* 1933 and of the proviso to sec. 2 (1) (*g*) of the *Income Tax Act* 1935, where the charging words are " any dividend, interest, profit or bonus credited, paid or distributed to " the shareholder. In neither case is the word " advantage " used. The use of the word " bonus " operates, in my view, against the commissioner because in Australia in 1933 and 1935 the word " bonus share " had become an accepted part not only of business but of income-tax language ; but it was not used.

The formidable array of authority is to be regarded as finally settling what was once a vexed question, leaving it to the legislatures concerned to employ clear language in order to attach to the transaction of capitalizing profits and issuing bonus shares a resulting liability in the shareholder to pay income tax upon what can never be regarded as a true income receipt. Faced with the authorities, the commissioner pins all his faith to *James* v. *Federal Commissioner of Taxation* (2). But in that case the court did not decide that in each and every case where shares in a company are capitalized and are issued to shareholders as fully paid there must always and of necessity be a " crediting " to each shareholder of a dividend. That would have been a simple and effective way of determining the general principle involved, without any precise examination of the manner in which the dividend was " credited " to each shareholder. On the contrary, *Knox* C.J. finds as a fact that there was a " crediting " (3). *Gavan Duffy* J. and *Starke* J. said : " On the cases, it may be established that the profits were not paid or released to the shareholders ; but it is clear, we think, that these profits were credited to the shareholders " (4). An equally cautious approach to a question of fact seems to be indicated by *Rich* J. (5). *Isaacs* J. also emphasised " the actual crediting of £3,168 in the share register " (6). Affected by the overwhelming weight of subsequent authority, *Knox* C.J. and *Gavan Duffy* J., in *Executor Trustee and*

(1) (1930) A.C., at p. 732.
(2) (1924) 34 C.L.R. 404.
(3) (1924) 34 C.L.R., at p. 411.
(4) (1924) 34 C.L.R., at p. 418.
(5) (1924) 34 C.L.R., at p. 419.
(6) (1924) 34 C.L.R., at p. 417.

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*Agency Co. of South Australia Ltd.* v. *Deputy Federal Commissioner of Taxation (S.A.)* (1), said of a similar transaction in which a formal declaration of bonus was included in the machinery of capitalization :— " In other words, did the transaction amount to a crediting, payment or distribution to the said James Henry Gibbon of a dividend, bonus or profits, or to a distribution by the company to him of the paid-up value of shares representing the capitalization of profits of the company ? If the former, the respondent is entitled to succeed ; if the latter, the appellant." If the same two learned judges were right in regarding the draftsman of the 1925 Act as reasonably familiar with the *Blott* controversy and as having employed in an income-tax Act the phrase " dividends, bonuses or profits . . . credited, paid or distributed to the . . . shareholder " as antithetical to the distribution of paid-up shares representing the capitalization of the company's profits, a similar attitude is imperative to-day, when, for the first time in Victoria, as stated at the Bar, an attempt is made to use precisely similar language for the purpose of bringing into charge the paid-up value of bonus shares.

In the present case the facts stated in the special case negative, or at least do not establish, any actual " crediting " to the taxpayer of any sum of money whatsoever. According to the resolution the transaction was that of " distributing bonus shares " out of reserve account. During argument an attempt was made to extract an admission from learned counsel that there must have been some other material facts which are not stated in the case. He very properly declined to make any such admission, and in any event the court is confined to the facts as stated. They show that there was no " crediting " such as took place in *James' Case* (2). If it took place, it must have taken place upon some date. When did it take place ? I received no answer to this question. The conclusion is that the company refrained from declaring any dividend or " crediting " it to a shareholder. Then it is said : " Oh, you should have followed the form prescribed by *Palmer*." The taxpayer says :—" What if the form was never followed ? Even if the company can compel me to pay for the ' bonus ' shares, what has that to do with the commissioner ? " Here, everything that took place took place with the consent of all the shareholders, the intention was not to liberate profits or credit them at any stage of the transaction, but to conduct the whole affair

(1) (1928) 41 C.L.R., at p. 306. (2) (1924) 34 C.L.R. 404.

as one of capitalization and detention of undivided profits. I entirely agree with the observation of *Mann* C.J. that "if on the other hand it be true that the company in this case has exceeded its powers under the *Companies Acts* (the point has not been argued) I do not know that the commissioner's case will be advantaged thereby" (1). Because, if a company purports to issue "bonus shares" as fully paid and there remains in law a liability to pay on each share, how can there be any distribution of "dividend, interest, profit or bonus"?

In the result the opinion of the majority of the Supreme Court should be affirmed. It is not too much to ask that, if the Victorian legislature is really desirous of making the receipt of bonus shares the occasion of the shareholders' liability to income tax (which is to be doubted), it should follow the example of other Australian legislatures and make its intention plain. If the present transaction is examined "in substance," there has been nothing in the nature of an income receipt by the shareholder. If it is examined "step by step," I fail to see any step which brings the shareholder within the words of the statute. This court should loyally accept the authoritative exposition by the Privy Council of the *Swan Brewery Case* (2), and that exposition, in my opinion, concludes the matter in the taxpayer's favour.

The appeal should be dismissed.

McTIERNAN J. I have had the advantage of reading the judgment of my brother *Rich*, and I agree with the reasons and the conclusion stated therein.

*Appeal allowed with costs. Order of Supreme Court set aside. Special case remitted to County Court at Melbourne with the following opinion on the question submitted: "The assessment of the taxpayer for the purposes of special tax and unemployment-relief tax should have included the said amount of* £210,000." *Respondent to pay costs of special case.*

Solicitor for the appellant, *F. G. Menzies*, Crown Solicitor for Victoria.

Solicitors for the respondent, *Norris & Norris.*

H. D. W.

(1) (1937) V.L.R., at p. 341.

(2) (1914) A.C. 231.