[PRIVY COUNCIL.]

NICHOLAS . . . . . APPELLANT;

AND

THE COMMISSIONER OF TAXES (VICTORIA) RESPONDENT.

ON APPEAL FROM THE HIGH COURT OF AUSTRALIA.

PRIVY COUNCIL. 1940. April 25.

Viscount Caldecote L.C., Viscount Sankey, Lord Thankerton, Lord Russell of Killowen, and Lord Romer.

Income Tax (Vict.)—Special tax—Unemployment-relief tax—Assessable income—Bonus shares—Capitalization of profits—"Dividend . . . profit or bonus"—"Credited, paid or distributed"—Unemployment Relief Tax (Assessment) Act 1933 (*Vict.*) (*No.* 4171), *sec.* 4—*Income Tax Act* 1935 (*Vict.*) (*No.* 4309), *sec.* 2 (1) (*g*).

Where a company in Victoria applies its accumulated profits in satisfaction of an issue of fully-paid-up bonus shares to its shareholders in proportion to their holdings, the amount thus credited from profits to each shareholder in respect of his bonus shares is a "dividend . . . profit or bonus" credited to him within the meaning of sec. 4 of the *Unemployment Relief Tax (Assessment) Act* 1933 (Vict.) and sec. 2 (1) (*g*) of the *Income Tax Act* 1935 (Vict.) and, accordingly, for the purposes of special income tax and unemployment-relief tax must be included in his assessable income.

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

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

Decision of the High Court: *Commissioner of Taxes (Vict.)* v. *Nicholas*, (1938) 59 C.L.R. 230, affirmed.

APPEAL from the High Court to the Privy Council.

This was an appeal by George Richard Nicholas, a taxpayer who had objected to an assessment for Victorian income tax (special tax) and unemployment-relief tax, from the decision of the High Court of Australia in *Commissioner of Taxes (Vict.)* v. *Nicholas* (1), reversing a decision of the Supreme Court of Victoria (Full Court) (2) on a case stated by a judge of county courts to whom the taxpayer's objection had been transmitted.

(1) (1938) 59 C.L.R. 230. (2) (1937) V.L.R. 331.

PRIVY COUNCIL. 1940. NICHOLAS v. COMMISSIONER OF TAXES (VICT.). April 25.

LORD THANKERTON delivered the judgment of their Lordships, which was as follows :—

This appeal arises out of a special case stated by a judge of the County Court of Melbourne under the provisions of sec. 66 of the *Income Tax Act* 1928 of the State of Victoria (Victoria, 19 Geo. V. No. 3701), and the question is whether an amount of £210,000 ought to be included in the assessment made upon the appellant for the year 1935-1936 as part of his assessable income liable to unemployment-relief tax and special tax, which are imposed respectively by the *Unemployment Relief Tax (Assessment) Act* 1933 and the *Income Tax Act* 1935, both being statutes of the State of Victoria. The determination of the question rests upon the proper construction of these two statutes. The appeal is by special leave from a judgment of the High Court of Australia dated 25th March 1938, which reversed a judgment of the Full Court of the Supreme Court of the State of Victoria dated 1st September 1937.

The relevant provision of the *Unemployment Relief Tax (Assessment) Act* 1933 (Victoria, 24 Geo. V. No. 4171) is as follows :— "4. For the purposes of this Act—(*a*) in the case of any person who is a member or shareholder of a company registered in Victoria —any dividend interest profit or bonus credited paid or distributed to him by the company from any profit derived in or from Victoria or elsewhere by it; or (*b*) in the case of any person ordinarily resident in Victoria, who is a member or shareholder of a company whether registered in Victoria or not and whether carrying on business in Victoria or not—any dividend interest profit or bonus credited paid or distributed to him by the company—shall be deemed to form part of the assessable income of that person."

The relevant provision of the *Income Tax Act* 1935 (Victoria, 26 Geo. V., No. 4309) is as follows :—"2.—(1) . . . (*g*) In the case of any person (not being a company) whose taxable income within the meaning of this paragraph exceeds one hundred pounds, there shall be payable (and whether or not in his case there is also payable the tax additional tax and further additional tax or any of them chargeable under the preceding provisions of this section) a special tax on the whole of the said taxable income of such person as hereinafter provided, that is to say :—" (here follows a scale of

rates graduated according to the total amount of taxable income). "For the purposes of this paragraph (*g*) of this sub-section . . . (ii) subject to the said paragraph (*g*), the taxable income within the meaning hereof of taxpayers hereunder shall be calculated and the amount of the special tax aforesaid payable by each taxpayer hereunder shall be assessed in like manner as the taxable income within the meaning of the *Income Tax Acts* (not including the said paragraph) of taxpayers is calculated under the said Acts and as the amount of the tax payable under the said Acts is assessed, and for the purposes of the said paragraph the provisions of the said Acts as modified by the said paragraph shall take effect—as if in calculating the exemptions provided for in section twenty-one of the principal Act paragraph (*e*) of that section were omitted: . . . as if in the principal Act it were provided that—in the case of any person who is a member or shareholder of a company registered in Victoria—any dividend interest profit or bonus credited paid or distributed to him by the company from any profit derived in or from Victoria or elsewhere by it; and in the case of any person ordinarily resident in Victoria who is a member or shareholder of a company whether registered in Victoria or not and whether carrying on business in Victoria or not—any dividend interest profit or bonus credited paid or distributed to him by the company—is to be deemed to form part of the assessable income of that person."

As regards the question in this appeal neither party has suggested that there is any material distinction between the terms of the two Acts, the words immediately under construction being "any dividend interest profit or bonus credited paid or distributed to him by the company," and it is equally accepted that in the case of a person ordinarily resident in Victoria—as the appellant is—these words relate to an application of the profits of the company.

The material facts may be summarized as follows:—The appellant is a shareholder of Lorraine Investments Pty. Ltd., a company incorporated in Victoria in 1926 under the Victorian *Companies Acts* and carrying on business in Victoria. At the time of its incorporation the company had a nominal share capital of £100,000 divided into 100,000 shares of £1 each. On 22nd August 1932, the nominal capital was increased to £500,000 by the creation of 400,000 new

PRIVY COUNCIL. 1940. NICHOLAS v. COMMISSIONER OF TAXES (VICT.).

shares of £1 each. Prior to 29th August 1934 the company issued 50,000 of these shares and the same had been paid for in cash, and, on the said date, the shares of the company were held as follows :—

	Shares
George R. Nicholas (the appellant)	29,995
Trustees of Betty, Lindsay, Nola and Hilton Nicholas	20,000
F. J. Davey	5
	50,000

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

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

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

Each of the above resolutions was carried in the presence of and with the consent of all the shareholders of the company. In the books of the company journal entries and ledger-account entries were made, giving effect to these three resolutions. The unallotted capital account in the ledger shows that on 15th April 1926 cash was paid for the 50,000 shares then issued and, as regards the issue of 350,000 shares, there is an entry, under date 25th September 1934, "By reserve account £350,000."

The parties are agreed that the shares were issued as fully paid. The sum of £350,000, which was applied in satisfaction of the amount due on the shares was undistributed profits of the company, and the shares were distributed among the shareholders in proportion to their holdings in the company. 210,000 shares were issued to the appellant, which were at all material times of a value of £210,000.

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

Their Lordships are of opinion, on consideration of these facts, that a sum of £210,000 was credited to the appellant from the profits of the company within the meaning of the statutory provisions above quoted, and they agree with the views expressed by the majority of the High Court. This sum was therefore rightly included in the assessment of the appellant to unemployment-relief tax and special income tax. It thus becomes unnecessary to consider the other view expressed by *Gavan Duffy* J. of the Supreme Court of Victoria (1), viz., that the shares themselves were a bonus distributed or credited from profits within the meaning of the statutory provisions, and their Lordships express no opinion on this view.

There can be no doubt that the company applied a sum of £210,000 from undistributed profits in satisfaction of the amount of the liability which would have otherwise have rested on the appellant on the allotment of the 210,000 shares, which was made with his consent, and thus, by the action of the company, the appellant received a benefit in the issue to him of shares credited as fully paid by an application of undistributed profits. In the second place, the distribution of the shares and the application of undistributed profits was among the shareholders only and was in proportion to their holdings in the company, and the application of undistributed profits was also in those proportions, and therefore in the proportions which would regulate the distribution of a dividend. In their Lordships' opinion, such an application by the company of an appropriate proportion of undistributed profits for the benefit of the shareholder is aptly described as crediting the shareholder with the amount necessary to render the shares fully paid, the source of the credit being profits of the company.

It is said that this conclusion is inconsistent with the principles laid down by the House of Lords in *Inland Revenue Commissioners* v. *Blott* (2). In the first place, it must be observed that that decision

(1) (1937) V.L.R., at p. 348. (2) (1921) 2 A.C. 171.

PRIVY COUNCIL. 1940. NICHOLAS v. COMMISSIONER OF TAXES. (VICT.).

proceeded on different statutory provisions, and it requires to be shown that the reasoning of the decision is clearly applicable to the Victorian statutes here in question. That such need for care is required is well illustrated by the comments in *Blott's Case* (1) on the decision of this board on a Western-Australian statute in *Swan Brewery Co. Ltd.* v. *The King* (2), the limits of which were further discussed in *Commissioner of Income Tax, Bengal* v. *Mercantile Bank of India Ltd.* (3).

As stated by *Rowlatt* J. in *Blott's Case* (4), "what I do lay stress on is that one has to look for a 'payment.' Now I do not think that there is a payment of a dividend to a shareholder unless a part of the profits of the company is thereby liberated to him in the sense that the company parts with it, and he takes it. If, in this case, the company could have found means to capitalize their profits and divide them as capital without adopting the machinery of declaring a bonus and allotting shares by agreement (not, be it observed, a voluntary agreement) in satisfaction of such bonus, I do not think the case would have been arguable. I am asked to decide that there was a 'payment' of this bonus upon the strength of what I consider bare machinery. I cannot do so. The fact is simply that the shareholder was given shares instead of a bonus."

The decision of *Rowlatt* J. was affirmed by the Court of Appeal and by the House of Lords, and the reasoning of the majority in the House of Lords follows that of *Rowlatt* J. Lord *Haldane* says: —"My Lords, for the reasons I have given I think that it is, as matter of principle, within the power of an ordinary joint stock company with articles such as those in the case before us to determine conclusively against the whole world whether it will withhold profits it has accumulated from distribution to its shareholders as income, and as an alternative not distribute them at all, but apply them in paying up the capital sums which shareholders electing to take up unissued shares would otherwise have to contribute. If this is done the money so applied is capital and never becomes profits in the hands of the shareholder at all" (5).

(1) (1921) 2 A.C. 171.
(2) (1914) A.C. 231.
(3) (1936) A.C. 478.
(4) (1920) 1 K.B. 114, at p. 133.
(5) (1921) 2 A.C., at p. 184.

Viscount *Finlay* says :—" The resolution of 8th February 1915, was, that for the purposes of capitalizing £33,333 6s. 8d., part of the undivided profits of the company, a bonus on each of the issued ordinary shares be declared, and that the directors be authorized to satisfy such bonus by the distribution among the members holding ordinary shares of 33,316 of the unissued second preference shares of £1 each, credited as fully paid up. The effect of this operation was that the amount of the bonus was retained by the company as additional capital, and that the shareholders got the new preference shares. No option was left to any particular shareholder. He was compelled by the action of the company to take the preference shares. He could not have sued for the bonus in money, as the resolution which gave the bonus *uno flatu* declared that it was to be satisfied by the distribution of preference shares. Under these circumstances it seems to me impossible to treat the shareholders for the purpose of super-tax as having received the bonus and paid it back to the company to be retained as capital. They never received it at all " (1).

He then quotes with approval the passage already quoted from the judgment of *Rowlatt* J. Viscount *Cave* states :—" The resolution did not give to any shareholder a right to sue for the dividend in cash, his only right being to have an allotment of fully paid shares in the capital of the company. The profits remained in the hands of the company as capital, and the shareholder received a paper certificate as evidence of his interest in the additional capital so set aside. The transaction took nothing out of the company's coffers, and put nothing into the shareholders' pockets " (2).

These statements may be summarized as follows :—Although in form a dividend was declared, it was inevitably at once applied to payment of the capital sums which the shareholders would otherwise have had to contribute. The share of profits so applied was never in the hands of the shareholder, nor had he ever a right to sue for it. Therefore in no sense could the shareholder be said to have received payment or to have had the right to demand payment, of a share of the profits, which, in such an event, would have formed part of his income for the purposes of British super-tax.

(1) (1921) 2 A.C., at p. 194. (2) (1921) 2 A.C., at p. 200.

PRIVY COUNCIL. 1940. NICHOLAS v. COMMISSIONER OF TAXES (VICT.).

But it seems equally clear that the learned Lords accepted the view that the shareholder was credited with the discharge by such payment of his liability for payment in full on allotment. Lord *Haldane* refers to the application of the profits " in paying up the capital sums which shareholders electing to take up unissued shares would otherwise have to contribute " (1), and, in another passage, he refers to " the case of a company using a reserve over which it had full power of disposition, in order to make payments out of it for the benefit of the existing shareholders of capital sums which they would otherwise have had to contribute for the purchase of new shares " (2). Lord *Finlay* refers to the satisfaction of the bonus by distribution of the shares " credited as fully paid up." But this is made even clearer by their statements that the principles laid down in *Bouch* v. *Sproule* (3), were equally applicable in *Blott's Case* (4). In that case, not only was a dividend declared, but a dividend warrant for the money amount of the dividend was sent to each shareholder, although the shareholder was bound, under the terms of the resolution, to sign and return the warrant, which contained an authority from the shareholder for the application of the amount of the warrant in payment of the call on the shares. Clearly, in the opinion of their Lordships, in that case the dividend, even if not " paid " or " distributed," was " credited " to the shareholder from the profits of the company, and the fact that the credit was used for the discharge of a capital liability, however relevant in a question of British super-tax, is not relevant in the case of the Victorian statutes, under which it is to be deemed to form part of his assessable income.

Their Lordships would add that the decision of the House of Lords in *Ooregum Gold Mining Company of India* v. *Roper* (5), was before the House in *Blott's Case* (4), and it cannot be taken that the learned Lords, who formed the majority in the latter case, intended to lay down any principle which was inconsistent with the earlier decision, in which it was made clear that liability for the amount due on the issue of shares is on the allottee, and the liability must

(1) (1921) 2 A.C., at p. 184.
(2) (1921) 2 A.C., at pp. 187, 188.
(3) (1887) 12 App. Cas. 385.
(4) (1921) 2 A.C. 171.
(5) (1892) A.C. 125.

be satisfied from some source external to the company, in money or money's worth, an example of which might consist of the discharge of the company's legal indebtedness for goods supplied or services rendered by the allottee ; but that would mean crediting the allottee with the sum due by the company and, with his consent, applying the credit in discharge of the allottee's liability on the shares. In this view, it was correct, in *Blott's Case* (1), to treat the shareholder as credited with the amount of the dividend, although he had no right to get the amount into his hands or to sue for it.

Their Lordships are therefore of opinion that *Blott's Case* (1) is not only distinguishable from the present case, in view of the difference of the statutory provisions under consideration, but that the reasoning of the speeches in *Blott's Case* (1) above referred to, is helpful in illustratng the contrast between the two cases.

On the other hand, the Australian Federal legislation is nearly akin to the Victorian statutes as regards the matter under consideration ; but their Lordships desire to make clear that they consider that the meaning of the provisions of the Victorian statutes under consideration is clear and unambiguous, and they do not find it necessary to consider their historical genesis, or to trace their parentage to the Federal legislation of 1915, or the decision of the High Court in *James* v. *Federal Commissioner of Taxation* (2). But the decision in *James's Case* (2) is helpful as regards the meaning of the words " dividends, interest, profits or bonuses credited or paid " to a shareholder. The decision was unanimous, and *Blott's Case* (1) was discussed and distinguished on grounds similar to those already expressed by their Lordships. In the present case, the majority of the learned judges base their decision on the reasoning in *James's Case* (2), and their Lordships agree with their views, and in particular with the analysis of *James's Case* made by *Rich* J (3). The earlier case of *Webb* v. *Federal Commissioner of Taxation* (4) related to a distribution in the winding up of the old company, which had been reconstructed, of shares in the new company, which formed part consideration for the latter company's purchase of the undertaking of the old company, and these facts led to a contrary result to that

(1) (1921) 2 A.C. 171.
(2) (1924) 34 C.L.R. 404.
(3) (1938) 59 C.L.R., at pp. 242-244.
(4) (1922) 30 C.L.R. 450.

PRIVY COUNCIL. 1940. NICHOLAS v. COMMISSIONER OF TAXES. (VICT.).

in *James's Case* (1), but similar views were expressed as to the proper construction of the Act of 1915.

Their Lordships are of opinion that a dividend, profit or bonus of £210,000 was credited to the appellant from the profits of the company, and that the question stated by the learned County Court judge should be answered in the affirmative.

Their Lordships will accordingly humbly advise His Majesty that the appeal should be dismissed and that the judgment of the High Court of Australia dated 25th March 1938 should be affirmed. The appellant will pay to the respondent his costs in the appeal.

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