[HIGH COURT OF AUSTRALIA.]

THORNETT . . . . . APPELLANT;

AND

THE FEDERAL COMMISSIONER OF TAXATION RESPONDENT.

H. C. OF A. 1938.

SYDNEY, *May* 5, 6.

MELBOURNE, *June* 6.

Latham C.J., Starke and Dixon JJ.

Income Tax (Cth.)—Assessable income—Company—"Dividends, bonuses or profits credited, paid or distributed" to shareholder—Reduction of capital by cancellation of shares—Payment to shareholder in retirement of shares—Income Tax Assessment Act 1922-1929 (*No.* 37 *of* 1922—*No.* 11 *of* 1929), *sec.* 16 (*b*) (i).

The capital of a company wherein the taxpayer held three-fortieths of the issued shares was reduced by paying off and cancelling certain of the issued shares, including those of the taxpayer. The taxpayer was paid out by the transfer and payment to her of money and investments representing three-fortieths of the value of the net assets of the company. The commissioner assessed the taxpayer to income tax in respect of the amount received by her in so far as it exceeded a full return of capital paid up by her.

Held that the sum received by the taxpayer was paid and received in satisfaction of, and by way of replacement for, her share interest, and no part thereof was a dividend, bonus or profit credited, paid or distributed to a shareholder within the meaning of sec. 16 (*b*) (i) of the *Income Tax Assessment Act* 1922-1929.

Commissioner of Taxation (*N.S.W.*) v. *Stevenson*, *ante*, p. 80, applied.

CASE STATED.

On the hearing of an appeal to the High Court by Mrs. Christian Rowe Thornett from an assessment made upon her by the Federal Commissioner of Taxation under the *Income Tax Assessment Act* 1922-1929, in respect of income derived by her during the year

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ended 30th June 1929, *Rich* J. stated, for the opinion of the Full Court, a case which, as amended, was substantially as follows :—

1. On 29th October 1919 a family company (hereinafter called " the company ") was duly incorporated in Hong Kong under the corporate name of " Hafic Limited " and at all material times the company had its registered office at Hong Kong aforesaid. Art. 51 of the articles of association of the company provided that : " The company may from time to time reduce its capital and may consolidate or subdivide its shares and may cancel any shares that have not been taken up or agreed to be taken up and paid-up capital may be returned upon the footing that the amount may be called up again in the same manner as if it had never been paid up."

2. The nominal capital of the company was £1,000,000, divided into 1,000,000 shares of £1 each, of which 350,000 shares were issued, such 350,000 shares being fully paid up.

3. After the incorporation of the company the appellant paid for in full and became the holder of 26,250 shares of £1 each in the company, portion of the said 350,000 shares.

4. In the year 1928 the appellant and Mrs. M. L. Wells, another shareholder in the company, who was then also the holder of 26,250 fully paid-up shares of £1 each in the company, were desirous of ceasing to be members of the company.

5. In order to effectuate the desire of the appellant and of Mrs. M. L. Wells there was duly passed and confirmed at extraordinary general meetings of the company, held on 5th and 21st September 1928 respectively, a special resolution in the words and figures following : " That the capital of the company be reduced from £1,000,000 divided into 1,000,000 shares of £1 each of which 350,000 shares have been issued, to £947,500 divided into 947,500 shares of £1 each and that such reduction be effected by paying off 52,500 of the issued shares and by cancelling the shares in the company numbered 126,876 to 153,125 and 205,626 to 231,875."

6. On 17th December 1928, upon the petition of the company, the Chief Justice of the Supreme Court of Hong Kong by order confirmed the reduction of capital of the company so resolved upon as aforesaid.

7. The assets and liabilities of the company at all relevant dates were as follows :—

ASSETS.

Share investments (Australia)		£491,306	0 6
Share investments (New Zealand)		3,947	6 8
Share investments (London)		40,217	8 3
British Funding Loan		13,513	12 11
E. S. & A. Bank, London		500	0 0
Sundry Debtors		8,160	9 5
		£557,644	17 9

LIABILITIES.

Capital issued		£350,000	0 0
Reserve Fund	£184,750 0 0		
Profit and Loss Account ..	3,647 5 6		
Revenue Account	19,247 12 3		
		207,644	17 9
		£557,644	17 9

The above reserve account of £184,750 had been built up by transferring to the credit of that account the undistributed income of the company received in various years, and by crediting also to that account amounts representing the face value of 23,047 bonus shares of £1 each fully paid received by the company on 25th August 1921 from British Tobacco Co. (Australia) Ltd. in which the company held shares, and the face value of 84,750 bonus shares of £1 each fully paid received by the company on 8th December 1927 from the British Tobacco Co. (Australia) Ltd.

8. The shares referred to in the resolution set out in par. 5 hereof were duly cancelled and during the year ended 30th June 1929 the company transferred into the name of the appellant and paid to the appellant respectively the following investments and moneys, namely :—

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	Book Value
1,196 shares, British American Tobacco Co. ..	£3,016
22,247 ordinary shares, British Tobacco Co. (Australia) Ltd.	30,220
6,628 preferential shares, British Tobacco Co. (Australia) Ltd.	6,628
185 ordinary shares, Bank of New Zealand 23 " D " long term shares, Bank of New Zealand	296
£1,250 British Funding 4% Loan	1,014
Cash, being 3/40ths of sundry debtors and an adjustment of share fractions ..	649
149 ordinary stock Douglass Securities ..	Nil
37 deferred stock Douglass Securities ..	Nil
	£41,823

8A. Prior to the application to the Supreme Court of Hong Kong as hereinbefore mentioned it was agreed by all the members of the company that such application should be made and if approved by the court that the two shareholders whose shares were to be cancelled should be paid out partly by transferring to them a portion of the company's investments and partly by paying to them a portion of the company's cash, the amount of such investments and cash transferred and paid to them being proportionate to the number of shares in the company held by them and the transfers and payments mentioned in par. 8 were made pursuant to the said agreement.

9. The investments transferred and the moneys paid to the appellant as aforesaid represented three-fortieths of the whole of the property of the company as stated in the books of the company as at 30th June 1928.

10. A similar transfer of investments and payment of moneys representing three-fortieths of the property of the company as stated aforesaid was also made to Mrs. M. L. Wells.

11. The Federal Commissioner of Taxation has treated £15,573 (this sum being arrived at by deducting £26,250, being the face value of the shares held in the company, from the £41,823) as a dividend received by the appellant from the company.

12. On 6th December 1932 the Commissioner of Taxation issued an amended assessment including the said £15,573 as income of the appellant.

13. On 12th January 1933 the appellant lodged objections to the amended assessment as follows :—(*a*) That the assessment is excessive ; (*b*) that the amount of £15,573 alleged to represent dividends from Hafic Ltd. in fact represents part of the value of certain assets received consequent on a reduction in the capital of the company in question, and is not assessable as income ; (*c*) that the amount of £15,573 was not a dividend, bonus or profit distributed by the company within the meaning of sec. 16 of the *Income Tax Assessment Act* 1922-1929 ; (*d*) that the amount of £15,573 was not part of a distribution by the liquidator of a company, and no part of such amount is assessable income under sec. 16B of that Act ; (*e*) that the amount of £15,573 represents part of a capital receipt and as such is not liable to income tax. Alternatively, the *Income Tax Assessment Act* 1922-1929 is unconstitutional and invalid to the extent to which it purports to render the amount liable to taxation ; (*f*) that the rebates allowed are inadequate.

14. On 3rd August 1933 the commissioner disallowed all of the objections.

The question of law reserved for the opinion of the Full Court was whether the said £15,573 or any part of it was assessable or taxable income of the appellant within the meaning of the *Income Tax Assessment Act* 1922-1929 and was properly included in the amended assessment.

E. M. Mitchell K.C. (with him *Bowie Wilson*), for the appellant. This is a case of the extinguishment of shares, as in *British and American Trustee and Finance Corporation Ltd.* v. *Couper* (1). That case sanctions the expenditure of any sum of money the company thinks fit so long as the unreduced capital is intact. On a reduction of capital that depends entirely on the *Companies Act*, and not on the appropriate articles and resolutions. Reduction of capital may legitimately be associated with an arrangement whereby

(1) (1894) A.C. 399.

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the shareholder receives more than the capital which he has contributed upon the shares. The payment made to the appellant was not a distribution of a dividend or profit made to her as a member or shareholder of a company within the meaning of sec. 16 (*b*) (i) of the *Income Tax Assessment Act*; it was a payment or division of assets. The payment was made to the appellant after she had ceased to be a member of the company, and was made in consideration of her having ceased to be a member. This matter is entirely covered by the principle of the decision in *Commissioner of Taxation (N.S.W.)* v. *Stevenson* (1), that is, that the dividend in the sense of sec. 16 (*b*) (i) involves a detachment or liberation of profits and a retention by the shareholder of the shares. It is obvious that the substance of the matter is a transaction whereby the appellant as shareholder agreed to surrender her shares for cancellation in consideration of receiving a sum of money. [He was stopped.]

Weston K.C. (with him *E. F. McDonald*), for the respondent. The whole transaction did not take place under the aegis of the court's order as was suggested. *Couper's Case* (2) was directed mainly to determining whether or not there had to be a ratable reduction, and regard was had to the fairness of the transaction. Here, although there was a reduction of issued capital to some extent, a portion of the money paid to the appellant was not paid to her in reduction of capital (*Hill* v. *Permanent Trustee Co. of New South Wales Ltd.* (3)). The appellant is unable to show that the payment was a return of capital to the shareholders in the strict sense; therefore it must be a division of profits. Sec. 14 of the *Income Tax Assessment Act* 1915-1918, which was under review in *Webb* v. *Federal Commissioner of Taxation* (4), did not contain the word " distributed ", as does sec. 16 (*b*) (i) of the *Income Tax Assessment Act* 1922-1929. That difference is important and renders the case distinguishable; the transaction was, in effect, a transfer of shares, and there had been no detachment of assets. *Commissioner of Taxation (N.S.W.)* v. *Stevenson* (1), also, is distinguishable. There the majority of the justices inclined to the view that if the legislature had intended to tax *de facto* profits in the

(1) *Ante*, p. 80.
(2) (1894) A.C. 399.
(3) (1930) A.C. 720, at p. 731.
(4) (1922) 30 C.L.R. 450.

hands of shareholders it would have so provided in plain terms. The Federal Act means that the individual shareholder shall no longer escape tax by reason of such reasoning as led the court in *Inland Revenue Commissioners* v. *Burrell* (1) to conclude that in a winding up the difference between profits and capital disappeared. The decision in *Clarke* v. *Federal Commissioner of Taxation* (2) did not finally determine whether in a winding up there was taxability under sec. 16 (*b*). On its reasoning *Webb* v. *Federal Commissioner of Taxation* (3) is an authority in favour of the respondent. Sec. 16B taxes the profits, and was meant to displace *Inland Revenue Commissioners* v. *Burrell* (1) and *Webb* v. *Federal Commissioner of Taxation* (3). *Hill* v. *Permanent Trustee Co. of New South Wales Ltd.* (4) contains no limitation in itself but enunciates general propositions. A test is: Did the appellant receive in respect of the shares more than she paid for them? If she did, then the excess must be profit.

[DIXON J. referred to *Rowell* v. *John Rowell & Sons Ltd.* (5).]

Inland Revenue Commissioners v. *Burrell* (1) is not an authority for the proposition that in a winding up any assets or moneys distributed to shareholders are not income; in that case was recognized the propriety of the decisions in *In re Bridgewater Navigation Co.* (6) and *In re Spanish Prospecting Co. Ltd.* (7). The decision in *Commissioner of Taxation (N.S.W.)* v. *Stevenson* (8) is not a decision that sec. 16 (b) does not apply in respect of a company which continues to be a going concern. It is competent for the court to reconsider any dicta expressed in that case. Sec. 16 (*b*) extends to companies which are or are not going concerns, and is extended without the aid of sec. 16B to a company being wound up and to a distribution on a winding up. In *British and American Trustee and Finance Corporation Ltd.* v. *Couper* (9) the important word "purchase" was used only in the sense in which it was used in *Trevor* v. *Whitworth* (10). Here, it is not a purchase in the ultimate reality.

(1) (1924) 2 K.B. 52.
(2) (1932) 48 C.L.R. 56.
(3) (1922) 30 C.L.R. 450.
(4) (1930) A.C. 720.
(5) (1912) 2 Ch. 609, at pp. 620, 621.
(6) (1891) 2 Ch. 317.
(7) (1911) 1 Ch. 92.
(8) *Ante*, p. 80.
(9) (1894) A.C. 399.
(10) (1887) 12 App. Cas. 409.

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E. M. Mitchell K.C., in reply. The agreement and the conditions under which it was to be given effect to show that the transaction was a purchase by the company of the appellant's shares; there was not any distribution of profits within the meaning of sec. 16 (*b*) (*Webb* v. *Federal Commissioner of Taxation* (1)). This was a distribution, retirement and extinguishment of shares held by the appellant (*Commissioner of Taxation* (*N.S.W.*) v. *Stevenson* (2)). *Hill* v. *Permanent Trustee Co. of New South Wales Ltd.* (3) refers to the case of an existing and continuing shareholder.

Cur. adv. vult.

June 6.

The following written judgments were delivered :—

LATHAM C.J. This is a case stated by *Rich* J. under the *Income Tax Assessment Act* 1922-1929 of the Commonwealth. The case raises the question whether portion of certain moneys paid to the appellant during the year ending 30th June 1929 by a company, Hafic Ltd., is income taxable under the Act.

The company was incorporated in Hong Kong with a nominal capital of £1,000,000 divided into one million shares of £1 each. Three hundred and fifty thousand shares were issued and they were all paid up. The appellant was the owner of 26,250 fully paid-up shares, that is, 3/40ths of the shares issued. The appellant and another shareholder with an equal holding of shares were desirous of ceasing to be members of the company. It was agreed between all the shareholders that the two shareholders should be paid out by transferring to each of them 3/40ths of the assets of the company. Accordingly a special resolution was duly passed and confirmed in the following terms :—" That the capital of the company be reduced from £1,000,000 divided into 1,000,000 shares of £1 each of which 350,000 shares have been issued to £947,500 divided into 947,500 shares of £1 each and that such reduction be effected by paying off 52,500 of the issued shares and by cancelling the shares in the company numbered 126,876 to 153,125 and 205,626 to 231,875."

The proposed reduction of capital was duly confirmed by the Supreme Court of Hong Kong.

(1) (1922) 30 C.L.R., at pp. 461, 462. (2) *Ante*, p. 80.
(3) (1930) A.C. 720.

The 52,500 shares specifically mentioned in the resolution were the shares of the two shareholders mentioned. The company owed no debts to any external creditors and its assets were valued at £557,644. These assets consisted of share investments, Government loans, moneys in a bank and moneys owed by sundry debtors. The assets to the extent of £184,750, which was the amount of the company's reserve fund, consisted of certain bonus shares received by the company from a company in which it was a shareholder and of assets representing undistributed profits. The shares referred to in the resolution were cancelled, and the company transferred assets to the appellant to the value of £41,823, representing 3/40ths of the whole of the property of the company. The Commissioner of Taxation has regarded £26,250, the face value of the shares held by the appellant, as representing a return of capital to the appellant, and seeks to tax the appellant in respect of the balance, namely, £15,573, as a dividend, bonus or profit received by the appellant from the company.

The *Income Tax Assessment Act* 1922-1929, by sec. 16, provides (*inter alia*) that " the assessable income of any person shall include . . . (*b*) in the case of a member, shareholder . . . of a company which derives income from a source in Australia or of a company which is a shareholder in a company which derives income from a source in Australia—(i) dividends, bonuses or profits . . . credited, paid or distributed to the member or shareholder from any profit derived from any source by the company."

It is not disputed that the appellant was in the relevant year a shareholder of a company such as is described in this provision. The question is whether the sum of £15,573 is a dividend, bonus or profit credited, paid or distributed to her within the meaning of the section. It is agreed between the parties that the company law in force in Hong Kong is in all relevant particulars the same as that in force in England at the relevant date, and that the case may be treated as if the company were controlled by the English *Companies Act* 1908.

It is well established that a company cannot purchase its own shares (*Trevor* v. *Whitworth* (1)), but what was done in this case

(1) (1887) 12 App. Cas. 409.

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was not strictly a purchase of shares, though it may be loosely described as such. The shares in question were cancelled so that they ceased to exist, and the company paid to the shareholders a sum agreed upon as the value of the shares. The company, however, did not become the owner of the cancelled shares—those shares were extinguished. The validity of such a transaction as a method of reducing the capital of a company is established by *British and American Trustee and Finance Corporation Ltd.* v. *Couper* (1); and see *Palmer's Company Precedents*, 14th ed., vol. I. (1931), p. 1007.

This is not a case of the liquidation of a company, and accordingly the provisions of sec. 16B of the *Income Tax Assessment Act* do not apply. Under that section amounts distributed in a winding up are deemed to be assessable income of shareholders to the extent to which they represent income derived at any time by the company which would have been assessable in their hands if distributed to them by a company not in liquidation, with an exception in the case of profits properly applied in replacement of a loss of paid-up capital.

In my opinion, the sum in question in this case cannot be described as a dividend, bonus or profit which has been credited, paid or distributed to the shareholder within the meaning of sec. 16 (*b*) (i). The sum of £15,573 was derived from profits derived by the company but it was not a dividend, bonus or profit upon a share held by the shareholder. The section contemplates a shareholder who receives a dividend, bonus or profit in respect of a share which remains in existence as representing an interest in the capital of the company. In the present case, the shareholder received the payment as a step in a transaction directed towards the abolition or extinction of her interest in the capital of the company. There was no payment by the company which can be said to represent income upon the interest in the capital of the company represented by the shares which a shareholder continued to hold as a capital interest. The transaction really amounted to a surrender by a shareholder of all capital interest in the company in return for a lump sum payment.

In *Commissioner of Taxation (N.S.W.)* v. *Stevenson* (2), this court recently considered the effect of substantially identical legislation

(1) (1894) A.C. 399. (2) *Ante*, p. 80.

where all the assets of a company which was not in process of liquidation were distributed to the shareholders in proportion to their shareholdings. The decision of the court was that such a distribution of assets, though irregular, could not be regarded as amounting to the crediting, payment or distribution of a dividend to the shareholder. In the judgment of *Rich*, *Dixon* and *McTiernan* JJ. the following statement of the law was made, the case being regarded as in substance, though not in successful legal form, one of liquidation :—" In the liquidation the excess of its assets over its external liabilities is distributed among the shareholders in extinguishment of their shares. The shareholders, in other words, as contributories receive nothing but the ultimate capital value of the intangible property constituted by the shares. The *res* itself ceases to exist. The profits are not detached, released or liberated, leaving the share intact as a piece of property. There is no dividend upon the share. There is no distribution of profits because they are profits. The shareholder simply receives his proper proportion of a total net fund without distinction in respect of the source of its components and he receives it in replacement for his share. Both in the British and American systems of taxation such a transaction is acknowledged to be of a capital nature and to involve no receipt of income " (1).

The principle upon which the judgment is based is stated in short form at p. 103, viz., that the section did not apply to " distributions in retirement or extinguishment of the shares." Accordingly it was held that the transaction was of a capital nature and that it involved no receipt of income within the meaning of the Act. In the present case there has been a " retirement and extinguishment " of the shares. Thus the reasoning in *Stevenson's Case* (2) compels the conclusion that the moneys received by the appellant were not income within the meaning of the only provisions relied upon by the commissioner.

The question asked in the case should be answered in the negative.

STARKE J. Special case stated for the opinion of this court pursuant to the provisions of the *Income Tax Assessment Act* 1922-1929. The facts are stated in detail in the case.

(1) *Ante*, p. 99. (2) *Ante*, p. 80.

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The appellant and Mrs. M. L. Wells were shareholders in the "Hafic" Co., incorporated in Hong Kong. The capital of the company was divided into 1,000,000 shares of £1 each, of which 350,000 shares had been issued and were fully paid up. The appellant and Mrs. Wells each held 26,250 of the issued shares of the company, or each 3/40ths of the issued capital of the company.

The appellant and Mrs. Wells desired to retire from the company, and to effectuate their desire the company reduced its capital by a special resolution as follows :—"That the capital of the company be reduced from 1,000,000 shares of £1 each of which 350,000 shares have been issued to £947,500 divided into 947,500 shares of £1 each and that such reduction be effected by paying off 52,500 of the issued shares and by cancelling the shares in the company" which were held by the appellant and Mrs. Wells. The paid-up capital of the company and its accumulated and undistributed profits were representated by assets of the value of £557,644. The company transferred to the appellant various investments and moneys stated at a sum of £41,823, which was 3/40ths of the whole of the property of the company according to its books. This sum represented £26,250, the return of the capital paid up by the appellant, and the balance made up the 3/40ths share of the appellant in the property of the company. The commissioner deducted the sum of £26,250 from £41,823 and assessed the appellant to income tax for the balance, namely, £15,573, as a dividend received by her from the company.

The question is whether the appellant is assessable to income tax in respect of this sum of £15,573 or any part thereof. It is now settled that the proceeds from the realization of an investment is not income nor assessable to income tax (*Ruhamah Property Co. Ltd.* v. *Federal Commissioner of Taxation* (1)). But the commissioner's contention is that the sum of £15,573 represents the distribution of a dividend to the appellant out of the profits of a company. No doubt the assets of an incorporated company are its property and not the property of the shareholders for the time being (*In re George Newman & Co.* (2)). A shareholder, however, of a company limited by shares of equal amount is entitled to a proportionate

(1) (1928) 41 C.L.R. 148, at p. 151. (2) (1895) 1 Ch. 674, at p. 685.

part in the capital of the company and, unless otherwise provided by the regulations of the company, as a necessary consequence to the same proportionate part in all the property of the company (*Birch* v. *Cropper* (1)). It is a capital interest.

A shareholder has also various other rights and liabilities incidental to the ownership of his shares, namely, a right to vote and to receive dividends when distributed by the company out of its profits. All that the present case presents for our determination is whether the sum of £15,573 represents a capital or an income return to the appellant. Was it a realization of her share investment, or was it detached or severed from the capital funds of the company and liberated or distributed to the appellant as a dividend on the appellant's shares out of the profits of the company ? It is in truth a question of fact and the line is sometimes difficult to draw, though not I think in this case. The appellant and Mrs. Wells desired to withdraw from the company. Both the company and its shareholders acquiesced, and the capital was accordingly reduced. And there were handed over to the appellant, whether regularly or irregularly is unimportant, various investments and moneys of the company equal to the appellant's shareholding in the company according to book values. No dividend was declared nor was any provision made for the distribution of any accumulated profits of the company to other shareholders and none, I gather, was made in point of fact.

In my opinion the sum of £15,573 represents a realization of the share investment of the appellant and is not an income return assessable to income tax. The citation of cases in support of a conclusion of fact is not of much assistance at any time, but those who find comfort in decided cases may seek it in *Webb* v. *Federal Commissioner of Taxation* (2) and *Commissioner of Taxation (N.S.W.)* v. *Stevenson* (3).

The question stated should be answered in the negative.

DIXON J. The appellant held three fortieth parts of the paid-up capital in a family company. At the material time the balance-sheet of the company showed that the assets of the company were not only sufficient to repay the paid-up capital but also represented

(1) (1889) 14 App. Cas. 525, at p. 533.
(2) (1922) 30 C.L.R. 450.
(3) *Ante*, p. 80.

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reserved and undistributed profits amounting almost to sixty per cent of the paid-up capital. The taxpayer and another shareholder whose proportion of the paid-up capital was the same as hers desired to retire from membership of the company. An arrangement was made by which these two shareholders were paid out. Each was paid three-fortieths of the value of the net assets as shown in the balance-sheet; that is to say, each received almost one hundred and sixty per cent of her paid-up share capital. The question for decision is whether the extra sixty per cent represents income of the appellant prima facie liable to inclusion in her assessment as assessable income.

To give effect to the arrangement a special resolution was passed by the company that its capital should be reduced and that the reduction should be effected by paying off six-fortieths of the issued shares and cancelling shares specified by number, namely, the shares of the two retiring members. The special resolution was passed pursuant to an article of association authorizing the company to reduce its capital, and it was duly confirmed by the court. As a matter of company law the transaction rests on the power of reducing capital given, or at any rate regulated, by statute. It does not amount to the exercise of two independent powers, or the combination of two distinct transactions, that is, to the repayment of the paid-up capital on reduction and the distribution of part of an accumulated surplus by way of dividend, bonus or otherwise as and for a share of profits.

The nature of the transaction in the contemplation of company law is perhaps best seen from an extract from a note in the second edition of *Halsbury's Laws of England*, giving the effect of some unreported cases:—"The decision that the power to confirm a reduction of capital by affecting only some of the shares is legal (*Re Gatling Gun Ltd.* (1)) has been approved by the House of Lords in *British and American Trustee and Finance Corporation* v. *Couper* (2), where the reduction involved the cancellation of the shares of all the American shareholders, who were to take over the American investments of the company in consideration for which the company, which would then consist only of English shareholders, was to retain

(1) (1890) 43 Ch. D. 628.

(2) (1894) A.C. 399.

the English assets. The case has been followed in numerous unreported decisions. In *Re Bowman, Thompson & Co.* (*Cozens-Hardy* J., 24th June 1889) the shares of founders were cancelled in consideration of a purchase price far exceeding their nominal value, paid out of reserve profits. In *Re Knowles Ltd.* (*Neville* J., 1908) a firm which had amalgamated with two companies on the terms that they should receive paid-up capital for the assets which they brought in on desiring to go out, were allowed to surrender their shares on the terms that the works and other assets which they had brought in should be given back to them. And in *Re Hamlyn Brothers Ltd.* (*Warrington* J., December 1908) a reduction by cancelling the paid-up shares of a director was confirmed on his being released from a debt to the company of a smaller amount" (*Halsbury, Laws of England*, 2nd ed., vol. 5, p. 174, note *l*).

The question whether any of the amount paid to the shareholder in excess of a full return of the amount of paid-up capital forms part of her assessable income depends upon sec. 16 (*b*) (i) of the *Income Tax Assessment Act* 1922-1929. Under this provision the assessable income of any person includes, in the case of a member or shareholder of a company which derives income from a source in Australia, or of a company which is a shareholder in a company deriving income from such a source, dividends, bonuses or profits credited, paid or distributed to the member or shareholder from any profit derived from any source by the company. The generality of the clause is qualified by certain provisos, but they do not affect the present question.

The contention of the commissioner is simply that the sixty per cent in excess of the amount paid up in respect of the shares represents profits and that the amount received by the appellant from the company therefore included profits paid or distributed to her as a member within the meaning of the provision.

Upon the analogous clause of the New South Wales *Income Tax (Management) Act* 1928 a majority of this court decided that almost identical expressions ought not to be construed as covering all distributions in a liquidation, and further that they did not extend to an irregular division among the shareholders of the entire assets of a company in intended satisfaction of the share interests of the

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THORNETT v. FEDERAL COMMISSIONER OF TAXATION.

Dixon J.

members (*Commissioner of Taxation (N.S.W.)* v. *Stevenson* (1)). *Rich* and *McTiernan* JJ. and myself were of opinion that the provision did not bear the meaning that every distribution containing profits, or moneys traceable to profit, should form part of the shareholder's assessable income notwithstanding that the distribution extinguished the share and replaced it by payment of its capital value or equivalent in assets. We thought that it meant to include all distributions or detachments of profit by a company as a going concern but not distributions in retirement or extinguishment of the shares. *Evatt* J. said: "It is obvious that the 'income' which has its source in a company share does not include what the shareholder receives in final replacement of the rights represented by the share itself. If the share is regarded as the fund, the income from the share is the flow or product of the fund. But what is received at the time of the liquidation in exchange for the fund itself cannot be regarded as flowing from, or produced by, the fund" (2).

Sec. 16 (*b*) (i) of the Federal *Income Tax Assessment Act* 1922-1929 must, in my opinion, receive the same construction. The only attempt made to distinguish the two provisions was based on the existence in the Federal statute of sec. 16B, introduced in 1928, which expressly provides that a distribution made by a liquidator in the course of a winding up is assessable income of the shareholders to the extent that it represents profits which if distributed by a company not in liquidation would be deemed assessable income of the members. To my mind the tendency of the introduction of this provision into the statute is to confirm, and not to negative, the view that sec. 16 (*b*) (i) would not carry the same consequence.

The interpretation expressed in the passages in the majority judgments in *Stevenson's Case* (1), to which I have referred, appears to me necessarily to leave the whole amount received by the appellant in the present case outside the operation of sec. 16 (*b*) (i). The appellant received an entire and indivisible sum representing the value of her shares, that is, her interest in the company. It was paid and received in satisfaction of, and by way of replacement for, her share interest. It terminated her interest and extinguished the

(1) *Ante*, p. 80. (2) *Ante*, p. 108.

property or choses in action which it replaced. In my opinion none of the sixty per cent excess over the paid-up capital held by her in the company forms part of her assessable income.

The question in the special case should be answered: No.

Question answered: No. Case remitted. Costs to be costs in the appeal.

Solicitors for the appellant, *Stephen, Jaques & Stephen.*

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

J. B.