

[HIGH COURT OF AUSTRALIA.]

THE COMMISSIONER OF TAXATION (NEW } APPELLANT;
SOUTH WALES) }
RESPONDENT.

AND

HARDIE INVESTMENTS PROPRIETARY } RESPONDENT.
LIMITED }
APPELLANT,

ON APPEAL FROM THE SUPREME COURT OF
NEW SOUTH WALES.

H. C. OF A.
1946.

SYDNEY,
Nov. 22, 25,
Dec. 23.

Latham C.J.,
Rich, Starke,
Dixon,
McTiernan and
Williams J.J.

*Income Tax (N.S.W.)—Assessable income—Dividend—“Paid wholly . . . out of profits arising from the revaluation of assets . . .”—Valuation—Revaluation—Commercial practice—Special Income and Wages Tax (Management) Act 1936 (N.S.W.) (No. 43 of 1936), s. 2—Income Tax (Management) Act 1936 (N.S.W.) (No. 41 of 1936), ss. 5, 52, 53 (c).**

A company, for legitimate business purposes, had, over a period of years, written down the values of certain fixed assets in its balance sheets to a figure far below their true value. Subsequently the company resolved, also for legitimate purposes, to write up the values of such assets to a figure still less than, but nearer to, their true value. It was further resolved to capitalize and to apply the greater part of the amount by which the assets were written up, in the issue of fully paid bonus shares to existing shareholders. The Commissioner of Taxation claimed that the respondent, a shareholder in the company, should have included the value of such bonus shares as were received by it in its assessable income.

Held that the value of the bonus shares did not form part of the respondent's assessable income, being excluded therefrom by s. 53 (c) of the *Income Tax (Management) Act 1936 (N.S.W.)*.

Dickson v. Federal Commissioner of Taxation, (1940) 62 C.L.R. 687, applied.

Decision of the Supreme Court of New South Wales (*Owen J.*) affirmed.

* Section 53 (c) of the *Income Tax (Management) Act 1936 (N.S.W.)* is identical with s. 44 (2) (iii) of the *Income Tax Assessment Act 1936-1947 (Cth.)*.

APPEAL from the Supreme Court of New South Wales.

Hardie Investments Pty. Ltd. appealed to the Supreme Court of New South Wales against an assessment made under the *Special Income and Wages Tax (Management) Act* 1936 (N.S.W.) in respect of special income tax payable by that company in respect to the income derived by it during the year ended 30th June 1937.

By the combined operation of s. 10 of the *Special Income and Wages Tax (Management) Act* 1936 and of s. 53 (c) of the *Income Tax (Management) Act* 1936 (N.S.W.), a shareholder's assessable income does not include dividends paid on or after 1st January 1936 wholly and exclusively out of profits arising from the revaluation of assets not acquired for the purpose of resale at a profit if the dividends paid from such profits are satisfied by the issue of shares of the company declaring the dividend.

Hardie Investments Pty. Ltd. was at all material times a shareholder in a private company which in 1936 was carrying on a highly successful manufacturing and trading business under the name of James Hardie & Co. Ltd. Over the years prior to 1936 the directors of James Hardie & Co. Ltd. had pursued a policy of devoting substantial sums to writing down the book values of the company's assets with the result that in 1936 the values at which those assets appeared in the balance sheet for that year were far below their true values. In carrying out this policy the directors were actuated by a desire to provide substantial inner reserves so as to be better equipped to meet possible competition, in particular from overseas interests which they feared might enter the Australian market. In addition, and whilst disclosing sufficient profits to pay substantial dividends to shareholders, they desired to keep the disclosed profits as low as possible lest rivals should be encouraged to enter the field in which the company was operating. In 1936 it appeared possible that the company might cease to be a private company and be required to publish its balance sheets by filing them with the Registrar of Joint Stock Companies. At that time and as a result of the drastic writing down of the book values of its assets and of the increased profits which the company was then making, the amount of these profits was—to use the secretary's words—"getting close to our actual capital." For this reason, and having in mind also the provisions of s. 53 (c) of the *Income Tax (Management) Act* 1936, the directors decided to write up the book values of the assets to figures which would more nearly agree with their real values. Accordingly, on 8th December 1936, they resolved that each asset set out in the schedule to the resolution should be "re-valued at the sum at which the same now appears in the books plus the amount set opposite to

H. C. OF A.
1946.

COMMISS-
SIONER OF
TAXATION
(N.S.W.)

v.

HARDIE
INVESTMENTS
PTY. LTD.

H. C. OF A.
1946.

COMMISSIONER OF
TAXATION
(N.S.W.)
v.
HARDIE
INVESTMENTS
PTY. LTD.

the same in the said schedule and that the total appreciation of the said assets by this revaluation, being profits arising therefrom, be transferred to an Assets Revaluation Reserve Account."

The following table shows the assets involved, their values as appearing in the balance sheet of 30th September 1936, and the amount by which each item was written up:—

					Balance sheet		Appreciation	
					value as at		30. 9. 1936	
					£		£	
SYDNEY								
Goodwill	..	..	..	..	1,943	11 11		53,000
Camellia land	..	..	..	..	7,752	1 5		3,000
„ „ factory buildings	..	..	..	..	918	6 0		40,000
„ „ rail siding	..	..	..	..	10	0 0		400
Plaster buildings	..	..	..	..	295	3 0		2,000
Wire buildings	..	..	..	..	368	10 5		2,000
"Asbestos House"	..	..	..	..	200,650	8 1		30,000
Camellia plant	..	..	..	..	1,533	6 6		9,400
„ loose plant	..	..	..	..	500	0 0		180
„ sawmill	..	..	..	..	5	0 0		90
Plaster plant	..	..	..	..	239	14 6		1,150
Wire plant	..	..	..	..	131	5 5		200
Other land and buildings	..	..	..	..	3,390	0 0		
Office furniture and fittings	..	..	..	..	217	0 7		1,800
VICTORIA								
Land	..	..	..	..	11,840	8 9		
Buildings	..	..	..	..	2,693	9 2		11,000
Rail siding	..	..	..	..	15	16 0		150
Plant and machinery	..	..	..	..	1,724	8 7		6,500
Office furniture and fittings	..	..	..	..	320	12 2		270
Goodwill	..	..	..	..				20,000
WEST AUSTRALIA								
Land	..	..	..	..	1,435	11 0		500
Buildings	..	..	..	..	1,212	15 0		12,000
Plant and machinery	..	..	..	..	1,146	13 4		3,700
Rail siding	..	..	..	..	5	0 0		200
Office furniture and fittings	..	..	..	..	13	6 0		60
Goodwill	..	..	..	..				20,000

In the balance sheet the figure of £1,943 11s. 11d. shown as the value of the goodwill (including patents and trade marks) covered the goodwill in all States of the Commonwealth in which the company was operating.

The total amount by which the balance-sheet values were increased was £218,100, and it was clear that the new values placed upon the assets were far below their real values.

On 9th December 1936, the secretary reported that the resolution of the previous day had been carried out and thereupon the directors resolved that the sum of £217,600, being part of the sum standing to the credit of the Assets Revaluation Reserve Account, be capitalized and applied in paying up in full 217,600 unissued shares of the company of £1 each, and that such shares, when so paid up in full, be distributed amongst the existing shareholders. This resolution was duly carried out, and the appellant company received its due proportion of the shares in question.

The Commissioner of Taxation claimed that the paid-up value of the shares so issued to the appellant company should be included in its assessable income for special income tax purposes for the year ended 30th June 1937, and assessed the company accordingly. The appellant company claimed to be entitled to the benefit of s. 53 (c) of the *Income Tax (Management) Act* 1936, and being dissatisfied with the assessment requested the Commissioner to treat its objection as an appeal and that such objection be forwarded to the Supreme Court of New South Wales pursuant to s. 233 of the Act.

Owen J. held that this case could not be distinguished from *Dickson v. Federal Commissioner of Taxation* (1), allowed the appeal, set aside the assessment and remitted the matter to the Commissioner in order that he might amend the assessment.

From that decision the Commissioner appealed to the High Court.

Further facts and the relevant statutory provisions appear in the judgments hereunder.

Weston K.C. (with him Bridge), for the appellant. It is agreed that the assets which the dividend declaring company purported to revalue, had not been acquired by it for the purpose of resale at a profit, and if there has been (i) a valuation of those assets; (ii) a revaluation of those assets; and (iii) a profit disclosed by that valuation and revaluation, then the subject assessment was erroneous. If any one of those three elements was lacking then the assessment was right, the shares being assessable income by virtue of s. 52 of the *Income Tax (Management) Act* 1936 (N.S.W.) and the definition of the word "dividend" in s. 5 of the *Income Tax (Management) Act* 1936. Under s. 238 of this Act the onus of proof is on the respondent. The Court below misconstrued and misapplied *Dickson*

H. C. OF A.
1946.

COMMISSIONER OF
TAXATION
(N.S.W.)
v.
HARDIE
INVESTMENTS
PTY. LTD.

H. C. OF A.
 1946.
 }
 COMMISSIONER OF
 TAXATION
 (N.S.W.)
 v.
 HARDIE
 INVESTMENTS
 PTY. LTD.

v *Federal Commissioner of Taxation* (1). In applying the exception in s. 53 (c) of the *Income Tax (Management) Act* that Court failed to refer to the other ingredients, that the process of valuation and revaluation must reveal profits. What was done was done for the sole purpose of counter-balancing fictitious depreciation. The figures shown in the appreciation account as being the balance sheet value as at September 1936 had no relation to real values at all, and the "appreciation" shown therein was the addition of a figure which still left everything referred to well below the real value as originally shown. No relevant figures represent or constitute a valuation or a revaluation. Even assuming against the appellant an original valuation and a revaluation, the process pursued did not reveal the profits. The process must reveal profits, it cannot create profits. The figures referred to are only book entries used for the purpose of paying for bonus shares. Shortly, the argument is: there was no valuation, no revaluation and no profit. The value must be a real value. The writing down and writing up of the values did not, as a whole transaction, reveal a profit (*Dickson v. Federal Commissioner of Taxation* (2)). Revaluation imports a previous valuation. Writing down may be entirely different from revaluation, although the writing down may simply reflect the previous valuation or revaluation.

[WILLIAMS J. referred to *Stapley v. Read Bros. Ltd.* (3).]

The word "profits" in s. 53 (c) of the *Income Tax (Management) Act* means what is shown in the account provided the values so shown are genuine. It is a recognized principle to bring in assets, particularly fixed assets and investments, at cost price. That is a valuation adequate to found a revaluation. Then, a revaluation according to some accepted accountancy principle is a revaluation within the meaning of the section.

[WILLIAMS J. referred to *Bishop v. Smyrna and Cassaba Railway Co.* [No. 2] (4).]

Where book values have been written down for a purpose other than that of showing the true values, the result of writing up again is not and cannot be profits. The practice of creating or seeking reserves may be justified. Whatever the purpose for creating reserves may be, this Court will take judicial cognizance of the purpose therefor. The question is whether it was a common practice. *Dickson v. Federal Commissioner of Taxation* (1) laid down the principle that if there be a valuation in fact, something worthy of being regarded as a valuation, and if there be a revaluation, the valuation and revaluation proceeding upon accepted commercial principles,

(1) (1940) 62 C.L.R. 687.

(2) (1940) 62 C.L.R., at p. 745.

(3) (1924) 2 Ch. 1.

(4) (1895) 2 Ch. 596.

and the valuation and revaluation ascertain a real profit, then bonus shares may be issued in respect of that profit and will be free from tax in the hands of the recipients. In this case there was a writing down which was not in accordance with a recognized business practice. It could be asserted that in *Dickson's Case* (1) there was a real profit and that in this case there was no profit. Before there can be a profit the revaluation must show a valuation in excess of cost. Whether there has been a profit is a question of fact. The test is objective and not subjective.

H. C. OF A.
1946.
COMMISSIONER OF
TAXATION
(N.S.W.)
v.
HARDIE
INVESTMENTS
PTY. LTD.

Kitto K.C. (with him *Macfarlan*), for the respondent: This case is covered in principle by *Dickson v. Federal Commissioner of Taxation* (1). That case decides that a valuation, and also a revaluation, means a bona fide assessment of a figure as representing the value of assets for accounting purposes, and that if the revaluation is higher than the valuation and the resulting figure is profit then s. 53 (c) applies. That section is directed to business men in an accountancy sense. The section involves a question of accountancy. The words "paid from . . . profits" in that section do not mean "paid from money" but that out of an accountancy fund there must be subtracted the amount in question from an account in the books. This explains the use in the section of the word "arising." In order to ascertain whether the section applies in a particular case, and, approached from the point of view that it is an accountancy problem, two questions arise, namely, (i) did the figure arise from a revaluation and (ii) is the figure correctly described as a figure of profit. What the Court was concerned with in *Dickson's Case* (1) was not the application of any principle of value, but the reason for the adoption of a figure which had no relation to value, that is, was it adopted for the purpose of defeating income tax, or for the purposes of the company in keeping its accounts, or as a real figure. If there had been a writing down as a preliminary to a writing up so to produce an income tax result, then neither the writing down nor the writing up was a real adoption for the company's accountancy purposes but a sham adoption. But that is not the case here. Here the writing down was for sound commercial reasons, namely the company feared competition and wanted to increase its strength and to build up hidden reserves. Thus the company did bona fide show the low figures of its assets as being the figures to be used for its accountancy purposes. The revaluation of the assets gave rise to a figure which is properly described as a profit figure. The requirements of s. 53 (c)

(1) (1940) 62 C.L.R. 687.

H. C. OF A.
1946.

COMMISSIONER OF
TAXATION
(N.S.W.)

v.

HARDIE
INVESTMENTS
PTY. LTD.

therefore were satisfied. To say that what was done was done for the purpose of creating an internal reserve is the very antithesis of saying it was done *mala fide* for the purpose of securing an income tax advantage. Once the view that there must be a one hundred per cent real value is abandoned the only alternative is to accept a bona fide assessment made by the company in its books. It is merely a question of degree and no question of principle is involved. If writings down are out of profits then writings up must disclose profits: *Halsbury's Laws of England*, 2nd ed., vol. 5, pp. 393, 394. In this case the writings down were out of profit and loss account. If some of the profits are utilized, motives must be disclosed (*Stapley v. Read Bros. Ltd.* (1)). There is nothing in s. 53 (c) to warrant the conclusion that it should be confined to capital assets, profits arising from increase in value of an asset over cost.

Weston K.C., in reply. Section 53 (c) deals with an alteration in figures corresponding to a profit in fact in what is being valued. The profit arising is the profit in the item valued. The evidence shows that the subject assets were never revalued at any stage; the account was an independent one the true nature of which was recognized throughout.

Cur. adv. vult.

Dec. 23.

The following written judgments were delivered:—

LATHAM C.J. This is an appeal from an order of the Supreme Court of New South Wales (*Owen J.*) allowing an appeal from an assessment of the respondent company to income tax under the New South Wales *Special Income and Wages Tax (Management) Act* 1936. That Act incorporates certain provisions of the *Income Tax (Management) Act* 1936 (N.S.W.), including the provisions relating to the inclusion in or exclusion from assessable income of dividends received from companies. By s. 53 (c) of the latter Act it is provided that the assessable income of a shareholder shall not include dividends paid on or after 1st January 1936 wholly and exclusively out of . . . profits arising from the revaluation of assets not acquired for the purpose of resale at a profit . . . if the dividends paid from such profits are satisfied by the issue of shares of the company declaring the dividend.

My brother *Williams*, in his reasons for judgment, states the facts of the case in detail. The respondent company received during the relevant period from another company in which it was a shareholder

bonus shares in satisfaction of dividends declared and paid out of what are claimed by the respondent, and denied by the Commissioner, to be profits arising from the revaluation of assets not acquired for the purpose of resale at a profit. It is not disputed that the assets which, it is claimed, were revalued, were assets not acquired for the purpose of resale at a profit. They were capital assets of the company which declared the dividend—mainly land, factories, and goodwill.

The company declaring the dividends had made large profits over a number of years and, for purposes which were found by *Owen J.* to be legitimate business purposes, and in accordance with recognized commercial practice, wrote down the value of these assets to very low amounts—to figures representing much less than the real values of the assets. Later, also for legitimate business reasons, the values of these assets were written up, but not to amounts in excess of their real values. Part of the increased value so recorded was applied to the payment of dividends which were satisfied by the issue of the bonus shares which, the respondent claims, should therefore not be included in its assessable income.

The learned judge was of opinion that the case was governed by *Dickson v. Federal Commissioner of Taxation* (1), a decision upon an identical provision (s. 44 (2) (b) (iii)) in the Commonwealth *Income Tax Assessment Act* 1936. In that case it was held that that provision was intended to recognize, and was based upon a recognition of, the well known company practice of valuing assets conservatively, and that values attributed bona fide and in the ordinary course of business to assets in the balance sheets of a company in accordance with such practice may properly be regarded as the result of valuations. If upon a restatement of value, not exceeding the true value, an increase in value is disclosed, such income is a profit “arising from” the revaluation within the meaning of the section, though a revaluation can never produce or create or be a source of profit in any causal sense. *Dixon J.* dissented from the judgment of the Court because he took a different view of the facts of the case, being of opinion that what was “revalued” was not the same as that which had previously been valued, and that the evidence showed that the profits in question arose, not from any revaluation, but from what should be regarded as the acquisition of an additional asset in the form of bonus shares. *Owen J.* was, in my opinion, right in regarding the legal propositions stated in *Dickson’s Case* (1) as governing this case, there being no question of any arrangement &c. to evade tax—See *Income Tax (Management) Act* 1936, s. 296. In my opinion, the appeal should be dismissed.

H. C. OF A.
1946.

COMMISSIONER OF
TAXATION
(N.S.W.)

v.

HARDIE
INVESTMENTS
PTY. LTD.

Latham C.J.

H. C. OF A.

1946.

COMMISS-
SIONER OF
TAXATION
(N.S.W.)

v.

HARDIE
INVESTMENTS
PTY. LTD.

RICH J. In this matter *Owen J.* very properly regarded himself as bound by the decision of this Court in *Dickson v. Federal Commissioner of Taxation* (1). His decision is strictly in accordance with what was there determined; and this appeal, in substance although not in form, is a request to this Court to review and overrule what it decided in *Dickson's Case* (1). Nothing that has been said in argument has convinced me that we should be justified in doing so.

The relevant statutory provision enacts that the assessable income of a shareholder in a company "shall not include dividends . . . paid . . . wholly and exclusively out of . . . (c) profits arising from the revaluation of assets not acquired for the purpose of resale at a profit or from the issue of shares at a premium, if the dividends paid from such profits are satisfied by the issue of shares of the company declaring the dividend." No one with any knowledge of company law, or any experience of the practice of companies, could have the slightest doubt about the intention of the legislature as indicated in the language of this exemption. The ordinary commercial practice of most well-conducted companies, adopted for the purpose of determining what they may safely regard as their financial position, is to make a very conservative valuation of their capital assets, and to make a very liberal allowance for the depreciation of capital assets which are subject to the risk of depreciation. If the company prospers, a time comes when the actual capital (and market) value of a share in the company greatly exceeds its nominal value; and when this happens it is frequently thought desirable by those who control the company's affairs to take a course which will bring the actual value of the shares into closer relation to their nominal value. This is often done by a process which, for example, in a case in which the shares have a nominal value of £1 and a real capital value, if paid up, of £2, may involve each holder of a fully-paid £1 share receiving an additional fully-paid £1 share. In order to comply with the statutory provisions regulating the proceedings of joint stock companies, it is frequently necessary for the company to revalue its capital assets by writing them up in its accounts to a sum more nearly approximating to their real value, and then going through the form of declaring a dividend out of the "profit" so appearing, and using this declaration to justify the issue of additional shares to the members as fully paid up. There is no legal necessity for employing an outside expert to do the work of revaluation. The company's officers could do it themselves, just as it is commonly they who make the original conservative valuation. But an expert is commonly employed from prudential motives, lest it should be

objected that the course which the company has taken is a colourable sham, designed, not to evade income tax, but to perpetrate a fraud on the law of companies and the public. The propriety of the course which I have roughly outlined, so long as it is taken bona fide, has been repeatedly affirmed by cases of the highest authority, to which it would be superfluous to refer. It is obviously to this that the provision of the income tax legislation now in question refers. Indeed it would make nonsense of the provision to treat it as having reference to anything else ; for in no other sense can profits “ arise ” from the revaluation of assets. The case of *L. C. Ltd. v. G. B. Ollivant Ltd.* (1), shows how important a bearing upon legal rights can be exercised by an express provision that they are to be determined by “ the general principles . . . of ordinary commercial practice.” I think it clearly implied in the language of the clause here in question that it is intended by the legislature that regard is to be had to ordinary commercial practice.

The appeal should be dismissed.

STARKE J. Appeal on the part of the Commissioner of Taxation from a judgment of the Supreme Court of New South Wales which set aside an assessment of the respondent to special income tax in respect of income derived during the year which ended on 30th June 1937 made pursuant to the *Special Income and Wages Tax (Management) Act* 1936 and the *Income Tax (Management) Act* 1936 of New South Wales.

In 1936 James Hardie & Co. Ltd. distributed a dividend in the form of bonus shares to its shareholders, including the respondent, the taxpayer. The Commissioner included the value of the bonus shares in his assessment of the taxpayer to special income tax, already mentioned, pursuant to the provisions of the Acts already mentioned : See particularly *Income Tax (Management) Act* 1936, s. 5, “ Dividend.”

The taxpayer claimed that the value of these shares should not have been included in its assessment by reason of the provisions of s. 53 (c) of the *Income Tax (Management) Act* 1936 which provides : “ The assessable income of a shareholder shall not include dividends . . . paid on or after the first day of January, one thousand nine hundred and thirty six, wholly and exclusively out of . . . (c) profits arising from the revaluation of assets not acquired for the purpose of resale at a profit or from the issue of shares at a premium, if the dividends paid from such profits are satisfied by the issue of shares of the company declaring the dividend.” The question is

H. C. OF A.
1946.
COMMISSIONER OF
TAXATION
(N.S.W.)
v.
HARDIE
INVESTMENTS
PTY. LTD.
Rich J.

(1) (1944) 1 All E.R. 510.

H. C. OF A.
1946.

COMMISSIONER OF
TAXATION
(N.S.W.)

v.

HARDIE
INVESTMENTS
PTY. LTD.

Starke J.

what are profits within the meaning of this provision? The section has to do with dividends and dividends cannot be paid out of capital, that is, money subscribed pursuant to the memorandum of association of the company or what is represented by that money.

Dividends are payable out of profits.

And what is profit available for the purposes of s. 53 (c) depends upon a comparison between the revaluation of the assets mentioned in the sub-section and some other value of those assets. But the sub-section does not prescribe how those profits shall be ascertained. It assumes that a company keeps proper accounts of its assets and liabilities in accordance with the *Companies Act* and ordinary commercial practices. And the ascertainment of profits is really a matter for business men to decide, but the power of deciding it cannot be lawfully exercised for the dishonest purpose of making it appear that profits have been made, when in truth there has been a loss or, I would add, for the purpose of defrauding the revenue (See *Lindley on Companies* 6th ed. (1902), vol. 1, pp. 598, 599). In revaluing assets or ascertaining profits the directors of a company may themselves act but they are entitled to employ their own officers or skilled agents to assist them. And it is not essential for the purpose of s. 53 (c) that the revaluation should represent the full value of the assets revalued so long as it discloses profits available for dividend when compared with the other value contemplated by the sub-section. Conceivably that value might be cost, but not necessarily so, for the value of assets in the accounts of a company is frequently written up or down in accordance with ordinary commercial practices. I do not stay to inquire whether having hidden and secret reserves of profits available for dividends and other purposes of the company in the accounts of public companies is reconcilable with the provisions of the *Companies Act* 1936 of New South Wales, Part VII., Div. 6 (See *Palmer's Company Precedents* 15th ed. (1937), p. 716; *Palmer on Company Law* 17th ed. (1942). pp. 224, 225). But the practice is long established.

It must be remembered, however, that profits carried to reserve, whether general or secret, remain profits unless capitalized.

And when a revaluation of assets takes place it is legitimate to compare that value with the value of the assets appearing in the accounts of the company adopted in accordance with commercial practices. The difference if it discloses a profit, though not necessarily all the profit that is available for dividends, is the profit of the company, to use the words of the sub-section, arising from the revaluation of assets.

In the present case the assets of the company had been written down much below their real value for the legitimate purposes of the company and revaluation of those assets disclosed on comparison with that value a profit of not less than the amount distributed as a dividend in the form of bonus shares.

It was not disputed that the revalued assets were not acquired for the purpose of resale at a profit. And it is established that the dividends used for the purpose of paying for the bonus shares were paid wholly and exclusively out of the profits disclosed by the revaluation.

In my opinion, therefore, the decision of the Supreme Court was correct and the taxpayer was right in its contention that the value of these bonus shares should not have been included in its assessment.

The appeal should be dismissed.

DIXON J. In my opinion the reasoning upon which the decision of the Court was rested in *Dickson v. Federal Commissioner of Taxation* (1) governs this case and *Owen J.* was right in so holding and in setting aside the assessment accordingly. In support of this opinion I refer by line and page to specific passages in the judgments of *Latham C.J.* and *Evatt J.* without setting them out:—

p. 704, l. 19-36 ; p. 706, l. 6-11 ; p. 706, l. 35 ; p. 707, l. 2 ; p. 707, l. 6-9 ; p. 708, l. 29-36 ; p. 709, l. 1-9 ; l. 21-23 ; l. 27-30 ; p. 710, l. 3-16 ; pp. 711-712 ; p. 725, l. 20-27 ; p. 726, l. 23-26 ; p. 727 ; l. 2-3 ; p. 729, l. 21-29 ; p. 729, l. 33 ; p. 730, l. 21-28 ; p. 733, l. 13-17 ; p. 735 l. 23-28 ; p. 736, l. 24-28 ; p. 737, l. 4-6 ; p. 739, l. 7-15 ; p. 741, l. 5-11 ; p. 744, l. 17-25 ; p. 745, l. 1-8. Some of these passages contain significant references to the facts, some state company and accountancy practice and others deal with various legal positions. If they be collected and compared it will, I think, appear that the present case falls within the reasoning adopted by their Honours.

In matters of the kind with which *Dickson's Case* (1) and the present case are concerned boards of directors and their advisers may have acted upon the faith of the doctrine laid down by the Court and I think that we should not depart from the meaning which the reasons formulated by the majority of the Court for its decision fairly bear.

I am, therefore, of opinion that the appeal should be dismissed.

MCTIERNAN J. In my opinion this case cannot be satisfactorily distinguished from *Dickson v. Federal Commissioner of Taxation* (1), and the principle upon which the majority of the Full Court decided

(1) (1940) 62 C.L.R. 687.

H. C. OF A.
1946.

COMMISSIONER OF
TAXATION
(N.S.W.)

v.
HARDIE
INVESTMENTS
PTY. LTD.

Starke J.

H. C. OF A. 1946. that case governs the decision of the present case. For this reason I think that the appeal should be dismissed.

COMMISSIONER OF
TAXATION
(N.S.W.)
v.
HARDIE
INVESTMENTS
PTY. LTD.

WILLIAMS J. This is an appeal by the Commissioner of Taxation from an order allowing an appeal by the respondent company against the disallowance by the Commissioner of an objection lodged by the company against its assessment for special income tax in respect of income derived during the year ended 30th June 1937. The objection was that the Commissioner should not have included in the assessable income of the company 120,088 fully paid bonus shares allotted to the company as a shareholder in another company, then named James Hardie & Sons Ltd., in December 1936. Section 2 of the *Special Income and Wages Tax (Management) Act 1936* (N.S.W.) provides that it shall be read with the *Income Tax (Management) Act 1936* (N.S.W.) which is in this Act referred to as the principal Act. The effect of the two Acts is to incorporate in the former Act *inter alia* the definition of "dividend" in s. 5 and ss. 52 and 53 (c) of the latter Act. The definition of "dividend" includes the paid-up value of shares distributed by a company to its shareholders to the extent to which the paid-up value represents a capitalization of profits. Section 52 provides that the assessable income of a shareholder in a company shall, if he is a resident, include all dividends paid to him by the company. But s. 53 provides that the assessable income of a shareholder shall not include dividends paid on or after the first day of January 1936 wholly and exclusively out of (c) profits arising from the revaluation of assets not acquired for the purpose of resale at a profit . . . if the dividends paid from such profits are satisfied by the issue of shares of the company declaring the dividend. The effect of the two Acts is therefore to make the 120,088 bonus shares assessable income of the respondent company unless it can claim the benefit of the exemption in s. 53 (c). The appeal was heard by *Owen J.*, who held that the company was entitled to the benefit of this exemption.

The events immediately preceding the allotment of the bonus shares were that on 8th December 1936 the Board of Directors of James Hardie & Sons Ltd. resolved that the value of certain assets, none of which had been acquired for resale at a profit, exceeded the amounts at which they appeared in the books of that company by certain specified amounts which totalled £218,100, and that this sum should be transferred to an assets revaluation reserve account. The Board of Directors met again on the following day, when the secretary reported that this amount had been so transferred, and it was then resolved that the sum of £217,600, being part of the sum

standing to the credit of this account, be capitalized and applied in paying up in full 217,600 unissued shares of the company of £1 each and that such shares be distributed amongst the holders registered on 8th December 1936 in proportion to the shares held by them. The proportion of these shares received by the respondent company was the 120,088 shares.

The appellant contends that the respondent is not entitled to claim exemption under s. 53 (c) on three grounds—(1) that there could not be a revaluation unless there had been a valuation ; (2) that there had never been a revaluation ; (3) that if there had been a valuation and revaluation there was no profit arising from the revaluation. The appellant did not dispute that the assets which James Hardie & Sons Ltd. purported to revalue were assets not acquired for the purpose of resale at a profit.

The following table shows the values assigned to these assets in the balance sheet of the company at 30th September 1936 and the amount by which each item was written up pursuant to the resolution of 8th December 1936 :—

					Balance Sheet		
					Value as at	Appreciation	
					30/9/1936		
SYDNEY					£	£	
Goodwill	..	..	..	..	1,943 11 11	53,500	
Camellia land	..	..	..	..	7,752 1 5	3,000	
„	„	factory buildings	..	..	918 6 0	40,000	
„	„	rail siding	..	..	10 0 0	400	
Plaster buildings	..	..	..	..	295 3 0	2,000	
Wire buildings	..	..	..	..	368 10 5	2,000	
“Asbestos House”	..	..	..	..	200,650 8 1	30,000	
Camellia Plant	..	..	..	..	1,533 6 6	9,400	
„	„	loose plant	..	..	5 0 0	180	
„	„	sawmill	..	..	5 0 0	90	
Plaster plant	..	..	..	..	239 14 6	1,150	
Wire plant	..	..	..	..	131 5 5	200	
Other land and buildings	..	..	..	..	3,390 0 0		
Office furniture and fittings	..	..	..	..	217 0 7	1,800	
VICTORIA							
Land	..	..	..	..	11,840 8 9		
Buildings	..	..	..	..	2,693 9 2	11,000	
Rail siding	..	..	..	..	15 16 0	150	
Plant and machinery	..	..	..	..	1,724 8 7	6,500	
Office furniture and fittings	..	..	..	..	320 12 2	270	
Goodwill	..	..	..	..		20,000	

H. C. OF A.
1946.
COMMISS-
SIONER OF
TAXATION
(N.S.W.)
v.
HARDIE
INVESTMENTS
PTY. LTD.
Williams J.

H. C. OF A.	WEST AUSTRALIA	£	£
1946.	Land	1,435 11 0	500
COMMISS- SIONER OF	Buildings	1,212 15 0	12,000
TAXATION	Plant and machinery	1,146 13 4	3,700
(N.S.W.)	Rail siding	5 0 0	200
v.	Office furniture and fittings	13 6 0	60
HARDIE	Goodwill		20,000
INVESTMENTS			
PTY. LTD.			

Williams J.

Two directors of James Hardie & Sons Ltd. gave evidence which his Honour accepted. It was to the effect that the business of the company had been very prosperous, and that it had been the practice of the Board of Directors for many years to conceal a large part of these profits by using them to write down the value of the fixed assets not merely by a normal amount of depreciation but by special excess depreciation. This was done to create an inner reserve in case the company met competition, and to avoid competition by not disclosing how profitable the business was even to shareholders through whom the information might leak out to possible competitors. The writing down was not done with a view to the subsequent writing up of the value of the fixed assets and thereby to conjure up a fund really representing concealed trade profits but manipulated so as to appear to represent an accretion in the capital value of fixed assets. At the date the assets were written down the articles of association of the company provided that no dividends should be payable except out of the profits arising from the business of the company, so that before the trading profits used to write down the value of the fixed assets could have been utilized for the payment of dividends they would have had to be written back into the profit and loss account. But the New South Wales *Companies Act* 1936 was about to come into force on 1st January 1937, and the Board of Directors feared that the company might have to become a public company and be forced to keep and publish the accounts required by that Act. This led them to consider that the fixed assets of the company should be written up to a figure nearer their true value and the issued capital of the company correspondingly increased. Accordingly at general meetings of the company held on 12th and 30th November 1936 a special resolution was passed authorizing the Board of Directors to resolve that any moneys forming part of the assets revaluation reserve account be capitalized and distributed amongst the shareholders. At that time the goodwill which stood in the books at £1,943 was worth £250,000 to £300,000; the land at Parramatta and the Camellia factory built thereon stood in the books at the almost nominal figure of £8,670; and Asbestos House, which

stood in the books at £200,650, was greatly undervalued. Before the land and buildings owned by the company were written up to the values of 8th December the Board of Directors considered the valuations by the Valuer-General in New South Wales and other public authorities in the other States and itself made estimates based on the original cost and other factors. Care was taken that the increased values were on the conservative side. Finally, the value . . . of the goodwill was increased by £53,500 to bring the total amount of appreciation to the desired figure of £218,100. His Honour was satisfied that there was no arrangement to evade payment of tax within the meaning of s. 296 of the *Income Tax (Management) Act*. The sole question is whether the respondent company can claim the benefit of s. 53 (c).

This sub-section requires that the dividends must be paid wholly and exclusively—(1) out of profits which arise from the revaluation of assets; (2) these assets must be assets which have not been acquired for the purpose of resale at a profit. A profit can only arise from the revaluation of an asset which has a value at the date of revaluation. The profit is the difference between the amount at which the asset is revalued and the amount of the previous value. The question is what is meant by a revaluation? A revaluation connotes an existing valuation. The ordinary meaning of a valuation is an estimation of the worth of a thing. The ordinary meaning of a revaluation is a fresh estimation of the worth of the same thing. Generally speaking, estimates are made by experts. Clearly the sub-section would apply where an estimate of the value of an asset not acquired for the purpose of resale at a profit had been made by an expert and a further estimate of the value of that asset had been subsequently made by an expert and the amount of the second estimate exceeded the first. But the construction of taxation Acts must be approached not in a technical but in a practical business manner. It is not usual for companies to have the value of their assets estimated by experts before assigning a value to them in their books and balance sheets. This led the majority of the court in *Dickson's Case* (1) to place a meaning upon the corresponding provision in the Commonwealth *Income Tax Assessment Act* which would give it a practical operation having regard to the ordinary commercial and accounting principles upon which it is customary for trading companies to keep their books. *Latham C.J.* said that a figure placed against an asset in the balance sheet of a company “does represent a valuation if valuation is interpreted as meaning a bona-fide assignment of a figure as representing the value of assets

H. C. OF A.
1946.

COMMISSIONER OF
TAXATION
(N.S.W.)

v.
HARDIE
INVESTMENTS
PTY. LTD.

Williams J.

H. C. OF A.
1946.
COMMISSIONER OF
TAXATION
(N.S.W.)
v.
HARDIE
INVESTMENTS
PTY. LTD.
Williams J.

for accounting purposes" (1). Referring to the objection that the writing up of the value of assets could not be a "real" revaluation, he said "Whenever there is a revaluation there must be a change at a particular moment from the adoption of one value to the adoption of another value. The objection loses all its force if the section contemplates and provides for the effect of the procedure of writing up in accordance with commercial practice—even though such writing up be done with full knowledge of the provisions of income-tax law" (2). *Evatt J.* said "the clause addresses itself to the existing practice of presenting company accounts and of allowing a company's wide discretion in the method it adopts for assigning a value to its fixed assets" (3). Later he said "the legislature has acted prudently in allowing companies to act according to well-established principles of company management and book-keeping, and in regarding the company's own revaluations of fixed assets as occasions of a profit or gain which may be capitalized for the purpose of a bonus issue" (4). The material facts in *Dickson's Case* were briefly as follows. The taxpayer held shares in company A. Company A held 117,414 fully paid shares in company B. In December 1934 company B made a distribution of fully paid bonus shares of which 58,707 were allotted to company A, increasing its total holding to 176,121 shares which were shown on 30th September 1935 in the next balance sheet of company A at the same figure as the cost of the original 117,414 shares, that is to say, at £119,861. The directors of company A then obtained a report from their own and a firm of outside auditors that the shares were worth not less than 24s. a share. These were then written up to this amount, and their value shown in the books of the A company as increased by £91,483, out of which a sum of £87,500 was capitalized and fully paid bonus shares representing this amount issued to the shareholders, the taxpayer receiving his proportion of the shares. It is true that in *Dickson's Case* (5) the original shares were shown in the books of A company at cost, and it is a usual commercial practice for companies to take assets into their books and balance sheets at cost. *Evatt J.* cited a passage from the Australian edition of *F.R.M. De Paula's* work on *Auditing*, in which he said "Fixed assets are valued upon the basis of cost" (6). No addition was made to the cost of the original shares when the bonus shares were received because it was considered that they had cost the company nothing. It was held that there was a value on the basis of cost and a revaluation

(1) (1940) 62 C.L.R., at p. 708.
(2) (1940) 62 C.L.R., at p. 710.
(3) (1940) 62 C.L.R., at p. 741.

(4) (1940) 62 C.L.R., at p. 745.
(5) (1940) 62 C.L.R. 687.
(6) (1940) 62 C.L.R., at p. 726.

of at least 24s., and that the difference between the two amounts represented a profit arising from the revaluation of assets not acquired for the purpose of resale at a profit. There is a realized profit upon an asset where a company sells the asset for more than it cost and a book profit where a valuation discloses that the asset is worth more than the cost. *Dickson's Case* (1) is therefore not directly in point where the profit relied upon is a difference between a value to which an asset has been written down below cost and the sum for which it is subsequently sold or the value to which it is subsequently written up. But the passages from the judgments which I have cited place the decision on the broad ground that companies are from time to time entitled to assign any values to their fixed assets for accounting purposes which are justified by sound commercial practice, and that when there is an increase between the two values this is a profit arising from a revaluation within the meaning of the sub-section. The effect of the decision is, I think, correctly stated by *Jordan C.J.* in *Commissioner of Taxation (N.S.W.) v. Henry* (2). Light is thrown upon the meaning of "profits" in s. 53 (c) by considering the meaning of the same word in s. 53 (b). This sub-section exempts from the assessable income profits arising from the sale or compulsory resumption for public purposes of assets if the company was not liable to tax in respect of those profits under this or the previous Acts. Sub-section (b) relates to realized profits, whereas sub-s. (c) relates to book profits. But dividends can only lawfully be paid out of profits, and both sub-sections must, I think, refer to profits in this sense. The word "profits" in sub-s. (b) cannot be confined to the amount by which the purchase or compensation moneys exceed the cost of the asset to the company. It must refer to the whole of these moneys which the company could lawfully distribute by way of dividend. Otherwise a dividend paid out of the amount by which these moneys exceeded the cost or, in other words, out of the accretion in capital value, would not be taxable, whereas a dividend paid out of the balance representing the original capital value would be taxable. The amount which could be lawfully distributed by way of dividend would be the amount which the company could lawfully regard as profits available for this purpose. This would depend upon the value assigned to the asset in the books of the company. If the value so assigned was its cost to the company, only the excess of the purchase or compensation moneys over the cost would be profits. But if the asset had been written down below cost, even if it had been written down to

H. C. OF A.
1946.

COMMISSIONER OF
TAXATION
(N.S.W.)

v.
HARDIE
INVESTMENTS
PTY. LTD.

Williams J.

(1) (1940) 62 C.L.R. 687.

(2) (1941) 41 S.R. (N.S.W.) 185, at
pp. 187, 188; 58 W.N. 193.

H. C. OF A.
1946.

COMMISSIONER OF
TAXATION
(N.S.W.)

v.

HARDIE
INVESTMENTS
PTY. LTD.

Williams J.

a nominal value, the profits would be the excess over the written down value, and if the value was nominal the whole of the purchase or compensation moneys in the absence of a countervailing loss would be profits which the company could distribute by way of dividend. The word "profits" in sub-s. (c) must have a similar meaning. Profits available for distribution by way of dividend arise from the sale of an asset because the amount realized upon the sale exceeds the book value of the asset. Profits arise from the revaluation of an asset because the amount of the revaluation exceeds the amount at which the asset is at the moment of revaluation standing in the books of the company.

For these reasons I would dismiss the appeal.

Appeal dismissed with costs.

Solicitor for the appellant, *F. P. McRae*, Crown Solicitor for New South Wales.

Solicitors for the respondent, *Dawson, Waldron, Edwards & Nicholls*.

J. B.