REPORTS OF CASES

DETERMINED IN THE

HIGH COURT OF AUSTRALIA

[HIGH COURT OF AUSTRALIA.]

McCATHIE AND OTHERS . . . . APPELLANTS;

AND

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

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SYDNEY, *Mar.* 20, 23; *April* 28.

Williams J.

Estate Duty (Cth.)—Assessment—Dutiable estate—Proprietary company—Shares—Valuation—Matters for consideration—Events subsequent to material date—Estate Duty Assessment Act 1914-1940 (*No.* 22 *of* 1914—*No.* 12 *of* 1940).

The real value of shares which a deceased person held in a company at the date of his death depends more upon the profits which the company has been making and should be capable of making, having regard to the nature of its business, than upon the amounts which the shares would be likely to realize upon a liquidation.

In estimating the value of shares held by a deceased person evidence of events subsequent to the date of death may be taken into consideration to determine the proper weight to attach to relevant circumstances existing on the material date.

Moneys paid as fees to directors in excess of a reasonable amount should be treated as profits when determining the reasonable earning capacity of a proprietary company which bears the character of a partnership trading with limited liabilities.

The proper approach to the problem of determining the value of shares in a company as at the date of the death of the deceased holder thereof, considered.

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McCATHIE v. FEDERAL COMMISSIONER OF TAXATION.

APPEAL from the Federal Commissioner of Taxation.

Kate Edith McCathie, Jack Henderson McCathie, Kenneth Henderson McCathie and David Henderson McCathie (Junior), the executrix and executors of the will of David Henderson McCathie, who died on 7th August 1940, appealed to the High Court against the value placed by the Federal Commissioner of Taxation upon the shares which the testator held in McCathies Pty. Ltd., in an amended assessment of his estate for the purposes of Federal estate duty.

The testator held 48,000 A shares, 1,500 B shares and 26,435 C shares, all of one pound each and all fully paid.

The executrix and executors, hereinafter called the executors, made no distinction between the three classes and valued the shares for the purpose of duty at 7s. 7d. per share, or at a total value of £28,792. The Commissioner, in his amended assessment, valued the A shares at £1 per share, the B shares at 19s. per share and the C shares at 15s. 5d. per share, making a total value of £69,801, or approximately 18s. 3d. per share.

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

Kitto K.C. and *Hooke*, for the appellants.

Teece K.C. and *Dignam*, for the respondent.

Cur. adv. vult.

April 28.

WILLIAMS J. delivered the following written judgment :—

This is an appeal by the executors of the will of the late David Henderson McCathie, who died on 7th August 1940, against the value placed upon the shares which he held in McCathies Pty. Ltd. in an amended assessment of his estate for the purposes of the Federal estate duty.

On 7th August 1940 the nominal and issued capital of the company was £300,000, divided into 128,000 A shares, 13,000 B shares and 159,000 C shares, all of one pound each and all fully paid, of which the deceased held 48,000 A shares, 1,500 B shares and 26,435 C shares, so that his total shareholding was 75,935 shares.

Under the articles of association of the company the A and B shares are entitled to the payment of a fixed non-cumulative dividend at the rate of five per cent per annum upon the paid-up capital, after which the surplus profits, subject to the provisions relating to the reserve fund and to the rights which may be conferred from time to time upon the holders of the C shares, are applicable to the payment of a further dividend to the holders of the A shares for the

time being issued in proportion to the capital paid up thereon as the company may in general meeting determine.

Article 5 of the articles of association of the company provides as follows :—Subject to the provisions of the articles of association the C shares shall be under the control of the directors who may from time to time allot or otherwise dispose of the same to such persons on such terms and conditions and with such privileges attached as the directors may at any time and from time to time determine.

Article 132, so far as material, provides that upon a winding up the surplus assets of the company shall be applied in repaying *pari passu* to the holders of all shares in the company the amount paid up thereon, and that the residue, if any, shall be divided among the holders of all shares in the company other than B shares in proportion to the nominal amount of the capital held by them respectively.

The C shares were not issued with any special terms, conditions or privileges attached thereto, so that they would appear only to be entitled whilst the company is a going concern to such dividends as the directors may from time to time determine to distribute amongst them. The position on 7th August 1940, therefore, with respect to the payment of dividends was that the holders of A and B shares were entitled to a non-cumulative preferential dividend of five per cent, and that the surplus profits not allocated to the reserve fund were divisible amongst the holders of the A and C shares as the directors might determine, while upon a winding up the holders of all three classes were entitled to a return of their capital, after which the holders of the A and C shares were entitled to any balance of the surplus assets *pari passu*.

Article 68 provides that upon a poll at a general meeting every member shall have one vote for every twenty shares other than B shares held by him. The articles of association contain restrictions on the transfer of shares, but, applying, *mutatis mutandis*, what I ventured to say in *Perpetual Trustee Co. (Ltd.)* v. *Federal Commissioner of Taxation* (*Murdoch's Case*) (1), I do not consider that they are such as to depress the value of the shares to any appreciable extent.

The company was incorporated in 1913 to take over as a going concern the business of general drapers and milliners then being carried on by its predecessor, Mrs. McCathie Ltd., at Nos. 197, 199 and 201 Pitt Street, Sydney, and the company has, ever since the date of its incorporation, continued to carry on the business of a

(1) (1942) 65 C.L.R. 572, at p. 580.

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general retail store in women's, children's and fashion goods, piece goods, millinery, hosiery, general drapery and household china, glass and crockery.

The assets of the company appearing in the balance-sheet as at 15th July 1940 (and it is agreed that they were substantially the same on 7th August 1940) were as follows :—(1) The freehold property already mentioned, which has a frontage of seventy-one feet to Pitt Street and a total depth of two hundred and twenty feet and which is situated on the western side of Pitt Street about midway between Market Street and King Street in the heart of the retail shopping area of Sydney, the improvements consisting of a retail store building constructed of brick with wooden floors and containing a basement, ground, and three upper floors. The building was erected in 1882, but in 1937 a sum of £41,000 was expended in extensive remodelling and structural alterations, internal walls being demolished, new shop fronts put in, new lifts installed, and other internal improvements effected. This work continued throughout the whole of the year 1937. Mr. Waldron said that no further substantial alterations would be required for at least another ten years. I accept his valuation of the improved value of this property of £225,000 as at 7th August 1940, and I also accept his estimate of what the net rental would have been if the property had been let on that date, namely £11,471. (2) Fittings, £9,000. (3) Australian Consolidated Bonds and Commonwealth Free Loan £31,000, investments in shares in other companies £68,500, stock on hand £94,000, debtors £15,340, family current accounts £6,600, deposits at call £8,000, cash with bankers and at hand £6,800, against which must be set off as owing to creditors a sum of £62,000 mainly comprised of amounts totalling £47,000 owing to members of the McCathie family on loan at call carrying interest at the rate of four per cent per annum. The surplus of assets over liabilities upon a winding up and distribution of assets was therefore £406,000, equivalent to £1 7s. per share on the A and C shares after allowing for one pound per share on the B shares.

The balance-sheets for the eight years ended 15th July 1933 to 15th July 1940 are in evidence and show that the gross sales during those years were as follows :—For the year ended 15th July 1933 £301,135 ; 1934 £264,466 ; 1935 £283,368 ; 1936 £283,741 ; 1937 £270,547 ; 1938 £272,324 ; 1939 £266,651 and 1940 £280,972 ; that the gross profits were as follows :—For the year ended 15th July 1933 £74,333 ; 1934 £70,310 ; 1935 £79,479 ; 1936 £87,771 ; 1937 £78,808 ; 1938 £82,559 ; 1939 £84,560 and 1940 £93,437 ; and that the gross profit percentage on sales was as follows :—

for the year ended 15th July 1933 24.68 ; 1934 26.59 ; 1935 28.05 ; 1936 30.93 ; 1937 29.13 ; 1938 30.32 ; 1939 31.71 and 1940 33.26. The total expenses (adjusted for depreciation and income tax) were as follows :—for the year ended 15th July 1933 £78,446 ; 1934 £77,160 ; 1935 £77,301 ; 1936 £78,417 ; 1937 £77,440 ; 1938 £82,988 ; 1939 £83,547 and 1940 £83,771 ; the total expenses percentage of sales (similarly adjusted) was as follows :—for the year ended 15th July 1933 26.05 ; 1934 29.18 ; 1935 27.28 ; 1936 27.64 ; 1937 28.62 ; 1938 30.48 ; 1939 31.33 and 1940 29.82.

In order to arrive at the net profits an adjustment of the balance-sheets in respect of depreciation disallowed by the Commissioner of Taxation and by substituting taxes payable for taxes paid is required. Both Mr. Wolfenden and Mr. Nelson made these adjustments. There are only slight differences in their results and I shall use Mr. Wolfenden's figures. On these figures the net profits in the years in question were as follows :—for the year ended 15th July 1933 £348 ; 1935 £7,460 ; 1936 £15,221 ; 1937 £7,077 ; 1938 £4,237 ; 1939 £5,788 and 1940 £14,495 ; while there was a loss of £1,844 in the year 1934.

During these years the company paid the same dividends on all its shares irrespective of class, namely, in 1933 and 1934 four per cent, in 1935 three per cent, in 1936 five per cent, in 1937, 1938 and 1939 three per cent and in 1940 four and a half per cent.

The appellants, making no distinction between the three classes, valued the shares for the purposes of duty at 7s. 7d. per share or at a total value of £28,792, while the Commissioner in his amended assessment which is the subject matter of the appeal valued the shares as follows :—the A shares £1, the B shares 19s. and the C shares 15s. 5d., making a total value of £69,801, or approximately 18s. 3d. per share.

Opinions as to the value of the shares held by the deceased in the company were expressed by Mr. Miller, a member of the Sydney Stock Exchange, and by Mr. Wolfenden, an experienced chartered accountant and actuary, on behalf of the appellant, and by Mr. Nelson and Mr. Bogan, experienced chartered accountants, on behalf of the respondent.

Mr. Miller considered that on past results the A shares could be expected to pay a dividend of four per cent, and that an investor who purchased these shares would require at least ten per cent on his money, so that they were worth at the maximum 8s., and he then proceeded to value the B shares roughly at 7s., and the C shares roughly at 2s. His total valuation was £22,368.

Mr. Wolfenden, after analysing the dividends that could have been paid on the three classes of shares out of the average of the adjusted

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net profits for the years ended 15th July 1938, 1939 and 1940, namely, £8,173, and after analysing the return that he considered an investor would have required, having regard to the average dividend yield from the cumulative preference shares of eight companies registered on the Stock Exchange ranging from £5 1s. 1d. to £12 15s. 8d. per cent, considered that a purchaser of the A shares would have required an eight per cent return on his money and on that basis valued them at 10s. 1d. each, that a purchaser of the B shares would have required a ten per cent return on his money and on that basis valued them at 8s. 1d. each, and that a purchaser of the C shares would have required a return of twelve and a half per cent on his money and on that basis valued them at 2s. 6d. each. His total valuation was £28,110.

It is true that in order to arrive at the value of shares at the date of death the courts have often applied the same test as that which they have applied in the assessment of compensation upon the compulsory purchase of property, which is to ascertain the price which a reasonably willing vendor should be agreeable to accept and which a reasonably willing purchaser should be agreeable to pay for the property in its actual condition at the time of expropriation with all its existing advantages and with all its possibilities. But at the date of death no expropriation in fact takes place. The executors have the executor's year to realize the property and the court of equity can always sanction a postponement if the executors consider that it is inadvisable to sell during that year and require protection against the creditors. So far as the beneficiaries are concerned there may be a power of postponement in the will, and if there is not there is a statutory power under the *Trustee (Amendment) Act* 1929 (N.S.W.). The shares may not require to be sold at all in the due course of administration. The court has to ascertain the real value of the shares at the date of death, and the market value is not always the same as the real value (*Potts* v. *Miller* (1)). In *Inland Revenue Commissioners* v. *Crossman* (2) Lord *Macmillan*, in referring to an Act in which the value had to be fixed by a particular criterion, said :—" It may be unfortunate for the revenue that the legislature has chosen a method of measuring value for estate duty purposes which may not in the present instance yield the real value of these shares. But that is not your Lordships' concern. It is not the value of the shares as they were held and enjoyed by the deceased shareholders or their value as they are now held and enjoyed by their successors that is in question. It is simply and solely on their market value that the toll of estate duty is to be

(1) (1940) 64 C.L.R. 282, at p. 299. (2) (1937) A.C. 26, at pp. 70, 71.

levied." So that this test, though valuable and persuasive, is by no means final or conclusive, and it should not be used so as to depress the value of property by exaggerating temporary disadvantages to which it is subject at the date of valuation and failing to give proper weight to its more permanent advantages. But neither Mr. Miller nor Mr. Wolfenden applied this test. They considered that they had to ascertain what would have been the market value of the shares on the Stock Exchange at the date of death. They estimated the value from the purchaser's point of view alone, although subsequently they said that because the prices at which they had arrived would be all that a prudent purchaser could be expected to pay, they were also of opinion that these prices were all that a reasonable vendor could expect to receive. They worked upon the past results of the company, and were inclined to discount even these results, because in August 1940 France had fallen and Britain was in grave peril, so that the outlook for the future of the retail trade was ominous, and they failed to take into account the future possibilities of the business, although, as Mr. Wolfenden said, if the company conducted its business properly, it should be able, with the position of its building and the state of its assets, " to earn handsome dividends." He ascribed the low net profits to poor management, and said that, not only was the rate of gross profit too low in most of the years, but also, and this was even more important, a comparison between the percentage of salaries and wages with the gross profits showed that these outgoings were very high and that they were " most startling and most unconvincing as to the efficiency of the management."

It is to be noted that the amounts paid for directors' fees, to which I shall advert later, were not included in the salaries and wages to which Mr. Wolfenden referred, so that, if these amounts were included, his criticism would be, I imagine, even stronger. But, with respect to this criticism, it is legitimate, in my opinion, in considering the future possibilities of the business, to take into account that the person chiefly to blame, namely, the deceased, who had been the sole managing director during the period, had died, so that there would be a change in the management; that, with respect to the percentage of gross profits on sales, the accounts for the year ended 15th July 1940 showed a percentage of slightly over thirty-three per cent, which it is common ground would be a reasonable gross profit for the business of a retail store, and that this percentage could be expected to continue because one of the present joint managing directors, who gave evidence, said that in the year ended 15th July 1939 they were endeavouring to mark the goods a little higher, and that in the year ended 15th July 1940 on account of the

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war there was no difficulty in achieving a gross profit of thirty-three per cent. Mr. Wolfenden made his valuation upon the basis that the future net profits of the business could only be reasonably expected to average £8,173 per annum, although the income from the investments amounts to £4,800, or, in other words, he assessed the future net earning power of a business carried on in a building, the net rental value of which is £11,470, at £3,300. In adopting the three years ended 15th July 1938, 1939 and 1940 he did not take into account any disturbance of business due to the structural alterations to the company's premises in 1937, although in the calendar year 1936 the company's gross sales were £282,255, while in the calendar year 1937 they dropped to £266,017, a falling-off of over six per cent. I accept Mr. Nelson's evidence that during the year 1937 there was a buoyancy and general increase in sales in the neighbourhood of seven per cent, so that, when the company suffered a decline in its sales in such circumstances, I agree with him that the proper inference is that the structural alterations did interfere with the company's trade in spite of the precautions which were taken to prevent it doing so. Indeed, the joint managing director, in his evidence in chief, in referring to the reduced profits in the year ended 15th July 1938, said that there was a decrease in sales following the alterations, although he added that it was not sufficient to make any appreciable difference in the trading.

I am unable to accept Mr. Miller's or Mr. Wolfenden's valuations. Of Mr. Miller it can be said, I think, that shares in private companies containing restrictions on transfer are not a species of property with which he is familiar. His valuation was admittedly chiefly based on his experience, which has been no doubt confined mainly to advising clients who desire to buy and sell shares in public companies listed on the Stock Exchange, so that the purchasers with whom he is familiar would probably require, as he said, an attractive price before they would invest in a private company.

Mr. Wolfenden was not, in my opinion, addressing his mind to the right problem, because he was considering what he would have advised a client to pay for the shares on the basis that they were quoted on the Stock Exchange in competition with other shares of retail stores at a time when the value of shares on the Stock Exchange was depressed by the international outlook and buyers were scarce. In estimating the future capacity of the company to make profits he has, in my opinion, placed too much emphasis on features in the company's accounts which, however startling, are of a transient nature, and too little emphasis on the more permanent and therefore more important characteristics of the company's business. These

characteristics are an old and well-established business, an excellent site situated right in the heart of the shopping centre of Sydney well suited to the carrying on of that business, a building which has just been remodelled and modernized at a cost of £41,000, and its investments, which are more than ample to meet its liabilities, so that it not only owns the whole of its business assets free of debt, but it has ample liquid reserves to meet any emergency or to take advantage of any opportunity. He has also, in my opinion, over-emphasized the depressing effect on the company's shares of the perilous international outlook on 7th August 1940. He said that the future of the retail trade was doubtful, so that an investor would not be content to rely on the figures for the year ended 15th July 1940, but would want to rely on the average of the figures for the previous three years, although I quite fail to see what guide the state of business in the years ended 15th July 1938 and 1939 could be as to the future of the business in war-time. Fortunately it is unnecessary to express an opinion as to the extent of the peril, or, what is more important, as to the extent to which the purchasing public realized the relation between Britain's peril and the future safety of Australia. Let me hope that it was, as Mr. *Kitto* contended, fully realized, although there were many indications to the contrary. But I must decide this appeal upon the basis that the shares, like any other private property, could only have a real value if Britain survived (and few of those who have read her history and knew the character of her people could have doubted that she would), and that, on that basis, however long and perilous the war, the clothes of adults would still wear out, children would still grow out of their clothes, babies would still be born, and crockery would still be broken, so that in August 1940 there was no reason that I can see why the profits from the business of a retail store should have been in greater jeopardy than the profits from most other businesses.

The result of Mr. Miller's and Mr. Wolfenden's evidence is that, although the balance of assets over liabilities on 7th August 1940 was over £400,000, if all the shareholders in the company had sold their shares independently on that date, the total amount which they could have expected to realize would have been, according to Mr. Miller £71,000, and according to Mr. Wolfenden £94,000.

Mr. Nelson and Mr. Bogan selected the years ended 15th July 1936, 1939 and 1940 as the three most suitable years to ascertain the average net profits made by the company. Mr. Nelson estimated the average net profits, after adjusting the directors' fees as hereinafter mentioned, to be £15,639 or 5.231 per cent on its total capital and on that basis valued the A shares at one pound, the B shares at 19s. and the C shares

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at 15s. 5d., the total value being the amount of the amended assessment. Mr. Bogan, after making the same adjustment for directors' fees, reached the figure of £15,641, from which he deducted the amount received from investments, £4,829, which left the average net profits from the trading operations at £10,812. He then capitalized these net profits at the rate of six per cent, which amounted to £180,200, and, after adding the value of the investments, he arrived at a total value of £279,373, or in other words 18s. 7½d. per share, which gave the shares owned by the deceased a total value of £70,714, which was slightly higher than that reached by Mr. Nelson. I feel some difficulty in accepting the three years selected by Mr. Nelson and Mr. Bogan. I could understand them taking the years ended 15th July 1936 and 1940 and rejecting the years ended 15th July 1937, 1938 and 1939 as affected by the structural alterations. If this was done, the net profits would, of course, have been considerably higher. But the year ended 15th July 1936, though apparently a normal year after the depression had vanished, is perhaps too remote. If three years have to be selected I prefer the years selected by Mr. Wolfenden, due allowance being made, at least in the year ended 15th July 1938, for disturbance of business. Further, while there is a great deal to be said for the view taken by Mr. Bogan that because the Commonwealth loans and shares in other companies were earning a full return having regard to their nature the company was in part an investment company, so that a purchaser of shares in the company would be willing to buy on the basis that these assets were worth 20s.; the difficulty is whether to charge the £47,000 owing to the shareholders against the investments as Mr. Wolfenden suggests, or against the trade assets as Mr. Bogan suggests. Further, so long as the company continues to carry on its present business, some part of the investments may at any time be required to be realized for the purposes of the business, so that it would appear to be safer and fairer to the appellants to treat the whole of the assets as the assets of the business of a retail store. On the whole, since the average of the gross sales for the whole eight years was approximately the same as the gross sales for the year ended 15th July 1940, and the gross profit in that year was at the normal rate of thirty-three per cent, it is safer, I think, as Mr. Bogan was obviously inclined to do, to work mainly on that year. As the expenses for that year were above the average of the expenses for the eight years both in amount and in their percentage to the percentage of gross profit, such a method cannot be unfair to the appellants.

It appears to me that the true approach to the problem is as follows:—(1) I have to find as a fact what was the real value of

the shares owned by the deceased in the company on 7th August 1940 on the whole of the available materials. (2) In approaching such a problem the courts have, as I have said, applied the same test as that applied in assessing what would be reasonable compensation for the compulsory purchase of property. (3) In applying this test to a hypothetical purchase of shares in a company, the distinction must not be lost sight of between the acquisition by a purchaser of property which becomes subject to his sole control and the acquisition of shares in a company, which only confer on the holder those rights to which he becomes entitled from time to time under the constitution of the company and the general law. (4) A purchaser of shares in a company which is a going concern does not usually purchase them with a view to attempting to wind up the company. (5) A prudent purchaser, therefore, 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 his shares, and such a purchaser would no doubt expect to receive such dividends as were appropriate to the nature of the business in which the company was engaged. It follows, therefore, that the real value of shares which a deceased person holds in a company at the date of his death will depend more on the profits which the company has been making and should be capable of making, having regard to the nature of its business, than upon the amounts which the shares would be likely to realize upon a liquidation. (6) But, where the shares are shares in a private company which bears the character in many respects of a partnership trading with limited liabilities, and the net profits as disclosed by the balance-sheet available for payment of dividends are less than they should be owing to features which should not exist in a business carried on with probity, efficiency and economy, there are two grounds upon which it may be possible for a purchaser to have the company wound up. In the first place s. 208 (2) of the *Companies Act* 1936 (N.S.W.) authorizes the court to wind up a company if satisfied that the directors have acted in their own interests rather than in the interests of members as a whole. Secondly, the court will more readily wind up a company on the ground that it is just and equitable to do so if the circumstances are such that the court would dissolve a partnership. So in *Loch* v. *John Blackwood Ltd.* (1), in the judgment of the Privy Council delivered by Lord *Shaw of Dunfermline* (2), a passage is cited from the judgment of Lord *Clyde*, Lord President, in *Baird* v. *Lees* (3), where he pointed out

(1) (1924) A.C. 783. (2) (1924) A.C., at p. 793.
(3) (1924) Sess. Cas. 83, at p. 92.

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that a shareholder puts his money into a company on certain conditions, one of which is that the business shall be conducted in accordance with certain principles of commercial administration defined in the statute which provides some guarantee of commercial probity and efficiency, and that if shareholders find that these conditions or some of them are deliberately and consistently violated by the action of a member and official of the company who wields an overwhelming voting power, and if the result of that is that, for the extrication of their rights as shareholders, they are deprived of the ordinary facilities with which compliance with the *Companies Act* would provide them, then a situation arises in which it may be just and equitable for the court to wind up the company. In the present case, therefore, a purchaser or purchasers of the shares owned by the deceased in the company would be entitled to complain if in certain respects the company's business was not being conducted with probity and efficiency; and, if the other shareholders as members of the McCathie family then combined to prevent these wrongs being righted, he or they would be entitled to apply to have the company wound up. I wish to make it quite clear that there is no suggestion in the present case of any lack of probity in the conduct of the company's business. But Mr. Wolfenden has strongly criticized its efficiency in certain respects which are obviously capable of rectification. Further, I have no doubt that the company has been paying an exorbitant amount by way of directors' fees. For many years prior to 7th August 1940 the board of directors held only one regular meeting in each year, but during these years the total amount paid by way of directors' fees was £6,980. Mrs. Hepner was in receipt of £1,800 per annum. In 1940 she was seventy-eight years of age and seldom went to the shop, although she appears to have been in younger days an astute business woman, and in 1940 still to have been able to give sound advice on matters which were referred to her, but it could hardly be suggested that £1,800 per annum was not an excessive remuneration for the services which she was rendering. Mrs. Brown, then aged seventy years, who joined the board when her husband died in 1919, was in receipt of £1,450 per annum, but she does not appear to have ever taken any real part in the company's business, the representative of her family being the present joint managing director, Mr. G. H. Brown, who, during the lifetime of the deceased, was the manager of the business, and who, no doubt, received an appropriate salary for his work. Mrs. McCathie, the wife of the deceased, received £729, and Lady Manisty £291. There is no evidence that either of these ladies rendered any services to warrant such payments.

There was nothing seriously irregular in distributing the profits in this way whilst the company remained a family company and the shareholders approved, but, in estimating the reasonable earning capacity of the company's business, I agree with Mr. Nelson that at least £3,800 should be deducted from the directors' fees and added to the company's profits. If this had been done in the lifetime of the deceased the annual dividends could have been increased by one and a quarter per cent. As, in Mr. Wolfenden's opinion, the amount paid for wages and salaries was excessive, if, like Mr. Nelson, I confine any adjustment in respect of expenses to the directors' fees, the appellants should have small cause for complaint. On this point Mr. *Kitto* contended that I must take the company as it was being conducted on 7th August 1940, but, if I were bound to do this, then, in a case where the only shareholders in a company owning substantial assets and with a profitable business were also directors, and the practice of the company was to divide all the profits as directors' fees and never to pay any dividends, if one of the shareholders died, the court might be forced to assess the value of the shares on the basis that the only profits available for dividends in the future would be the share of the profits previously paid to him.

The position of the company on 7th August 1940, from the point of view of capital security for the money invested in its shares and from the point of view of capacity to carry on its present business profitably or if necessary to change that business into that of an investment company, was extremely strong. If in the future it became unprofitable for the company to continue to carry on its retail trade, the company could realize its stock and let the building, in which case it would have an income of £11,400 from rent and £4,800 from its existing investments, while its surplus funds, consisting mainly of the proceeds of sale of its stock, after paying thereout the outstanding liabilities including the debt of £47,000, would amount to at least £50,000, and this sum, if it were invested to return three and a half per cent, would produce £1,750. The total annual revenue of the company would therefore be approximately £18,000, from which there would have to be deducted income tax on the rent, and interest and directors' fees and other expenses of management, which would be small. As an investment company, therefore, the shares could be said to have in their totality a safe potential yield of at least five per cent per annum. To carry on the business of a retail store is to carry on a more hazardous business than that of an investment company, so that it is reasonable to anticipate that the company would only continue to carry on the business of a retail store if it could make at least as large profits in this way. The

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largest net profits as shown in the company's accounts up to 7th August 1940, after adjusting taxation, were £15,200 in 1936 and £14,500 in 1940. In other years the profits were well below these figures, so that, unexplained, the business has shown disappointing results. But, accepting the expenditure on wages and salaries, I am satisfied that this is mainly due to three factors. First, the structural alterations which proceeded throughout 1937 affected the company's sales whilst the work was going on and for some time afterwards, although eventually they could be expected to produce an increase in business. Secondly, £3,800 of the company's profits, which should have been available to pay dividends, were being distributed amongst the directors. Thirdly, except for the year ended 15th July 1940, the margin of gross profit was too low, but the company could reasonably be expected to be able to sell after that date at a normal gross profit. As I have said, the average of the gross sales for the eight years was approximately the same as the gross sales for the year ended 15th July 1940. The gross profit on sales in that year was a normal gross profit, so that, if the directors' fees are adjusted, unless the war has introduced unusual features into that year's trading, the net profit for that year, adjusted in respect of directors' fees, would appear to represent, on a somewhat conservative basis, because no allowance has been made for excessive wages and salaries, the fair earning capacity of the company's business on 7th August 1940. This adjusted amount would be over £18,000, so that again the company would appear to be well capable of paying five and a half per cent on its total shareholdings. Further, I am satisfied that I can rely on the year ended 15th July 1940, because it was largely a year unaffected by special conditions due to the war; and, in any event, the making of a normal gross profit in that year and the adjustment of the directors' fees have no relation to any special condition due to the war, but relate to the future conduct of the company's business in a proper and efficient manner under any conditions.

I find, therefore, that, upon the information available up to 7th August 1940, a fair basis for friendly negotiation between a willing vendor and a willing purchaser would have been that the company could reasonably be expected to earn profits sufficient to pay dividends at least equal to five and a half per cent on its total shareholding, so that, at a price of 18s. 3d. a purchaser of the shares of the deceased could reasonably anticipate a return of six per cent. As I said during the argument, it appears to be unnecessary to place separate values on the A, B and C shares. The deceased held more A than C shares so that, if his holding was sold in lots, the prudent

course would be to include a proportionate number of shares of each class in each lot. Any surplus profits, after a dividend of five per cent has been paid on the A and B shares, would be available to pay a dividend on the C shares, so that it would be largely immaterial to which of these shares the surplus profits were allocated, but it is reasonable to assume that after five per cent had been paid on the C shares any surplus would go to the A shares or would be apportioned between them and the C shares.

As I have said, Mr. Wolfenden, in order to determine the yield an investor would expect on the company's shares, averaged the dividend yield of the cumulative preference shares of eight companies registered on the Stock Exchange. I will venture to repeat what I said in somewhat analogous circumstances in the recent case of *Daandine Pastoral Co. Pty. Ltd.* v. *Commissioner of Land Tax* (1), where a valuer for the Crown had averaged the sales of five properties alleged to be in some respects comparable to the land to be valued in order to assist him to place a value on that land :—" This method of averaging is to my mind unsound. The prices obtained at comparable sales should not be aggregated and averaged, especially when the prices obtained on sales of small areas are dealt with in this way in order to obtain the value per acre of a large area. The only safe course is to compare each sale with the subject land separately. For instance, if three sales considered to be comparable of £3, £2 10s. and £2 per acre are averaged, the average value would be £2 10s. per acre. But if the subject land was closer in value to the land sold at £2 per acre than to the other lands, the average value would cause the subject land to be seriously overvalued. When such a method is applied to a large station in order to arrive at the proper value upon which to calculate a progressive land tax it can lead to a grave injustice." So in the present case the basis of eight per cent is reached by averaging yields between five per cent and twelve and a half per cent. None of the shares in fact yield eight per cent, and the yield is considerably less in some cases and considerably more in others. It is evident that many investors are quite satisfied to receive five to six per cent on these shares. Moreover, the yield was calculated at a date when the Stock Exchange was what I called in *Murdoch's Case* (2) " subject to abnormalities ", and the shares, being preference shares, are subject to the comments which appear later in that judgment (3). As the yield from five of these preference shares is less than six per cent, I fail to see why a

(1) Unreported. (High Court (*Williams* J.), 26th August 1943.) See *The Valuer*, (1943), vol. vii., p. 299.

(2) (1942) 65 C.L.R., at p 579.

(3) (1942) 65 C.L.R., at pp. 581, 582.

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prudent investor should not be prepared to purchase the shares in McCathies on a six per cent basis, or why a prudent shareholder should be expected to sell the shares for less. It follows that, in my opinion, at 18s. 3d. the shares which the deceased held in the company were not overvalued in the amended assessment.

I have arrived at this conclusion without taking into account the result of the trading for the year ended 15th July 1941. In that year the gross sales were £325,338, and the net profit, after paying directors' fees £6,000, was £26,000. But I will venture to repeat the remarks that I made in the *Daandine Case* (1) on the question whether this evidence was admissible :—" Values must be calculated in the light of circumstances which existed on the material date, in this case 30th June 1939, but subsequent events can be taken into account in order to determine the proper weight to attach to such circumstances. Subsequent sales are just as admissible in evidence as prior sales, provided that in all the circumstances they are comparable. If between the material date and the date of the subsequent sale supervening events occur which alter the conditions previously existing, the subsequent sales would not be comparable and would be useless. But if on the material date there was a tendency in a district to closer settlement and for prices to rise, subsequent sales of property in subdivision at rising prices would be evidence in support of the view that it was correct to value land in the district suitable for subdivision which was being applied for some other purpose in the light of this potential value. The whole tendency of the courts is to admit evidence of any events prior to the date of trial which will throw any real light on the issues : See the authorities referred to in the judgment of my brother *Rich* in *Australian Apple and Pear Marketing Board* v. *Tonking* (2)—see also *In re Bradberry*; *National Provincial Bank Ltd.* v. *Bradberry* (3). In *Federal Commissioner of Land Tax* v. *Duncan* (4) the whole contention of the Commissioner was that sales of the subject land subsequent in date to that upon which it had been valued showed that the original valuation was too low and ought to be increased." The accounts for the year ended 15th July 1941 would be admissible, in my opinion, on the question whether the structural alterations had affected the trade in the years ended 15th July 1938 and 1939, whether these alterations would in the future lead to improved business, and whether the grave international situation was going to interfere with the trade of a retail store. These were matters existing and to be taken into account

(1) Unreported. (High Court (*Williams* J.), 26th August 1943.) See *The Valuer*, (1943) vol. vii., p. 299.
(2) (1942) 66 C.L.R. 77, at p. 108.
(3) (1942) 167 L.T. 396, at p. 400.
(4) (1915) 19 C.L.R. 551.

at the date of death, and the court should not be forced to speculate as to their future when the facts are known and can speak for themselves.

The evidence, therefore, was admissible to this extent within the principles laid down by this Court in *Trustees Executors and Agency Co. Ltd.* v. *Commissioner of Taxes* (*Vict.*) (1), but, as I have said, I do not require to use it upon the question whether the valuation of the shares in the amended assessment was excessive, and I have not been asked to increase the assessment. If I had been asked to do so I would require more details with respect to this year than appear in the evidence. I would, for instance, want to know the percentage of profits on sales and the amount and percentage of expenditure.

For these reasons I am of opinion that the appeal should be dismissed with costs and I make an order accordingly.

Appeal dismissed with costs.

Solicitors for the appellants, *Crichton-Smith & Innes Kay.*

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

J. B.

(1) (1941) 65 C.L.R. 33.