[HIGH COURT OF AUSTRALIA.]

THE FEDERAL COMMISSIONER OF TAXATION . . . . . } APPELLANT;

AND

WEST AUSTRALIAN TANNERS AND FELLMONGERS LIMITED . . . . } RESPONDENT.

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PERTH, *Sept.* 12, 13, 14.

Rich, Dixon and McTiernan JJ.

Income Tax (Cth.)—Company—Whether "private company"—Control—Selection of group of seven shareholders by Commissioner—Actual circumstances of control of company—Income Tax Assessment Act 1936-1941 (*No.* 27 *of* 1936—*No.* 69 *of* 1941), *s.* 103.*

Section 103 of the *Income Tax Assessment Act* 1936-1941 provides, *inter alia*, that, for the purposes of the Act, "private company" means "a company which is under the control of not more than seven persons," and that "a company shall be deemed to be under the control of any persons where the major portion of the voting power or the majority of the shares is held by those persons and nominees of those persons or where the control is, by any other means whatever, in the hands of those persons."

Held that a company is not a "private company" within the meaning of this part of the section unless there exists a group or groups of not more than seven persons holding the major portion of the voting power, or the majority of shares and unless there is, in addition, actual control of the company exercised by one of such groups: there is such an actual control whenever there is only one such group.

Adelaide Motors Ltd. v. *Federal Commissioner of Taxation*, (1942) 66 C.L.R. 436, discussed and followed.

*Section 103 of the *Income Tax Assessment Act* 1936-1941 provides as follows:—"(1) In this Act, unless the contrary intention appears— . . . 'private company' means a company which is under the control of not more than seven persons, and which is not a company in which the public are substantially interested or a subsidiary of a public company . . . (2) For the purposes of this Division— . . . (*c*) a company shall be deemed to be under the control of any persons where the major portion of the voting power or the majority of the shares is held by those persons or is held by those persons and nominees of those persons or where the control is, by any other means whatever, in the hands of those persons."

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APPEAL from the Board of Review.

West Australian Tanners and Fellmongers Ltd. was a company formed in November 1921 to acquire the business of Doig and Dalgleish, Tanners and Fellmongers, at Fremantle. By its articles, the company adopted the agreement of sale, which had been made before its formation between the two vendors, of the first part, seven named persons of the second part, and a trustee for the company of the third part. The agreement provided for a nominal capital of £30,000, divided into 30,000 shares of £1 each. The consideration for the sale was £3,000, to be satisfied by the allotment of 3,000 fully paid £1 shares to the vendors. Each of the seven persons of the second part undertook to apply and pay for a specified number of shares, the total for the seven being 2,600.

The relevant articles of association of the company were as follows :—

" 4. The Directors may decline to register any transfer of shares without assigning any reason therefor " &c.

" 15. Every member shall have one vote for each share held by him."

" 17. The number of directors shall not be more than five nor less than two. The persons hereinafter named shall be the first directors of the Company, that is to say," (six named persons) " who shall hold office until otherwise determined by the Company in general meeting. Two directors shall form a quorum for the transaction of business."

" 19. (a) At the first Ordinary Meeting of the Company in the year 1927, the whole of the Directors shall retire from office, and at the first ordinary meeting in every subsequent year, one-third of the Directors for the time being, or if their number is not multiple of three, then the number nearest to one-third shall retire from office.

(b) The one-third or other nearest number, to retire during the first and second years after the ordinary General Meeting of the Company in the year 1927 shall, unless the Directors agree among themselves, be determined by ballot. In every subsequent year, the one-third, or other nearest number, who have been longest in office, shall retire."

" 21. The office of director shall be vacated if the person filling it :— (a) shall cease to be the holder either solely or jointly with some other person of two hundred and fifty shares in the Company, provided however that the nominee of any incorporated company holding not less than five hundred shares in this Company shall be eligible for appointment and to act as a Director of the Company so long as the company nominating him is the holder of not less than

five hundred shares in this Company. (b) shall become bankrupt or assign his estate in pursuance of any bankruptcy act for the time being in force in the State. (c) no director shall be disqualified from his office by reason of his contracting with the Company either as vendor purchaser or otherwise nor shall any such contract or arrangement or any contract or arrangement entered into by or on behalf of the Company with any Company or partnership of or in which any director shall be a member or shareholder or otherwise interested be avoided. Nor shall any director so contracting or being such member shareholder or so interested be liable to account to the company for any profit realised by any such contract or arrangement by reason only of such director holding that office or of the fiduciary relations thereby established."

"31. The directors in addition to the powers by the said Act" (*The Companies Act* 1893 (W.A.)) "or herein conferred shall regulate and determine the mode of carrying on the business of the Company and without prejudice to and not by way of limitation of the general powers thereby and hereby conferred shall have control and disposal of the affairs, property and funds of the Company consistently with the objects thereof and shall have the appointment of secretaries, bankers, solicitors and of all agents, clerks and of other servants of the Company and shall allow them respectively such reasonable salary, payment, wages, compensation and other benefits as they may deem fit and may from time to time suspend or dismiss any such person or persons and appoint another or others in his or their stand as they shall think proper and may make calls, declare dividends and make and accept contracts and affix the common seal of the Company to such documents as shall require to be under such seal and to accept from any member on such terms as shall be agreed a surrender of his share or stock or any part thereof and to make and give receipts releases and other discharges for money payable to the Company and for claims and demands of the Company. The Directors shall have power to acquire any freehold, leasehold or other property, rights or privileges or any interest therein which the Company is authorised to acquire at such price and generally upon such terms and conditions as they may think fit and to accept such title as in their opinion may be or may be deemed to be reasonably sufficient and to acquire through and cause any such property or interest to be held by any individual as trustee or agent for the company and to sell or otherwise deal with any such property rights or privileges or any parts thereof for such consideration as they may think fit and in particular for any shares debentures or securities of any company or authority."

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"32. The Directors shall have absolute discretion as to the entering into carrying on abandoning assisting or participating in financial, mercantile, industrial, manufacturing, mining, agricultural, and other operations, businesses, works, contracts, and undertakings which the Company is authorised to acquire or undertake and also as to the terms and conditions of any contracts businesses or engagements entered into for the company and in particular they may lend or advance money either with or without security and on such terms and conditions and stipulations as the Directors shall in their absolute discretion think fit."

"37. In the event of the Company making any fresh issue of shares over and above the first fifteen thousand (15,000) the shareholders for the time being shall have the first right to take the shares so issued but must exercise such right within 28 days from their being called upon so to do by the directors of the Company and in the event of their omitting to exercise such right within the said period the shares so issued or so many thereof as shall not have been taken up by one or more of the shareholders for the time being may be offered to the public in the discretion of the directors Provided always that no fresh issue of shares shall be made without the consent of the majority in value of the shareholders at an extraordinary general meeting duly convened for the purpose; Shareholders shall have the first right to take any fresh shares so issued pro rata according to the number of shares for the time being held by them and should any of such shareholders not desire to take any shares so issued the others of such shareholders shall have the right to take up any of the shares so declined pro rata according to their then holdings."

The company adopted an accounting period of twelve months ending on 30th November in each year. On 30th November 1941, its paid-up capital was £20,232, the shares being held by forty-two persons, nine of whom held 100 or less shares, nine between 101 and 200, seven between 201 and 300, two between 301 and 400, two between 401 and 500, one between 501 and 600, four between 601 and 700; the remaining shares were held by eight persons in the following numbers, namely, 900, 980, 1,100, 1,164, 1,300, 1,600, 1,836 and 2,545.

During the year in question (the year ended 30th November 1941), there were three directors. The shares of the company were all ordinary shares, and had never been quoted in the official list of a Stock Exchange. Though the directors had power to decline to register any transfer of shares (article 4), in practice they never

did so. Most of the transfers made in the past had been to persons who were already shareholders.

General meetings, which were held annually, were not advertised in the press, but every shareholder was notified in writing. Mr. W. C. R. A. Doig, a director of the company since its inception, and at the time its manager and secretary, gave evidence before a Board of Review that proxies had never been used at these meetings. He also stated that he was not aware of any agreement whatever between any of the shareholders as to how they should exercise their voting power.

On 1st June 1943, the Deputy Federal Commissioner of Taxation issued a notice of assessment under Div. 7 of Part III. of the *Income Tax Assessment Act* 1936-1941 requiring the company to pay £136 15s. additional income tax claimed to be payable by it, as a " private company," in respect of the income year ended 30th November 1941.

By letter dated 7th July 1943, the company objected to the assessment on the following grounds : (1) that the company was not a " private company " within the meaning of Div. 7 of Part III. of the *Income Tax Assessment Act* 1936-1941 ; (2) that it was not at any material time under the control of not more than seven persons within the meaning of s. 103 of that Act ; and (3) that neither the major portion of the voting power, nor the majority of its shares, was held by those persons, or nominees of those persons, nor was the control by any means whatever in the hands of those persons.

By notice dated 1st May 1944, the Deputy Commissioner disallowed the company's objection, and, by letter dated 17th May 1944, the company requested that the matter be referred to a Board of Review. On 30th October 1944, the Board of Review upheld the company's objection that it was not a " private company " within the meaning of the Act.

In its decision, the Board found (*inter alia*) that a bare majority of the shares in the company at 30th November 1941 was 10,117 ; that the aggregate of the holdings of the seven largest shareholders was 10,525 shares ; that, without grouping together as one person any shareholders who were relatives of each other, it was possible to find quite a number of groups of seven shareholders whose aggregate holdings were a majority of the shares ; and that it was quite satisfied from the evidence that none of the groups in fact added together in control of the company so as to be distinguishable for that reason from other shareholders.

From this decision, the Commissioner of Taxation appealed to the High Court.

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Louch (with him *Brown*), for the appellant. The company is a "private company." Seven of the largest shareholders hold a majority of the shares, and therefore of the voting power, of the company, so that the company falls within s. 103 (2) (*c*) of the *Income Tax Assessment Act*. It is immaterial that other groups might be made up which would hold a major portion of the voting power. *Adelaide Motors Ltd.* v. *Federal Commissioner of Taxation* (1) does not apply since that decision was based at least in part on the question of public interest in the company. [He also referred to *Himley Estates Ltd. and Humble Investments Ltd.* v. *Inland Revenue Commissioners* (2); *Tatem Steam Navigation Co.* v. *Inland Revenue Commissioners* (3).] The case turns on the question of control (*Gunn*: *Commonwealth Income Tax Law and Practice* (1943), pp. 704-706). [He also referred to *Muller* v. *Dalgety & Co. Ltd.* (4); *Shepheard* v. *Broome* (5); *International Hotel Ltd.* v. *McNally* (6).] The decision in *Adelaide Motors Ltd.* v. *Federal Commissioner of Taxation* (1) should be re-argued before the Full Bench of the High Court.

Downing K.C. (with him *F. E. Downing*), for the respondent. The Commissioner is not entitled to select the seven largest shareholders and hold that they have control when several other groups holding the greater part of the voting power could equally well be selected. [He referred to *Tatem Steam Navigation Co. Ltd.* v. *Inland Revenue Commissioners* (7); *Adelaide Motors Ltd.* v. *Federal Commissioner of Taxation* (1), per *Latham* C.J. (8), per *Rich* J. (9), and per *Starke* J. (10).] The operation of s. 103 does not depend upon the exercise of a discretion by the Commissioner, but upon the actual state of facts upon which the real control of the company depends. The company is not in fact controlled by any one group of seven or less shareholders, and therefore is not a "private company."

Louch, in reply.

Cur. adv. vult.

Sept. 14.

The following written judgment was delivered:—

RICH, DIXON and MCTIERNAN JJ. This is an appeal by the Commissioner of Taxation from a decision of a Board of Review. The question decided by the Board of Review arises under the very difficult provisions of Div. 7 of Part III. of the *Income Tax Assessment*

(1) (1942) 66 C.L.R. 436.
(2) (1933) 1 K.B. 472.
(3) (1941) 2 K.B. 194.
(4) (1909) 9 C.L.R. 693, at p. 696.
(5) (1904) A.C. 342, at p. 345.
(6) (1940) 64 C.L.R. 24, at p. 28.
(7) (1941) 2 K.B., at p. 203.
(8) (1942) 66 C.L.R., at pp. 443, 445.
(9) (1942) 66 C.L.R., at p. 449.
(10) (1942) 66 C.L.R., at p. 451.

Act 1936-1941 relating to private companies. The respondent company was assessed under those provisions as a private company on the footing that it had not made a sufficient distribution of its income of the year of income ended 30th November 1941. By s. 104 (1) it is provided that, where a private company has not, before the expiration of six months after the close of the year of income . . . made a sufficient distribution of its income of the year, the Commissioner may assess the aggregate additional amount of tax which would have been payable by its shareholders if the company had . . . paid the undistributed amount as a dividend to the shareholders . . . and the company shall be liable to pay the tax so assessed. The company had adopted the twelve months ending 30th November in lieu of that ending 30th June as its year of income.

The question is whether the company fulfils the definition of "private company." That definition in its terms depends, in the circumstances of this case, upon a fiction or presumption established by s. 103 (2) (*c*). "Private company" is defined to mean a company which is under the control of not more than seven persons, and which is not a company in which the public are substantially interested or a subsidiary of a public company. Paragraph *c* of sub-s. 2 of s. 103 provides that a company shall be deemed to be under the control of any persons where the major portion of the voting power or the majority of the shares is held by those persons or nominees of those persons or where the control is, by any other means whatever, in the hands of those persons. Section 103 (2) (*a*) provides what shall be deemed a company in which the public are substantially interested, and for the purpose of this case it is enough to say that, upon the facts, the respondent company cannot claim to be one which falls within the description of that paragraph.

The question in the case, therefore, is whether it is a company which is under the control of not more than seven persons, a question which depends on par. *c* of s. 103 (2). That question the Board of Review decided in the negative, basing its decision upon the decision of this Court in *Adelaide Motors Ltd.* v. *Federal Commissioner of Taxation* (1).

The issued share capital, namely 20,232 shares, is held by 42 shareholders. The seven largest shareholders hold a majority of these shares, and, accordingly, a major portion of the voting power. Their aggregate shareholding is 10,525 shares. But a number of other groups of seven shareholders may be made up having an aggregate holding giving a majority of shares, and therefore a major portion of voting power. There do not appear to be any shareholders who are actual nominees of other shareholders. But "nominee" in s. 103 (1)

(1) (1942) 66 C.L.R. 436.

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is defined in such a way that anybody who is a relative appears to be included. If this definition be used in relation to s. 103 (2) (*c*) in its application to the facts, a still greater number of groups may be made up having a majority of shares and a majority of voting strength. Neither the group consisting of the seven largest shareholders nor any other of these groups has in fact acted together so as to control the company.

For the purposes of his assessment, the Commissioner has chosen the group of seven consisting of the largest shareholders, and he contends that because they have a major portion of the voting power, or because a majority of shares is held by them, the company must be deemed to be under the control of those persons, with the consequence that it is a company, within the meaning of the definition of "private company," which is under the control of not more than seven persons.

A reading of the provisions of par. *c* of s. 103 (2), as well as a reading of the definition of "private company," suggests very strongly that these provisions were framed upon the view that there could be only one control, and that there could be only one group of seven or less possessing the major portion of the voting power or the majority of the shares.

Any analysis of the possible numerical situations of voting power or shareholdings in any given case, and of the various combinations open, will show that the assumption that there can be only one group of seven or less having the major portion of the voting power or holding the majority of the shares is quite fallacious. It is, of course, true that the conception expressed by the word "control" is not consistent with the existence at one time of more than one control. The difficulties which result from this, as well as from other peculiarities of this legislation, have brought upon it some strong, but by no means unjustified, judicial criticism, both here and in England, where these provisions originated. It is not necessary to repeat what has been said. It is enough to refer to the decision of Mr. Justice *Rowlatt* and of the Court of Appeal in *Himley Estates Ltd. and Humble Investments Ltd.* v. *Inland Revenue Commissioners* (1), and to *Tatem Steam Navigation Co. Ltd.* v. *Inland Revenue Commissioners* (2), and, in this Court, to *Adelaide Motors Ltd.* v. *Federal Commissioner of Taxation* (3).

The more the language of par. *c* is studied the more difficult it is to be sure of its meaning and application. It is not easy to believe that, where there are many groups of shareholders of each of which

(1) (1933) 1 K.B. 472.
(2) (1941) 2 K.B. 194.
(3) (1942) 66 C.L.R. 436.

it may be truly said that the group holds a major portion of the voting power or a majority of the shares, it is intended to attribute the control of the company to every one of such groups, either alternatively or cumulatively. To meet this difficulty, it is contended on behalf of the taxpayer in the present case that the provision is applicable only to cases where there is one group and no other group of whom possession of the voting power or the majority of the shares may be predicated.

The objection to this explanation of the provision is that it cannot often be true that one group only of seven or less shareholders can make up a majority of voting strength or of shareholding. It would, of course, cover cases in which one shareholder has a majority of shares, or in which two or three shareholders together make up a majority of shares and the numbers are such that no majority composed otherwise can be made up.

Another explanation suggested is that an actual exercise of control, as well as the capacity to control, must reside in the seven shareholders. There are difficulties upon the exact words of the provision in this interpretation, which, however, gains some support from the general sense or purpose of the provisions.

Another possible way of applying the enactment where there are numerous groups satisfying its exact terms is to treat it as applying to that group which has the largest voting strength or shareholding.

Still another interpretation of the provisions is to take them as meaning that, wherever there is any group or groups, however numerous, of seven persons or less holding the voting power or a majority of shares, the first part of the definition of " private company " is satisfied and that it then remains a question whether the public is substantially interested or whether the company is a subsidiary of a public company.

The view adopted by the Commissioner appears to be that, where there are numerous groups, it is for him to select one of them, and when he does so it is that group which has to be considered. At all events, that contention was advanced on his behalf. It is open to the objection that the provision does not depend upon the exercise of the discretion either of the Commissioner or the Board of Review, but places the liability of the company upon the actual existence of the state of facts it attempts to describe. The Commissioner's function is merely to ascertain the existence of that state of facts, subject to review by a Board of Review, or to appeal to the Court.

But the definition of " private company " and the application of par. *c* of s. 103 (2) received the consideration of this Court in

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Adelaide Motors Ltd. v. *Federal Commissioner of Taxation* (1), and the decision in that case is one which we should follow. The Commissioner contends that the Board of Review was wrong in interpreting the decision as governing the present case. It is true that, in the case of Adelaide Motors Ltd., there was a question whether that company was one in which the public were substantially interested. It is true, moreover, that his Honour the Chief Justice decided the case upon that question. His Honour decided that it was a company in which the public were substantially interested. *Rich* J. and *Starke* J., however (who, with the Chief Justice, composed the Court), did not confine their decision to that ground. On the contrary, *Starke* J. does not appear to have dealt with it. It was contended before us that the objection of the taxpayer and the arguments of counsel went no further than that particular ground, and that, in so far as *Rich* J. and *Starke* J. dealt with the question before us, their opinions should not be taken to form part of the *ratio decidendi* of the court.

The objections of the taxpayer appear in the report (2) and, though it is true that the second and third of them relate only to the public character of the company or the interests of members of the public, the first is a general objection that the company is not a private company within the meaning of the statute, and it is this question that was asked in the case stated. The arguments of counsel as reported appear to be directed to that question, but, even in the brief account of those arguments, there are indications of a general discussion of the provisions. But, in any case, the failure of counsel to argue the question could scarcely detract from the authority of the decision.

A study of the judgment of *Rich* J. makes it clear that he expressly dealt with the ground that the major portion of the voting power or the majority of the shares was held by many groups of not more than seven persons, as well as with the ground that it was a company in which the public were substantially interested. He refers to the fact that courts are called upon to solve the puzzle set by the " bewildering " definition clause found in the English *Finance Act* and the Federal *Income Tax Assessment Act*. He speaks of the judgment of the Chief Justice, which he had had the opportunity of reading, and that of *Romer* L.J. in the *Himley Estates Ltd. Case* (3), and of the comment made by those two learned judges on the ridiculous result of an arbitrary grouping of persons in control. The judgment of *Rich* J. then proceeds as follows :—" But the facts in this case show

(1) (1942) 66 C.L.R. 436.
(2) (1942) 66 C.L.R., at p. 441.
(3) (1933) 1 K.B. 472.

that the *de facto* control of the company is in the hands of more than seven persons. Thus one element or condition is wanting to comply with the definition " (1).

Now the facts of the case showed that there were many groups of seven shareholders holding a major portion of the voting power or a majority of the shares, and that the Commissioner had chosen one of them. The passage quoted from the judgment of *Rich* J. plainly means that this is not enough without *de facto* control. In other words, where there are many such groups, only that group which not only has the capacity to control, but also exercises it, can be regarded as in control. In Adelaide Motors Ltd., there was no group which exercised control, although there were many groups of persons who, by combining together, might have done so. *Rich* J. expressed this view as the first ground of his decision. He then proceeded to decide that it was a company in which the public were substantially interested, but as a second ground for his decision.

Starke J. expressed the ground of his decision as follows :—

" Similar provisions have been described by English judges as ' bewildering ' and ' ridiculous,' and so they are if applied in the manner suggested by the Commissioner. In terms the section only refers to a company which is under the control of not more than seven persons ; it contemplates and provides for a single group of not more than seven persons of whom it can be established that they, and no other, control the company. Those persons may control the company because they have the major portion of the voting power, the majority of the shares may be held by them or their nominees, or the control is by any other means whatever in their hands. The section becomes unintelligible if, according to the Act, the control of the company may be deemed to be in any of a number of groups of shareholders not exceeding seven persons, and as in this case, in several thousands of such groups.

In my opinion, the section has no application in such circumstances " (1).

We take this to mean that, unless there is a group of not more than seven people who actually control the company or a group of not more than seven people which is the only group of that description holding the major portion of the voting power or the majority of the shares, the conditions prescribed by the provisions in question are not fulfilled.

His Honour the Chief Justice explained in full the difficulties of the interpretation of these sections, but, as we understand his judgment, did not pronounce an actual decision upon the question with which

(1) (1942) 66 C.L.R., at p. 450.

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we are concerned. We regard his judgment as neither dissenting from nor assenting to the views expressed by *Rich* J. and *Starke* J.

We interpret the decision of the Court in the *Adelaide Motors Case* (1) as giving to par. *c* of s. 103 (2) in its application to the definition of " private company " in s. 103 (1) an operation which may perhaps be compendiously stated as follows. The paragraph applies where a group or groups exist holding the major portion of the voting power of a company or the majority of the shares, if, in addition, there is an actual control of the company by one of the groups, and there is such an actual control whenever there is only one such group who hold the major portion of the voting power or the majority of the shares. If the group so ascertained consists of not more than seven persons, then the first condition prescribed by the definition of " private company " is fulfilled. We should perhaps interpolate the observation that neither the decision in the case of *Adelaide Motors Ltd.* (1) nor in this case deals in any way with that part of par. *c* which refers to a case where the control is by any other means in the hands of a group of persons : Compare *British American Tobacco Co.* v. *Inland Revenue Commissioners* (2).

Interpreting the decision in this way, we think that our decision is governed by it and must be for the taxpayer. We were asked by the Commissioner to take steps to submit the decision in the case of *Adelaide Motors Ltd.* v. *Federal Commissioner of Taxation* (1) to a Bench consisting of all the judges with a view to its reconsideration. We do not think this is a course which we should pursue.

The enactment presents very great difficulties—difficulties, indeed, to which it may perhaps be said no satisfactory solution can be offered. The decision in the case of *Adelaide Motors Ltd.* (1) disposes of some of them and provides a practical answer which does not appear to us to be unworkable. If the law as there laid down does not carry out the intention of the legislature, the desirability of amending the provisions will no doubt receive the consideration of the appropriate authorities. They are provisions the form of which in any event appears to merit a full reconsideration.

The appeal from the Board of Review must be dismissed with costs.

Appeal dismissed with costs.

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

Solicitors for the respondent, *Downing & Downing.*

E. L. B.

(1) (1942) 66 C.L.R. 436.

(2) (1943) A.C. 335.