[HIGH COURT OF AUSTRALIA.]

ABRAHAMS . . . . APPELLANT;

AND

THE FEDERAL COMMISSIONER OF TAXATION . . . . RESPONDENT.

H. C. OF A.
1944.

MELBOURNE,
Oct. 23, 27, 30, 31;
Nov. 1.

SYDNEY,
Nov. 23.

Williams J.

Estate Duty (*Cth.*)—*Assessment*—*Dutiable estate*—*Shares in companies*—*Valuation*—*Investment companies*—*Restrictions on transfer of shares*—*Control of companies vested in one director*—*Estate Duty Assessment Act* 1914-1928 (*No.* 22 *of* 1914—*No.* 47 *of* 1928).

In estimating the future profits of a company for the purpose of determining the amount which would be paid on a hypothetical purchase of shares at the date of death of a deceased, the method of estimating these profits from those past years considered most appropriate is usually a convenient method of approach. In the case of a business where it is necessary to estimate the future volume of the trade, it may well be the only method, but in the case of an investment company, an alternative method is to examine the investments owned by the company and estimate their future earning capacity. Whether assets are owned by a company or an individual, they cannot be expected to produce a higher income than is appropriate to the nature of the particular assets; and, speaking generally, it can be said that the greater the risk that an asset will not produce the estimated income or that the capital invested in an asset will be lost, the higher the income yield that an investor, whether a company or an individual, will expect from that asset. In the case of companies engaged in various kinds of trade, it may be relatively simple to ascertain an appropriate rate of profit or dividend yield which an investor could reasonably require on the price he paid for the shares, but in the case of companies engaged in investment business the profit and therefore the dividend yield must vary considerably according to the nature of the assets in which the shareholders' funds have been invested.

At the date of his death E. owned shares in five companies, three of which carried on investment businesses, the fourth a comparatively small hardware and a considerable investment business, and the fifth a pastoral business. E. and his brother A., who was appointed his sole executor, held equal interests in the whole of the issued capital of the companies. With the exception of

H. C. of A. 1944.

Abrahams v. Federal Commissioner of Taxation.

the X company no dividends had been paid by any of the companies, though they had all made large profits, and at the date of E.'s death large sums stood to the credit of the profit and loss accounts of four of the companies. In addition large sums had been advanced to the two brothers by three of the companies free of interest but repayable on demand, and these debts were outstanding at the date of E.'s death. The memorandum and articles of association of each company other than the Y company contained a restriction on transfer of shares whereby the board of directors might refuse to register any transfer of shares to a transferee who was in their opinion an undesirable person to admit as a member of the company; the articles of association of each of these companies also contained provisions which entitled A., after the death of E., for the rest of his life to exercise all the powers of the company, and entitled the other directors, if any, to exercise only such powers as A. might delegate to them, and placed them under his control and made them liable to be removed by him. The articles of association of the Y company provided that there was no right of transfer of shares without the consent of the governing directors and that the directors might refuse to register any transfer of shares; these articles also provided that the governing directors should have the right at any time of purchasing the shares of all or any of the members of the company, the purchase price to be the amount paid up thereon or, at the option of the governing directors, the amount which bore the same proportion to the excess value of the assets over the liabilities of the company as the total amount paid up on the shares bore to the total paid-up capital of the company; A., after the death of E., was also given large powers of control of the company.

Held that the final assessment of the value of E.'s shares in the five companies for estate duty purposes must be made principally on the basis of the income yield (including, in the circumstances of the case, the strong probability of the distribution of accumulated profits in at least three of the companies). But the assets value can be used as a check, and in the exceptional circumstances of this case it was legitimate to rely more than usual on the assets value.

Held, further, that the effect of the restrictions on transfer of shares and the power given to A. during his life to control the companies must be taken into account, but each case must depend on its own circumstances, and, as any depreciation on this account had been allowed for in the primary valuation, no further reduction should be made.

Appeal from the Federal Commissioner of Taxation.

Alfred Abrahams, the sole executor of the estate of his brother Emanuel Abrahams, who died on 17th October 1938, appealed to the High Court against the valuation placed by the Federal Commissioner of Taxation upon the shares in five companies owned by the deceased in an amended assessment of his estate for the purposes of Federal estate duty.

The appeal was heard by *Williams* J., in whose judgment the facts are fully stated.

Ham K.C., *Menzies* K.C., *Fullagar* K.C. and *Coppel*, for the appellant.

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

Cur. adv. vult.

Nov. 23.

WILLIAMS J. delivered the following written judgment:—This is an appeal by Alfred Abrahams, the sole executor of the estate of his brother Emanuel Abrahams, who died on 17th October 1938, against the valuation placed by the respondent upon the shares in five companies owned by the deceased in an amended assessment of his estate for the purposes of Federal estate duty.

In his return for the purposes of duty the appellant stated the total value of the assets in the estate to be £228,284, the liabilities to be £291,315, and the excess of liabilities over assets to be £63,030.

On 4th October 1941 the respondent made an assessment of duty on a dutiable estate of the value of £269,698 and demanded payment of duty amounting to £40,454. On 18th March 1943 the respondent amended the assessment by reducing the value of the dutiable estate to £234,776 and demanded payment of duty amounting to £35,216 8s. On 14th April 1943 the appellant objected to the amended assessment, as he had previously done to the original asssessment, on the ground that he was not liable to pay any duty.

Originally the parties were at issue with respect to the values of the shares owned by the deceased in twelve companies, but the appellant has not appealed with respect to the final values placed upon the shares of seven of these companies by the respondent, leaving the value of the shares in five companies to be determined on this appeal. The full names of these five companies are as follows:—Opera House Investment Pty. Ltd., Interstate Investment Co. Pty. Ltd., Small Arms Co. Pty. Ltd., Mia Mia Pastoral Co. Ltd., and Avrom Investments Pty. Ltd. Four of the companies, namely, Opera House, Interstate Investment, Small Arms and Avrom, were incorporated in Victoria under the provisions of the Victorian *Companies Acts* on 25th February 1919, 18th June 1924, 25th February 1919 and 7th April 1934 respectively, while the fifth company, Mia Mia, was incorporated in Western Australia under the Western Australian *Companies Act* 1893 on 15th February 1918.

The memorandum of association of each of the companies other than Avrom contains a clause that the right to transfer shares in

H. C. OF A. 1944. ABRAHAMS v. FEDERAL COMMISSIONER OF TAXATION. Williams J.

the company is restricted and the directors may refuse to register any transfer of shares upon which the company has a lien or any transfer to a transferee who is in their opinion an undesirable person to admit as a member of the company and the directors shall in no case save in the case of a lien be bound to assign any reason for refusing to register any transfer and their decision shall be conclusive. This restriction is repeated in the articles of association of each of these companies. The articles of association of each of these companies also contain provisions the effect of which is, shortly stated, that, now that Emanuel is dead, Alfred for the rest of his life will be entitled to exercise all the powers of the company and the other directors, if any, of the company shall only exercise such powers as he may delegate to them and they shall be under his control and liable to be removed by him and shall be bound to conform to his directions in regard to the business of the company.

The validity of the provisions which purport to confer upon Alfred the power to compel other directors, in the exercise of their fiduciary powers as directors, to conform to his directions has not been raised, and I propose, therefore, to consider the value of the shares in these four companies upon the basis that for the rest of his life Alfred will, through his control of the board of directors, be entitled to exercise the power to refuse to register a transfer of shares to a transferee who is in his opinion an undesirable person to admit as a member of the company, and to control the business and affairs of each company, including the power to recommend and thereby to limit the amount of any dividend which the company may declare in general meeting, and before recommending any such dividend to set aside out of the profits of the company and carry to reserves such sums as the directors think proper. On 17th October 1938 Alfred was aged 74 years and 5 months; and, according to actuarial calculations, his expectancy of life was then 7½ years, but fortunately it is unnecessary, in order to dispose of the appeal, to have to hazard an opinion whether this calculation will prove correct.

The articles of association of Avrom contain provisions appointing Emanuel and Alfred joint governing directors of the company during such period during their lifetime as they shall desire so to remain; giving to each of them power by will to appoint any person or persons to be a governing director or governing directors of the company after their respective deaths; and, subject to any appointment by them, power to their executors to make such appointments and to remove them, but it is expressly declared that notwithstanding anything in the articles all powers authorities and discretions conferred by the articles upon the governing director or governing directors for the time being (other than Emanuel and Alfred) shall be subject to all restrictions, limitations and conditions as may be imposed upon such other governing director or governing directors on or during appointment by Emanuel and Alfred or by other the person or persons entitled for the time being to make such appointment. These articles also provide that there shall be no right of transfer of any shares in the company except subject to the absolute discretion and with the written consent of the governing director or governing directors for the time being or if there shall be no governing director or governing directors then with the consent of the board of directors; that the directors shall decline to register any transfer of shares unless with such consent as aforesaid and may at their discretion decline to register or allow any transfer of shares without assigning any reason for such refusal; and that the governing director or governing directors for the time being shall have the right at any time of purchasing the shares of all or any of the members of the company, the purchase price to be the amount paid up thereon or at the option of the governing director or governing directors the amount which bears the same proportion to the excess value of the assets over the liabilities of the company as disclosed by the audited balance-sheet of the company on 30th June then last past as the total amount paid up on the shares bears to the total paid-up capital of the company.

At the date of death the issued capital of the companies was as follows:—Opera House 28,000 ordinary shares of £1 each fully paid; Interstate Investment 25,000 ordinary shares of £1 each fully paid; Small Arms 45,000 ordinary shares of £1 each fully paid; Mia Mia 125,000 ordinary shares of £1 each fully paid; and Avrom 329,000 ordinary shares of £1 each fully paid. With the exception of Avrom, the two brothers held in equal numbers the whole of the issued capital of the companies. In Avrom, they were registered as the joint holders of 4,000 shares, but in his return for duty Alfred has admitted, and he does not now contest, that a half interest in these shares belongs to the estate. I propose, therefore, to dispose of the appeal on the basis that the beneficial interest in these shares belonged to the two brothers as tenants in common.

With the exception of Avrom, no dividends have been paid by any of the companies, although they have all made large profits. On 30th June 1938, therefore, large sums stood to the credit of the profit and loss accounts of four of the companies upon which ordinary company income tax, Federal and State, and Federal undistributed profits tax had been paid. The amounts of these undistributed profits were as follows :—Opera House £241,721 ; Interstate Investment £40,969 ; Small Arms £117,325 ; Mia Mia, reserve account £29,776, profit and loss account £88,240 (total £118,016). In addition large sums had been advanced to the two brothers by three of the companies free of interest but repayable on demand. The total sums so advanced as at 30th June 1938 were as follows :—Opera House £180,630 ; Small Arms £55,988 ; Mia Mia £166,653. Total £403,271. As Emanuel's share of this total was £201,635, this debt comprised roughly two-thirds of the liabilities of his estate.

The businesses which the companies were carrying on in October 1938 may be shortly described as follows :—Opera House, Interstate Investment, and Avrom, investment businesses ; Small Arms, a comparatively small hardware and a considerable investment business, the accounts of the two businesses being kept distinct ; and Mia Mia a pastoral business of growing wool in Western Australia upon an area of about 500,000 acres comprising almost entirely leasehold land in the district of West Gascoigne, where there is a low rainfall and the country is of light carrying capacity.

For the purposes of the appeal, the parties have agreed to accept as evidence the entries in the books and accounts of the companies, and the values placed upon the assets in the balance sheets, subject to the variations set out in exhibit B ; and subject to a determination by the Court of the proper values to be placed upon the lease of Hardware Chambers, in which the Small Arms company carries on its business, and that of Rickards and Tivoli Buildings which is an asset of the Opera House Investment Co. The values of these assets appearing in the balance-sheets as at 30th June 1938 were as follows : —Hardware Chambers £1,445 and Rickards and Tivoli Buildings £11,495. On this issue the appellant relied upon the evidence of Angus McIntyre and the respondent on that of J. D. O'Brien. Mr. McIntyre valued the lease of Hardware Chambers at £3,902, and that of Rickards and Tivoli Buildings as £31,800, subject in each case to a possible deduction, which he was unable to assess of the lessee's liability to restore the buildings to a proper state of repair on the expiry of the lease ; while Mr. O'Brien valued the lease of Hardware Chambers at £6,557, and that of Rickards and Tivoli Buildings at £43,912. I do not intend to spend much time on this issue, which is somewhat on the fringe of the case, and it will be sufficient to say that I am unable to accept Mr. O'Brien's evidence, mainly because I am satisfied that his rate of capitalization, namely 4 per cent, was too low, and that I propose to substitute Mr. McIntyre's values for those in the balance-sheets.

The *Estate Duty Assessment Act* 1914-1928, s. 8, provides that estate duty shall be levied and paid upon the value, as assessed under the Act, of the estates of persons dying after the commencement of the Act. In order to comply with the Act, it is necessary to ascertain the real value as at the date of death of the assets which form part of the dutiable estate. The Act does not, as in s. 7 (5) of the English *Finance Act* 1894 which has recently been considered by the House of Lords in *Inland Revenue Commissioners* v. *Crossman* (1), and in s. 71 of the New Zealand *Death Duties Act* 1921, which has recently been considered by the Supreme Court of New Zealand in *In re Harvey*; *Public Trustee* v. *Commissioner of Stamp Duties* (2), *Tremaine* v. *Commissioner of Stamp Duties* (3), *McGregor* v. *Commissioner of Stamp Duties* (4) and *In re Crawford*; *Public Trustee* v. *Commissioner of Stamp Duties* (5), direct that the value of the shares shall be estimated to be the price which such property would fetch if sold in the open market at the time of the death of the deceased. In *Crossman's Case* (1) it was held by the House of Lords, approving *Attorney-General* v. *Jameson* (6) and *Salvesen's Trustees* v. *Inland Revenue Commissioners* (7), that this meant that the value of the shares for the purpose of duty was to be estimated at the price which they would fetch if sold in the open market on the terms that the purchaser should be entitled to be registered and to be regarded as the holder of the shares, and should take and hold them subject to the provisions of the articles of association, including those relating to the alienation and transfer of shares in the company. It has been held, however, in the case of other Australian statutes which, like the *Estate Duty Assessment Act*, do not direct any particular method of estimating the value of the assets, that it is proper to estimate the value of shares held by a deceased in a company, the articles of association of which contain restrictions on transfer, in the same manner, and that the court should endeavour to ascertain (as in the case of property compulsorily acquired) the price which a willing but not anxious vendor could reasonably expect to obtain and a hypothetical willing but not anxious purchaser could reasonably expect to have to pay for the shares if the vendor and purchaser had got together and agreed on a price in friendly negotiation, the basis of the bargaining being that the purchaser would be entitled to be registered as the owner of the shares but when registered would hold them subject to the provisions of the memorandum and articles of association of

(1) (1937) A.C. 26.
(2) (1942) N.Z.L.R. 150.
(3) (1942) N.Z.L.R. 157.
(4) (1942) N.Z.L.R. 164.
(5) (1942) N.Z.L.R. 170.
(6) (1905) 2 Ir. R. 218.
(7) (1930) Sc.L.T. 387.

H. C. of A. 1944.

Abrahams v. Federal Commissioner of Taxation.

Williams J.

the company, including any restrictions on transfer which they might contain: See *Macarthur Onslow* v. *Commissioner for Stamps* (1); *Blackwood's Executors* v. *Commissioner for Stamps* (2); *Myer* v. *Commissioner of Taxes* (3)—Cf. *Deputy Federal Commissioner of Taxation* v. *Gold Estates of Australia* (1903) *Ltd.* (4).

In *Borland's Trustee* v. *Steel Bros. & Co. Ltd.* (5), *Farwell* J. said :—" These shares can have no value ascertainable by any ordinary rules, because having held, as I do, that the restrictive clauses are good, it is impossible to find a market value. There is no quotation. It is impossible, therefore, for anyone to arrive at any actual figure, as to which it may be said it is clear that that is the value, or something within a few pounds of the value. Having regard to the fluctuation in profits that has occurred, it is impossible to say the value can be ascertained upon a 10 or 20 per cent basis—that must be illusory. If it were necessary—I do not think it is—I should be prepared to hold upon the evidence that the price offered by the company in this particular case represents the fair value. I think that by no means an unfair test is afforded by the fact that Mr. Borland himself in January, 1899, sold some of his shares at about the same price. It is not immaterial to consider that two other persons under the compulsory power have been compelled to sell and have not objected. So far as I can see, the terms are reasonably fair, and, assuming that it is a fair mode of arriving at the value—and I think it is—I do not see that it differs from the ordinary provision for valuation such as I find in *Whitmore* v. *Mason* (6) applicable to those cases where assets are capable of valuation. I have to bear in mind that I am dealing with a company whose assets are really in a sense incapable of valuation, but in which the parties have agreed on a basis of valuation which seems to me to be fair."

Crossman's Case is fully reported before *Finlay* J. and in the Court of Appeal in the *Law Times Reports* (7). The judgment of *Finlay* J. was reversed by the Court of Appeal (Lord *Hanworth* M.R. dissenting), but his Lordship's judgment was restored by the House of Lords (8). *Finlay* J. said that " enormous difficulty must arise when one has got to apply notionally the principle of the open market to shares which, in fact, by reason of restrictions, could not be sold in the open market " (9).

(1) (1913) 13 S.R. (N.S.W.) 354.
(2) (1917) 17 S.R. (N.S.W.) 447; 34 W.N. 204.
(3) (1937) V.L.R. 106.
(4) (1934) 51 C.L.R. 509.
(5) (1901) 1 Ch. 279, at pp. 291, 292.
(6) (1861) 2 J. & H. 204, at p. 216 [70 E.R. 1031, at p. 1036].
(7) (1935) 152 L.T. 98.
(8) (1937) A.C. 26.
(9) (1935) 152 L.T., at p. 101.

H. C. of A. 1944. ABRAHAMS v. FEDERAL COMMISSIONER OF TAXATION. Williams J.

Further, in applying the test, it must be remembered that the value to be ascertained is the value *to the seller* of the property in its actual condition at the relevant time (in the present case at the date of death) with all its existing advantages and all its possibilities: per Lord *Romer*, when delivering the judgment of the Privy Council in *Vyricherla Narayana Gajapatiraju* v. *Revenue Divisional Officer, Vizagapatam* (1); per Sir *Wilfred Greene* M.R. in *Horn* v. *Sunderland Corporation* (2). I have italicized the above words because there was a marked tendency on the part of the witnesses for the appellant in this case, as occurred in the two previous appeals which came before me in *Perpetual Trustee Co. Ltd.* v. *Federal Commissioner of Taxation* (*Murdoch's Case*) (3) and in *McCathie* v. *Federal Commissioner of Taxation* (4), to estimate what a willing purchaser, having an alternative choice of buying shares in public companies, would have been agreeable to pay for the shares, and then to say that this amount was all that a willing vendor could reasonably expect to obtain for them. But in *Pastoral Finance Association Ltd.* v. *The Minister* (5) Lord *Moulton*, in delivering the judgment of the Privy Council, said that: "Probably the most practical form in which the matter can be put is that they" (that is, the owners of the land) "were entitled to that which a prudent man in their position" (that is the purchasers) "would have been willing to give for the land sooner than fail to obtain it." A practical example of the price that a hypothetical purchaser must reasonably expect to pay is given by Lord *Romer* in *Vyricherla's Case* (6) where he says:—"Take as an example the case of an owner of vacant land that adjoins his factory. The land possessed the potentiality of being profitably used for an extension of the factory. But the owner is the only person who can turn that potentiality to account. In valuing the land, however, as between him and a willing purchaser, the value to him of the potentiality would necessarily have to be included" (7).

In *McCathie* v. *Federal Commissioner of Taxation* (8), I attempted to summarize the manner in which the valuation should usually be approached. But the problem is complicated in the present case by the abnormal amounts standing to the credit of the profit and loss accounts of four of the companies, and the large debts owed by the brothers to three of the companies. The conventional manner of estimating the probable future profits from those of the past is

(1) (1939) A.C. 302, at p. 321.
(2) (1941) 2 K.B. 26, at p. 32.
(3) (1942) 65 C.L.R. 572.
(4) (1944) 69 C.L.R. 1.
(5) (1914) A.C. 1083, at p. 1088.
(6) (1939) A.C. 302, at p. 314.
(7) (1939) A.C., at p. 314.
(8) (1944) 69 C.L.R., at pp. 10, 11.

H. C. of A. 1944.

Abrahams v. Federal Commissioner of Taxation.

Williams J.

also complicated by the fact that these debts have not been interest bearing, and that abnormally large cash balances have been lying idle in the accounts of the Opera House, Interstate Investment and Small Arms companies. There has been, therefore, no consistent policy in four of the companies with respect to the allocation of certain percentages of the profits to reserves and the payment of the balance by way of dividends, and the past profits are by no means a reliable guide to the future profits of some of the companies.

Generally it may be said that the possibility of a distribution of accumulated profits by way of dividend or a capitalization of such profits by the issue of bonus shares does not enter largely into the calculation of the prices that investors will pay for shares in companies, but this possibility is important in the present case because of the large outstanding debts to the three companies already mentioned ; the large amounts standing to the credit of the profit and loss accounts of all the companies except Avrom and in particular of these three companies ; and the complex position of Alfred as the holder of half the shares in and a large debtor to each of these three companies, as the director in control of their business and affairs, and as the sole executor of and residuary beneficiary under the will of Emanuel, whose estate is the owner of the other half of the shares and which is similarly indebted to each of these companies. In the case of the Opera House and the Small Arms companies, it is clear that their future as going concerns would not be prejudiced by the declaration of dividends out of the undistributed profits of sufficient amounts completely to discharge the debts owing to them, and in the case of Mia Mia that a dividend of a sufficient amount could be declared without prejudice to its future stability so as to discharge a large part of the indebtedness to this company. It is also clear that Alfred, as executor of and the residuary beneficiary under the will of Emanuel, should press himself as the director in control of these three companies to declare these dividends, unless it could reasonably be anticipated that, if the debts were repaid, the amounts could be put to such profitable use by the companies concerned that it would be an advantage to the estate for this to be done. The Court is dealing on this appeal with the valuation of shares in five companies as going concerns, but in order to estimate the value of these shares to the seller, it must pay considerable attention to this aspect of the matter ; because it would be highly improper for Alfred as executor, and against his interest as residuary beneficiary, to sell the shares owned by the estate in these three companies to a stranger without obtaining a satisfactory quid pro quo for the loss of the right to press for the debts to be discharged in

H. C. OF A. 1944.

ABRAHAMS v. FEDERAL COMMISSIONER OF TAXATION.

Williams J.

this manner, and thus, while failing to obtain an adequate price for the shares, leave the estate under an obligation to repay the debts in full.

The three witnesses called by the appellant estimated the future profits of the companies from the profits of those past years which they considered the most appropriate for this purpose. This method, subject to the qualifications stated in the case of *In re Finlay*, shortly reported in the *Solicitors' Journal* (1), is generally a convenient method of approach. In the case of a business where it is necessary to estimate the future volume of the trade, it may well be the only method, but in the case of an investment company an alternative method is that pursued by Mr. Mirams of examining the investments owned by the company and estimating their future earning capacity. Mr. Philip and Mr. Outhwaite both made adjustments of the profits in respect of taxation and abnormal items in order to obtain the actual profits of each year and so make them a more accurate guide for the future. With respect to the outstanding debts: Mr. Philip assumed that they would not be called in until the death of Alfred, so that he ascertained their present value on an actuarial calculation of £695 for each £1,000 based on Alfred's expectancy of life; Mr. Outhwaite and Mr. Taylor both allowed notional interest on their average amounts, the former at 4 per cent and the latter at 4½ per cent per annum. All these witnesses then proceeded to capitalize the net profits at what they considered to be appropriate rates.

In order to determine the rates of capitalization, Mr. Philip averaged the dividend yields on the market prices of certain investment companies registered on the stock exchange which he considered to be comparable with the present investment companies and found that this average was 5¼ per cent. He then investigated the accounts of 122 companies registered on the same exchange to ascertain the amount usually allocated to reserves out of net profits before arriving at the amount available for distribution by way of dividend and found that this averaged between 2¼ and 2½ per cent. He thus arrived at a rate of capitalization for the Opera House, Interstate Investments and Avrom companies, on the supposition that they were public companies registered on the stock exchange, of 7½ per cent. He treated the Small Arms company as a trading company, although only one-fifth of its assets were used in the business, and, in order to arrive at his rate of capitalization for this company on the same supposition, adopted a dividend yield on the market price of shares in similar public companies of 6½ per cent and added 2½

(1) (1938) 82 Sol. Jo. 805.

H. C. of A. 1944.

Abrahams v. Federal Commissioner of Taxation.

Williams J.

per cent to arrive at the net profit yield. He then made a discount of 20 per cent from the capital values of the shares at which he had arrived on account of the restrictions on transfer, and a further 20 per cent on account of the amount of control vested in Alfred. In the case of Opera House, Small Arms, and Mia Mia he then added the present values of the debts ; but, since the restrictions on transfer in these companies are contained in the memoranda of association and are unalterable, it is difficult to see why he did not discount these present values by at least 20 per cent, except on the assumption that he considered that distributions would be made of sufficient amounts to cancel the debts on Alfred's death. But if these distributions could be made at this stage, there is no reason why distributions to the extent of the credits to the profit and loss accounts of these companies should not have been made at Emanuel's death.

Mr. Outhwaite considered that the average net profit yield from companies on the stock exchange was 6 per cent, that at least 1 per cent should be added to the yield on account of the restrictions on transfer, and that an investor would therefore require a net profit yield of at least 7 per cent on shares in proprietary companies. Mr. Taylor considered that proprietary companies would distribute the whole of their profits by way of dividend so that the two yields would be the same, and, having estimated that $5\frac{1}{2}$ per cent was the average dividend yield from certain companies registered on the stock exchange which he considered comparable, thought that an additional rate of from $2\frac{1}{2}$ per cent to 4 per cent should be added on account of the restrictions. The rates of capitalization which these three witnesses adopted were as follows :—

	Opera	Interstate	Small Arms	Mia Mia	Avrom
Philip ..	$7\frac{1}{2}$%	$7\frac{1}{2}$%	9%	15%	$7\frac{1}{2}$%
Outhwaite	7%	7%	8%	8%	8%
Taylor ..	$8\frac{3}{4}$%	6%	$8\frac{3}{4}$%		10%

The values at which they arrived for the shares were as follows:—

	Opera	Interstate	Small Arms	Mia Mia	Avrom
Philip	£5 17s. 11d.	11s. 5d.	£1 6s. 3d.	19s. 6d.	11s. 5d.
Outhwaite	£5 5s. 8d.	£1 0s. 2d.	£1 8s. 6d.	13s. 4d.	15s. 1d.
Taylor	£5 5s. 1d.	£1	£1 17s. 4d.		15s.

The total capital values of the whole of the shares thus obtained are as follows :—

	Opera	Interstate	Small Arms	Mia Mia	Avrom
Philip ..	£165,000	£14,270	£59,000	£121,875	£183,700
Outhwaite	£147,930	£25,200	£64,125	£100,000	£248,100
Taylor ..	£147,100	£25,000	£84,000		£246,750

The net values of the assets as appearing in the balance-sheets of the companies but adjusted in accordance with the agreement of the parties and those placed upon the leaseholds by Mr. McIntyre are approximately as follows :—Opera House £292,000 ; Interstate Investments £68,000 ; Small Arms £165,000 ; Mia Mia £234,000 ; Avrom £356,000. From these figures there would have to be deducted the costs, charges and expenses of liquidation and a further percentage of profit for a purchaser, and some of the assets, as for instance those of Mia Mia station, and the stock-in-trade of the Small Arms company, might realize amounts below their book values. But if the value of the Mia Mia assets is reduced to £220,000, and that of the Small Arms company to £155,000, and 20 per cent is then deducted to cover the costs, charges and expenses of liquidation and to give the purchaser a profit on the proceeds of realization, the amounts would be Opera House £233,000 or £8 7s. per share ; Interstate Investments £54,400 or £2 3s. 6d. per share ; Small Arms £124,000 or £2 15s. per share ; Mia Mia £175,000 or £1 8s. per share ; Avrom £284,000 or 17s. 3d. per share.

Mr. Nixon has said that, as far as he could follow them, he agreed with virtually all Mr. Outhwaite's adjustments, so that, as this witness has included in his calculations notional interest on the outstanding debts, I shall use his adjusted figures in the first instance. When Mr. Philip's figures were first tendered, I told the respondent's counsel that, unless they were challenged, I would accept them as correct ; and, as they have not been challenged, and closely correspond to Mr. Outhwaite's figures, I shall use them for a purpose which will appear later. But I must state at once that I cannot accept the rates of capitalization adopted by any of these witnesses. Whether assets are owned by a company or an individual, they cannot be expected to produce a higher income than is appropriate to the nature of the particular assets ; and, speaking generally, it can be said that the greater the risk that an asset will not produce the anticipated income or that the capital embarked in an asset may be lost, the higher the income yield an investor, whether a company or an individual, will expect from that asset. Although a company and not its shareholders is the legal and equitable owner of its assets, the value of its assets must necessarily be reflected in the value of its shares. I have already stated in *Murdoch's Case* (1) and *McCathie's Case* (2), and indeed it is beyond dispute, that a prudent investor, while taking care to see that his purchase money is well secured by tangible assets, would look mainly to the dividends which he could reasonably expect to receive on the shares ; but it is, to my mind, also beyond

(1) (1942) 65 C.L.R. 572. (2) (1944) 69 C.L.R. 1.

H. C. OF A. 1944. ABRAHAMS v. FEDERAL COMMISSIONER OF TAXATION. Williams J.

dispute that such a purchaser could only reasonably expect to receive such dividends as were appropriate to the nature of the business in which the company was engaged (*Smyth* v. *Revenue Commissioners* (1) ; *Crossman's Case* (2)). In the case of companies engaged in various kinds of trade, it may be relatively simple to ascertain an appropriate rate of profit or dividend yield which a prudent investor could reasonably require on the price he paid for the shares, but in the case of companies engaged in investment businesses the profit and therefore the dividend yield must necessarily vary considerably according to the nature of the assets in which the shareholders' funds have been invested. This is, I should think, self-evident, but it is, in any event, supported by the following evidence :—

Mr. *Eager* K.C. to Mr. Philip : I put it to you that if you take investment companies in Victoria . . . the public are prepared to accept a very low return upon their money invested in investment companies.

A. As a matter of fact they are very well held.

Q. If they were very well held it would be a very good reason why the price realized could be very high ?

A. No, because if you go for security your yield is very low, and these are companies where there is tremendous spread of investment, and, therefore, good security. A lot of people invest in these companies because they get splendid security and a low rate.

His Honour : I suppose you would agree that would be so where an investment company invested in nothing but Commonwealth loans ?

A. It would be a low return, because it would be very solid—almost gilt edged.

Q. Supposing the loan were producing 3 per cent ?

A. It would be a little more.

Q. And the company paid a three per cent dividend ; in that particular case you would agree that those shares could command a value of £1 ?

A. Yes, if the bond interest was about 3 per cent it would be about £1. In October 1938 I think it was 3.78.

Q. I am putting a suppositious case. I am putting that the yield that an investor can expect depends very greatly upon the type of investment which the company is carrying on ?

A. Yes, your Honour.

His Honour to Mr. *Eager* : I think he (Mr. Philip) has made his attitude quite clear. He told me that if an investment company

(1) (1931) Ir. R. 643, at p. 656. (2) (1935) 152 L.T., at p. 102.

carried on business investing in Commonwealth bonds and nothing else you could not expect from that company a dividend yield except a yield that would correspond to the interest on the bonds, and the people who invested in that particular type of company would expect to pay £1 for them (that is the shares) or thereabouts. (To the witness) Is that right ?

A. Yes.

Mr. Taylor gave evidence to the same effect. He evidently considered that there was a close connection between the nature of a company's assets and the value of its shares because he said that the shares of a company which owned nothing but first mortgages would be below par on the stock exchange because they were assets which were not of a sufficiently realizable nature ; and he capitalized the profits of Interstate Investments at 6 per cent because of the liquid character of its assets, so that presumably he considered that the shares in this company would have been at par if it had been registered on the stock exchange and had been paying dividends of 3½ per cent. It is true that Mr. Outhwaite gave evidence to the contrary, and suggested that it was proper to charge notional interest on the outstanding debts at 4 per cent and then to capitalize the value of the shares in the creditor companies at 7 or 8 per cent because the two things were not related to one another, but I am unable to accept this evidence.

The evidence shows that in October 1938 a fair interest return on Commonwealth bonds was 3¾ per cent, on first mortgages 5 to 5½ per cent, on freehold real estate such as that owned by the four investment companies 5 to 5½ per cent, and on leaseholds 7½ per cent. Mr. Outhwaite, as I have already said, allowed interest at 4 per cent on the brothers' debts, placing this indebtedness in the same category as Commonwealth bonds, while Mr. Taylor allowed interest at the rate of 4½ per cent which he understood to be the rate on first mortgages. I should think that, if the indebtedness was to remain outstanding after strangers had become shareholders in the companies concerned, the rate of interest would have to be higher, but for the purpose of valuing the shares the rate does not appear to me to matter, because if the rate of 4 per cent suggested by Mr. Outhwaite be accepted and the valuation is made on the basis that the debts are as safe an investment and otherwise as valuable as Commonwealth bonds, then the companies to which the debts are owed (subject to what follows with respect to Mia Mia) must be considered as having invested that amount of their shareholders' funds in Commonwealth bonds. The Opera House company should, therefore, be regarded as an investment company which,

H. C. of A. 1944. ABRAHAMS v. FEDERAL COMMISSIONER OF TAXATION. Williams J.

speaking broadly, had at the date of death about five-sixths of its assets invested in Commonwealth bonds or their equivalent and the remaining one-sixth in leaseholds. The gross yield that could be expected from five-sixths of the assets would therefore be 4 per cent, and from the remaining one-sixth $7\frac{1}{2}$ per cent or on the whole of its assets $4\frac{1}{2}$ per cent. Interstate Investments should be regarded as a company which had about one-third of its assets invested in realty, say at $5\frac{1}{2}$ per cent, and the remaining two-thirds in bonds at 4 per cent, the gross average yield being $4\frac{1}{2}$ per cent. Small Arms should be regarded as a company which had about one-fifth of its assets invested in the hardware business which could be expected to yield say 8 per cent, about one-fifth of its assets invested in loans on mortgage which could be expected to yield say 5 per cent, and the remaining three-fifths in bonds which could be expected to yield 4 per cent, so that the gross average yield would be 5 per cent. The assets of Avrom were invested in freehold real estate and leasehold and loans on mortgage from which the gross average yield should be say $6\frac{1}{2}$ per cent. Mia Mia had about one-third of its assets invested in the pastoral business which could be expected to yield say 15 per cent and two-thirds of its assets in bonds or their equivalent which could be expected to yield 4 per cent, giving a gross average yield of 8 per cent. An investor who in 1938 owned the assets belonging to the respective companies individually could not have expected a greater profit yield than those which I have mentioned, and those profits would still have been subject to payment of Federal and State income tax, but, if the evidence of the expert witnesses for the appellant is correct, an investor would have expected, if the company was a public company, a net profit yield, after payment of income tax and after deducting the expenses of running the company, above this gross average yield, and, if it was a proprietary company, a further additional amount of profit to compensate for the restrictions on transfer of shares in such companies. The witnesses have sought to support their opinions by reference to the average profit and dividend yield upon the prices paid for shares in companies registered on the Melbourne stock exchange in October 1938. In both *Murdoch's Case* (1) and *McCathie's Case* (2), I pointed out the danger of taking such averages except as a very remote background to an investigation of the profit and dividend yield that an investor could reasonably expect to obtain from any particular company, and an examination of the evidence with respect to the companies relied upon by the witnesses

(1) (1942) 65 C.L.R. 572. (2) (1944) 69 C.L.R. 1.

in this case confirms, to my mind, how little light such a process of averaging can throw on the true value of shares in any particular company.

One public investment company registered on the Melbourne stock exchange, Beacon Investments Ltd., was referred to by Mr. Outhwaite as a company with whose affairs he was thoroughly familiar because it was managed from his office. This was a company with an issued capital of £32,000 which started in 1936 and in 1938 had no reserves to speak of. In 1938 it had a net profit yield of approximately $5\frac{1}{2}$ per cent. He said that some of its investments, apparently in shares in other companies, were good and some were not too good, so that it would appear to be a company that takes risks with some proportion of its capital in order to increase the profit yield. But, apart from the capital employed in the trading business of the Small Arms company, and that employed in the pastoral business of Mia Mia, no such risks are taken with the capital of the companies in the present case. The Beacon Investment company could scarcely be considered to compare in soundness and stability with the present investment companies, but it is said that an investor would expect the same profit yield from these companies if they were public companies. I am unable to see how an investor could possibly expect a greater gross profit yield from these companies, assuming that they were public companies, than the percentages already mentioned, or a greater dividend yield than this amount less the amounts required to meet the reasonable expenses of running the companies, taxation, and such sums as the directors should consider necessary to allocate to reserves. I am also unable to see how an investor could expect to purchase such shares on the stock exchange for below par. Certainly he could not expect to obtain them at a price which would show a net profit yield of these amounts.

I shall now proceed to take Mr. Outhwaite's finally adjusted profits and capitalize these profits at the gross rates which I have mentioned. Opera House: profit £10,353 capitalized at $4\frac{1}{2}$ per cent equals £230,000. If this sum is divided by 28,000 shares it gives a capital value of £8 4s. per share. Interstate Investments: profit £1,765, capitalized at $4\frac{1}{2}$ per cent equals £39,220. If this sum is divided by 25,000 shares it gives a capital value of £1 11s. 6d. per share. Small Arms: profit £5,131, capitalized at 5 per cent equals £102,620. If this sum is divided by 45,000 shares it gives a capital value of £2 5s. 6d. per share. Mia Mia: profit £6,673, capitalized at 8 per cent equals £83,410. If this sum is divided by 125,000 shares it gives a capital value of 13s. 4d. per share. Avrom: profit £19,851,

H. C. OF A. 1944.

ABRAHAMS v. FEDERAL COMMISSIONER OF TAXATION.

Williams J.

capitalized at 6½ per cent equals £305,400. If this sum is divided by 329,000 shares it gives a capital value of 18s. 6d. per share.

A subsidiary but useful check can, I think, be made on the values of the shares in the Opera House, Small Arms and Mia Mia companies by assuming that dividends are declared to discharge the brothers' debts owing to them wholly or in part, and then taking and capitalizing Mr. Philip's adjusted profits for these companies, which, as I have said, were reached without allowing for any notional interest on these debts, and adding these capitalized values to these dividends. In the case of the Opera House company, it would require the declaration of a dividend (in round figures) of £6 10s. per share to discharge the indebtedness to this company ; in the case of the Small Arms company the dividend would be £1 5s., while in the case of Mia Mia it would be safe to declare a dividend of 15s. per share, which would amount to £93,750, and leave £72,903 of the debt to be repaid, or even to declare a dividend equal to the total amounts to the credit of the profit and loss accounts of 19s. per share which would leave £48,000 of the debt to be repaid. These are possibilities which, as I have said, must, in the special circumstances of this case, be taken into account in any valuation of the shares. Accepting for the moment the rates of capitalization which he applied, namely Opera House 7½ per cent and Small Arms 9 per cent, and adding the amounts per share at which he arrived, namely Opera House £2 7s. and Small Arms 15s., to these amounts of £6 10s. and £1 5s., the capital value of the shares in these companies would be Opera House £8 17s. and Small Arms £2. But, having regard to the nature of the businesses which the Opera House and the Small Arms companies were carrying on, even after leaving the advances out of account, the highest rates at which their profits could be capitalized would be, in my opinion, Opera House 7 per cent and Small Arms 8 per cent. On this basis the result would be as follows :—Opera House profit £4,944 capitalized at 7 per cent would be £70,600 which divided by 28,000 shares would give each share a capital value of £2 10s., so that the value of the Opera House shares would be £9. Small Arms profit £3,068 capitalized at 8 per cent would be £38,350, which divided by 45,000 shares would give a value of 17s. per share, so that the value of the Small Arms shares would be £2 2s. per share. In the case of Mia Mia Mr. Philip capitalized at 15 per cent, but the extra security afforded by leaving the balance of the debt with the company is sufficient ground, I think, to reduce the rate of capitalization to 10 per cent. Mr. Philip's adjusted net profit for this company is £1,598 per annum. This sum capitalized at 10 per cent gives £15,980, which, divided by 125,000 shares, gives a capital value of

2s. 6d. per share. If this sum is added to the 15s. already mentioned, the value of the shares in Mia Mia would be 17s. 6d. per share, but if the whole of the £118,000 to the credit of the profit and loss account and reserve account was distributed by way of dividend, the distribution would be 19s. per share, so that the appellant as a prudent executor and residuary beneficiary could hardly be expected to sell these shares for 17s. 6d. Further, the balance of the debt, either £93,710 or £73,903, would also have to be taken into account. If these amounts are deemed to be invested in Commonwealth bonds at 3¾ per cent they would produce approximately £3,515 and £2,770 respectively. Deducting Federal income tax at 1s. 2d. in the pound would reduce these sums to approximately £3,310 and £2,608. Capitalizing these two sums at 10 per cent would give £33,100 and £26,080 which divided by 125,000 shares would work out at approximately 5s. and 4s. per share respectively. If 5s. be added to 17s. the value rises to 22s., and if 4s. be added to 21s. 6d. the value rises to 25s. 6d.

It is to be noted that there is a reasonable correspondence between the values reached by the use which I have made of Mr. Outhwaite's and Mr. Philip's adjusted net profits, or in other words on an income basis, and those reached by ascertaining the net value of the assets on a liquidation basis, except in the case of Interstate Investments and the Small Arms company. In the case of Interstate Investments the value on the former basis is £1 11s. 6d. and on the latter £2 3s. 6d. per share ; while in the case of the Small Arms company the value on an income basis lies between £2 2s. and £2 5s. 6d. and on a liquidation basis £2 15s. 6d. I have already mentioned that there were abnormally large cash balances in the balance-sheets to the credit of the bank accounts of the Opera House company, Interstate Investments and the Small Arms company. The failure to invest these moneys must have curtailed the profits of these companies to a considerable extent, but the evidence is insufficient to measure this extent with any accuracy. In the case of Interstate Investments, the largest asset on 30th June 1938 was £35,000 cash in bank, and if the accounts for the four years prior to the date of death are investigated it can be seen that there was a sum of at least £45,000 which was only partially invested from time to time. If £40,000 of this sum had been regularly invested in Commonwealth bonds at 3¾ per cent it would have produced £1,500 per annum less Federal income tax or say £1,400 net, or in four years £5,600 ; whereas, according to the accounts, the income received only amounted to £4,317 or after deduction of income tax to say £4,100. Deducting £4,100 from £5,600 leaves £1,500 or £375 per

H. C. OF A. 1944.

ABRAHAMS v. FEDERAL COMMISSIONER OF TAXATION.

Williams J.

annum. £375 capitalized at 4½ per cent equals £8,330, which, divided by 25,000 shares, gives an additional value of approximately 6s. 8d. per share.

In the case of Small Arms, some increase should be made to the adjusted net profits arrived at by Mr. Outhwaite, because he chose two years in which a loss was made on the hardware business, and deducted this loss from the profits of the investment business. I can see no reason why the two sections of the business should not be kept separate. At the date of death, the lease of Hardware Chambers had only 4½ years to run and it would be unreasonable to contemplate that this company would have continued this business after the lease had expired if it had continued to show losses. At any rate, the profits should, I think, be increased by approximately £400. This sum capitalized at 5 per cent would be £8,000, so that the capital value of the shares should be increased by 3s. 6d. It is also to be noted that the accumulated profits of Interstate Investments are equal to £1 12s. 9d. per share and those of the Small Arms company to £2 10s. per share.

The valuation of the shares in Mia Mia presents a difficult problem because neither side has seen fit to adduce any specific evidence as to the condition of the run, of the stock, or of the wool market at the date of death. From the chart of the rainfall and the losses of stock appearing in the accounts as at 30th June 1938, it would appear that the station was then drought-stricken, although the evidence is insufficient to draw any safe inferences. But it appears that the company had in the 19 years prior to 1938 accumulated £118,000 of profits, so that it has a profitable history. These accumulated profits were so amply covered by liquid assets that it would have been safe to distribute all or at least the greater part of them and still leave ample liquid reserves to restock after a drought.

The final assessment of the value of the shares must be made principally on the basis of the income yield (including the strong probability of the distribution of accumulated profits in at least three of the companies) but where, owing to exceptional circumstances, the valuation on this basis presents " enormous difficulties " it is legitimate, as *Farwell* J. pointed out in *Borland's Trustee* v. *Steel Bros. & Co. Ltd.* (1), to rely more than usual on the assets value: And cf. *Halsbury's Laws of England,* 2nd ed., vol. 13, p. 271; *M'Connel's Trustees* v. *Inland Revenue Commissioners* (2); *Smyth* v. *Inland Revenue Commissioners* (3).

The result of all these calculations is to show, I think, that the values of the shares in the various companies must be somewhere

(1) (1901) 1 Ch. 279.
(2) (1927) Sc.L.T. 14.
(3) (1931) Ir. R. 643.

between the following amounts :—Opera House £8 4s. to £9 per share ; Interstate Investments £1 11s. 6d. to £2 3s. 6d. per share ; Small Arms £2 4s. to £2 15s. per share ; Mia Mia 13s. 4d. to £1 8s. per share ; and Avrom 17s. 3d. to 18s 6d. per share.

H. C. OF A. 1944.

ABRAHAMS v. FEDERAL COMMISSIONER OF TAXATION.

Williams J.

The question whether any deduction should be made from these values on account of (1) the restrictions on transfer, and (2) the so-called lack of control of the companies by the shareholders during the rest of Alfred's life, now arises for consideration. It is convenient to deal with the companies other than Avrom in the first instance. In the case of these companies, the restriction on transfer is that the board of directors may refuse to register a transferee whom they consider would be an undesirable member of the company. This restriction, with some embellishments, is the ordinary article which is recommended in *Palmer's Company Precedents* for a proprietary company. It confers a fiduciary power which must be exercised by the board of directors bona fide for the benefit of the company. If it is not used for this purpose, the transferee is entitled to apply to the court to have the register rectified and his name inserted on the register of members (*In re Coalport China Co.* (1) ; *In re Bede Steam Shipping Co. Ltd.* (2) ; *In re Smith and Fawcett Ltd.* (3) ; *Manning River Co-operative Dairy Co. Ltd.* v. *Shoesmith* (4) ; *Australian Metropolitan Life Assurance Co. Ltd.* v. *Ure* (5)). It is not an appropriate article in the case of a public company where the restriction should be confined to shares which are not fully paid, but it is entirely appropriate to proprietary companies which bear many analogies to partnerships and in which the shareholders, as in the case of partnerships, usually desire to exercise some control (which is almost invariably confided to the directors) over the introduction of new shareholders into the company (*Re Royal British Bank* ; *Re Joint Stock Companies Winding-up Acts* 1848 *and* 1849 (*Nicol's Case*) (6)). The articles of association of such companies almost invariably also contain restrictions requiring shareholders to offer shares which they wish to sell to the existing shareholders either at par or at some fair value fixed by the articles in the first instance, and it is usually these latter restrictions which are relied upon as depreciating the value of the shares. The present restriction would, no doubt, as some witnesses said, often make the shares unacceptable to banks as a security for an overdraft, and they would not be readily realizable like shares in companies registered on the stock exchange. A share in a partnership would have the same disadvantages, but it has

(1) (1895) 2 Ch. 404.
(2) (1917) 1 Ch. 123.
(3) (1942) Ch. 304.
(4) (1915) 19 C.L.R. 714.
(5) (1923) 33 C.L.R. 199.
(6) (1859) 3 DeG. & J. 387, at p. 433 [44 E.R. 1317, at p. 1335.]

H. C. of A. 1944.

Abrahams v. Federal Commissioner of Taxation.

Williams J.

never been suggested that such a share should be discounted on this account. Such a restriction undoubtedly limits the market and makes the shares unattractive to many investors. But since *Vyricherla's Case* (1), applied by this Court in *Geita Sebea* v. *Territory of Papua* (2), it is clear that the full value to the seller must be ascertained, however limited the market may be, even where there is only one possible hypothetical purchaser. To a prudent purchaser willing to give full value for the shares sooner than fail to obtain them, this restriction should not, to my mind, have many terrors.

It is also said that a further discount should be made because of Alfred's control of the companies' affairs to the exclusion of the shareholders. It is true that the articles give very complete control to Alfred during his life. But these powers are also fiduciary powers to be exercised bona fide for the benefit of the companies. The past history of the companies shows that he is an extremely capable business man, and the appeal has proceeded on the footing that, whatever liberties were taken with the companies' affairs whilst they were thoroughly solvent and the two brothers were the only shareholders, Alfred would recognize that as soon as strangers became shareholders it would become his duty to conduct the business of the companies on sound and profitable commercial lines. The argument that the shares should be discounted on this ground is really a two-edged sword, as it can just as reasonably be suggested that he is such an able business man that people would be induced to put their money into these companies just because he was in control of their affairs. Thus in two of the New Zealand cases already cited the appellants, seeking naturally to place the lowest possible value on the shares for the purposes of death duty, contended (I will add unsuccessfully) that the future prospects of the companies there in question judged from previous results should be discounted because their past successes had been caused by the outstanding business ability of the managing directors who had died, so that the probabilities were that the companies would not be so successful in the future. After all, judging from past results, the risks inherent in Alfred having sole control would appear to be that he might continue to overpay himself as a director and allow these large cash balances to lie idle, but these contingencies, however remote, have already been allowed for in the profits used for the purposes of capitalization.

Taking the following considerations into account, I am of opinion that no further deduction should be made from the values already mentioned on either of these grounds. In the first place, I have capitalized on the basis that the income yields which I have mentioned

(1) (1939) A.C. 302.

(2) (1941) 67 C.L.R. 544.

are net income yields and if an investor would be prepared to invest his money in similar assets as an individual or to buy shares in public companies owning such assets to produce such yields subject to taxation, he could reasonably be expected to invest his money in companies possessing such assets, even with restrictions on transfer of the shares, on the basis that they were net profit yields when he would obtain the benefit of a rebate of the taxes paid by the companies on any dividends which he received ; in the second place, the adjusted net profits calculated by Mr. Outhwaite and Mr. Philip, even allowing for notional interest on the outstanding debts, are on the low side compared with what they would have been if the companies' assets had been used to their full capacity during the years on which they relied instead of large cash balances lying idle, and I have made no adjustments for this except in the case of Interstate Investments ; and, in the third place, the expenses, particularly those for salaries and wages, which include the directors' fees, in some of the accounts are distinctly on the high side, having regard to the small amount of time that it would require to manage investment businesses such as the companies were carrying on. Mr. Outhwaite said that the amounts in the case of the Small Arms company were too high. The respondent did not challenge the amounts in the accounts of the Opera House company, but I agree with Mr. Mirams that they would also appear to be on the high side. No doubt the two brothers, as is so often the case in proprietary companies where the only shareholders are also directors, were distributing some part of the profits as directors' fees, which in public companies would have to be paid as dividends. The right of the court to adjust such distribution in valuing the shares for the purposes of death duties has been asserted in *Smyth* v. *Revenue Commissioners* (1), *In re Crawford* (2), and *McCathie's Case* (3). And cf. *Aspro Ltd.* v. *Commissioner of Taxes* (4). I am not able on the evidence to attribute any definite increase to the profits arrived at by Mr. Outhwaite or Mr. Philip on these grounds, but I have no doubt that they should be increased to some considerable extent.

The restrictions on transfer in the case of Avrom are more severe than those contained in the articles of association of the other companies. The restriction which confers upon the governing directors the power to prevent shareholders disposing of their shares without their consent is, like the restriction upon transfer contained in the memoranda of association of the other companies, a fiduciary power which must be exercised bona fide for the benefit of the

(1) (1931) Ir. R. 643.
(2) (1942) N.Z.L.R. 170.
(3) (1944) 69 C.L.R. 1.
(4) (1932) A.C. 683.

H. C. OF A. 1944.

ABRAHAMS v. FEDERAL COMMISSIONER OF TAXATION.

Williams J.

company (*In re Copal Varnish Co. Ltd.* (1)). These restrictions should not be sufficient to discount the shares below the values already mentioned. The more serious article is that which enables the governing directors at any time to acquire the shares of any shareholder at their par or asset value, whichever is the lower. The asset value of the shares calculated in accordance with this article was as at 30th June 1938 above par. In *Salvesen's Trustees* v. *Inland Revenue Commissioners* (2), approved by the House of Lords in *Crossman's Case* (3), the articles of association contained a provision that the company might at any time, by extraordinary resolution, resolve that any shareholder, other than a director or a person holding more than 10 per cent of the shares of the company do transfer his shares, and, to put it shortly, that upon such a transfer the vendor would only be entitled to their nominal value if fully paid. In *Crossman's Case* (4), there was no article which compelled a shareholder to sell his shares involuntarily, but there was an article which provided that upon a voluntary sale he had to sell at a fair value calculated as therein mentioned and this value was well below the market value calculated upon the dividend return. Nevertheless, the court in *Salvesen's Case* (5) fixed the value of fully paid £1 shares for the purposes of duty at £3, and in *Crossman's Case* (6) shares for which the fair value was £221 and £209, at £351 and £355 respectively. In the Court of Appeal, Lord *Hanworth*, in referring to this provision, said :—" It is not easy to affirm that some private and exceptional method of confiding the possession of certain property to members of a family, or the special devices for ascertaining the amount to be paid by one member of that family to another, or another's estate upon his death, ought to be allowed to depreciate the quota to be paid upon that property, which in the hands of the members of the family provides them with an income and wealth that if measured by the ordinary standards would reach a figure at least half as high again as that which the family estimate of the the sum to be paid allows " (7).

I can see no reason why this article should depreciate the shares below par. Further (although I think that the valuations at which I am about to arrive can be sustained without this ground), I am of opinion that Alfred's position as a hypothetical purchaser of the shares must be taken into account. The headnote in *Crossman's Case* (8) says that the value of the shares there in question should not be appreciated by reason of the special value of the shares to

(1) (1917) 2 Ch. 349.
(2) (1930) S.L.T. 378.
(3) (1937) A.C. 26.
(4) (1937) A.C. 26.
(5) (1930) S.L.T. 378.
(6) (1937) A.C. 26.
(7) (1935) 152 L.T., at p. 104.
(8) (1937) A.C. 26.

trust companies although there was evidence that the value of the shares in the open market would be enhanced if trust companies were to be included amongst possible competitors. But Lord *Blanesburgh* said :—" I agree with, I believe, all your Lordships in thinking that any possible bid for the shares by a Trust Company was allowed for by Lord *Plender* in his estimate of £355 a share, accepted by the learned judge as reliable. Had that not been so the Crown's contention on this point would have been, I think, unanswered " (1).

It appears to me that this part of the headnote is too widely stated, and that the reason why the trust company could not be taken into consideration as a competitor was, as *Finlay* J. pointed out, because the directors would have refused to register such a company. In the present case, Alfred was in a very favourable position as a purchaser of the shares, and he could hardly have objected to have registered himself on the ground that he was an undesirable person to admit as a member. He could not alter the nature of the restrictions on transfer which are contained in the memoranda of association of four of the companies, but he could sell and transfer the shares as he liked through his control of the Board. He was the residuary beneficiary under the will so that, subject to the payment of funeral and testamentary expenses, death duties and debts, and subject to paying the legacies and setting aside a fund to secure the annuities during the lifetime of the annuitants, he was entitled to the estate. If he had paid or provided for the liabilities other than the debts owed by the estate to three of the companies he could, whilst he owned the whole of the shares, have arranged to leave these debts outstanding. The shares had, therefore, a special value to him. Mr. Outhwaite capitalized at the following rates for the three companies to which these debts were owed : Opera House 7 per cent ; Small Arms and Mia Mia each 8 per cent ; which means in effect that, while the appellant for the purposes of duty is claiming the benefit of a deduction of the full amount of these debts as a liability of the estate, he is at the same time seeking to bring in the same amounts as assets (although the two entries might be expected approximately to cancel one another) on the basis that, if they were repaid to the companies, they would only have about half that value when reflected in the price which a prudent purchaser might reasonably be expected to pay for the shares. Such a price would not be likely to attract Alfred as residuary beneficiary, however reasonable it might appear to be when valuing the estate for the purpose of estate duty.

(1) (1937) A.C., at p. 62.

In all the circumstances, the following would appear to be the fair values of the shares: Opera House £8 10s.; Interstate £2; Small Arms £2 10s.; Mia Mia £1 2s.; Avrom 18s.

I have not, so far, referred to the evidence of Mr. Nixon and Mr. Mirams. Mr. Nixon's valuations were as follows:—

	Opera House	Interstate Investments	Small Arms	Mia Mia	Avrom
1st Method	£10 11s. 9d.	£2 11s. 9d.	£3 12s. 3d.	£1 15s. 10d.	£1 1s. 1d.
2nd Method	£10 17s. 1d.	£2 14s. 9d.	£3 14s. 5d.	£1 17s.	

Mr. Nixon, instead of basing his valuations principally on the income yield, preferred to rest his opinion upon the amounts the shareholders would have received upon an immediate liquidation of the companies, or alternatively upon the basis that a large part of the accumulated profits of the companies other than Avrom would be immediately distributed to the shareholders. In the case of Mia Mia, his alternative method involved a reduction of the capital of the company, and would have left the company seriously depleted of cash resources to restock after a drought. But the financial position of each of the companies was extremely strong, so that the possibility of a liquidation upon a creditor's petition could be dismissed, and, as there was no indication that Alfred desired to wind up the companies, the only ground upon which they could have been wound up against his will at the date of death would have been that it was just and equitable to do so. This ground gives the court a wide discretion, and, in the case of companies like the present, it would not hesitate to exercise the power if one of the shareholders had control of the company and was misusing his powers for his own benefit and to the detriment of the other shareholders, but, as there is no evidence that Alfred would not conduct the companies on sound and profitable lines and pay reasonable dividends if strangers were introduced as shareholders, I can see no justification for valuing the assets on the basis that the companies would be immediately wound up. Further, there is not sufficient evidence to ascertain what the assets would have realized upon a winding up, and, a purchaser buying the shares on this basis would surely require some profit on the realization. In the same way, Alfred would not be under any legal compulsion to discharge the debts by making any distribution of the accumulated profits of the three creditor companies, or to make any distribution of the accumulated profits of Interstate Investments or of the balance of the accumulated profits of the Small Arms company, so that what Mr. Nixon has done is by the first method to elevate a remote possibility, and by the second method a strong possibility, into a basis of valuation, instead of adopting the method usually, if not invariably, adopted by the courts of ascertaining the values from the probable future income in the first instance, and considering the results thereby obtained in the light of the values which the shares would have in other possible circumstances.

Mr. Miram's method was to take the assets which existed at the date of death, estimate the amount of income they were likely to produce in the future, taking into account the income which they had produced in the past, and to value them by comparing their capacity to earn income with the income which assets of that nature should reasonably be expected to produce. His general approach to the problem was sound, but he spoilt his evidence by analyzing the assets in too much detail. There were also several aspects of his evidence with which I could not agree. In particular, he considered that the purchaser of the shares would take over the debts, but this appears to me to be impracticable ; and his view that the option to purchase the shares from the other shareholders in Avrom was a right attached to the 4,000 shares held by the brothers which would pass to the purchaser was clearly erroneous. Also I do not think it is right to leave income tax out of account in estimating net profits, although the fact that a shareholder would get a rebate on his dividends of the tax paid by a company would be a matter that a purchaser would take into account. Further, I could not find sufficient justification in the evidence for his crediting the Mia Mia accounts with the item of £4,870 as being the difference between the cost of 12,000 sheep purchased for £9,070 13s. 7d. and the amount of £4,200 obtained by applying to them the standard valuation of 7s. per head adopted for the purposes of the annual accounts, and I think that five years was too short a period to estimate the future profits of a business of that nature. Also I could not agree that it was reasonable to treat the trading business of Small Arms as though it would be liquidated at the date of death just because losses had been made in the two previous years. His first values of £10 3s. for Opera House, £2 6s. 3d. for Interstate Investments, £3 2s. 2d. for Small Arms, £1 12s. 10d. for Mia Mia and £1 4s. 8d for Avrom were, in my opinion, too high. But I entirely agree with him that 20 per cent was an ample percentage by which to discount the values of the shares because they were held in proprietary companies ; and during the addresses Mr. Tait handed in corrected figures to show what his values would be if adjusted to the values of the assets and if 20 per cent was deducted from the values he placed upon the debts. These figures would require some further adjustment because they were based on Mr. O'Brien's and not

H. C. OF A. 1944.

ABRAHAMS v. FEDERAL COMMISSIONER OF TAXATION.

Williams J.

on Mr. McIntyre's valuations of the leaseholds. The corrected values as handed in by Mr. Tait were as follows :—Opera House £8 13s. 8d., Interstate Investments £2 3s. 8d., Small Arms £2 19s. 6d., Mia Mia £1 9s. 7d. and Avrom 17s. 3d. These corrected values have been of considerable assistance in that they show that, if the problem is approached by estimating the value of the shares as shares in public companies and then discounting those values by 20 per cent, the result is much the same as that at which I have arrived by a different route.

There remains the question of costs. The values placed upon the shares by the appellant in his return for duty totalled £90,533. The values placed upon the shares by the respondent in his amended assessment totalled £379,978. The values which I have placed upon the shares total £270,800. The appellant has therefore succeeded in reducing the valuation placed upon the shares by the respondent by between one-third and one-fourth. The values which he placed upon the shares in his return were fantastically low, and he has not attempted to justify them on the appeal. The valuations which he attempted to justify on the appeal were also, in my opinion, too low. On the whole I think that justice will be done if I direct the respondent to pay one-third of the appellant's costs. The order I make is therefore as follows :—

Appeal allowed. Amended assessment set aside. Liberty to the respondent to reassess the appellant, valuing the shares in Opera House Investment Pty. Ltd. at £8 10*s. per share, Interstate Investment Co. Pty. Ltd. at* £2 *per share, Small Arms Co. Pty. Ltd. at* £2 10*s. per share, Mia Mia Pastoral Co. Ltd. at* £1 2*s. per share, and Avrom Investments Pty. Ltd. at* 18*s. per share. Respondent to pay one-third of the appellant's costs of the appeal, including his costs of the shorthand notes. Liberty to apply.*

Solicitors for the appellant, *Blake & Riggall.*

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

J. M.