[HIGH COURT OF AUSTRALIA.]

DICKSON . . . . . APPELLANT;

AND

THE FEDERAL COMMISSIONER OF TAXATION . . . . . RESPONDENT.

H. C. OF A 1939-1940.

MELBOURNE, 1939, *Mar* 23, 24; *June* 2.

McTiernan J.

Oct. 31; *Nov.* 1, 2.

1940, *Feb.* 21.

Latham C.J., Dixon and Evatt JJ.

Income Tax (Cth.)—Assessable income—Dividend—Unrealized profits—Issue of bonus shares—Revaluation of fixed assets—Income Tax Assessment Acts 1936 (*Nos.* 27 *and* 88 *of* 1936), *secs.* 6, 44 (2) (*b*) (iii)*.

For many years, the A Co. had owned 117,414 shares in the B Co., and its balance-sheets throughout had shown these shares at their actual cost. In December 1934 the B Co. out of undistributed profits allotted the A Co. 58,707 fully paid-up shares by way of bonus, making a total holding of 176,121 shares, which were shown on 30th September 1935 in the next balance-sheet of the A Co. at the same figure as the cost of the original 117,414 shares. After this distribution of shares, and with the intention of issuing bonus shares to its members so that they would not be taxable as income, the A Co. had its holding in the B Co. revalued by accountants, who certified that each share was worth not less than 24s. Although worth considerably more than 24s., the B Co's. shares were on 11th October 1935 taken into the accounts of the A Co. at 24s. each, and, out of the profit arising from that revaluation, bonus shares were issued to members of the A Co. In assessing a member of the A Co. to income tax, the Federal Commissioner of Taxation included in his income the bonus shares so received by him.

*The *Income Tax Assessment Acts* 1936 provided:—By sec. 6, that "'dividend' includes . . . the paid-up value of shares distributed by a company to its shareholders to the extent to which the paid-up value represents a capitalization of profits," and "'paid' in relation to dividends includes credited or distributed." By sec. 44 (2), that the assessable income of a shareholder in a company "shall not include dividends . . . (*b*) paid wholly and exclusively out of . . . (iii) profits arising from the revaluation of assets not acquired for the purpose of resale at a profit or from the issue of shares at a premium, if the dividends paid from such profits are satisfied by the issue of shares of the company declaring the dividend."

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

Held, by *Latham* C.J. and *Evatt* J. (*Dixon* J. dissenting), that, although, by virtue of sec. 6 of the *Income Tax Assessment Acts* 1936, the paid-up value of the bonus shares was a "dividend" which ordinarily would be included in the member's assessable income, it was a "dividend" which was "paid wholly and exclusively out of . . . profits arising from the revaluation of" the 176,121 shares, which were "assets" of the A Co. "not acquired for the purpose of resale at a profit," and accordingly the paid-up value of the bonus shares did not form part of the member's assessable income, being excluded therefrom by sec. 44 (2) (*b*) (iii) of the Act.

Decision of *McTiernan* J. reversed.

APPEAL from *McTiernan* J.

Raynes Waite Stanley Dickson appealed to the High Court from a decision of the Deputy Commissioner of Taxation whereby he disallowed objections made by the appellant to an assessment made upon him in respect of income tax based upon income derived during the year ending 30th June 1936. The appeal was heard by *McTiernan* J., in whose judgment hereunder the material facts appear.

Fullagar K.C., *Coppel* and *Ellis*, for the appellant.

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

Cur. adv. vult.

1939, June 2.

McTIERNAN J. delivered the following written judgment:—

The appellant, who at all material times was a shareholder in the Castlemaine Brewery Co. Melbourne Ltd., was allotted by the company 801 fully paid shares during the financial year ending 30th June 1936. The assessment of Federal income tax on income received by the appellant during this financial year is governed by the Federal legislation which is to be cited as the *Income Tax Assessment Acts* 1936. Sec. 6 of the Act says that, unless the contrary intention appears, "dividend" includes any distribution made by a company to its shareholders, whether in money or property, and any amount credited to them as shareholders, and that it also includes the paid-up value of shares distributed by a company to its shareholders to the extent to which the paid-up value represents a capitalization of profits. The parcel of bonus shares which the appellant received was a dividend within the meaning ascribed to the word by this

section. Sec. 44 (1) (*a*) provides, in the respects which are material, that the assessable income of a shareholder in a company shall, subject to the section, include dividends paid to him by the company out of the profits derived by it from any source. The parcel of bonus shares was, therefore, assessable income unless excluded by sub-sec. 2 of sec. 44. The appellant's objection to the inclusion of the shares in his assessable income is based upon sec. 44 (2) (*b*) (iii), which provides that "the assessable income of a shareholder shall not include dividends paid wholly and exclusively out of profits arising from the revaluation of assets not acquired for the purposes of resale at a profit or from the issue of shares at a premium if the dividends paid from such profits are satisfied by the issue of shares of the company declaring the dividend."

The Castlemaine company had assets consisting of shares in the Carlton and United Breweries Ltd., which it is admitted were not acquired for the purpose of resale at a profit. The appeal turns on the question whether the amount which the Castlemaine company applied in order to pay up in full the bonus shares allotted to the appellant and the other shareholders who participated in the distribution was paid wholly and exclusively out of the profits arising from the revaluation of these assets.

The Castlemaine company had, at 30th September 1934, 117,414 shares in the Carlton and United Breweries Ltd. These shares were taken into its balance-sheet as at that date at cost, the value represented being £119,861. The shares were made up of the following lots: 102,500 fully paid-up shares of £1 each, which were allotted in July 1907 in consideration of the transfer of certain assets to the Carlton and United Breweries Ltd.; 5,125 fully paid-up preference shares of £1 each, which were allotted in February 1913 in consideration of the payment of £5,125; and 9,789 fully paid-up preference shares of £1 each, which were allotted in December 1924 in consideration of the payment of £12,236 5s., these shares having been issued at a premium of 5s.

In December 1934 the Carlton and United Breweries Ltd. allotted to the Castlemaine company, by way of bonus, 51,250 fully paid-up ordinary shares of £1 each and 7,457 fully paid-up preference shares of £1 each. This allotment increased the number of shares held by

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

McTiernan J.

the Castlemaine company in the capital of the Carlton and United Breweries Ltd. from 117,414 to 176,121, but in the Castlemaine company's balance-sheet as at 30th September 1935 the total holding of 176,121 shares was taken in at £119,861, which is the value at which 117,414 shares appear in the balance-sheet for the previous year. The Castlemaine company then made an alteration in the amount at which the value of its total holding of shares in the Carlton and United Breweries Ltd. was stated in the balance-sheet of 30th September 1935. The appellant claims that this alteration, which was an upward revision of that amount, was a revaluation of the 176,121 shares which disclosed a surplus available for distribution to the shareholders. Since the various issues of shares forming the total of 117,414 had been allotted to the company, they had appreciated in value, and the amount at which they appeared in the balance-sheet as at 30th September 1934 was an understatement of their value. This was, nevertheless, a genuine valuation of those shares, and a revaluation of them would have disclosed a large surplus. By taking the 176,121 shares into the balance-sheet of 30th September 1935 at £119,861, which was the valuation of the 117,414 shares, the company wrote down the value of the shares to a figure which, as the evidence shows, was equivalent only to two-thirds of their cost. This balance-sheet represents the value of the shares of the Carlton and United Breweries Ltd. at substantially below par, whereas they could have been sold then at a considerable premium. The Castlemaine company then substituted a valuation at the rate of 24s. per share for the value at which the 176,121 shares were represented in the balance-sheet of 30th September 1935. The appellant's contention is that the amount of the difference between the sum of £119,861, at which the 176,121 shares are represented in that balance-sheet, and a valuation of the shares at the rate of 24s. per share, is profit arising from a revaluation of the 176,121 shares.

The valuation of the 117,414 shares at cost was undoubtedly a genuine valuation. The appellant justifies the retention of the sum of £119,861 as the figure at which the increased holding should be represented in the balance-sheet of 30th September 1935, by the proposition that the allotment of bonus shares to a shareholder

does not necessarily add to his wealth. This proposition is not universally true of every allotment of bonus shares by any company. An addition of bonus shares to those already held by a shareholder may increase the value of his holding of shares in the company. I am satisfied in this case that the value of the holding which the Castlemaine company had in the Carlton and United Breweries Ltd. was substantially increased by the allotment to it of 58,707 bonus shares in December 1934. The Act, however, does not lay down any criterion of valuation for the purposes of sec. 44. The Castlemaine company might have valued the increased holding of shares at the sum of £119,861 if it determined to adopt a conservative valuation. The company was entitled to act upon its own views about the amount of future dividends which would be paid by the other company and other matters which it considered would affect the value of the shares it held in that company. But I am not satisfied that the Castlemaine company did truly value its holding of 176,121 shares at £119,861, although its balance-sheet stated that amount as the value of the shares. The inference that I draw from the evidence adduced on behalf of the appellant is that, when the 176,121 shares were taken into the balance-sheet at £119,861, the Castlemaine company did not value the shares at that amount, but had determined that the shares were worth not less than 24s. each. It is not the case that the company, having taken the 176,121 shares into the balance-sheet at £119,861, found that, by reason of the appreciation in value of the shares, the value was under-stated, and made a revaluation of the shares at 24s. each, thus disclosing a surplus for distribution among the shareholders. The inference which I draw from the evidence is that the valuation of £119,861 was retained for the increased holding of shares, not because it represented the valuation which the company then placed upon its total holding of shares, but as a step in a scheme to disclose a predetermined surplus, which would be produced by writing up the value of the shares to 24s. each. The company did not alter the value of the shares to this figure because they had appreciated in value above the figure at which they were previously stated. The so-called valuation at £119,861 and the so-called revaluation at 24s. per share were figures selected by the company in order to

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

McTiernan J.

produce the surplus which it determined to distribute by way of bonus shares amongst its shareholders and in the distribution of which the appellant was allotted the bonus shares now in question.

In November 1934, before making the issue of bonus shares (which were allotted in December 1934), the Carlton and United Breweries Ltd. sent a circular to its shareholders about this bonus issue. A general meeting of the shareholders of the Castlemaine company was held on 4th December 1934. The appellant, who was chairman of directors of the company, presided at the meeting and made a speech in which he explained to the shareholders the provisions of the *Income Tax Assessment Act* with respect to the taxation of bonus shares, and informed the shareholders that £975,000 of the undivided profits of the Carlton and United Breweries Ltd. would be capitalized by that company and issued as bonus shares before the end of the year, and that the Castlemaine company would receive under that scheme 51,250 ordinary shares fully paid up to £1 and 7,457 preference shares fully paid up to £1, on which no Federal or State taxes would be payable. In the course of his speech the appellant also said :—" These shares, of course, will be allotted to our company and will not go to individual shareholders, but your directors will subsequently consider at some convenient period next year the advisability of revaluing the assets of our company and of issuing bonus shares to our shareholders individually in respect to such valuation. As at present advised such assets which will be so revalued were not acquired for the purpose of resale at a profit, and the dividend arising therefrom, which will be issued in the form of bonus shares, will be free of Federal and State income tax in the hands of shareholders, but may be subject to State unemployment tax and special State tax. Even so, it will, in my opinion, be well worth doing. This, however, is a matter for the future, and when the directors have formulated their proposals, they will be placed before shareholders." The appellant objected to the admission of this speech in evidence. In my opinion, it is admissible. It explains the motive which induced the Castlemaine company to take the action which is described as the revaluation of the assets of the company. I should not infer from that speech by itself that the alteration in the stated value of the company's holding in the Carlton

and United Breweries Ltd. was not a genuine revaluation of those assets. It was not improper to take such action as was necessary to make any dividend which the Castlemaine company proposed to distribute among its shareholders free from income tax. But, reading the speech with the evidence of subsequent action taken by the directors, it is, in my opinion, relevant evidence on the question whether the alteration of the value of those assets was a genuine revaluation or a scheme for passing on to its shareholders, in the guise of profits arising from a revaluation of assets, the profits which the Castlemaine company received from the Carlton and United Breweries Ltd. as bonus shares. In my opinion, it supports the inference that the alteration of the value of the company's holding of shares was not a revaluation of those assets.

It has been stated that Carlton and United Breweries Ltd. made the allotment of the 58,707 bonus shares to the Castlemaine company in December 1934. The latter company received the scrip in that month or in January 1935. The secretary of the company, who was called as a witness on behalf of the appellant, gave evidence that the scrip was not entered in the books of the company. The additional shares appeared for the first time in the balance-sheet of 30th September 1935, in which they were treated as not having added any value to the company's holding of shares in the Carlton and United Breweries Ltd. But in August 1935, the directors decided to instruct the auditor to make a valuation of the company's shareholding in the Carlton and United Breweries Ltd. Two letters, each of which is dated 9th October 1935, from the auditor and another firm of accountants to the chairman of the Castlemaine company, were produced by the secretary of the company. Both documents are in these terms: "As requested, we have made a revaluation of the shares held by your company in the Carlton and United Breweries Ltd., and certify in our opinion these shares are worth not less than 24s." The minute of the directors' meeting of 16th August 1935 shows that they decided to instruct the auditor to "make a valuation" of the shares. There is no record of any decision to instruct any other valuer. It may be observed that the minute says that it was decided to instruct the auditor to make "a valuation." The documents produced assert that the writers were

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

McTiernan J.

requested to make a " revaluation." The secretary says that verbal instructions were given to them but no written instructions. This witness, however, admitted that both valuers were instructed to supply a valuation in a certain form. He was asked whether they (the company's auditor and the other valuer who was an " outside accountant ") were asked " to value " the Carlton and United Breweries Ltd. shares, or whether they were asked " to say whether they were worth not less than 24s." The witness replied: " I should say it was obvious from the report that they were asked the second question." The witness admitted that the documents dated 9th October 1935, which are in identical terms, were furnished to the company after collaboration between their respective authors. It is quite inconsistent with the evidence which reveals how the letters of 9th October 1935 were obtained to say that the directors entertained the opinion that the amount at which the shares were taken into the balance-sheet of 30th September 1935—which represented only two-thirds of the par value of the shares—was in any sense a valuation of the shares. The secretary deposes that the directors instructed him to take the 176,121 shares into that balance-sheet at the amount of £119,861. In the course of his evidence, the witness said that the " mere " fact (he emphasized the word " mere ") of an issue of bonus shares would not justify a " writing up " of the value of the total holding of shares which a company or a person held. I am not satisfied that the figure at which the shares of the Castlemaine company, held in the other company, were taken into the balance-sheet of 30th September 1935 was adopted in obedience to that principle. The difficulty which confronts the appellant is to show any justification for writing down the value of the shares below par. I do not think he surmounted the difficulty. The inference which I draw from the evidence is that the figure at which the shares were represented in that balance-sheet was a fictitious valuation. It has no reference to any admissible criterion of value. It should be observed that the secretary swore that he did not consider that any one share held in the Carlton and United Breweries Ltd. at that date was worth less than 20s., and that any person who considered the matter at that date would have thought likewise. The appellant objected to this evidence and the evidence

of a witness who was called by the respondent on the question of the value of the shares. I think that this evidence was relevant to the issue whether the figure at which the total holding of shares was taken into the balance-sheet of 30th September 1935 was a real valuation or a sham. The valuation of a company's assets is not necessarily fictitious because it does not approximate to current market opinion or the theoretical opinion of an expert in share values. The directors may, in the exercise of a cautious discretion, determine on a figure which widely differs from the opinion of markets or experts. In the present case, however, the directors' instructions which produced the letters of 9th October 1935 refute the idea that they had any belief that the figure at which the shares were taken into the balance-sheet was anything but a sham valuation. I think, therefore, that the evidence of the secretary and the other evidence of value are admissible as tending to expose the sham and to attack the figure at which the balance-sheet represented the shares as a pretended valuation.

After the letters of 9th October 1935 came to hand the next step of which there is evidence was the passing by the directors on 11th October 1935 of resolutions in the following terms :—" Resolved that a revaluation of the company's holding of 176,121 shares in the Carlton and United Breweries Ltd. having been made by the company's auditors, Messrs. Cook, Tomlins & Mirams, chartered accountants (Aust.) and by Messrs. Runting & McDonald, chartered accountants (Aust.) wherein both parties valued the shares at not less than 24s. per share, the shares be taken to account in the company's books at a value of 24s. each and the amount by which this valuation exceeds the present book value of these shares, namely, £91,483 19s., be credited to an assets revaluation reserve account. Resolved that extraordinary general meetings of shareholders be called for the purpose of considering and if thought fit passing the necessary resolutions (*a*) to increase the capital of the company to £262,500 by the creation of 100,000 new shares of 17s. 6d. each ranking for dividend and in all other respects *pari passu* with the existing 200,000 shares of the company."

Another meeting of the directors was held on 25th October 1935, at which the following resolutions were passed : " That the directors

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

McTiernan J.

recommend to the shareholders that the sum of £87,500 being part of the profits arising from the revaluation of shares (not acquired for the purpose of resale at a profit) held by the company in the Carlton and United Breweries Ltd., carried to assets revaluation reserve account forming part of the undivided profits of the company which are not required for paying dividends be capitalized and distributed amongst the holders of the shares in the company on the footing that they became entitled thereto as capital and for this purpose that the capital of the company be increased to £262,500 by the creation of 100,000 new shares of 17s. 6d. each and that the said sum be applied in payment in full of the 100,000 new shares, such shares to be allotted to the holders on the twelfth day of November 1935 in the proportion of one new share for every two shares held ; that in furtherance of the direction to call extraordinary meetings as provided at the last meeting of directors extraordinary general meetings to pass the necessary resolutions to give effect to the above recommendation be held ; that contingent on the increase of the capital to £262,500 divided into 300,000 shares of 17s. 6d. each it be recommended to shareholders that the capital be reduced to £225,000 divided into 300,000 shares of 15s. each and that such reduction be effected by returning capital to the extent of 2s. 6d. per share and by reducing the nominal amount of each of the said shares from 17s. 6d. to 15s. and that the necessary application be made to the court for its sanction thereto."

Subsequently these resolutions were adopted and carried out, and the appellant received as his quota the parcel of bonus shares the subject of this appeal. It has been shown that " the present book value of the shares " referred to in the minute was £119,861, the figure which appeared in the balance-sheet of 30th September 1935. In truth, that balance-sheet did not attribute any value to the additional 58,707 shares allotted in December 1934. It failed to do so because the shares held by the Castlemaine company had not at that date depreciated in value below par and the par value of these shares, namely, the shares held by the company before it received the 58,707, was the sum of £119,861. The revision of this fictitious figure is not a revaluation of that asset. That the directors were rather merely altering book values than revaluing the assets

is demonstrated further by the following evidence of the secretary given in cross-examination :—

" Q. Can you tell me why 24s. per share was the figure ? Perhaps I should read the wording : ' As requested, we have made a revaluation of the shares held by your company in Carlton and United Breweries Ltd. and certify that in our opinion these shares are worth not less than 24s. per share.' Why the 24s. ? A. I had at an earlier stage worked out the bonus issues that my company could make at different values of the Carlton and United Breweries shares, and before the directors would revalue these shares, they desired expert opinion as to whether the values which would allow for one to two bonus issues could be justified.

" Q. And so you worked out the 24s. so as to allow for a bonus issue of one to two ? A. That is correct.

" Q. You did that yourself ? A. I did that myself.

" Q. And told the directors that if the shares were written up to 24s. that would allow sufficient for your bonus issue of that nature ? A. That is correct.

" Q. When did you tell them that ? A. About July 1935."

It is not necessary to say whether 24s. per share was a fair appraisement of the shares as fixed assets of the company. But I am not satisfied that it had the character of a revaluation which took the place of a genuine valuation of the assets of the company. The appellant has, in my opinion, failed to prove that the sum of £91,483 was wholly profit arising from a revaluation of the shares. I am not satisfied that the shares were allotted in satisfaction of a dividend paid wholly and exclusively out of profits arising from a revaluation of assets not acquired for the purpose of resale at a profit.

The appeal should be dismissed.

From this decision the appellant now appealed to the Full Court.

Fullagar K.C. (with him *Coppel* and *Ellis*), for the appellant. Although the bonus issue to the appellant would come within the definition of " dividend " in sec. 6 of the *Income Tax Assessments Act* 1936, it does not constitute assessable income (sec. 44 (2) (*b*) (iii)). The profits arise, not from the bonus issue of the Carlton company, but from a revaluation of the assets of the Castlemaine company. The

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

fact of a bonus issue by the Carlton company shows that the holding in Carlton company had been undervalued prior to the new issue. The property had been there for years but the revaluation does not alter the property. The judge's finding that the revaluation was a sham was wrong and is opposed to the evidence. The commissioner cannot disregard what the company has done (*Burland* v. *Earle* (1), per Lord *Davey*; *Inland Revenue Commissioners* v. *Blott and Greenwood* (2), per Lord *Haldane*; *Inland Revenue Commissioners* v. *Fisher's Executors* (3)).

Ham K.C. (with him *Tait*), for the respondent. The question is whether the valuation was made up for the purpose of the account or whether it is a figure merely put down for the purpose of comparison with another figure. From 1924 the shares were carried through at cost in pursuance of a conservative policy, and that may be treated as the value up to 1934. Income-tax Acts are not concerned with values placed on assets. If we find that there had been no issue of shares by the Carlton company, and if it were then decided to write the original shares up, and it were to appear that there was a difference in two values, then the company would be perfectly entitled to show it and issue shares from the difference. But, here, the gravamen of the judgment is the finding that the revaluation was a sham. Then either the Castlemaine company never took the bonus shares into books of account at all at any relevant time (that is, the company got the shares in January 1935 and did not enter them in the ledger accounts at all but entered them into assets revaluation reserve account some time later in October 1935), or if it did, then the valuation was not a genuine valuation (that is, the figure in the 1935 balance-sheet was a sham). For the purpose of income tax, the motive may be the determining factor. The problem then is: Was this a valuation or was it a sham? *McTiernan* J. found the latter in the respondent's favour, and there was evidence to support it. The figure of 13s. 4d. per share set out in the balance-sheet in September 1935 was not the value of the shares at any relevant time; therefore, it must have been a sham.

(1) (1902) A.C. 83, at p. 93.
(2) (1921) 2 A.C. 171, at pp. 184, 185.
(3) (1926) A.C. 395, at p. 407, per Lord *Shaw*; at pp. 411-413, per Lord *Sumner*.

The standard of reality or genuineness of a valuation is the test required by the *Companies Act*; that is, the balance-sheet shall show the true financial position of a company. The profit was derived at least in part from a new benefit received and not exclusively from a revaluation (*Swan Brewery Co. Ltd.* v. *The King* (1)). It is an advantage to water the stock. Expectation of dividends determines the value of the assets. *Blott's Case* (2) accepts *Swan Brewery Case* (3) as correct. What was done by the Castlemaine company was that (i.) no valuation of the bonus shares, or (ii.) no valuation of any shares, was made. Alternatively (iii.) there was not a proper valuation by the Castlemaine company, (iv.) there was not an appraisement by the directors of the value of the shares such as was proper to put it into a balance-sheet as a value of the shares. The taxation authority is not concerned with values put on properties but is concerned where valuations and revaluations are made to obtain a benefit free from taxation. On the facts no one could urge that the values were accurately set out in the balance-sheet, and, unless they were so set out, there was no revaluation at all.

[DIXON J. referred to *Executor, Trustee and Agency Co. of South Australia Ltd.* v. *Deputy Federal Commissioner of Taxation* (*S.A.*) (4).

[EVATT J. referred to *Eisner* v. *Macomber* (5).]

Suppose there was no new issue, the company could not put a value of shares at 24s. when they were really 40s. and then write them down to write them up again subsequently, to make a profit by revaluation. The judge's findings of fact should not be disturbed.

Coppel, in reply. Sec. 44 of the *Income Tax Assessment Acts* 1936 clearly contemplates a book value at a figure less than the correct market value. Revaluation is a well-known commercial expression meaning to write up. If that is so, then no qualification, except as company law would prescribe, is to be placed on the subsequent value. Any figure which the company could lawfully have in its books is a starting point to compare with a subsequent figure. The only question then is whether the directors were justified in taking

(1) (1914) A.C. 231, at p. 235.
(2) (1921) 2 A.C., at pp. 188, 202.
(3) (1914) A.C. 231.
(4) (1928) 41 C.L.R. 299, at p. 309.
(5) (1919) 252 U.S. 189 [64 Law. Ed. 521].

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

the total holding in Carlton company at the same figure as previously shown before the bonus issue. All they did was to show that holding at the cost to the Castlemaine company. Always in ascertaining how the sub-section operates, you must find a cause of the profit, assuming that it arises from the comparison of two figures, the later in time being an appreciation on the former. As far as the identity of assets are concerned, assets disclosed in the 1935 balance-sheet and revalued eleven days later are the same. The assets valued in the 1935 balance-sheet were 176,121 shares (including the bonus shares); these were revalued at 24s. per share.

Cur. adv. vult.

1940, Feb. 21. The following written judgments were delivered :—

LATHAM C.J. In an assessment of the appellant, Mr. Raynes W. S. Dickson, under the *Income Tax Assessment Acts* 1936, 801 bonus shares received by him from the Castlemaine Brewery Company Melbourne Ltd. were included in his income for the year ended 30th June 1936. Sec. 6 of the Act provides that "dividend" includes, *inter alia*, the paid-up value of shares distributed by a company to its shareholders to the extent to which the paid-up value represents a capitalization of profits. The shares issued to the appellant represented a capitalization of profits. Prima facie, therefore, they were dividends within the meaning of the Act. Sec. 44 provides that the assessable income of a shareholder in the company shall, subject to the section, if the shareholder is resident (as the appellant was), include dividends paid to him by the company out of profits derived by it from any source. But sub-sec. 2 of sec. 44 provides that "the assessable income of a shareholder shall not include dividends . . . (*b*) paid wholly and exclusively out of one or more of the following . . . (ii) profits arising from the sale or compulsory resumption for public purposes of assets not acquired for the purpose of resale at a profit; (iii) profits arising from the revaluation of assets not acquired for the purpose of resale at a profit or from the issue of shares at a premium, if the dividends paid from such profits are satisfied by the issue of shares of the company declaring the dividend." This section recognizes that profits may arise which are of a capital nature and

assumes that they may properly be used for paying dividends (*Ammonia Soda Co.* v. *Chamberlain* (1))—and see *Verner* v. *General and Commercial Investment Trust* (2) ; *Lee* v. *Neuchatel Asphalte Co.* (3). The sub-section is limited to capital profits by the words "assets not acquired for the purpose of resale at a profit." If profits arise from the sale of such assets, then, under sec. 44 (2) (*b*) (ii), the dividend may be paid in cash and yet not be assessable. But if the profits arise from revaluation of such assets, then the dividends are excluded from assessment only if they are satisfied by the issue of shares of the company declaring the dividend (sec. 44 (2) (*b*) (iii)). In *Laws of England*, 2nd ed., vol. 5, p. 393 (*f*), it is said, with reference to the payment of dividends by a company : "The question whether accretions to capital can be distributed when they are unrealized but proved to exist has not been decided." The section assumes that such a distribution can properly be made. In the present case, the court is not, I take it, concerned with the doubt suggested by the passage which I have quoted. If a distribution of bonus shares in fact falls within the terms of the section, the shares cannot be taxed as income under the Act, whatever view may be taken upon the question mentioned.

The commissioner assessed the taxpayer upon the basis that the shares were included in his income. The taxpayer objected that the 801 shares were not assessable dividends within the meaning of the Act because they were shares the issue of which satisfied dividends which were paid wholly and exclusively out of profits arising from the revaluation of certain assets, namely, shares in the Carlton United Breweries Ltd., which had not been acquired for the purpose of resale at a profit. The objection was disallowed and the taxpayer appealed to the High Court. Upon the appeal *McTiernan* J. held that the profits which were the source of the dividends which were satisfied by the issue of the bonus shares did not arise from a real revaluation of assets and dismissed the appeal. The taxpayer has appealed to the Full Court.

The Castlemaine Brewery Company Melbourne Ltd. was a holding company and, from 1902 to 1934, owned 117,414 shares in the

(1) (1918) 1 Ch. 266. (2) (1894) 2 Ch. 239.
(3) (1889) 41 Ch. D. 1.

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

Latham C.J.

Carlton and United Breweries Ltd. In 1934 the Carlton United company took advantage of legislation which enabled it to distribute £975,000 out of accumulated profits in the form of bonus shares without the imposition of any liability in respect of income tax upon the shareholders. The Castlemaine company received 58,707 shares from the Carlton United company when this distribution was made. The Castlemaine company then owned 176,121 shares in the Carlton United company. The 117,414 shares had throughout, that is, from 1902 to 1934, been valued at cost, namely, £119,861, although it is not disputed that the value of the shares had greatly increased since 1902. When the new shares were received from the Carlton United company, nothing further was paid for them, and the total number of new and old shares, namely, 176,121 shares, was still taken into account in the balance-sheet of the Castlemaine company at £119,861. The directors of the Castlemaine company, being fully aware of the provisions of sec. 44 of the Act, informed the shareholders that they proposed to consider taking advantage of the section so as to make a distribution of bonus shares which would not be taxable as income in the hands of the shareholders. In order to accomplish this result it was necessary under the section to have a revaluation of the shares. It was necessary to determine the basis upon which new shares should be issued, and the directors ascertained the amount of profits which it would be necessary to distribute in order to issue one fully paid bonus share for every two existing shares. An arithmetical calculation showed that if the 176,121 shares (new and old) were valued at 24s. each, the excess of the total value of the shares over the amount of £119,861 would be sufficient to provide for a bonus issue of fully paid shares in the proportion of one for two. The auditors of the company and another firm of accountants were, in effect, invited to state whether the shares, that is, the 176,121 shares, were worth not less than 24s. The reports of the two firms of accountants, which were in the same terms, stated that a revaluation of the Carlton United shares held by the Castlemaine company had been made, and certified that, in their opinion, "these shares are worth not less than 24s." The directors then directed that the shares should be taken into account at 24s. each. This was done. The result was that the value of the

shares was, according to the accounts of the company, shown as increased by £91,483, out of which a sum of £87,500 was capitalized, and fully paid bonus shares representing this amount were issued to the shareholders. As already stated, the taxpayer received 801 of these shares. *McTiernan* J. dismissed the appeal substantially upon the ground that there had been no genuine revaluation of the Carlton United shares held by the Castlemaine company, but that the figure of 24s. had been adopted merely in order to pretend that there was a revaluation, so as to take advantage of sec. 44 (2) (*b*) (iii) of the Act.

The articles of association of the Castlemaine company provide for the issue of bonus shares in certain cases. In the present case the provisions of the relevant article, art. 101 (*d*), were observed. A recommendation of the directors for the issue of the bonus shares was made, and a general meeting authorized and directed the directors to apply the sum of £87,500 on behalf of the holders of shares in paying up in full 100,000 unissued shares of 17s. 6d. each which were proposed to be issued. The directors acted under this resolution, and the distribution was accordingly made. The resolution of the directors shows that the provisions of sec. 44 of the Act were held in view when the bonus shares were issued. The resolution determined that "the sum of £87,500 being part of the profits arising from the revaluation of the shares (not acquired for the purpose of resale at a profit) held by the company in Carlton and United Breweries Ltd. carried to assets revaluation reserve account forming part of the undivided profits of the company which are not required for paying dividends be distributed as a capital bonus amongst the holders registered on the twelfth day of November 1935." Thus, it is quite clear that the directors acted deliberately in order to obtain for the shareholders the benefit of sec. 44 of the Act.

Sec. 44 (2) (*b*) (iii) requires, in order that dividends should be excluded from the income of a shareholder, that the dividends paid from the profits mentioned should be "satisfied by the issue of shares of the company declaring the dividend." The section is, therefore, based upon the view that when bonus shares are issued there is a real or notional declaration of a dividend which is applied

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

Latham C.J.

to pay for the shares—a view which has been the subject of much controversy in and since *Blott's Case* (1). It is unnecessary, however, to engage in any discussion of this particular question, because it is not disputed that in the present case dividends were satisfied by the issue of bonus shares.

The question which arises is: "What does this sum of £87,500 represent?" In the resolution of the directors, which I have already quoted, and in an antecedent resolution of a general meeting of the company, it was described as being part of the profits arising from the revaluation of the shares (not acquired for the purpose of resale at a profit) held by the company in Carlton and United Breweries Limited. If this description of the sum of £87,500 is accurate, the bonus shares should not be included in the income of the taxpayer for the purposes of the Act.

This sum of money came from the assets revaluation reserve account. This reserve account was, as already indicated, created by writing up the value of certain shares to an amount of 24s. each. The sum of 24s. admittedly does not represent the full value of the shares, and it was known at the time that this was the case. All the evidence on the point is to the effect that the shares at the time of writing up were probably worth 36s. The taxpayer claims that the writing up was a revaluation of the shares within the meaning of sec. 44 (2) (*b*) (iii). What was done by way of revaluation has already been stated in a general way. It is necessary now to state the facts in greater detail. In a balance-sheet dated 30th September 1935, but only agreed upon and signed by the directors on 11th October 1935, the value of the 176,121 shares was stated as at 30th September 1935 at £119,861. On the same date, 11th October 1935, the directors considered the report of the two firms to which I have already referred, and it was resolved that the 176,121 shares should be taken into account in the company's books at the value of 24s. each. The shares were so taken into account in an entry in the ledger made on 12th October. That entry records an amount of £91,483 as a profit on the revaluation of the shares, that sum being the difference between the balance-sheet value of £119,861 and the new value at 24s. per share.

(1) (1921) 2 A.C. 171.

Up to the balance-sheet of 30th September 1934 the 117,414 shares in the Carlton United company had been valued in the balance-sheet of the Castlemaine company at the cost price of £119,861. In fact these shares greatly increased in value between 1902 and 1934. The estimate given in evidence of the value of the shares in 1934, after the bonus issue contemplated by the Carlton United company had become known, was about 54s. a share. After the bonus issue was actually made the value per share of the then increased number of shares in the Carlton United company became, according to the evidence, 36s. per share. In other words, the evidence showed that before the issue of the bonus shares by the Carlton United company, the market absorbed the additional value which was either revealed or expected to be created by the issue of bonus shares. The result was that, after the issue of bonus shares by the Carlton United company, each share in the company was worth less than each share in the company had been before the bonus issue was made. The directors retained the figure of £119,861 as the value of the increased number of shares, that is, they continued to value all the Carlton United shares at cost—the acquisition of the new bonus shares not having involved the Castlemaine company in any expenditure.

It is not disputed that the Carlton United shares were assets not acquired for resale at a profit. It is unnecessary in the present case to consider whether the positive words " acquired for resale at a profit " are applicable only in a case where there was an original acquisition by purchase. The Carlton United shares certainly answered the negative description of assets not acquired for resale at a profit.

The question then is whether the sum of £87,500, part of the £91,483 19s. represented profits arising from the revaluation of the Carlton United shares.

The relevant sub-section evidently contemplates that profits may arise from a revaluation of assets. It is, I think, clear that profits cannot be produced, caused, or brought about by a mere process of revaluation. But, though revaluation cannot create profits, it may reveal or disclose profits. In order to give any effect to the section, it must, I think, be read as applying to profits so revealed

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

Latham C.J.

or disclosed and utilized in the manner stated in the sub-section. Upon any other interpretation the section could never apply in any case, because there could never be any profits to which it could possibly apply.

Upon the basis of the facts stated, the taxpayer contends that the conditions of sec. 44 (2) (*b*) (iii) have been satisfied—there was a valuation of the shares at £119,861 in the balance-sheet of 30th September 1935, and a revaluation by the directors on 11th October 1935, and the sum of £87,500 which was appropriated in payment for the bonus shares was part of the profits disclosed by that revaluation. It is contended for the taxpayer that the facts which I have just stated, added to the undisputed fact that the shares were not acquired for the purpose of resale at a profit, bring about the result that the dividends should not be included in the taxpayer's income for the purpose of the Act.

The commissioner, however, contends that other evidence shows that there was no revaluation of assets within the meaning of the section. It is urged that there cannot be a revaluation unless there has been a prior valuation of the same assets ; that there was no prior valuation of the 176,121 shares, and that there was no genuine revaluation, but only an alteration of book values for the purpose of endeavouring to pay a dividend in the form of bonus shares which would be free from taxation in the hands of shareholders. The new shares received from the Carlton United company were taken into the balance-sheet as worth nothing because (the taxpayer contends) the figure of £119,861 remained unchanged as the value of the Carlton United shares, although the number of those shares had increased. But the commissioner argues that the new shares were a new asset and that the attribution of no value to an asset cannot be called a valuation of that asset. It is argued that, when a company merely makes alterations in its books for the purpose of getting the benefit of such a provision as that contained in sec. 44 (2) (*b*) (iii), it is not genuinely valuing or revaluing its assets.

In my opinion the evidence fully justifies the findings of the learned judge that the original 117,414 shares were undervalued at £119,861 and that the new and old 176,121 shares together were

still under-valued at 24s. each. Indeed, these facts are not really disputed. It is also apparent that the distribution of bonus shares was made by the Castlemaine company with a full realization of the existence of sec. 44 (2) (*b*) (iii) and that the bonus issue was made in order to obtain for the shareholders the benefit of that section. Further, the evidence also justifies the further finding of the learned judge that the issue of the bonus shares by the Carlton United company to the Castlemaine company conferred a real benefit upon the Castlemaine company, and that the issue of the bonus shares by the Castlemaine company to its shareholders conferred a real benefit upon the shareholders of the latter company, even though in each case the increased number of shares owned by each shareholder only represented the same proportional right in respect of the assets of the company as he had formerly possessed by virtue of the ownership of a smaller number of shares. Upon these facts the learned judge reached the conclusion that the revaluation relied upon was not "a genuine valuation" of the shares.

I proceed now to state more in detail certain findings of the learned judge, with which I agree, though, as will be seen, I do not find myself able to agree with the conclusion which he reaches.

The learned judge found that the 117,414 shares were under-valued at £119,861 but that "this was, nevertheless, a genuine valuation of those shares and a revaluation of them would have disclosed a large surplus." His Honour expressed the same view in the words, "the valuation of the 117,414 shares at cost was undoubtedly a genuine valuation." His Honour further said: "I am not satisfied that the Castlemaine company did truly value its holding of 176,121 shares at £119,861, although its balance-sheet stated that amount as the value of the shares." Accordingly "the valuation of £119,861 was retained for the increased holding of shares, not because it represented the valuation which the company then placed upon its total holding of shares, but as a step in a scheme to disclose a predetermined surplus, which would be produced by writing up the value of the shares to 24s. each." From those facts his Honour draws the conclusion that the alleged revaluation was a sham or pretended valuation—"the revision of this fictitious figure (£119,861) is not a revaluation of that asset.

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

Latham C.J.

. . . The directors were rather merely altering book values than revaluing the assets." Thus the ground of His Honour's decision is that there was " no genuine revaluation " of the shares.

If revaluation of assets means an estimate of the full value of the assets, then I agree entirely, not only with the findings of fact, but also with the conclusion of the learned judge that the alleged revaluation of the 176,414 shares at 24s. each was not a revaluation. The evidence is clear that the shares were worth more than 24s. each. But if, *for this reason only*, the revaluation was not a genuine *revaluation* within the meaning of the section, I have great difficulty in understanding how the figure of £119,861 in respect of the 117,414 shares can be said to have been a genuine *valuation*. There was no evidence whatever (as distinct from surmise) to show that the actual value of the shares at any time was £119,861. That sum represented simply the cost price of the shares, and it was retained as a constant valuation notwithstanding changes in value from time to time. There is much evidence to show that prudent directors of a company decline to overvalue assets in their balance-sheets, and that it is a common and generally approved practice in well-managed companies to understate the value of assets. The reasons which have led to the general adoption of this practice are referred to in the judgment of *Fletcher Moulton* L.J. in *In re Spanish Prospecting Co. Ltd.* (1).

But the existence of this practice, however well founded it may be from a commercial point of view, cannot change into a " real " valuation, in the sense of a genuine estimate of value, that which is not an estimate of value at all, but simply a figure prudently chosen so as to be certainly not above the real value of the asset in question. When assets are taken into a balance-sheet at a value known to be much less that the real value, it seems to me to be clear that it cannot be said that the stated value represents a valuation of the assets if " valuation " is interpreted as meaning a genuine estimate of value. But such a figure does represent a valuation if valuation is interpreted as meaning a bona-fide assignment of a figure as representing the value of assets for accounting purposes.

(1) (1911) 1 Ch. 92, at pp. 99, 100.

The contention of the appellant may be simply stated in the proposition that profits arise from a revaluation of assets whenever the value of assets is written up in the books of a company. It is urged that sec. 44 (2) (*b*) (iii) recognises the ordinary safe and sound practice of understating the value of assets for accounting purposes, and that it is intended to permit companies to write up the value of capital assets, and to pay a tax-free dividend out of such written up value, if the dividend is distributed in the form of bonus shares in the company. This is what the company has done in the present case.

In all balance-sheets up to 30th September 1935 the company retained cost price as representing the value of its holding in the Carlton United company. If the adoption of a recognised business practice in assigning cost price as the constant value of assets which have in fact appreciated in value can ever be a valuation in the relevant sense, then the figure of £119,861 in the 1934 balance-sheet represented the valuation of the 117,414 shares then held and the same figure in the 1935 balance-sheet represented the value of the 176,121 shares then held. In each case the holding of the Castlemaine company in the Carlton United company was valued at its cost to the former company.

The only basis upon which this conclusion can be resisted is that a valuation (and a revaluation) must be a genuine estimate of full value. But this proposition is expressly disclaimed on behalf of the commissioner, who, as already stated, is prepared to concede that the retention of £119,861 in the balance-sheet for many years as the apparent value of shares which were in fact worth a greater sum was a genuine valuation. The proposition is also rejected by the learned trial judge. But it appears to me to be impossible to define valuation as a genuine estimate of value and at the same time to regard an admitted underestimate of value as a valuation, however commercially wise such an understatement may be.

If it is not necessary to make as true as possible an estimate of value in order to have a valuation within the meaning of the section, I cannot see why what would otherwise be a valuation should cease to be such because it is made in view of provisions of income-tax legislation which allow freedom from tax if a certain course is followed. The desire to take advantage of relatively benevolent

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

Latham C.J.

provisions of the *Income Tax Assessment Act* cannot in itself invalidate the procedure which the Act itself requires as a necessary antecedent to the application of those provisions. Thus, in my opinion, upon the basis that a valuation or revaluation is not necessarily an estimate of real value at a particular time, there is no reason for describing a valuation as a sham or as not genuine simply because it is not such an estimate or because it is made for the purpose of obtaining an advantage which the Act offers to those who comply with its terms.

It is objected that on 11th October 1935 the directors signed the balance-sheet as of 30th September 1935 and on the same date determined to write up the value stated in the balance-sheet so as to be able to distribute tax-free bonus shares. This objection is based on the view that the directors could not " really " have valued the shares at different amounts on the same day—there being no evidence of any change of value on that day. The same criticism, however, would be applicable in any case where a valuation which had been allowed to stand up to a particular day was then varied as the result of the adoption on that day of a revaluation. Whenever there is a revaluation there must be a change at a particular moment from the adoption of one value to the adoption of another value. The objection loses all its force if the section contemplates and provides for the effect of the procedure of writing up in accordance with commercial practice—even though such writing up be done with full knowledge of the provisions of income-tax law.

Thus, in my opinion, the argument actually presented for the commissioner, involving as it does the admission or concession that the adoption of an admitted undervalue may be a valuation within the meaning of sec. 44, leads to the result that the appeal should succeed. There was a valuation as at 30th September 1935 of all the shares, new and old, at £119,861. There was a revaluation on 11th October at 24s. a share. Both figures were undervalues, but both represented a valuation in the relevant sense. Profits arose from the revaluation and the profits were used in dividends which were satisfied by the issue of shares including the shares of the appellant.

It has been urged, however, for the commissioner, that if the section is construed so as to permit a company first to write down assets and then to write them up and to pay a tax-free dividend in the form of bonus shares, the result will be that distributions of ordinary trading profits may be made periodically without any liability in the shareholder to tax. When a company had made profits it could write down some capital asset to any desired extent and then, by subsequently writing it up, could create an apparent capital profit which it could place in a reserve fund and out of that fund distribute a dividend and satisfy the dividend by the issue of bonus shares. In the first place, however, there are practical limitations upon the indefinite issue of bonus shares by a company. Further, such a writing down of assets by a company without any kind of business justification followed by a writing up might well be held to be an arrangement which was obnoxious to sec. 260 of the Act and so to be void as against the commissioner. But there would be no reason for the application of that section in a case such as the present where there has been a bona-fide valuation of assets at cost continued for many years in accordance with a common and justifiable business practice, and a subsequent writing up of the value of the assets to a figure which is well within the real value. In the present case the difference between the value of the shares at cost and the written-up value certainly represents a real increase in the value of capital assets, though it does not represent the whole of that increase.

The only alternative to the view which I have put appears to me to involve a disregard of well-known accountancy practice and to deal with the accounts of companies upon a basis which, it is well known, does not exist in fact. If, for the purpose of the section, revaluation means the operation of " genuinely " re-estimating the real value of assets which have already been the subject matter of valuation (in a corresponding sense), then the section would apply to very few existing companies. The evidence shows that in company accounts it is the ordinary practice to value assets " conservatively," that is, not to take them in at full value. The balance-sheet values would hardly ever represent the result of a process of valuation in the sense stated, and yet a balance-sheet provides the necessary and

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

Latham C.J.

universally recognised means of presenting a view of the assets and liabilities of a company. All or nearly all balance-sheet values would be irrelevant in relation to the section. The possibility of applying the section would depend upon the mere chance of a " real valuation " of an asset happening to have been made at some time in the past, though in nearly every case that value would not have been represented by any figure in the accounts of the company. In the absence of the accident of such a valuation the section could not be applied unless, indeed, it could be held that a valuation could at any time be made as a retrospective valuation and that a revaluation could subsequently be made. But if the section were interpreted so as to cover such a procedure when *both* the valuation and the revaluation were made for the purpose of escaping payment of income tax, sec. 260 of the Act might well apply. If so, the result would be that the section would in practice, in the case of existing companies, never apply to any company which, for reasons of prudence and good business practice, had followed recognised methods of accounting, unless some value other than that which appeared in the company's balance-sheet had at some time been attributed to a capital asset of the company. An ordinary company could not make a bonus issue of tax-free shares even though there had been a real increase in the value of capital assets. But a company which, in its balance-sheet or elsewhere, had happened to make a valuation of assets at full value could revalue, and then the section would apply to make such an issue of bonus shares possible. Upon such a view the application of the section would necessarily be capricious and arbitrary.

I can see no reason for reading the section in a sense which excludes a recognition of ordinary and well-known company practice. In my opinion the section is intended to recognise that practice, with the result that values attributed bona fide and in the ordinary course of business to assets in the balance-sheet of a company may properly be regarded as the result of valuations. If those assets are found to have increased in value (which is the present case) and are bona fide revalued at a higher figure, then profits are disclosed which arise from a revaluation, and, if the other conditions of the section are satisfied, as they are in the present case, the bonus shares

received from the shareholder do not form part of his assessable income.

In my opinion the appeal should be allowed and the assessment should be amended by excluding therefrom all reference to the 801 shares which were issued to the appellant.

DIXON J. The taxpayer is a shareholder in the Castlemaine Brewery Company Melbourne Ltd., one of six holding companies which among them hold five-sixths of the share capital of Carlton and United Breweries Ltd. The former company made a capitalization of profits and distributed to its shareholders one fully paid-up share in its own capital for every two shares previously issued. The law now is that the paid-up value of bonus shares distributed by a company forms part of the shareholder's assessable income, unless the capitalization falls within one or other of a limited number of exceptions. The question for decision is whether the case falls within that exception which excludes the paid-up value of shares if paid wholly and exclusively out of profits arising from the revaluation of assets not acquired for the purpose of resale at a profit.

In my opinion the case does not fall within this exception, because the profits capitalized arose in part from a distribution that had been made by Carlton and United Breweries Ltd. among its shareholders of one new paid-up share in its capital for every two previously issued, a distribution which meant an increment not only in the number of shares held by its constituent members, including Castlemaine Brewery Company Melbourne Ltd., but also in the value of their holdings.

The grounds for this opinion lie rather in the facts of the case than in any special construction of the legislation, the meaning of which does not seem obscure. The matter is governed by the *Income Tax Assessment Acts* 1936 and the material provisions are sec. 44 (1), sec. 6, definition of " dividends," and sec. 44 (2) (*b*) (iii) ; provisions which were introduced by the *Income Tax Assessment Act* 1934, sec. 7, in consequence of an interim report of the Royal Commission on Taxation Laws. In 1924 the question whether shareholders should be liable to income tax on distributions of bonus shares was

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

Dixon J.

attacked by the Federal legislature from a new standpoint. The question had been dealt with by the courts both here and in Great Britain by considering the nature of the benefit, if any, which a shareholder obtains either as a result of or in the course of the capitalization of profits and the distribution of new paid-up share capital. One view, that adopted in *Blott's Case* (1), denied that the shareholder received any advantage that could be called income; what he got was a greater number of shares, representing the same proportionate right to share in the assets and vote upon the management of the company. The other view, that supported by Lord *Sumner* in *Blott's Case* (1), emphasised the fact that the shareholder obtained a marketable security in the form of a share, his liability upon which had been discharged by an appropriation to that purpose of a ratable part of the company's distributable profits. The presence in the Commonwealth *Income Tax Assessment Act* 1915-1918, sec. 14 (*b*), of an express direction that the income of any person should include profits credited to the shareholder of a company made this consideration decisive in Australia against the shareholder (*James* v. *Federal Commissioner of Taxation* (2)).

But in 1924 the Federal legislature deserted altogether the ground taken by these rival views and established the nature, source or taxability of the profits whence the bonus shares had been paid up as the test of the shareholder's liability (Act No. 51 of 1924 sec. 4 (*h*)). From that time the assessable income of a shareholder has included bonus shares unless they have been paid up out of some special class of profits and on the ground that they have been paid up from that source are made the subject of an express exception. The course of the legislation has been to narrow the scope of the exemptions; and the principle has been not only maintained but strengthened, the principle that stock dividends are taxable as income in the hands of the shareholder subject to particular exemptions based upon some peculiarity in the profits capitalized. Sec. 6 of the Act of 1936 includes in the meaning of the word "dividend," the paid-up value of shares distributed by a company to its shareholders to the extent to which the paid-up value represents a capitalization of profits. Sec. 44 (1) (*a*) provides that the assessable

(1) (1921) 2 A.C. 171.

(2) (1924) 34 C.L.R. 404.

income of a shareholder in a company shall, subject to what follows, include, if the shareholder resides in Australia, dividends paid to him out of profits derived by it from any source. Sec. 44 (2) then follows with the exceptions. Of these, we are concerned with par. *b* (iii) only, which, so far as material, is expressed thus :— The assessable income of a shareholder shall not include dividends paid wholly and exclusively out of profits arising from the revaluation of assets not acquired for the purpose of resale at a profit if the dividends paid from such profits are satisfied by the issue of shares of the company declaring the dividend.

The facts of this case, which, in my opinion, show that some other element, namely, the acquisition of a new asset, contributed to the profits capitalized, present features which are perhaps out of the common run, but they are not complicated. Carlton and United Breweries Ltd. had been formed many years ago as an amalgamation of the undertakings of the companies which now hold most of its shares. In the five years from 1930 to 1934 its rate of dividend had ranged from fifteen to ten per cent per annum, but in none of these years was the annual profit nearly absorbed by the dividends declared. The income-tax legislation of 1924 contained a provision exempting from liability to tax in the hands of shareholders the paid-up value of shares distributed by a company to its shareholders to the extent to which the paid-up value represents the capitalization of profits derived before 1st July 1915 or of profits upon which the company had paid or was liable to pay income tax for any year prior to the financial year beginning 1st July 1923 (No. 51 of 1924, sec. 4 (*h*)). But the Act of 1934 terminated the latter part of this exemption as from the 31st December 1934 (No. 18 of 1934, sec. 7, inserting sec. 16AA (2) (*b*)). Carlton and United Breweries Ltd. had large reserves of profits falling within the exemption and decided to capitalize enough to enable it to make a distribution of bonus shares in the proportion of one paid-up share for every two shares of its existing issued capital and, of course, to do so before 31st December 1934. The decision was carried out on 19th December 1934. 58,707 fully paid-up shares of £1 in Carlton and United Breweries Ltd. were allotted to Castlemaine Brewery Company Melbourne Ltd., which already held 117,414 £1 shares. Its holding thus became

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

Dixon J.

176,121 shares. Both the new shares and the old consisted partly of preference and partly of ordinary shares. In the last balance-sheet of the latter company, that for the year ending 30th September 1934, the old shares numbering 117,414 were set down on the assets side at cost, a sum of £119,861 5s. The same figures appeared in the company's ledger, where the shares, of which some had been acquired on the amalgamation and some had been taken up at a premium, were entered in respect of the money equivalent of the consideration that Castlemaine Brewery Company Melbourne Ltd. had given, a money sum carried down from year to year. The scrip for the new shares was received in January 1935, but no further entry was made in the company's ledger. On 4th December 1934 a general meeting of the Castlemaine Brewery Company Melbourne Ltd. was held for the purpose of adopting resolutions in connection with the capitalization of profits by Carlton and United Breweries Ltd. then in progress. The chairman, who is the appellant taxpayer, made a statement to the shareholders which, after describing the capitalization and the reason for it and giving the number of new bonus shares the company would receive, went on as follows—"These shares, of course, will be allotted to our company and will not go to individual shareholders, but your directors will subsequently consider at some convenient period next year the advisibility of revaluing the assets of our company and of issuing bonus shares to our shareholders individually in respect of such valuation."

The shares of the Carlton and United Breweries Ltd. are not listed on the Stock Exchange, and there are no market quotations for them. But the shares of the holding companies are listed and were quoted. They began to rise in price from the time when the information leaked out that the capitalization was in contemplation, and after the fact that Carlton and United Breweries Ltd. would capitalize £950,000 of reserves of profits was announced they reached prices which showed a very considerable appreciation in value. This meant that the distribution of the bonus shares was regarded as substantially increasing the assets of the constituent companies which would receive them. The reason was obvious; for, as an experienced share-broker said in evidence, it was anticipated that the total profits which would be distributed by Carlton and United

Breweries Ltd. after the capitalization would be much greater than before. The expectation was based on good grounds and was realised. The percentage rate of dividend had been high; yet, applied to the existing capital, it had failed to absorb the profits earned. Even if the rate fell somewhat, applied to the new capital, it would liberate a much greater sum to the holding companies. The value of shares is affected by the prospect of dividends at least as much as by considerations which go only to capital strength. In the event, the belief that a greater amount of profits would be distributed was more than borne out. In the following year the percentage rate of dividend was eight per cent on the increased capital; in the year after that it rose to ten per cent and then to $12\frac{1}{2}$ per cent.

In these circumstances it appears to me to be quite clear that the distribution of bonus shares by Carlton and United Breweries Ltd. in December 1934 meant a considerable increase in the assets of the Castlemaine Brewery Company Melbourne Ltd. The value of the existing shares was no doubt to some extent adversely affected by the issue of half as many paid-up shares again. But, after compensating for such a loss in the value of the old shares, the remaining value in the new shares meant a large increment of wealth or, in other words, profit. The increment or profit was not a mere enhancement in value of the original shares. It was the fruit they bore. The bonus shares are in truth new and independent things distributed by way of dividend upon the original shares. As appears from the statement made by the chairman on 4th December 1934, the fact that the bonus shares were distributed by Carlton and United Breweries Ltd. was the occasion of the distribution of the bonus shares by the Castlemaine Brewery Company Melbourne Ltd. In July 1935 the secretary of the latter company worked out the amount which it was necessary to obtain by a revaluation of its shareholding in Carlton and United Breweries Ltd. in order to make a distribution of one fully paid-up share for every two already issued. At the same time and as part of the same scheme it was decided that a reduction of capital would be effected in order to return £37,500 in cash to the shareholders. For this purpose money was available lying invested in government stocks. The plan was to increase the

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

Dixon J.

capital so as to issue bonus shares paid up out of profits arising from the revaluation of assets not acquired for the purpose of resale and then to reduce the increased capital by 2s. 6d. per share in order to allow of the distribution of £37,500 as a return of capital and therefore without liability to income tax in the hands of the shareholders. In August the directors decided to instruct the auditor to make a valuation of the company's shareholding in Carlton and United Breweries Ltd., and in September they resolved that the government securities should be sold to provide the sum required in connection with the reduction of capital.

As the old shares stood in the company's books at cost and the new shares had not been taken into the books at all, it must have been quite clear that the shares, the value of which was much above par, contained a surplus value much more than enough to provide a fund sufficient for the capitalization in hand. The accountants were accordingly instructed, not to determine the value of the shares, but to certify whether they were not at least of the value found to be sufficient for that purpose. Two accountants returned certificates dated 9th October 1935 that in their opinion the shares held by Castlemaine Brewery Company Melbourne Ltd. in Carlton and United Breweries Ltd. were worth not less than 24s. per share. On the following day, 10th October 1935, the profit and loss account for the year ending 30th September 1935 and the balance-sheet as at that date, which had been in course of preparation, were certified by the auditor. This balance-sheet showed the increased number of shares, viz., 176,121, but retained the same amount of money as appeared in the books and in the previous balance-sheet for the old number of shares, 117,414, that is, a sum of £119, 861. The balance-sheet and the certificates of the accountants as to the value of the shares came before the board of directors next day, both at the same meeting. The balance-sheet was approved, and the certificates of value were acted upon. It was resolved that the 176,121 shares be taken to account in the company's books at a value of 24s. each and the amount by which that valuation exceeded the present book value of the shares, namely £91,483 19s., be credited to an assets revaluation account. Up to this time no entry had been made in the company's books in reference to the 58,707 new bonus shares

which had been allotted to the company on 19th November 1934. But the minutes of the next directors' meeting, held on 25th October 1935, record that the books of the company were produced by the secretary showing a sum of £91,483 19s. standing to the credit of assets revaluation reserve account representing profit arising from the revaluation of the company's shareholding in Carlton and United Breweries Ltd.

Regular steps were then taken to increase the capital of Castlemaine Brewery Company Melbourne Ltd. from 200,000 shares of 17s. 6d. to 300,000 shares of that amount and to issue the additional 100,000 shares as fully paid up out of the sum at the credit of the assets revaluation reserve account, £87,500 being required for that purpose.

In one respect only did these proceedings go outside the common course ; the resolutions for increasing the capital and for capitalization were accompanied by resolutions, expressed to be contingent thereon, for the reduction of the increased capital by 2s. 6d. a share. In the result the allotment of the bonus shares was made on 12th November, the resolution for reduction was passed on 22nd November and for confirmation 10th December and the confirmation of the Supreme Court was given on 19th December 1935.

Upon these facts it appears to me that an analysis of the profits credited to the assets revaluation reserve account out of which the taxpayer's bonus shares were paid up is enough to show that they are not wholly and exclusively profits arising from the revaluation of assets not acquired for the purpose of resale at a profit. The sum credited to that account represented the difference between the value, or minimum of value, of 24s. a share applied to the whole 176,121 shares in Carlton and United Breweries Ltd. belonging to Castlemaine Brewery Company Melbourne Ltd., that is to say, a sum of £211,345 and the consideration given by the latter company for the original 117,414 shares, which amounted to £119,861. The difference between these two sums, £91,484, is composed of two quite distinct ingredients. One of them consists of the increase in value assigned to the original 117,414 shares, that is to say, the difference between £119,861, the original consideration given for them, and their value at 24s. each, or £140,896, a difference amounting to £21,036.

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

DIXON J.

The other ingredient consists in the full value of the bonus shares at 24s. each. The value at 24s. of the 58,707 bonus shares is £70,448. This latter sum cannot, in my opinion, fill the description "profit arising from the revaluation of assets." It is the value, or minimum value, of the whole asset, *scil.*, of the bonus shares. It is the value placed upon that asset for the first time after its acquisition, if that be material. The asset, the bonus shares, had been recently acquired and represented a profit, whether of a capital nature or of an income nature is immaterial, accruing to the Castlemaine Brewery Company Melbourne Ltd. upon its shares in Carlton and United Breweries Ltd. The exemption in sec. 44 (2) (*b*) (iii) is of profits arising from the revaluation of assets and does not extend to a profit accruing, not by an enhancement in value of a capital asset, but in the form of money or property received in virtue of the enjoyment or ownership of an investment or other capital asset. Here the Castlemaine Brewery Company Melbourne Ltd., in virtue of the enjoyment or ownership of their investment or asset consisting of their original 117,414 shares, received valuable securities, namely, the 58,707 bonus shares. To place a value on these securities is only to determine the amount of the gain arising from their receipt. It may be true that it is right to take into account against that gain the diminution in value, no very great diminution in value apparently, suffered by the original 117,414 shares as a consequence of the distribution of the bonus shares and the capitalization of the Carlton and United Breweries Ltd.'s reserves of profit. But the twenty-four shillings falls so far short of the actual value of the shares that it does not reflect any part of the diminution and in any case, after deducting enough to make up the decrease in the value of the original shares, the remaining value of the bonus shares is very great. A great part therefore of the sum of £70,448 represents the net gain or profit arising to the Castlemaine Brewery Company Melbourne Ltd. from the new securities, that is to say, from the allotment to it of bonus shares by way of stock dividend. An increment in the total value of assets arising from the allotment of new and additional shares is quite a different thing from the growth or increase in value which a revaluation of capital assets may show that they have undergone. The purpose of the exemption given by sec. 44 (2) (*b*) (iii) is to exclude

capitalizations of unrealized profits which the company consider to have been produced by an enhancement in value of assets of a capital nature ascertained by comparison between, on the one hand, a former value as fixed by the purchase price paid by the company or by estimate and, on the other hand, a later value fixed by an estimate made for the purpose of finding a figure proper for use in commercial accounting. A profit consisting in the acquisition, growth or creation of a new thing falls outside its purpose. A flock of stud sheep kept for breeding purposes has been held to be things not produced for the purpose of sale (*Austin Pastoral Co. of Bringagee Ltd.* v. *Federal Commissioner of Taxation* (1)). According to the decision, a flock of stud ewes kept for breeding purposes would apparently form assets not acquired for the purpose of resale at a profit. Surely it would be impossible to treat the added value given to the flock by the lambs dropped since the last valuation as a profit arising from the revaluation of the asset, simply because a new value at so much a head was placed upon the flock, sheep and lambs.

I have just said that it is immaterial whether the profit accruing from the allotment by Carlton and United Breweries Ltd. of the bonus shares is of a capital nature or of an income nature. The reason is that in neither case does the profit arise from revaluation. But it is significant that under the provisions with which we are dealing the stock dividend or distribution of bonus shares by Carlton and United Breweries Ltd. would form part of the assessable income of Castlemaine Brewery Company Melbourne Ltd. It happens that because the distribution was made before 31st December 1934 and out of a special class of profits, it was excluded under an exemption, now expired. But this ought not to obscure the fact that the distribution of bonus shares is classed as a dividend by the legislation we are applying and, unless a specific exemption covers it, is included in the shareholder's assessable income. Here the taxpayer is seeking to bring under the exemption in favour of profits arising from the revaluation of assets what the Act regards as a dividend and as forming, unless specifically excluded, part of the company's assessable income, a result which to say the least of it, appears odd.

(1) (1928) 41 C.L.R. 75 : See, at p. 81, *per Knox* C.J.

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

Dixon J.

In my opinion the taxpayer's claim that the capitalization falls within the exemption in favour of shares paid up wholly and exclusively out of profits arising from the revaluation of assets not acquired for the purpose of resale fails on the ground that, in part, the profits capitalized arose from something else, namely, the allotment to the company of paid-up shares by way of stock dividend. It was sought, however, to avoid this consequence by reliance upon a matter which, to my mind, is quite beside the question whether the profits capitalized arose in part from the allotment to Castlemaine Brewery Company Melbourne Ltd. of bonus shares by Carlton and United Breweries Ltd. That matter is the inclusion in the former company's balance-sheet as at 30th September 1935 of the full number of 176,121 shares at the same figure of £119,861 as stood in the company's books and previous balance-sheet as the cost or value of the original 117,414 shares in Carlton and United Breweries Ltd. It will be remembered that at the time this balance-sheet was prepared the valuation of the shares as at least worth 24s. was in course of settlement and the certificates on this valuation and the balance-sheet were both presented at the same meeting of the directors and then and there approved and adopted by the board. Nevertheless it is said that the balance-sheet adopted one value for the entire number of the shares, namely, £119,861, and the valuation a higher value by £91,484, that is to say, a value of £211,345 or 24s. a share for the entire number of 176,121 shares. The difference between the two, it is claimed, is a profit arising on revaluation. The directors in adopting the balance-sheet were not purporting to value the bonus shares. They were simply stating the number of shares held by the company and the cost to the company. They were, for the purpose of the balance-sheet, simply ignoring the fact that the allotment of the bonus shares included in the number of shares set down meant an increase in the value of the holding. That fact they brought into account elsewhere but at the same time. It was brought into account by adopting the revaluation of the total holding.

But to my mind it would not matter what value they placed upon the bonus shares in the balance-sheet. It would not alter the fact

that the profit arose from their allotment and not from their revaluation. Once it appears, as, in my opinion, it clearly does from the evidence, that the stock dividend brought net gain or profit to the company, it is futile to attempt to use the figure in the balance-sheet as taking up the profit and then to use the valuation, adopted on the same day, as giving rise to a new and independent profit, namely, a profit arising from revaluation, a profit of which the stock dividend formed no part. It is the same profit, and it was taken up, at all events in part, in the valuation at not less than 24s. and not in the balance-sheet.

By relying on the figure in the balance-sheet as a valuation which formed a basis for a revaluation giving rise to a profit, notwithstanding that both the alleged valuation and the revaluation were made at the same time, the taxpayer has provoked an attack, by way of retort, upon the genuineness of the alleged valuation. The retort is not unnatural, but its justification lies, not in what the directors did or intended to do, but in the contention which is now advanced. In putting the total number of shares down in the balance-sheet at the cost of the original shares there was in fact no attempt to value the bonus shares, nor for that matter the total holding. The facts show that from the beginning the distribution of the bonus shares by Carlton and United Breweries Ltd. among its shareholders, the holding companies, was the occasion of a corresponding distribution by Castlemaine Brewery Company Melbourne Ltd. of bonus shares to its shareholders. The chairman in effect said so in his statement to the shareholders on 4th December 1934. Not only did the head distribution provide the occasion of the subsidiary distribution but it provided the source, at all events in part. The value of the bonus shares received by the Castlemaine Brewery Company Melbourne Ltd. could not be utilised as a source whence to pay up the bonus shares distributed by that company without exposing its shareholders to income tax in respect of the distribution.

Part of the plan of the company was to reduce capital at the same time and thus to distribute cash as a return of capital. To increase capital and reduce it at the same time is an operation which, I imagine, would not be undertaken except for the purpose of following

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

a path which would allow of the distribution of money without the recipients incurring a consequent liability to income tax. In the view I have taken liability to tax is incurred by the shareholder at an earlier stage, viz., when the bonus shares are allotted, and the return of capital upon the reduction does not come into the question.

In my opinion the order appealed from is right and the appeal should be dismissed with costs.

EVATT J. The Commonwealth *Income Tax Assessment Act* 1936-1938 includes in the " assessable income " of a resident who is a shareholder in a company, the dividends paid to such shareholder (sec. 44 (1)). " Dividends " are defined so as to include the paid-up value of shares distributed by the company to its shareholders to the extent to which the paid-up value represents a capitalization of profits (sec. 6).

But for the express statutory provision, the paid-up value of bonus shares issued and allotted to a shareholder in pursuance of a scheme of capitalizing profits could not possibly be regarded as " income " in the hands of the shareholder. But the Commonwealth income-tax legislation made a shareholder's tax liability in respect of his receipt of bonus shares dependent upon the extent to which their paid-up value represented a capitalization of the company's profits.

From the point of view of a sound economic distinction between capital and income, this rule may seem artificial, even arbitrary. For such reason, no doubt, the actual or supposed harshness of the result produced has been mitigated by sec. 44 (2) (*b*) (iii), which provides that the assessable income of a shareholder shall not include dividends paid wholly and exclusively out of " profits arising from the revaluation of assets not acquired for the purpose of resale at a profit . . . if the dividends paid from such profits are satisfied by the issue of shares of the company declaring the dividend."

This appeal from the judgment of *McTiernan* J. involves consideration of the meaning and application of such provision. What does it do ? It exempts a shareholder from liability to pay income tax in respect of the paid-up value of bonus shares issued to him and does so although the fund which the company uses for the payment

of the liability on the bonus shares consists entirely of profits: provided that such profits are of a specified character. The profits must have arisen from the "revaluation" of what will hereafter be called the "fixed" (as distinct from the "floating") assets of the company—i.e., from the revaluation of assets "not acquired for the purpose of resale at a profit."

It seems to me that some aspects of the legislative scheme embodied in clause iii of sec. 44 (2) (*b*) may at once be noted.

1. The clause requires that the "dividend" of the shareholder shall be "satisfied" by the issue to him of the bonus shares. This requirement may be expressed with at least equal accuracy by saying that each shareholder's obligation to pay for the bonus shares is "satisfied" from portion of a special fund of "profit" which is credited to the shareholder.

2. The special fund of profits must arise from "the revaluation" of the fixed assets of the company.

3. From such special fund and from it alone, the company must "pay" to each shareholder the "dividend" representing payment for the bonus shares distributed.

4. Sec. 44 (2) (*b*) (iii) postulates that "profits" may "arise" from the "revaluation" of fixed assets. It contemplates that, from time to time, a company may decide to assign a new valuation to part or all of such assets; and that if such revaluation reveals or evidences an accretion or gain, the fact of such accretion or gain, or any part thereof, if duly capitalized and distributed to the shareholders in the form of bonus shares, will not render a shareholder liable to income tax in respect of such distribution.

5. In the case of a "holding" company which retains shares in other companies by way of permanent or indefinite investment, the shares in such companies, including "bonus shares" issued by it, may be, and ordinarily will be, fixed assets within the meaning of the clause.

6. The clause does not contemplate, still less require, any departure by a company from the well-established practice of (1) valuing its fixed assets at cost for the purpose of presenting its balance-sheet, (2) continuing such valuation of fixed assets at cost despite the fact that there has been a probable or a certain accretion in value of

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

Evatt J.

such fixed assets, and (3) rewriting the value of such fixed assets at a higher figure at such times and upon such occasions as those in charge of the business of the company think fit, even though such higher figure is considered by such persons still to understate the true value of the fixed assets.

The well-established practice in relation to companies is evidenced by many standard authorities. According to Professor *L. R. Dicksee*, fixed assets are "those which, in a broad sense, represent the equipment of the undertakings: the possessions which it owns with the object of continuing to hold them in their existing form, and to use them as a means, directly or indirectly of making profits. They are held for use." (*Encyclopaedia Britannica*, 14th ed., vol. 2, p. 957). This leading authority has pointed out that:—

1. "Because the fixed assets of an undertaking are not intended for sale, but rather for use, their precise realizable value at any given moment is comparatively unimportant, so long as there is always a sufficiency of floating assets to meet the floating liabilities as they fall due."

2. "It is not reasonable in all cases to assume that the figures attached to the various items of a balance-sheet represent in the view of the accounting parties their respective current realizable values; but it is submitted that if, the published balance-sheet is to serve any useful purpose, the basis of valuation should be stated in each case."

3. "Most successful companies have fixed assets actually worth more than the figures set against them in the balance-sheet, and the provision for outstanding liabilities is commonly upon the generous side. Usually, therefore, a successful concern has in fact a secret reserve" (*ibid.*).

In the Australian edition of F. R. M. De Paula's work on Auditing, it is said:—

"Fixed assets are valued upon the basis of cost. . . . Fixed assets are not valued upon their saleable value, but upon their value to the proprietor of the business—in other words, upon their ability to earn profits (regard being had to their cost) and not upon their intrinsic worth. . . . It must be observed that an auditor cannot possibly value the assets of the businesses whose accounts he audits. This valuation must be carried out by the partners, directors or other responsible officials" (*The Principles and Practice of Auditing*, Austn. ed., pp. 100-101).

From the fact that successful companies will continue to value their fixed assets at cost, despite the fact of antecedent accretion in value, it necessarily follows that the description of the company's position as contained in any particular balance-sheet will understate the true strength of the company's position, and the effect of such

understatement will be increased as the fixed assets further appreciate. But, in the absence of any intention to deceive or defraud, this understatement concerns only the company and its shareholders. As Lord *Wrenbury* has pointed out in relation to a balance-sheet illustrating the above principle, "the result will be to show the financial position of the company to be not as good as in fact it is. If the balance-sheet be so worded as to show that there is an undisclosed asset, whose existence makes the financial position better than that shown, such a balance-sheet will not, in my judgment, be necessarily inconsistent with the Act of Parliament. Assets are often, by reason of prudence, estimated, and stated to be estimated, at less than their probable real value. The purpose of the balance-sheet is primarily to show that the financial position of the company is at least as good as there stated, not to show that it is not or may not be better" (*Newton* v. *Birmingham Small Arms Co. Ltd.* (1)).

These matters are of decisive importance in the interpretation and application of sec. 44 (2) (*b*) (iii) of the *Income Tax Assessment Act*. As a general rule, a company will gain no advantage by revaluing and "writing up" fixed assets which have long stood in its books and balance-sheets at cost price. But some tangible advantage will or may be gained if the purpose of the company is to use part or all of the accretion which will ultimately appear when the fixed assets are revalued either at their full value or at some figure higher than the original "cost." That those in charge of a company's affairs may attempt to gain such an advantage is not ground for criticism, particularly when the company itself if general meeting approves and endorses the action of its directors. Unless it be for the purpose of gaining some such advantage, revaluation of a company's assets previously taken in "at cost" would be an absurd and futile procedure. Referring to a case in which it was sought to make the directors of a company liable for misfeasance because a revaluation of assets had been attempted by one of the directors without any "outside" assistance, *Peterson* J. said :—

> "It was said that the object of this revaluation was to enable the company to obtain further capital by the issue of preference shares. I think that this is so ; but there is nothing unlawful or reprehensible in that object. The only ground on which complaint could be made is that the object was achieved

(1) (1906) 2 Ch. 378 at p. 387 ; 22 T.L.R. 664, at p. 666.

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

Evatt J.

by improper means. The directors no doubt would have been better advised if they had obtained a revaluation from some expert valuer, although, if one may judge by the evidence on the subject which I have heard, the margin of difference between the views of values on the subject is very great. But there is no rule of law which requires directors to obtain outside assistance in such matters or prevents them from valuing the property themselves, provided, of course, that they act honestly in doing so" (*Ammonia Soda Co.* v. *Chamberlain* (1)).

In the present case, the actions of the company's directors has not been challenged upon the ground of impropriety; and from first to last, such actions have met with the entire approval of the shareholders.

I now turn to the facts of the particular case. The taxpayer, who is the present appellant, was a shareholder in the Castlemaine Brewery Company Melbourne Ltd. (hereinafter called the Castlemaine company). He received 801 bonus shares from the company in pursuance of a scheme of capitalizing profits embodied in certain resolutions. The fund from which the obligation to pay for the bonus shares was discharged was a fund of £87,500 out of a total sum of £91,483 19s. consisting of profits from a revaluation of fixed assets duly credited to an account called "the assets revaluation reserve account." The fixed assets alleged to have been revalued consisted of the company's total holding of 176,121 shares in the Carlton and United Breweries Ltd. (hereinafter called the Carlton company). The crucial question is whether in truth the said sum of £91,483 19s. was a profit arising from the revaluation of such holding of 176,121 shares in the Carlton company.

At all material times, the Castlemaine company was a holding company, a main object being to hold as investments shares in the Carlton company. It is expressly admitted that "the Castlemaine Brewery Company Melbourne Ltd. did not acquire any of the shares held by it at any time in the capital of the Carlton and United Breweries Ltd. for the purpose of resale at a profit." It follows that the whole of the 176,121 shares were fixed assets of the Castlemaine company within the contemplation of sec. 44 (2) (*b*) (iii) of the *Income Tax Assessment Act*.

The evidence shows that the Castlemaine company's total holding in the Carlton company was acquired over a long period of years.

(1) (1918) 1 Ch., at p. 271; 33 T.L.R. 509, at p. 513.

(1) First of all, it acquired 102,500 shares fully paid up to 20s. Until September 30th, 1934, these shares were always included in the assets side of the annual balance-sheets at cost price, viz., £102,500. (2) The company subsequently acquired 5,125 preference shares in the same company at the cost of £1 each, and, up to September 1934, these shares also were valued at cost, viz. £5,125, in the company's balance-sheets. (3) Finally, the company acquired 9,789 preference shares at a cost of 25s. each, and this asset also was always included in the company's balance-sheets at cost, viz. £12,236 5s.

Accordingly, the balance-sheet bearing date September 30th, 1934, showed that the company held a total holding of 117,414 shares in the Carlton company, and the value ascribed to the total holding was the cost of acquiring the three groups, viz. £102,500 plus £5,125, plus £12,236 5s. totalling £119,681 5s.

Shortly after the issue of the balance-sheet dated September 30th, 1934, the Carlton company decided to make a bonus issue of fully paid-up shares, and, as a consequence, the Castlemaine company became entitled to receive 51,250 ordinary, and 7,457 preference shares, totalling 58,707 Carlton shares. These shares were duly allotted to the Castlemaine company in December 1934, and the scrip was received by it in January 1935.

The secretary of the Castlemaine company, Mr. Scott, explained that the directors of the company decided to group the 58,707 new shares with the existing shareholding of 117,414 shares, and, in respect of the total fixed asset of 176,121 shares, to continue for the time being the policy adopted throughout the history of the company of valuing at cost. As the cost of the bonus shares was nil, it necessarily followed that the 176,121 shares would be valued at the cost of the 117,414 unwatered shares, viz., £119,681 5s. "We decided," said Scott, "from the receipt of the shares to continue to value them at cost." And the same witness pointed out that no consideration whatever was given by the Castlemaine company for the bonus shares. No doubt, it was mainly for this reason that no specific entry in respect of the bonus shares was made in the ledger of the Castlemaine company when the scrip was received in January 1935. There was no absolute necessity for such an entry, and it is beyond question that those in charge of the Castlemaine company

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

Evatt J.

had already determined to revalue the company's Carlton shares at some time late in the same year. Indeed, the present appellant, who was the chairman of directors of the Castlemaine company, had announced in December 1934 that when the Carlton company had issued the bonus shares, the directors of his company would, at some convenient period during 1935, consider the advisability of revaluing the assets of the company with a view to making on its own account an issue of bonus shares.

This general plan was duly carried to completion. From first to last there was no concealment whatever; and I do not think that any question as to taxation liability would have arisen, but for the startling effect produced upon the mind of some departmental official by the apparent contrast between the Castlemaine company's balance-sheet of September 1934 and September 1935. Yet what was done in the latter balance-sheet was merely to set forth the company's holding of 176,121 shares in the Carlton company and to value such holding at cost, in strict accordance with accountancy practice and the company's past procedure. Inasmuch as the bonus shares cost nothing, one result was that the 102,500 shares held as at September 30th, 1934, was lumped together with the 51,250 ordinary bonus shares acquired since September 30th, 1934. The 102,500 shares held on September 30th, 1934, were then valued at £102,500, (i.e., their cost); whereas, on September 30th, 1935, 153,750 ordinary shares were valued at £102,500, i.e. the same figure. As £102,500 was undoubtedly the cost price of the 153,750 ordinary shares held on September 30th, 1935, the dilution of the old ordinary shares by the bonus issue was shown as reducing the value of each ordinary share from £1 to 13s. 4d.

Similarly with the two groups of preference shares. The bonus shares acquired were shown as added to each group.

In my opinion, the procedure adopted in the balance-sheet was justifiable. Once it is admitted that, despite steady accretion in value, fixed assets may properly be valued at cost, such method of valuation should be followed to its logical conclusion until some other basis of valuation is adopted. It may at once be conceded that, on September 30th, 1935, the 176,121 Carlton company shares held by the Castlemaine company were worth a sum considerably in excess

of the £119,861 5s. then attributed to them in the balance-sheet. But this discrepancy, if that is the correct word for it, was equally present in the balance-sheet of September 30th, 1934, and during many previous years as well.

A great deal of the argument for the respondent was based upon the theory that, after the watering of the Carlton shares, none of the shares was reduced in value by the watering: so that the proper inference is that in September 1935 the shares were deliberately undervalued. This theory is opposed to the evidence and to the weight of authority. The evidence shows that, after the issue of the bonus shares in the proportion of one to two, the value of the Carlton shares was reduced to a value of approximately two-thirds of the previous market value per share. Of course, the evidence does not show that, after the bonus distribution, the value of each ordinary share was reduced from £1 to 13s. 4d. But it does show that, just so far as the value of 13s. 4d. per share failed to express the then market value of each ordinary share, so the 1934 balance-sheet value of £1 per share failed to express the then market value of each ordinary share. Speaking proportionately, the 1935 value of 13s. 4d. per share was just as accurate as the 1934 value of £1 per share. This matter of fact I refer to hereafter.

The effect of a bonus distribution of paid-up shares upon the value of shares previously held has been adverted to in the leading cases as to the nature of a capitalization of profits carried through by a bonus distribution of shares.

In the leading United States decision *Eisner* v. *Macomber* (1), *Pitney* J. said that the issue of the new shares "does not alter the pre-existing proportionate interest of any stockholder or increase the intrinsic value of his holding or of the aggregate holdings of the other stockholders as they stood before. The new certificates simply increase the number of the shares, *with consequent dilution of the value of each share.*" (I italicize the relevant phrase.)

Later, in *Blott's Case* (2) Viscount *Cave* referred to the "luminous reasoning" of *Pitney* J. which, so far as it discussed the supposed

(1) (1919) 252 U.S. 189, at p. 211 [64 Law. Ed. 521, at p. 530].
(2) (1921) 2 A.C., at p. 202.

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

Evatt J.

"income" character of bonus shares or "stock dividends," was accepted by *Holmes* J. whose dissent was based upon a special ground.

In the United States, the economic and business aspects of the dispute have been regarded as authoritatively settled by the judgment of *Pitney* J. Thus, *Thomas Reed Powell*, a very eminent authority, commented: "So far as *Eisner* v. *Macomber* (1) turns on economic issues, the majority has much the better of the argument" (*Columbia Law Review*, vol. 20, p. 536).

Professor *Powell* also said:—

> "Only Mr. Justice *Brandeis* and Mr. Justice *Clarke* thought that stock dividends really are income, and possibly even they did not go quite so far. They had agreed in *Towne* v. *Eisner* to include a stock dividend. They acquiesced in the analysis that a stock dividend is nothing but a rearrangement of the indicia of what is already capital to the stockholder. As Mr. Justice *Holmes* put it: 'In short, the corporation is no poorer and the stockholder is no richer than they were before'."

An excellent illustration of the operations involved was given by *Scrutton* L.J. in the Court of Appeal in *Blott's Case* (2):—

> "A company of £10,000 share capital has assets which have increased in value to £20,000, and it has £20,000 reserve fund of undivided profits. Its £1 shares may be worth £4. It thereupon capitalizes £10,000 of its reserve fund, and issues 10,000 new shares fully paid. The result is that the same profits and property which were divisible among 10,000 shares become divisible among 20,000 shares with the probable result that the shares which were £4, may fall to £2 each, the exact fall depending on the prospects of the company and the higgling of the market."

It is to be observed that *Scrutton* L.J. is dealing with cases of actual market value, which in the case of a holding company like the Castlemaine company was of little interest or importance. The company was never interested in the market. When a bonus issue is contemplated, speculators may enter the field and take a profit or make a loss, so that as *Scrutton* L.J. recognized, the diluted shares may not fall in value per share according to the exact mathematical formula of theory. None the less, a bonus issue of "one for two" will usually reduce the value of each unwatered share to about two-thirds of its previous value. From a slightly different angle, the illustration of *Scrutton* L.J. was accepted in the House of Lords in *Blott's Case* (3). There Viscount *Finlay* said:

> "The shareholder got his proportionate share in the business of the company as increased by the additional capital. The proportion of his share in that business as compared with the proportions of other shareholders was in no way

(1) (1919) 252 U.S. 189, at p. 211 [64 Law Ed. 521, at p. 530].
(2) (1920) 2 K.B. 657, at p. 676.
(3) (1921) 2 A.C., at pp. 195, 196.

> affected by the issue of the preference shares, as all the shareholders alike got them. The benefit, and the sole benefit, which the respondent derived was that the business in which he had a share was a larger one with more capital embarked in it, precisely as might have been the case if the accumulated profits had been applied in the improvement of the company's works and machinery."

I cite this imposing array of reasoning not to show that as a matter of law the Castlemaine company was bound to regard its aggregate holding after the bonus issue (i.e., 176, 121 shares) as being of precisely the same intrinsic value as its previous holding (117,414 shares), but to show that the company was clearly entitled to treat the intrinsic value of its holding as being unchanged by the bonus distribution. If so, the automatic result of the valuation of the aggregate holding at the same figure was to give a reduced value to each old share, the amount of the reduction being $33\frac{1}{3}$ per cent of its antecedent value, and of course to give to each new bonus share a value equal to the new value of each old share.

As at September 30th, 1935, therefore, the company's valuation of the 176,121 shares (including the 58,707 bonus shares) remained at £119,861 5s. The retention of such figure was not part of a scheme of writing down in order to write up, but a necessary result of its decision to retain valuation at cost pending revaluation, a decision amply justified by the economic factors involved in every bonus distribution.

Subsequently, on October 9th, 1935, two independent accountants revalued each of the 176,121 shares, and agreed that each was worth at least 24s. per share. Thereupon, on October 11th, the directors decided to take all the 176,121 shares into account in the company's books at a value of 24s. per share. The resulting aggregate value of the shares was £211,345 4s. which exceeded by £91,483 19s. the value of £119,861 5s. appearing in the balance sheet of September 30th, 1935. Of this excess of £91,483 19s., it was determined to utilise £87,500 in order to make a bonus issue to shareholders of 100,000 shares of 17s. 6d. each, fully paid.

The Castlemaine company thus made two distinct and separate valuations of identical assets (the 176,121 shares), the first based upon the principle of cost valuation which had been in force ever since the company was formed, and the second being a valuation

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

Evatt J.

based upon the opinion of the directors (confirmed by outside valuers) that the value of each of the 176,121 shares could safely and prudently be treated as increased to 24s. per share. The gain revealed by a comparison of the two figures should be regarded as a profit arising from a revaluation of the 176,121 shares within the meaning of sec. 44 (2) (*b*) (iii) of the *Income Tax Assessment Act*.

Before analysing certain contentions raised by the commissioner, it is desirable to turn to an examination of the evidence.

A feature of the cross-examination of Mr. William Scott, secretary of the Castlemaine company was the attempt to prove that, in the balance-sheet of September 1935, the valuation of the 176,121 shares (involving with it the assessment of each ordinary share at 13s. 4d., and of each preference share at 16s. 8d.) was not based upon an opinion of the directors that these were the real values of the shares at the time in question. The following is a typical extract from his cross-examination :—

"We are still at the September 1935 balance-sheet. You brought in 58,000 new shares that you had got by the bonus issue at the same figure per share as those other ones. 13s. 4d. for some of them and 16s. 8d. for the others. Is that right ? A. That would be the effect.

I am not asking the effect. I am asking—did you bring them in at that figure ? A. Yes.

Do not be argumentative. I am not saying there is anything wrong. You brought the old ones in at 13s. 4d. and 16s. 8d. respectively, and the new ones at the same figure. That is the position is it not ? A. We treated it as a whole.

I know the effect. I am asking what you did. The balance-sheet shows it ? A. That is so.

Did you consider that the old shares were worth less than you paid for them in September 1935 ? A. I consider that the value had been reduced by the bonus issue.

You did not answer my question. I wish you would address yourself to answering the very question asked of you. The question is—did you consider that the old shares were worth less than 20s. ?

Mr. *Fullagar* K.C. : I object to that question. It is not a relevant question in the inquiry.

His Honour : I will admit it.

Mr. *Tait* : Now will you please answer the question. Did you consider that the old shares were worth less than 20s. in September 1935 ? A. I did not consider the value of the shares individually at that date.

Do you consider now that any one share, held in the Carlton company was worth less than 20s. on September 30th, 1935 ? A. I consider they must have been worth at least 20s. at that date.

And you will agree that anybody who had considered it at that time would have thought the same ? A. Yes."

It will be observed that Mr. Scott is merely being forced to repeat what is obvious, viz., that on the 1935 balance-sheet, the directors continued to bring in at cost the 176,121 shares and that this decision necessarily carried with it a reduction in the value per share as compared with September 1934. It is also clear that Mr. Scott believed that the value per share of the old shareholding had been reduced by the bonus issue. His statement that, on September 30th, 1935, as a matter of actual value, all the shares were worth at least 20s. is plainly correct; but in my view the fact is irrelevant.

Later in the cross-examination, the attention of the witness was again drawn to the same point:—

"Did they consider the real value of these new shares in—take the next date, August 1935; that being the time when they decided to have the revaluation made? A. They did not consider it then.

They did not consider the real value in September, 1935, when the balance-sheet was made out? A. No.

But they brought those new shares into the balance-sheet at 13s. 4d. and 16s. 8d.? A. They brought the total holdings in at cost. That is the best way I know of answering the question.

Did they consider that same question, the real value of the new shares, in October, 1935, when the directors decided to write up the value? A. They revalued them at 24s."

In this passage, counsel is only attempting to lay the ground for a contention of law that there can never be any valuation or revaluation of fixed assets within the meaning of the Act unless there is a determination of the governing body of the company as to the "real value" of such assets. In my view, such contention is erroneous, and it was not pressed very seriously on the present appeal.

Mr. Scott explained the position clearly and frankly:—

"One of the things you should consider is, what the values are of assets? A. Not of fixed assets.

You consider the other assets; what the liquid assets are? A. I do the trading assets.

And that you put down as subject to certain things, as the value recorded as true value? A. Of trading assets, that is so.

Whether you put the value in or not; the corresponding true value of fixed assets, the fixed assets have a true value? A. Yes.

But what you are saying is that in the balance-sheet you did not bring in the true value of the fixed assets? A. Not necessarily.

Those Carlton United shares were fixed assets? A. Yes.

Now you know what the true value means? A. Yes.

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

Evatt J.

It is not a thing you bring in on fixed assets in the balance-sheet, but the same value as the trading assets, the true value ? A. Yes.

. . . . . .

Did they consider it. You do not need to know it. You have told me they were worth much more than 24s. ? A. My opinion of the value would be that they would be more than the directors brought them in at.

I want to know whether they considered what was the true value ? A. I find it difficult to answer that question.

Then answer this question. Why do you find it more difficult to answer that question than those you have already answered, namely, whether they have considered the true value at the earlier date. You have told me clearly that they did not at the earlier dates ? A. Because at the earlier dates they definitely valued the whole holding at cost at a definite value which had no relation to the real value. In the second case they valued them according to the revaluation.

We have gone into the form of revaluation and why it was in that form ? A. The directors made that revaluation at 24s., and the advisers merely advised them as to whether that was justified.

Are you telling the court that the directors made a decision that the real value of these shares was 24s., or did they not merely follow what the auditors told them, that the shares were worth at least 24s. ? A. They followed the advice that they were worth at least 24s.

They did not give any consideration to the real value at all ? A. I do not think they went into any detail as to the real value."

It is the same point over again. The witness is stating, in my opinion quite accurately, that at no time did the valuation of the fixed assets in the books and balance-sheet of the Castlemaine company imply that the opinion of the directors was that the assets as so valued were worth only the amount of such valuation. This is true however not only in relation to 1935, but in relation to every year before that. For many years, while the Carlton shares were valued at cost, the real value of the shares was gradually increasing, and, by continuing such valuation, the company was only forming an internal or hidden reserve of profits. The procedure adopted in the balance-sheet of September 1935 which appears to have disturbed some officer of the Commissioner of Taxation was in strict accordance with the procedure adopted in all previous years.

The same comment applies to the valuation of the 176,121 shares at 24s. each. The opinion of the directors was that they could safely value them at 24s. each, although, no doubt, they regarded them as being of a much higher value.

If the view which has already been expressed is sound, it follows that a great deal of the evidence which I have quoted is not material to the question at issue. Mr. *Fullagar* K.C. objected to the admissibility of the evidence, arguing : " It is not a question of what the real value of the shares was at all ; it is what they chose to make of them in order to release funds of the company. That is what has been making me smile from time to time, the suggestion that there has been a deliberate under-valuation. I am suggesting that it is matter for amusement that there is room for criticism somewhere because the company has not valued those shares at their maximum value. Companies frequently do that."

In my view, the case of the commissioner, however expressed, turns almost entirely upon the fact that, after the distribution, the value of each share was shown as reduced by one-third of its previously stated value. This result follows as a matter of mere arithmetical calculation unless the company was disentitled to pursue its established method of valuing fixed assets, pending their subsequent revaluation. As the aggregate cost was not added to by the free gift of the bonus shares, the cost per share of the increased holding necessarily became reduced by one-third. The authorities cited above show clearly that, if, before a bonus distribution of one for two, the real value of each share was £X, it necessarily follows that the real value of every such share after the distribution is reduced to approximately two-thirds of £X. In the present case, the real basis for the criticism of the commissioner is, not that (e.g.) the ordinary shares were valued at only 13s. 4d. each in September 1935, but that they were valued at only £1 each in September 1934. As a matter of fact, this must be conceded. In spite of this, no valid objection can possibly be raised to the action of the directors in valuing each ordinary share at two-thirds of £1. It seems to me to be quite unreasonable to isolate the fact of the reduced value assigned to each share when that result followed inevitably from the continuance of the principle of assessing all the fixed assets at cost, and is entirely justified by the economic results of a watering of stock which is held for investment.

At all times, Mr. Scott acted under instructions from his directors. None the less, he was naturally concerned at the suggestion that,

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

Evatt J.

in some mysterious way, his conduct was open to criticism. But his procedure seems to have fully commended itself to Mr. Wilson, an actuary and sharebroker, called by the commissioner. Mr. Wilson was cross-examined thus :—

"Suppose a company had taken in at cost parcels of shares in another company which it was holding as a permanent investment and the cost was 20s. per share, you see nothing wrong with that ? A. I see nothing wrong with it whatever.

Now, suppose in these circumstances, that there is an issue of one to two shares to holders, and among the holders is this company which has on its books a parcel of the shares at cost : would you agree that it was proper to show the new holding at two-thirds of the previous value, assuming no change in policy in the meantime ? A. I think that it would be a matter of consideration for the directors, and I do consider that they would take in their account the fact that the market value of the shares had appreciated by reason of that watering. They might still retain the value.

What I am asking you is, first of all, to take a case in which at all times you had them in your balance-sheet at cost, whatever their market value had been, up or down. Do you follow ? A. Yes.

And the directors of the company, I am assuming, are maintaining that policy of keeping the assets in at cost.

Would you not agree then that there, after the watering of one to two, they would show at cost the new shares at 13s. 4d. ? A. Undoubtedly, if they are maintaining that policy of keeping them at cost, they would not alter it."

Mr. Wilson was called by the commissioner because prior to, and immediately after, the issue of the bonus shares, the market value of the shares in the Carlton company was said to be considerably in excess of the value attributed by the Castlemaine company both to the unwatered and to the watered shares of the Carlton company. Mr. Wilson was asked :—

"Am I right in attributing to you that, as at the time when the distribution was announced, your personal estimate of the value of the Carlton and United shares was 54s. for the unwatered shares ? A. Yes.

And for the watered shares it was 36s. ? A. Yes.

Is it the position that if your 54s. figure is correct—I do not say it is not—the 36s. follows automatically ? A. That is so.

May I take it that your view, as an expert, is that when you have a watering which involves the distribution of 1 to 2, once you find the value of the unwatered stock, it is a matter of simple arithmetic to find the value of the watered stock ? A. It is a matter of simple arithmetic, involving sometimes other considerations than a mere proportionate value. Sometimes the watered shares do not carry the same first-year dividend as the unwatered.

Quite so, but I am entitled to conclude from the figures you have given me that this is not an exceptional case ? A. I think it was not. I am afraid

that is a point, when working out the figures I did not go into, to see if the new Carlton and United shares carried the same dividends as the old shares."

From this witness, therefore, the Castlemaine company obtained a striking vindication of its action in valuing each share after the watering at precisely two-thirds of its value before watering. This is in accordance with the general principles and illustrations suggested from the cases which I have cited. The fact that in the opinion of the witness each unwatered share was worth 54s. and each watered share was worth 36s. is very interesting, but, in my opinion, quite immaterial and irrelevant. Once it is admitted that it is within the power of the governing body of the company to value its fixed assets at cost, to create an internal reserve by continuing conservative valuations, and to revalue such fixed assets as and when it thinks fit in order to create a fund of profits, consideration of actual or market value becomes irrelevant for the purposes of sec. 44 (2) (*b*) (iii).

I now turn to deal with the grounds relied upon by the commissioner for his decision that sec. 44 (2) (*b*) (iii) does not apply, and that the paid-up value of the 801 shares (fully paid up to 17s. 6d. per share) should be included in the assessable income of the appellant.

1. One contention (that adopted by *McTiernan* J.) was that the value assigned to the 176,121 shares in the balance-sheet referable to September 30th, 1935, was a " sham value," that the directors were " rather merely altering book values than revaluing the assets," that, at the time of the balance-sheet of September 30th, 1935, the company or its directors were already of opinion that each share had an actual value of not less than 24s. per share, and that the figure of £119,861 5s. was retained in the balance-sheet as part of a scheme of writing down values with a view to writing them up subsequently.

McTiernan J. thus referred to the balance-sheet of September 30th, 1935 :—" In truth, that balance sheet did not attribute any value to the additional 58,707 shares allotted in December, 1934. It failed to do so because the shares held by the Castlemaine company had not at that date depreciated in value below par and the par value of these shares, namely, the shares held by the company before it received the 58,707, was the sum of £119,861. The revision of this fictitious figure is not a revaluation of that asset."

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

Evatt J.

However, earlier in his judgment, His Honour found that "the valuation of the 117,414 shares at cost was undoubtedly a genuine valuation." I take this to mean, not that each unwatered share was worth only the value attributed to it in the balance-sheet of September 1934, but that the company was entitled to assign such value to each share (on the basis of valuation at cost). Obviously the directors, if they addressed their minds to the matter at all, must have considered that in September, 1934, the 117,414 shares then held were worth much more than £119,861 5s., the figure at which they were valued in the assets column. I agree that the valuation as at September 30th, 1934, was a perfectly proper and justifiable valuation. But it follows that the directors were equally entitled to value the 176,121 shares at precisely the same figure in September, 1935. Each of the two valuations was based upon the cost of acquiring the fixed assets. If valuation at cost was proper in relation to the first balance-sheet, it was equally justified in relation to the second.

I fully accept the finding that in September, 1935, the directors believed that each of the watered shares was worth at least 24s. per share. But it is also plain that in September 1934, they must have believed that the true value of each of the 117,414 unwatered shares was very greatly in excess of the value at which they were then stated in the balance-sheet. I agree that late in 1934, and early in 1935, the directors had, as Mr. Scott admits and asserts, determined to value the 176,121 watered shares at the cost of acquiring them, and that this determination meant that the aggregate value of £119,861 5s. was to be retained in the September 1935 balance sheet. I will assume also that, early in 1935, the directors determined not to revalue the watered shares until after September 30th, 1935, in respect of which date the balance-sheet of the year 1934-1935 was to be issued. In one sense, undoubtedly, the decision to continue valuation at cost *was* a step in a scheme of creating a fund of profits which was to be used in a particular way. But all this is true of every balance-sheet valuation in which a successful company values its fixed assets at cost, and deliberately refrains from revaluation until the time arrives when, in the judgment of the directors, it is proper and convenient to obtain the use of the whole or any portion of

the resulting accretion as profits of the company. It is only in that sense that the valuation in the balance-sheet of September 30th, 1935, can fairly be characterized as a " sham " or as being " fictitious" or as constituting a step in the carrying out of a scheme of making profits available and distributing them.

It is to be observed that sec. 44 (2) (*b*) (iii) does not speak of profits arising from the " increase in value " of certain assets, but of profits arising from " the revaluation " of such assets. It is for this reason that I have held that the clause addresses itself to the existing practice of presenting company accounts and of allowing a company a wide discretion in the method it adopts for assigning a value to its fixed assets.

It seems to me that the final conclusion of His Honour was due to his opinion that " I am satisfied in this case that the value of the holding which the Castlemaine company had in the Carlton and United Breweries Ltd. was *substantially increased* by the allotment to it of 58,707 bonus shares in December, 1934."

It is to be observed that Mr. Wilson, in his evidence, does not expressly deal with the value of the total holding of the Castlemaine company in the Carlton company (1) before, and (2) after, the bonus distribution. However, he estimated (1) that before the official announcement of the issue of the bonus shares was made, the value of such Carlton shares was 53s. per share ; (2) that after the announcement was made, the value was 54s. ; and (3) that when the process of watering was complete, the value of each share had fallen to 36s. From these figures, it might be deduced that, long before the allotment of the new shares to the Castlemaine company, the 117,414 shares had appreciated in value from 43s. per share to 54s. per share. If so, the value of the Castlemaine company's holding of Carlton shares was not increased to any degree by the former's actual acquisition of the bonus shares, but rather by the opinion of the market *that the unwatered shares were at far too low a price having regard to the fact that a watering was probable, and that, in the long run, shareholders might reasonably expect to receive greater proportionate profits from the business of the Carlton company.* The figures would require revision because the shares in the Carlton company were owned almost entirely by holding companies such as the

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

Evatt J.

Castlemaine company, so that the market was a peculiarly restricted one. But I am not concerned to dispute the fact that, to a substantial extent, the value of the Castlemaine company's holding in the Carlton company was increased by the proposal to issue bonus shares, and by the formal announcement of such proposal, and by the carrying of such proposal into completion. For the crucial point is whether, in the balance-sheet as at September 30th, 1935, the Castlemaine company was entitled to value its fixed assets upon the basis of cost. Every valuation upon the basis of cost postulates that antecedent accretion of value must be ignored.

II. The commissioner also contended that, before the exemption can operate, the assets first valued must be identical with the assets subsequently valued; otherwise there is no revaluation of identical assets. For the purposes of the present appeal, this contention may be accepted, because the requirement is fully satisfied. For the same 176,121 shares as were valued by the directors of the company as at September 1935 at £119,861 5s. were subsequently valued at the figure of £211,345 4s., and the material fund of profits was thereby created. But I do not wish to be taken as holding that, in every case, absolute identity of fixed assets must be established in order to permit of the application of sec. 44 (2) (*b*) (iii). I can imagine cases where assets have been and have to be, grouped for the purposes of valuation, where minor changes in such assets must take place before the group is subsequently revalued, and where the section may possibly operate. The point need not be pursued further in the present case.

Perhaps I should repeat here that it was not, and, in my opinion, could not, be disputed that bonus shares issued to a holding company in pursuance of a capitalization of profits are "assets" within the meaning of sec. 44 (2) (*b*) (iii).

III. The commissioner also contended that the gain of £91,483 19s. from which the sum of £87,500 was taken to satisfy the obligation to pay in full for the new 17s. 6d. bonus shares, although admittedly a "profit" of the company, was not a profit arising solely from the revaluation of the 176,121 shares, and also, as I understand the argument, that the paid-up value of the shares issued to the appellant

and other shareholders of the company was not paid "wholly and exclusively" out of the said profit of £91,483 19s.

It is important to restate what actually took place. Undoubtedly, the paid-up value of the appellant's shares, being "dividends" with which he would be otherwise chargeable with income tax, came wholly and exclusively from the fund of £91,483 19s. profits which had been placed to the credit of the company's "assets revaluation reserve account." For the £87,500, being part of such fund of £91,483 19s., was devoted entirely to the payment of the new issue of bonus shares. Therefore the "dividend" of the appellant was paid wholly and exclusively out of the profits contained in the fund of £91,483 19s.

The earlier part of the argument is different in character. The real contention seems to be that, although the main source of the gain of the £91,483 19s. was the revaluation of the 176,121 shares, another, though subordinate source, was the allotment to the company of its part of the bonus issue. But if, as has been held, the bonus shares are themselves portion of the assets which were revalued, the mode and scheme by which such assets came into existence and were acquired by the company are of no moment. As a matter of narrative, it is true that the acquisition of the bonus shares played its part in the final gain, and may, in that sense, be regarded as one of the "sources" of such gain. But equally the acquisition of the 117,414 shares also played *its* part before the final gain was crystallized. Through excellent business management, a company may succeed in acquiring fixed assets at a very low cost. Then the procedure of valuing at such cost will be adopted until the time is ripe for revaluation. If, upon such revaluation, a considerable surplus is shown over the cost price carried from year to year in the books, I am of opinion that, on the true construction of sec. 44 (2) (*b*) (iii), such gain is a profit "arising from the revaluation of assets," although, as a matter of history, and of remote causation too, one of the "sources" of the final profit was the good bargain which was made when the assets were originally purchased. Exactly the same principle must apply wherever fixed assets have been acquired by a company without any cost to the company. In the case of an acquisition of bonus shares by a holding company, such

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

Evatt J.

acquisition can never represent a clear gain because the true value of the new asset will usually be balanced or very nearly balanced by the depreciation in value of the original holding. But, even in cases where a company acquires a valuable fixed asset for no consideration whatever, the gain revealed upon subsequent revaluation of the fixed assets (including the fixed asset acquired for nothing) is a profit "arising from the revaluation of assets" within the meaning of sec. 44 (2) (*b*) (iii), and it is not material that, but for the acquisition, the profit would not or might not have been so large as it turned out to be. In all such cases, the various acquisitions of the fixed assets constitute occasions without which the company could not have subsequently made a profit from its revaluation of fixed assets. But, I hold that, when the provision in the statute speaks of profits "arising from the revaluation of assets not acquired for the purpose of resale at a profit," the circumstances surrounding the acquisition of each asset are only material for the purpose of determining whether such asset is of the character contemplated by the provision. If it is of such a character, the clause postulates (1) that it *is* an asset from a revaluation of which profits *may* arise, (2) that the first relevant question is whether the asset (either alone or with other assets of the same character) has been revalued, and (3) that the second relevant question is whether upon a comparison of two values, a gain has been shown. Thus, although "revaluation" itself can never give rise to or cause profits, but can only show that in the opinion of a valuer, profits have already arisen, the statute looks to revaluation as a possible and exclusive source of profit.

I therefore hold that the profit of £91,483 19s. arose from the revaluation of the 176,121 shares, and not otherwise, and that it is not material either that the acquisition of the bonus shares was of substantial gain to the company, or that the three previous acquisitions of shares in the Carlton company may have been gainful operations in the business life of the company. Indeed, I think that it can be stated quite dogmatically that, in the case of the Castlemaine company, its acquisitions of the 117,414 shares turned out to be far more gainful and advantageous than the subsequent acquisition of 58,707 bonus shares, assuming that some actual gain was derived from the last acquisition.

Learned counsel for the commissioner suggested that, if the appellant was successful, companies might abuse the provision for exemption. I do not think that there is any real danger of such an abuse. If fixed assets are deliberately undervalued solely with a view to subsequent restoration of the real value, the " profit " shown from the second part of the transaction will do no more than balance the " loss " shown from the deliberate undervaluing. Thus, the transaction as a whole will reveal no " profit." But these exceptional cases can be dealt with if and when they occur. All that sec. 44 (2) (*b*) (iii) does is to mitigate the very rigid rule that the total paid-up value of bonus shares issued in capitalizing a company's profits should be treated as income in the hands of the shareholder. The legislature has modified the rule in relation to profits of a company which are attributable to accretions in the value of the company's fixed assets. In doing so, the legislature has acted prudently in allowing companies to act according to well-established principles of company management and book-keeping, and in regarding the company's own revaluations of fixed assets as occasions of a profit or gain which may be capitalized for the purpose of a bonus issue. The revenue will always be protected by the restrictions which the general law imposes upon the distribution of company profits and by the fact that, as a general rule, the result of issuing bonus shares is not to make shareholders more wealthy, but to enable the company to distribute an equal, or even a greater, money sum while declaring a lower *rate* of dividend on the watered shares. I should add that, in the present case, it is conceded that all those concerned in the management of the Castlemaine company acted in good faith, and that there was ample justification in law for its material acts and decisions. Perhaps it should also be added that admittedly the reduction in the share capital of the company which was effected in November 1935 (when the nominal amount of each share was reduced from 17s. 6d. to 15s., the reduction being subsequently approved by the court) has no bearing on the case.

In my opinion, the appeal should be allowed with costs here and before *McTiernan* J., and the Commissioner of Taxation should be directed to amend the assessment by excluding from the amount of

H. C. OF A. 1939-1940.

DICKSON v. FEDERAL COMMISSIONER OF TAXATION.

the appellant's assessable income the sum of £701 attributable to the paid-up value of the 801 shares distributed to him as shareholder in the Castlemaine Brewery Melbourne Ltd.

Appeal allowed. Order dismissing appeal from commissioner set aside. In lieu thereof order that the appeal from the commissioner be allowed. Declare that the 801 *paid-up shares in Castlemaine Brewery Company Melbourne Ltd. were not assessable income of the appellant in the year ending* 30*th June* 1936. *Remit assessment to the commissioner for amendment in accordance with this order. Respondent to pay appellant's costs of appeal to High Court and to Full Court.*

Solicitors for the appellant, *Raynes Dickson, Kiddle & Briggs.*

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

O.J.G.