[HIGH COURT OF AUSTRALIA.]

GRIFFITHS HUGHES PROPRIETARIES LIMITED . . . . APPELLANT;

AND

THE FEDERAL COMMISSIONER OF TAXATION . . . . RESPONDENT.

H. C. OF A. 1950.

SYDNEY, *May* 25; *June* 2.

Williams J.

1951.

SYDNEY, *April* 4–6; *July* 16.

Dixon, McTiernan, Webb, Fullagar and Kitto JJ.

Taxation (*Cth.*)—*Company*—*War-time profits*—*Assessment*—*Holding company*—*Subsidiary companies*—*Branches of holding company*—*Election*—" *Taxable profit* "—" *Capital employed* "—*Ascertainment*—*War-time* (*Company*) *Tax Assessment Act* 1940-1942 (*No.* 90 *of* 1940—*No.* 52 *of* 1942), *ss.* 3, 17, 19, 20, 24.

Upon an election under s. 17 of the *War-time* (*Company*) *Tax Assessment Act* 1940-1942 that a subsidiary company should be treated as a branch of the holding company the section should be complied with by ascertaining the " taxable profit " and the " capital employed " of each of the companies separately, and applying the appropriate rate of tax to the difference between the sum of the several amounts of " taxable profit " and five per centum of the sum of the several amounts of " capital employed ".

The intended operation of s. 17 is to attach subsidiary companies to their holding company as branch companies, in contradistinction to attaching the businesses of the subsidiaries to the business of the holding company.

Semble (1) under s. 17 (1) of the *War-time* (*Company*) *Tax Assessment Act* 1940-1942, a holding company may choose between two alternative methods by which its tax liability may be assessed, namely, the normal method which the Act provides for all companies and the special method which the section prescribes for a holding company which elects to have its subsidiaries treated as branches, and (2) a right of election is given only to such holding companies as are themselves liable to war-time (company) tax.

Bankers and Traders' Insurance Co. Ltd. v. *Federal Commissioner of Taxation*, (1946) 73 C.L.R. 39, referred to.

Decision of *Williams* J. affirmed.

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Appeal from *Williams* J.

An objection was lodged on behalf of Griffiths Hughes Proprietaries Ltd. against a notice of assessment issued under the *War-time (Company) Tax Assessment Act* 1940-1941, in respect of the taxable profit for the accounting period ended 30th June 1941, derived by the subsidiary companies of Griffiths Hughes Proprietaries Ltd. which were operating in Australia, namely, E. Griffiths Hughes Pty. Ltd. and E. Griffiths Hughes Ltd., on the grounds :—(1) that the capital employed was a much greater sum than the amount of £20,000 (" minimum capital as provided by s. 24 (6) ") allowed in the assessment ; (2) that the percentage standard was inadequate and should be increased ; (3) that there was either no excess of taxable profit over the percentage standard or, alternatively, that the excess was a much lesser sum than that shown in the notice of assessment ; and (4) that the rates of tax and amount of tax charged were excessive. It was also stated in the notice of objection that Griffiths Hughes Proprietaries Ltd. was a public company which was formed in England in 1934 to acquire all the issued shares in E. Griffiths Hughes Ltd., an operating company manufacturing various named products including, *inter alia*, Kruschen salts, Radox bath salts, Karswood poultry spice and poultry meal, and Karswood dog powders and pig powders. In Australia " Radox " was manufactured by E. Griffiths Hughes Pty. Ltd., and Kruschen salts by a branch of the English operating company, E. Griffiths Hughes Ltd. The consideration paid by Griffiths Hughes Proprietaries Ltd. for all the shares in E. Griffiths Hughes Ltd., the operating company, was £2,500,000 of which £1,000,000 was paid in cash and £1,500,000 by the allotment of 1,500,000 shares of £1 each. At the time of purchase, the excess of the value of the assets over the liabilities of E. Griffiths Hughes Ltd. was, according to the information, approximately £410,000, and the consideration, therefore, included an amount of £2,090,000 for goodwill, formulae, trade marks, &c., and it was claimed that a substantial amount of that capital was invested in Australia and used in the production of the taxable profit from the manufacture of Kruschen salts and Radox bath salts.

A similar objection on similar grounds was lodged against a notice of assessment issued in respect of the taxable profit for the accounting period ended 30th June 1942, derived by the said subsidiary companies.

The objections were wholly disallowed by the Commissioner of Taxation and those decisions were upheld by the Taxation Board of Review No. 1. Griffiths Hughes Proprietaries Ltd. appealed to the High Court.

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

N. H. Bowen, for the appellant.

J. D. Holmes K.C. (with him *J. D. O'Meally*), for the respondent.

Cur. adv. vult.

June 2, 1950.

The following written judgment was delivered by :—

Williams J. These are appeals by Griffiths Hughes Proprietaries Ltd., a company incorporated in the United Kingdom, from its assessment for war-time company tax in respect of the accounting periods ended 30th June 1941 and 30th June 1942. The appeals are from a decision of the Board of Review which confirmed the assessments of the respondent. The appeals come to this Court under s. 196 of the *Income Tax Assessment Act* 1936-1940 which is one of the sections incorporated in the *War-time (Company) Tax Assessment Act* 1940-1942 by s. 34 of the latter Act. Under s. 196 there must be a question of law involved in the decision of the Board before this Court has jurisdiction to entertain the appeal. It was not contended that there was not such a question on these appeals.

In order to state the question it will be necessary shortly to set out the material facts. The appellant is a holding company within the meaning of s. 3 of the *War-time (Company) Tax Assessment Act* with two subsidiary companies, E. Griffiths Hughes Ltd., a company incorporated in the United Kingdom, and E. Griffiths Hughes Pty. Ltd., a company incorporated in Australia. On 28th November 1941 the appellant duly elected under s. 17 of the Act to have its subsidiary companies treated as branches of the holding company. Section 17 (1) is in the following terms :—"A holding company may elect, in the manner and within the time prescribed, to have all its subsidiary companies treated as branches of the holding company and thereupon those subsidiary companies shall, for all the purposes of this Act, be treated as branches of the holding company and no separate assessment shall be made in respect of any of those subsidiary companies." War-time company tax is imposed upon the amount by which the taxable profit as defined by the Act derived by any company exceeds the percentage standard. The taxable profit of a company is its

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taxable income of the accounting period less certain deductions. The percentage standard is an amount equal to the statutory percentage (in this case five per cent) of the capital employed or deemed to be employed during the accounting period. The capital employed is ascertained in accordance with s. 24 of the Act. The manner in which this section works has been discussed in *Warner Bros. First National Pictures Pty. Ltd.* v. *Federal Commissioner of Taxation* (1) and *Bankers and Traders' Insurance Co. Ltd.* v. *Federal Commissioner of Taxation* (2), and I shall not repeat what was there said. The capital in question is the commercial capital of the company and one of the assets constituting that capital can be the goodwill of the company. Section 24 (2) (*e*) of the Act provides, however, that where the asset is goodwill which has not been purchased by the company, the value of the asset shall be taken to be nil.

In ascertaining the capital employed of the taxpayer in each of the accounting periods with which these appeals are concerned, the respondent valued the goodwills of the holding company and its subsidiaries at nil. The taxpayer objected to this, and the question whether the respondent was right was the question at issue before the Board of Review, and the question which the Board decided in favour of the Commissioner. The question of law on these appeals is whether on the evidence the Board of Review could have reasonably come to this decision. The true construction of s. 17 of the Act is also involved in this decision.

A short history of the three companies is that the first company to be incorporated was E. Griffiths Hughes Ltd., which was incorporated apparently in 1912 and carried on in England for many years prior to 1934 the business of a manufacturing chemist and thereby established an extensive and profitable business in many parts of the world including Australia in its manufactured products, particularly in Kruschen Salts and to a lesser degree in Radox Bath Salts. The holding company was incorporated in 1934 and acquired the whole of the issued shares of E. Griffiths Hughes Ltd., the consideration being the payment to the shareholders in that company of £E.1,000,000 and the allotment to them credited as fully paid of 1,500,000 ordinary shares of £1 each (less seven subscriber's shares) in the capital of the holding company. At the time of this purchase the total of E. Griffiths Hughes Ltd.'s tangible assets exceeded the total of that company's outside liabilities by £E.410,140. The difference between that amount and the amount of £E.2,499,993, which the holding company paid for the shares in

(1) (1945) 72 C.L.R. 134. (2) (1946) 73 C.L.R. 39.

the operating company is £E.2,089,853, or £A.2,612,325, and it is claimed that this was the value of the goodwill of E. Griffiths Hughes Ltd. in 1934.

It is contended for the appellant that either by the joint operation of the purchase of all the shares in E. Griffiths Hughes Ltd. by the holding company and its election under s. 17 of the Act, or alternatively by this election alone, the holding company purchased the goodwill of E. Griffith Hughes Ltd., that the value of the Australian goodwill in the accounting periods was £182,340, and that the respondent and the Board should have allowed this sum as part of the capital employed in these periods. If the goodwill was so purchased and this is its proper value the taxable profit of the taxpayer in the two periods would not exceed the percentage standard and both assessments should be set aside. The contention can be divided into two parts (1) was any goodwill so purchased within the meaning of s. 24 (2) (*e*) of the Act, and (2) if it was, what was its value in the accounting periods. The second part only arises if the first part is answered in favour of the taxpayer and need only be dealt with in this event.

One thing is clear and that is that although the holding company, by virtue of its shareholding in E. Griffiths Hughes Ltd., could have wound up the latter company and acquired its assets including its goodwill, it never exercised this power and allowed the latter company to continue in business as the operating company. In April 1931, E. Griffiths Hughes Ltd. had caused a new company to be incorporated in Australia, called Radox Ltd., and it has always held all the shares in this company. In October 1939 Radox Ltd. changed its name to E. Griffiths Hughes Pty. Ltd. and this company has carried on business under this name in Australia since this date. The business of the Australian company has been to manufacture and sell Radox bath salts. E. Griffiths Hughes Ltd. has been the registered holder in Australia since 1912 of the trademark "Kruschen" and since 1940, in addition to the manufacture of Kruschen salts in England and their sale in Australia, has by its agents been manufacturing Kruschen salts in Australia although part of the materials used in the manufacture still continue to be imported from England for this purpose.

There is no doubt that E. Griffiths Hughes Ltd. and E. Griffiths Hughes Pty. Ltd., particularly the former company had in the accounting periods a valuable goodwill in Australia, and there is no doubt that in 1934 the former company had a valuable goodwill in Australia. But nothing occurred in 1934 which amounted to a purchase by the appellant of the goodwill of E. Griffiths Hughes

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Ltd. The appellant simply purchased the shares in this company and nothing more, and a shareholder has no proprietary interest either at law or in equity in the assets of the company. The present facts are altogether different from those adjudicated upon in *Associated Newspapers Ltd.* v. *Federal Commissioner of Taxation* (1). In that case the taxpayer was a new company formed for the purpose of bringing about an amalgamation between two existing companies, Sun Newspapers Ltd. and S. Bennett Ltd., by winding up those companies and acquiring their assets. Two methods were open to accomplish this object (1) for the new company to purchase the assets of the existing companies, and (2) for the new company to purchase all the shares in the existing companies and then to wind them up and take a transfer of their assets in specie in satisfaction of its rights as a shareholder. The second method was adopted and carried out so that the new company acquired the assets of Sun Newspapers Ltd. including its goodwill before the accounting period, and it was held that in these circumstances, giving the word " purchase " the wide meaning of anything that is acquired for money or moneys worth, the new company had purchased the assets of Sun Newspapers Ltd. including the goodwill. That case does not therefore assist the contention of the appellant that it purchased the goodwill of E. Griffiths Hughes Ltd. in 1934 in the slightest degree. It is clear, in my opinion, that the appellant never did purchase this goodwill at any time or in any sense. The appellant never did any business itself. It remained a purely holding company, and a company that does no business is not a company which has a goodwill. The goodwill remained throughout an asset of E. Griffiths Hughes Ltd., as the appellant must have intended that it should when it allowed that company to continue to be the operating company instead of winding that company up and going into business itself.

The appellant can only possibly succeed if on the true construction of s. 17 an election effects a fictional sale of the Australian assets of the subsidiary companies to the holding company. The holding company might then be deemed to be the purchaser of the Australian goodwills of its subsidiaries, and their values might then have to be brought into account as part of the capital employed of the taxpayer. But in my opinion this is not the true construction of s. 17. The section is, as Mr. *Holmes* said, purely a bookkeeping section. It does not effect any transfer of assets from the subsidiary companies to the holding company in fact or in fiction. The subsidiary companies are only to be treated as branches of the

(1) (1944) 69 C.L.R. 257.

holding company for the purposes of the Act, so that all the companies shall be assessed for war-time company tax as one company instead of each company being separately assessed. The purposes of the Act were to ascertain whether companies were making what the legislature considered to be excessive taxable profits on the capital employed in war-time, and to impose an additional tax on these profits. When s. 17 allows a holding company to treat its subsidiaries as branches for the purposes of the Act, it does not mean that the subsidiary companies are to be treated as disincorporated and their separate entities merged in that of the holding company. Each company still remains a separate company for the purposes of the *Income Tax Assessment Act* and each company is still entitled to deduct from its taxable income ascertained under that Act the items defined by s. 3 of the *War-time (Company) Tax Assessment Act* in order to ascertain its taxable profit. But the businesses carried on by the subsidiary companies are to be treated as part of the business of the holding company so that the taxable profits if any of each company, having been separately ascertained, are to be added together and treated as the taxable profit of the holding company, and the capitals employed of each company, having been separately ascertained, are to be aggregated and treated as the capital employed of the holding company. The holding company is then only liable to be assessed for war-time company tax if the total taxable profit exceeds the statutory percentage on the total capital employed. The conception of one company carrying on business not on its own account but as the mere agent or branch of another company is by no means novel: *Smith, Stone & Knight Ltd.* v. *Birmingham Corporation* (1) and the cases there cited: *In re Coutinho Caro & Co.* (2). The position that would arise where one or more of the companies has no taxable income but makes a loss in the accounting period was not argued and I express no opinion upon it, but it would seem to be consistent with the scheme of the Act that such a loss should be deductible from the taxable profits of the other companies. The section does not cause the goodwill of any of the companies to become an asset which has been purchased unless any of the companies has a goodwill which that company has in fact purchased. The appellant has never purchased the Australian goodwill of E. Griffiths Hughes Ltd. for it has never purchased any of the assets of that company but only purchased its shares. Nor have the subsidiary companies ever purchased any Australian goodwill, for they never purchased the goodwill of any existing Australian

(1) (1939) 4 All E.R. 116. (2) (1918) 2 Ch. 384.

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business but commenced from scratch and their present goodwill is attributable and attributable only to the progress which they have since made in their respective businesses.

In my opinion therefore the Board did not come to a decision not reasonably open on the evidence. On the contrary, it came to the only decision which was reasonably open on the evidence.

For these reasons I must dismiss the appeals with costs.

From that decision the appellant appealed to the Full Court of the High Court.

G. E. Barwick K.C. (with him *N. H. Bowen*), for the appellant. For present purposes, the holding company holds the whole of the shareholding of the operating company, E. Griffiths Hughes Ltd., the English company, and that company holds the whole of the shareholding in the Australian company, so that by virtue of the definition of " holding company " in s. 3 of the *War-time (Company) Tax Assessment Act* 1940-1942, the holding company, indirectly through the operating company, controlled the Australian company. Thus both the operating company and the Australian company were subsidiaries, by definition, of the taxpayer, the holding company. The question which arises is: How is s. 24 of the *War-time (Company) Tax Assessment Act* to be operated in the case of a non-resident holding company which has elected to treat its subsidiaries as branches ? One way of determining that question is to use the holding company's balance sheet for the purpose of taking out the items (*a*), (*b*) and (*c*) of s. 24 (2) of the Act, not seeking to make any adjustments of them upwards or downwards by the use of par. (d) and sub-s. (1), and regarding (iii) as not requiring any deduction in respect of common capital in respect of the investment in the subsidiary company. That results in an aggregate sum. To ascertain, as required by *Bankers and Traders' Insurance Co. Ltd.* v. *Federal Commissioner of Taxation* (1), whether that is capital employed in Australia, the ex-Australian employment is determined, prima facie, by finding the ex-Australian assets and the remainder is capital employed. Section 24 (3) is inapplicable because of the election. A second way is to take (A) item (*a*) of s. 24 (1) from the consolidated balance sheet of the holding company and subsidiaries ; (B) the paid up capital of the holding company ; (C) item (*b*), that is, the consolidated accumulated profits of the holding company and subsidiaries and branches—item (*c*), though taken from the same consolidation, would be only the reserve of

(1) (1946) 73 C.L.R. 39.

the holding company because it is on the issue of the principal capital. It is not sought in this computation to make any adjustment through (*d*) and (i) of what is really item (*b*). An upward or downward movement by the use of (*e*) or (i) is not sought; (ii) is inapplicable and (iii) does not call for any deduction because now, by reason of the consolidated balance sheet, there is not any capital invested in any subsidiary, it is all one concern. Having got the aggregate the *Bankers and Traders' Case* (1) is applied by ascertaining what is the ex-Australian employment of capital. The ex-Australian net assets are taken and that gives the net sum. In each of those instances goodwill or lost capital, whichever it may be, is not regarded as apportionable, and so the whole of the difference is claimed as capital employed. As an alternative on that point, if the true view be that the employment of the goodwill is apportionable as between Australia and ex-Australia, then in the evidence the method of apportionment is spoken of. If the capital be above £150,000 then there is no tax. On the only material before the Court there would be £182,340 of goodwill referable to this country. The third way of presenting the matter is that the items for s. 24 (1) (*a*), (*b*) and (*c*) are taken from the holding company's account alone, the taxpayer's account alone. That being a holding company, there is a very small profit, there is a reserve of some £125,000 created out of premiums on issued capital and there is £2,500,000 capital assets consisting predominant in the shareholdings now in the subsidiaries. So there are not any assets in the accounts of the company to which (*d*) or (i) would apply except in that way. To add the amounts of capital employed together is to deny the whole basis of the statute, which provides that on election there is only one taxpayer and one capital employed. The Commissioner has left those subsidiaries as separate operating taxpaying companies, taken their separate capitals employed, added them together, and added together their income from taxable profits, so as to arrive at the result. It is not the correct view that although the subsidiaries are to be treated as branches, they must be regarded as retaining their entire, distinct, corporate entity and their separate accounts, separate capital, &c. Applying, in the first instance, s. 24 to the balance sheet of the holding company, there should be taken the first item (*a*) £2,500,000, that is the capital paid up in money. The accumulated profits should be £4,446; the reserves out of premiums on shares would be £25,000. In the first method there would not be any use for (*d*), because there was not any question of any asset in the balance sheet that

(1) (1946) 73 C.L.R. 39.

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required adjustment one way or the other, according to the section. So that the only question that arises in the first way of putting the matter is whether, having in mind the election, s. 24 (3) could be used and then could be deducted the capital invested in the subsidiary, which is now to be treated as a branch. In *Carpenters Investment Trading Co. Ltd.* v. *Federal Commissioner of Taxation* (1) there was a question whether a dividend should be included or whether there should be brought into account on election, profit of the subsidiary. Upon an election the branch becomes part of the business of the taxpayer and the taxpayer cannot logically be regarded as having a shareholding in his own business. The effect of the election is to remove the indirectness of the ownership of the assets and to make them notionally direct (*Carpenters Investment Trading Co. Ltd.* v. *Federal Commissioner of Taxation* (2)). In the application of s. 24 to the case of a holding company which has elected to treat its subsidiaries as branches, it is not possible to make a deduction under s. 24 (1) (iii) because by hypothesis the investment in the subsidiary must be ignored. The first way of approaching this matter is whether on the material shown the whole of the capital except the amount of the value of the actual tangible Australian assets must be deemed to be employed outside Australia. The question is, following the decision in the *Bankers and Traders' Case* (3), is it shown that all but £7,000—the Commissioner's figure —of the capital was employed outside Australia ? To get that position on the figures the Commissioner would have to treat the gross value of the assets abroad as representing capital employed abroad, not the net value. The next step is to regard the whole of the goodwill of the company as representing capital employed outside Australia. The net assets must be taken. There are Australian assets and ex-Australian creditors, and the right step is to take the net assets as representing the employment of capital abroad. The first contention on s. 24 (1) (*a*) is limited to £2,500,000 ; under s. 24 (1) (*b*) there is taken £4,446, which is the balance in the profit and loss account at the commencement of the accounting period ; under s. 24 (1) (*c*) there is taken as share premium account in the balance sheet, £25,000 ; and the operation of s. 24 (1) (*d*) is excluded simply because, in point of fact, there is nothing in the balance sheet to which it could apply. Thus there is the total of (*a*), (*b*) and (*c*) ; no application, in fact, in this case on this submission of (*d*) and (i) ; no application of (ii), and (iii) is not useful to exclude shareholding in capital invested in the subsidiaries. Lost capital is treated as

(1) (1949) 79 C.L.R. 341.
(2) (1949) 79 C.L.R., at p. 350.
(3) (1946) 73 C.L.R. 39.

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capital employed (*Bankers and Traders' Insurance Co. Ltd.* v. *Federal Commissioner of Taxation* (1); *Federal Commissioner of Taxation* v. *Adelaide Electric Supply Co. Ltd.* (2)). A deduction in relation to the capital in the subsidiaries cannot be made under (iii). That is the right step to take to ascertain whether any of that capital is employed ex-Australia. The residue should be treated as employed in Australia including all lost capital. For the purpose of applying the decision in the *Bankers and Traders' Case* (3) regard should be had to the net assets abroad. A question which arises is : Has it been shown that the whole of that capital which is said to be represented by goodwill was employed abroad ? Section 17 should be construed as relating to subsidiaries which would otherwise be subject to the Act, but if not so construed, and they were all brought in, s. 24 (1) (ii) would probably exclude their assets from the capital of the company. Upon the ascertainment of the balancing figure representing the difference between the aggregate sums found by the use of s. 24 and the value of the external assets, it cannot be said in point of law or fact in this case, that none of that capital was used in Australia, that is if it be designated goodwill it cannot be said that none of the goodwill was employed in Australia. The idea of s. 17 is that a holding company is one which, having the ownership, has chosen to own the assets of the subsidiary as it were by derivation through shareholdings, or, in other words, it has chosen that legal structure for the control of the assets of the subsidiary. The whole scheme of s. 17 is to allow the holding company to reverse in some sense the deliberate policy it has adopted of holding the assets of the subsidiary by election through the holding of them, and if it holds them by holding the shares, one of the purposes of not having and not operating the local assets by doing it through holding companies may very well be to put itself beyond the reach of local tax as far as possible. The second way the matter may be approached is to treat the balance sheet as the consolidated balance sheet bringing the three balance sheets into harmony in one consolidated sheet eliminating items like the holding, subsidiaries, &c. There should be taken the paid up capital, shown in the sheet as £2,500,000; the share premium account—the capital reserve—£13,634 ; the general reserve, £180,000 ; the profit and loss balance at the opening period, £6,917 ; and the reserve in respect of assets in certain European countries, £35,550 ; the total of these items being £2,761,101. By so doing there would have

(1) (1946) 73 C.L.R., at pp. 57, 58, 61-63.

(2) (1950) 83 C.L.R. 413, at pp. 417, 423.

(3) (1946) 73 C.L.R. 39.

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been done the sum of (*a*), (*b*) and (*c*) of s. 24 (1) in relation to the consolidated balance sheet. Nothing is brought in under (*d*) and there is nothing that can be taken out under s. 24 (1) (i), nothing to which s. 24 (1) (ii) applies. Section 24 (1) (iii) has no application, and the sole problem remaining is whether there was any ex-Australian employment of that sum of £2,761,101. It cannot be said that the sum, the net assets, was not employed in Australia, or that it was wholly employed outside Australia. If it was not wholly employed outside Australia then the employment of capital in that intangible area cannot be apportioned in that way and there is not any room for any apportionment.

The third way of approaching the matter is that if, contrary to the above submissions, the shareholding in the subsidiary should be deducted under s. 24 (1) (iii) then the appellant is entitled to treat the goodwill as included under s. 24 (1) (*d*), in the first place, for its full purchase price of £2,089,000 sterling or, alternatively, for the *aliquot* portion of it, said to be referable to the Australian goodwill, namely £182,000 approximately. In the event only of s. 24 (1) (iii) being operated against the appellant, to deduct the amount of the investment in the subsidiaries, the argument is that upon election the separate corporate entity or existence of the subsidiaries must be disregarded and their assets regarded as assets directly owned by the taxpayer. By s. 17 the holding company is allowed to treat the matter as if it had originally acquired the shares rather than merely the shares of the company which holds the assets. The taxpayer purchased the goodwill (*Associated Newspapers Ltd.* v. *Federal Commissioner of Taxation* (1)).

J. D. Holmes K.C. (with him *J. D. O'Meally*), for the respondent. Section 14 (*e*) of the Act would seem to suggest that the holding company, which had no taxable property, was not a company which could elect under s. 17. The two things which have to be determined are the relation of the percentage standard to the capital employed, and the ascertainment of the taxable profit. There is not any more reason to go to s. 24 to work out capital employed than to go to s. 3 to work out taxable profit. If resort is had to s. 3 to work out taxable profit then there is every reason for following the course indicated in the Court below and obviously followed by the Commissioner, that is to say, a course of doing four sums by treating the holding company and each subsidiary company separately in the first place, and the fourth sum is the aggregation

(1) (1944) 69 C.L.R. 257.

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of the result of treating them separately. In that way it is still possible to perform what is required by the Act and treat the holding company and its subsidiaries as branches. The warrant for doing that is to be found in the way in which "taxable profit" is to be ascertained by reference to the definition of that expression in s. 3. The introductory words to that definition have to be made to do service in all the types of cases to which the Act applies. "Taxable profit" is arrived at by doing a series of subtractions. The primary sum from which the subtractions are to be made is the taxable income as assessed under the *Income Tax Assessment Act*. There is not any provision in that Act, nor in this Act, for notional assessments of notional incomes. The first sum to be deducted is the income tax payable in respect of that taxable income. There is not any authority in the *Income Tax Assessment Act* to assess the taxable income of a notional assessable income. There would be an assessment of the taxable income of each company and the deductions can be made from them. The sum must be done in two or three parts in ascertaining taxable income. When an election is made under s. 17 the correct way to treat the subsidiary companies as branches is to ascertain the taxable profit of the taxpayer in that way and then to add together the results. The position in *Carpenters Investment Trading Co. Ltd.* v. *Federal Commissioner of Taxation* (1) was that the Commissioner did not admit the whole of the dividend because he regarded some dividends as having been derived from a trading activity in shares; the dispute really was as to the amount of the deduction. It is agreed that the subsidiary companies are not disincorporated, so that the Act applies to the ascertainment of taxable profit in the way submitted. Capital employed under s. 24 should be ascertained in this case by doing not one sum but four sums. The capital employed in Australia is to be ascertained by applying s. 24 to each company separately and then aggregating the net results. That method produces the correct result. The choice of election under s. 17 is with the taxpayer, but once having been made he is held to it. Losses are not ignored but are accounted for in the taxable profit for the particular year. It is disputed that upon an election being made under s. 17 a loss in the branch has to be taken into account as a deduction of profit in the head company. The Act is really an excess profits tax Act. It is clear from the words of some of the sub-sections in s. 24 that when the capital employed is being ascertained a separate sum is done in respect of each company, but the accounts of the companies are not combined because in

(1) (1949) 79 C.L.R. 341.

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some of those sub-sections one is directed to not the notional accounts that have been constructed out of the activities of the company but the accounts of the company for the purpose of determining the figure. Not only is the Act workable in the way put, but the indications are that that is the way in which the appropriate sums are required to be done. There was not any transfer of the goodwill to the holding company. No transfer could take place because it was only the transfer of the results of the three sums referred to. There was not any purchase and there was not an amalgamation as in *Associated Newspapers Ltd.* v. *Federal Commissioner of Taxation* (1). Whatever the expression "treated as a branch" may mean there was not any notional liquidation of assets and, therefore, there was not any purchase. It follows that the Court below was correct in its decision on that matter. If there was a transfer of goodwill then s. 24 (4) applies. On the facts the holding company had only shares in the operating company as its assets. As such it was a channel for dividends, it had no independent trading activities of its own. The beneficial interest in the property is the beneficial interest of the shareholders (*Osborne* v. *The Commonwealth* (2); *Curzon Offices Ltd.* v. *Inland Revenue Commissioners* (3)). That principle applies when construing the words "held on behalf of" in s. 24 (4). The shares in the operating company are held on behalf of the same persons who hold the shares in the holding company. Therefore s. 24 (4) would apply as if there had been a transfer of the goodwill from the operating company to the holding company. That is put as an alternative. The value of the goodwill employed in Australia was left in such a state that it was not possible to make a finding that the figure which had been suggested, £180,000, was the correct figure. The arguments in the first and second methods addressed to the Court on behalf of the appellant are not covered by the notice of objection and therefore are not open to the appellant. Sections 185 and 190 (*a*) of the *Income Tax Assessment Act*, made applicable by s. 34 of the *War-time* (*Company*) *Tax Assessment Act*, mean that the taxpayer must give a complete and perfect statement of his grounds of objection (*R.* v. *Deputy Commissioner of Taxation*; *Ex parte Copley* (4); *Molloy* v. *Federal Commissioner of Land Tax* (5)). The question before the Board of Review and the Court below related entirely to goodwill. The two arguments are directed to the inclusion of a different figure, and not one relating to goodwill.

(1) (1944) 69 C.L.R. 257.
(2) (1911) 12 C.L.R. 321, at p. 365.
(3) (1944) 1 All E.R. 606.
(4) (1923) 30 A.L.R. 86, at p. 87.
(5) (1938) 59 C.L.R. 608.

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In regard to the balance sheet of the English holding company the Commissioner put the figure of the capital employed as "nil". There should be added together the £2,500,000 of issued capital; £25,000 on the share premium account, and £4,446 from the profit and loss figures. Applying par. (iii) of s. 24 (1) £2,499,993 should be taken from the total of that sum, namely, £2,529,446, which leaves £29,453. Whether any of that £29,453 was capital employed in Australia in respect of the company was decided by the Commissioner in the negative. There was not any evidence that any of that sum was employed in Australia, nor as to where it was employed. The onus is upon the appellant to displace the Commissioner's finding (*Trautwein* v. *Federal Commissioner of Taxation* (1)). If the matter be approached by the way suggested on behalf of the appellant ultimate goodwill will not be found, there is none in any account. It is common ground that the operating company never purchased any goodwill. The definition in s. 3 maintains the other companies because the sum as to taxable profit cannot be done without the existence of the other companies and in some cases the sum with respect to capital employed could not be done. The appellant's first and second arguments are based upon a fallacy. They assume that because the holding company is the taxpayer the accounts of it and its subsidiaries must be consolidated before s. 24 is applied. The fallacy is that in doing that the appellant has assumed that an election under s. 17 brings about a notional disincorporation of the subsidiaries. That assumption is opposed to the words of the legislation. The proper approach to the question is to examine what has to be done under the Act in all types of cases. There not being a notional disincorporation for the purpose of carrying out this assessment, it is not necessary to perform any operations to s. 24 or to the accounts of the subsidiary companies.

G. E. Barwick K.C., in reply. The Court did not say in the *Bankers and Traders' Case* (2) that the onus was upon the taxpayer to affirmatively show the employment of capital, nor, having regard to *Federal Commissioner of Taxation* v. *Adelaide Electric Supply Co. Ltd.* (3), did it intend to say so.

[DIXON J. referred to *Inland Revenue Commissioners* v. *Terence Byron Ltd.* (4).]

The balancing sum cannot be apportioned. It works wholly everywhere, wherever the company operates, and it is unapportion-

(1) (1936) 56 C.L.R. 63, at pp. 87, 88.
(2) (1946) 73 C.L.R. 39.
(3) (1950) 83 C.L.R. 413.
(4) (1945) 1 All E.R. 636, at p. 640.

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able. The language of the objections taken is completely appropriate to the claim made in the first two submissions, namely, that having regard to subsidiary branches, the company—now only one in contemplation for tax purposes—has £2,000,000 represented by goodwill, formulae, trade marks, &c., and it is claimed that that sum, or a substantial part of it, is employed in Australia. The grounds taken are not cut down by the argumentative statement which states precisely the argument put. The method suggested on behalf of the respondent, firstly, depends entirely on the use of s. 24 (1) (iii); secondly, almost stultifies itself when worked out; and, thirdly, gives no force to the words " treated as a branch ". The purpose of s. 17 is to allow the actual relationship to be disregarded; the separate identity to be swept aside, and once that is done then the assets of the subsidiaries must be regarded as being assets of the holding company, not in the sense of a transfer from one entity to another, but the separation of their identity swept aside. It refers to an actual transfer and not a notional transfer. It is to prevent a company transferring at a figure and creating a new cost figure in the hands of the subsidiary which can be used to increase the capital employed. That section has no bearing upon the problem which is before the Court. The main submission is that s. 24 is applied to the accounts of the holding company, and the only use made of s. 17 in that regard is to prevent the use of s. 24 (1) (iii) against the appellant; secondly, when ascertaining ex-Australian employment of capital, the assets of the subsidiary should be treated as assets of the holding company and the situation there regarded accordingly.

Cur. adv. vult.

July 16, 1951.

The COURT delivered the following written judgment:—

The respondent Commissioner made assessments of the war-time (company) tax payable by the appellant company in respect of the accounting periods ended respectively 30th June 1941 and 30th June 1942, and upon objections by the appellant being referred to a Board of Review the assessments were confirmed. The appellant appealed to this Court, and *Williams* J. upheld the decision of the Board. From his Honour's orders the present appeals are brought.

The determination of the appeals depends upon the construction of certain provisions of the *War-time* (*Company*) *Tax Assessment Act* 1940-1942, and their application to the facts of the case. As the amending Act of 1942 made no amendment affecting the questions for decision, the two appeals may be considered together.

The appellant company, which may be called the holding company, was incorporated in England in 1934, and in the same year it purchased the whole of the issued shares in the capital of another English company, E. Griffiths Hughes Ltd., which will be referred to as the operating company. The consideration for the purchase was satisfied by the payment of £1,000,000, in cash and the allotment of 1,499,993 fully-paid shares in the capital of the holding company. The issued capital of the holding company at all material times has stood at £2,500,000 divided into 2,500,000 shares of £1 each, all fully-paid.

The operating company held in 1934, and has always continued to hold, all the issued shares in an Australian company, which will be called the Australian subsidiary, known originally as Radox Ltd. and, since 1939, as E. Griffiths Hughes Pty. Ltd.

By reason of these facts, the appellant was, throughout the two accounting periods now in question, a " holding company " within the meaning of that expression as defined by s. 3 of the Act, and the operating company and the Australian subsidiary each satisfied the definition of " subsidiary company " in the same section. Those definitions are as follows :—" ' holding company ' means a company which controls, or is in a position to control, any other company (which other company is in this definition referred to as ' the subsidiary company ') either by virtue of its shareholdings in the subsidiary company or indirectly through another company, or by virtue of any agreement, express or implied, and which would be entitled to receive, either directly or indirectly, more than one-half of the profits earned by the subsidiary company during the accounting period if those profits were distributed." " ' subsidiary company ' means a company which a holding company controls or is in a position to control as specified in the definition of ' holding company ' ".

Before the making of the relevant assessments, the holding company purported to make an election to have the operating company and the Australian subsidiary treated as branches of the holding company, pursuant to s. 17 (1) of the Act, which provides that—" A holding company may elect, in the manner and within the time prescribed, to have all its subsidiary companies treated as branches of the holding company and thereupon those subsidiary companies shall, for all the purposes of this Act, be treated as branches of the holding company and no separate assessment shall be made in respect of any of those subsidiary companies ".

We do not decide that the appellant was entitled to make the election which it purported to make under s. 17. The sense of

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the section would seem to be that a holding company may choose between two alternative methods by which its tax liability may be assessed, that is to say, the normal method which the Act provides for all companies and the special method which the section prescribes for a holding company which elects to have its subsidiaries treated as branches. The postulate the section would seem to make is that the holding company is liable to be assessed for war-time (company) tax; that is to say that it is a company which either is a resident of Australia or derives income from Australia and is not outside the application of the Act by reason of s. 14 (*e*). So understood, the section would give a right of election to holding companies which are themselves liable to war-time (company) tax, and to them alone. The appellant, though within the definition of " holding company ", was not so liable, because it had no taxable income within the meaning of the *Income Tax Assessment Act* 1936-1940, and therefore it had no taxable profit within the meaning of the *War-time* (*Company*) *Tax Assessment Act*. However, the point, naturally enough, was not raised by the notice of objection. It is a matter therefore which is not in question between the parties. In the view we take of the appeal we find it unnecessary to deal with it. But it is proper to point out that none of the difficulties which have been raised would, upon the facts of the case, exist if the application of s. 17 were limited to a holding company liable to assessment under the Act.

The Commissioner accepted the election as one which the appellant was entitled to make under s. 17, and he made the assessments now in question in accordance with his conception of the effect of the requirement that, when an election has been made, the subsidiary companies shall be treated as branches of the holding company for all the purposes of the Act. The Act, in its application to a case such as the present, provides for a tax upon the amount by which the " taxable profit " derived by a company during an accounting period exceeds five per centum of the " capital employed " during that period: ss. 13, 19, 20. The Commissioner acted on the view that s. 17 was to be complied with by ascertaining the " taxable profit " and the " capital employed " of each of the three companies separately, and applying the appropriate rate of tax to the difference between the sum of the three amounts of " taxable profit " and five per centum of the sum of the three amounts of " capital employed ". The appellant, however, contends that s. 17 requires that the assessment shall be made by ascertaining the " taxable profit " and the " capital employed " of a notional enterprise consisting of an aggregation of the holding company and its subsidiaries, and by applying the rate of tax to the difference between the former amount and five per centum of the latter amount.

The appellant's contention is based upon the view that the direction in s. 17 to treat the subsidiary companies as branches of the holding company means that the subsidiary companies are to be treated as having no separate corporate existence, and that the holding company is to be treated as if it were the product of a merger of all the companies. The appellant presses the interpretation of " treated as branches " so far as to make it mean that, wherever the statute makes any provision which assumes a corporate existence on the part of a company, or relates to a matter arising from its corporate character or its existence as a taxable entity, then that provision can have no application. An exception is conceded by the argument in the case of the taxable income of each company for the purposes of the definition of " taxable profit " in s. 3 (1), doubtless because of the words " as assessed " in the definition. It will be necessary to refer again to this concession, and it is necessary now only to notice it. The appellant uses the main thesis in a variety of applications, the most important of which is in an attempt to have the goodwill belonging to the operating company, in whose balance sheet its value is not reflected, treated as an asset of the appellant as the holding company, treating it as an investment of its capital.

Williams J. disagreed with the interpretation of s. 17 which treats the subsidiaries as having no existence at all and requires a reconstruction or moulding of the provisions of the Act to make them appropriate to a case where, because of the notional amalgamation into one of several entities with distinct capital structures to which s. 24 would be applicable, it becomes incapable of any but a *cy-pres* application. Clearly there are great difficulties in accepting such an interpretation. The direction that the subsidiary companies shall be treated as branches doubtless suggests that special consequences shall ensue for the benefit of the company making the election, but that is very far from necessitating a disregard of the capital structures which they have as distinct entities and which afford the basis prescribed by the Act for the calculation of the percentage standard. The language of s. 17 does not itself suggest that it means to produce such sweeping consequences or throw on the Court the semi-legislative task of moulding provisions to apply otherwise than according to their terms.

Great difficulties in the way of the appellant's construction of the section are encountered when it is sought to apply that construc-

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tion in working out the provisions of the Act which prescribe the methods by which " taxable profit " and " capital employed " are to be calculated. Those provisions must now be considered.

Section 3 defines " taxable profit " as meaning the amount remaining after deducting from the taxable income of the accounting period as assessed under the *Income Tax Assessment Act* certain amounts, of which those relevant in this case are (a) the income tax payable in respect of that taxable income, and (b) so much of any dividend received by a company in respect of its shareholdings in any other company as is included in the taxable income of that first mentioned company of the accounting period. The taxable profit of a company is thus required to be ascertained by a procedure which takes account of certain pre-existing facts. The expression " the taxable income of the accounting period as assessed under the Income Tax Assessment Act " is apt to describe only the taxable income which has in fact been assessed for the purposes of income tax ; " the income tax payable " refers to an existing liability to pay income tax ; and " so much of any dividend received . . . as is included in the taxable income " refers to a dividend actually received and actually included in the taxable income assessed for the purposes of income tax.

The Commissioner's construction of s. 17 gives it an operation which allows " taxable profit " to be ascertained in precise accordance with the definition in respect of each of the companies concerned, and simply transfers the " taxable profit " of the subsidiaries to the holding company by way of addition to its " taxable profit ". The appellant's construction, on the other hand, would necessitate the abandonment of the statutory formula in respect of the holding company as well as the subsidiaries, and the ascertainment of a single " taxable profit " by a process resembling, but different from, that prescribed. It requires that s. 17 should be understood as effecting a notional transfer of the businesses of the subsidiaries to the holding company as from the commencement of the accounting period, with the result that a " taxable profit " is to be ascertained in respect of the combined business, without consideration of any taxable income that has been assessed, or any income tax that is payable, or any dividends that have been received by any of the companies from any of the others. On this view, it is necessary to substitute, for taxable income as assessed, the taxable income which would have been assessed if the several businesses had belonged to one company, and to substitute, for income tax payable, the income tax that would have been payable on that taxable income if it had been wholly derived by one company.

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It is also necessary to exclude from dividends received any dividends received by any of the companies from any of the others. If so considerable a departure from the definition had been intended, a much more explicit provision than that which s. 17 contains would surely have been made. It should be pointed out also that by reason of the definition of " holding company ", s. 17 is not limited to the case where the holding company owns all the shares in the subsidiaries and their businesses may for that reason be regarded for practical purposes as branches of the holding company's business. The section applies also to the case where persons or companies other than the holding company are interested, and even very substantially interested, in the subsidiaries; and it would not be a rational intention to ascribe to the legislature that a holding company entitled to receive (say) only fifty-one per cent of the profits of a subsidiary should on that account be permitted to treat the subsidiary's business as its own and, by so doing, to set off the whole of a loss made by the subsidiary against its own profit so as to reduce the amount of its " taxable profit ".

Counsel for the appellant appreciated the difficulty of treating the subsidiary companies as disincorporated and merged in the holding company for the purposes of ascertaining " taxable profit ", but they maintained that no such difficulty arises in relation to the ascertainment of " capital employed ". We therefore turn to the provisions which the Act makes upon that topic, pausing only to remark that it would be strange indeed if a provision that subsidiary companies are to " be treated as branches of the holding company " had a result for one purpose of the Act which it cannot have for another, especially when that provision is expressed to operate " for all the purposes of this Act ".

" Capital employed " is defined by s. 3 as meaning the capital of a company employed in Australia or in a Territory of the Commonwealth in gaining or producing the taxable profit. For the ascertainment of the capital employed, in the defined sense, s. 24 (1) provides a formula. Omitting items to which no attention need be paid in this case, the formula provides for the addition of—(*a*) the capital paid up in money or by other valuable consideration, averaged over the accounting period; (*b*) accumulated profits, averaged over the accounting period, including amounts standing to the credit of the profit and loss account at the commencement of the accounting period but not including any profit of the accounting period; (*c*) any reserve, averaged over the accounting period, which has been created out of premiums received on the issue of shares; (*d*) the amount by which the value prescribed by sub-s. (2)

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of s. 24 as the value of any asset to which that sub-section applies exceeds the value of that asset as appearing in the accounts of the company at the commencement of the accounting period, or, if no such value so appears, the amount prescribed by that sub-section; and for the deduction therefrom of—(i) the amount by which the value of any asset to which sub-s. (2) applies as appearing in the accounts of the company at the commencement of the accounting period exceeds the value of that asset prescribed by that sub-section; (ii) any capital, averaged over the accounting period, the income (if any) from which is not or would not be taken into account in assessing the income of the accounting period under the *Income Tax Assessment Act*; (iii) any capital, averaged over the accounting period, invested in shareholdings in any other company.

All that need be mentioned with regard to sub-s. (2) of s. 24 is that it applies to, *inter alia*, an asset being goodwill, a trade mark or a trade name, and prescribes as the value of such an asset for the purposes of sub-s. (1) the cost of the asset if it was purchased by the company, and nil if it has not been purchased by the company.

The appellant's construction of s. 17 cannot be applied in ascertaining " capital employed " in accordance with these provisions without regarding a subsidiary company, in relation to which an election has been made, as excluded from the expression " any other company " in par. (iii) of s. 24. So to regard it would necessitate giving to the expression a meaning different from that which it has in par. (*b*) of the definition of " taxable profit ". This is an important consideration against the appellant's construction; but the matter may be considered on broader lines.

It will be observed that throughout s. 24 attention is directed to actual accounts and to existing or historical facts. A construction of s. 17 which would require the " capital employed " of the holding company as ascertained in accordance with the formula to be ignored, and a new " capital employed " of the holding company to be calculated by reference to hypothetical accounts and unreal facts, would involve a radical departure from the scheme of the Act. One illustration, which goes to the root of the matter, may be taken. Just as the definition of " taxable profit " takes as a basic figure, not the net profit of the accounting period as ascertained afresh for the purposes of war-time (company) tax, but the taxable income as already assessed for the purposes of income tax, so par. (*b*) of s. 24 brings into the calculation of " capital employed ", not the credit balance of a profit and loss account specially constructed as at the commencement of the accounting period for the purposes of war-time (company) tax, but the amounts which in fact stood, at the commencement of that period, to the credit of the existing profit and loss account. The scheme thus works in relation only to the actual accounts of actual companies, and s. 17 would introduce a completely foreign and discordant element if it were construed as converting the formula into one applying to the notional accounts of a hypothetical company. The reason for saying that this goes to the root of the matter is that it strongly re-inforces the conclusion which the language of s. 17 suggests, namely that the intended operation of the section is to attach the subsidiary companies to their holding company as branch companies, in contradistinction to attaching the businesses of the subsidiaries to the business of the holding company. The section is superimposed upon provisions which operate to fix every company, whether a holding company or a subsidiary, with a " taxable profit " and a " capital employed ", each being calculated in a specified manner. It does not provide that upon an election being made the subsidiary companies shall no longer be regarded as existing, or that the provisions for calculating " taxable profit " and " capital employed ", shall no longer be precisely applicable to them and to the holding company. All it provides is that for the purposes of the Act the subsidiary companies shall be treated as branches of the holding company ; and no more appears to us to be imported by that expression than that, having regard to the organic connection between them and the holding company, the " taxable profit " and the " capital employed " with which the Act equips the subsidiaries, shall be annexed to the " taxable profit " and the " capital employed " which the holding company has in its own right, with the result that the tax assessable against the holding company is increased, while the subsidiaries are exonerated. The operation of the section, where an election is made, may be described as being to provide that the words " the taxable profit derived by any company ", in s. 13, shall be deemed to include, in relation to the holding company, the " taxable profit " derived by its subsidiaries, and that the words " the capital of a company employed " &c., in the definition of " capital employed ", shall be deemed to include, in relation to the holding company, the capital of its subsidiaries so employed. The most obvious case to which the section appears to be directed is that in which, by applying the prescribed formulae, a holding company finds itself with a large " taxable profit " and a small " capital employed ", while its subsidiaries have a small " taxable profit " and a large " capital employed ". The construction we have

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indicated enables the section to achieve its apparent object by operating as a concessional provision for cases of this kind.

The rate of tax was graduated according to the percentage which the excess profit bore to the capital employed; see Acts Nos. 91 of 1940 and 58 of 1941 (the Schedules). The result of an election under s. 17 operating according to the interpretation we give it might be greatly to reduce the amount of the aggregate tax even when in the case of each of the companies, holding company and subsidiary companies, the company's taxable profit exceeded the percentage standard prescribed by ss. 19 and 20. But if, in the case of one or more of the companies, the taxable profit was less than the percentage standard, it would produce the further result that the actual excess of profit is reduced as well as the percentage which the excess bears to the capital employed.

We are therefore of opinion that the Commissioner made the assessments in question upon a correct understanding of the effect of s. 17. The appellant conceded that, if this be so, the assessments are not open to attack, except upon one point which must now be considered. While recognizing that a necessary consequence of the Commissioner's view is that, in ascertaining the "capital employed" of the holding company, the capital invested by that company in shareholdings in the operating company must be deducted under par. (iii) of s. 24, the appellant contended that under par. (*d*) there should be included in the amounts to be added an item of £2,089,352 as being the amount prescribed by sub-s. (2) as the value of goodwill, trade marks and trade names of the operating company. Of course no value for these assets appeared in the books of the holding company, and if they could be regarded as purchased by it at a cost of £2,089,352, the appellant's contention would be made out. In order to show that they should be so regarded, the appellant pointed to the following facts.

When the holding company purchased the shares in the operating company in 1934, the purchase price, satisfied partly in cash and partly by the issue of fully-paid shares in the holding company, amounted to £2,499,993. This sum exceeded by £2,089,853 the total of the par value of the shares bought plus the undistributed profits of the operating company. It appears from a joint report made to the holding company on 4th July 1934 by two firms of chartered accountants, that the difference between the estimated value (not the book value) of the operating company's tangible assets and the amount of its external liabilities was £410,140; so that in paying £2,499,993 for the shares the holding company was allowing £2,089,853 for goodwill &c. That this was not an excessive allowance may be assumed to be established by a mutual admission as to the selling prices ruling on the London Stock Exchange for the shares of the holding company in 1935, from which it appears that the market did not consider the shares in the operating com- to have been acquired at an inflated value.

In view of these facts, it was said that the amount allowed in the purchase price of the shares for goodwill &c., should be treated, as a result of the election made under s. 17, as the cost of goodwill &c. " purchased by " the holding company within the meaning of s. 24 (2); and that, as no value for the goodwill &c. appeared in the accounts of the holding company, either the full amount of £2,089,853, or such proportional part of it as should be attributed to Australian goodwill &c., should be brought by par. (*d*) into the additions made in applying the formula prescribed by s. 24 (1).

The argument in support of this contention does not, indeed, take the bold step, which was apparently taken before *Williams* J., of asserting that an election under s. 17 effects a fictional purchase of the assets of a subsidiary by the holding company; but it takes the no less bold step of attributing to the election the effect of reversing the choice originally made by the holding company when it purchased the shares in the subsidiary instead of purchasing its assets, and of thereby enabling the holding company to treat itself for the purposes of s. 24 as if it had purchased the goodwill of the subsidiary. The short answer is that, whatever may be the proper construction of s. 17, that section cannot possibly be construed as entitling the holding company to have s. 24 applied on the supposition of a transaction essentially different from that which in fact occurred. The truth is that no goodwill was ever purchased by any of the three companies; it was brought into existence by the operating company, which still retains it; and sub-s. (2) of s. 24 prescribes no value for goodwill &c., unless it was in fact purchased. The appellant's contention therefore cannot be accepted as a basis for concluding that the Commissioner has arrived at too low a figure as the amount of the appellant's " capital employed ".

The attack upon the assessments therefore fails; but, as we are of opinion that it would fail even if the appellant were right in attributing to s. 17 the effect of requiring the subsidiary companies to be regarded as disincorporated, it is desirable that we should state our reasons for that view.

The appellant advances two possible methods by which " capital employed " might be ascertained on the basis that the subsidiary companies are considered as merged in the holding company and

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that references to accounts in s. 24 are treated as references to consolidated accounts derived from the actual accounts of all the companies. Each of these methods accepts the fact that no value would appear in the consolidated accounts for goodwill, trade marks and trade names, which in fact belong to the operating company, and therefore no attempt is made to include, in respect of these assets, any amount under par. (*d*) of s. 24. But, as has already been mentioned, if the merger theory be adopted it must be conceded that a substantial portion of the paid-up capital of the holding company is represented by the goodwill, trade marks and trade names of the operating company. It has been held by this Court that the formula provided by s. 24 is subject to the territorial limitation stated in the definition of " capital employed ", and that therefore the funds which that formula requires to be added together (which may shortly be termed shareholders' funds), must suffer any reduction which is necessary in order to restrict the " capital employed " to capital employed in Australia or a Territory of the Commonwealth (*Bankers and Traders' Insurance Co. Ltd.* v. *Federal Commissioner of Taxation* (1)). Because of this, the appellant's methods of calculating " capital employed " must allow for the subtraction from the shareholders' funds of any portion of the paid-up capital assumed to be represented by goodwill, trade marks and trade names which is not employed in Australia or a Territory. Since the business of the operating company extends to many other countries as well as Australia, it is impossible to regard the capital which is treated as invested in goodwill as employed wholly in Australia : see *Inland Revenue Commissioners* v. *Muller & Co.'s Margarine Ltd.* (2) and *English Scottish and Australian Bank Ltd.* v. *Inland Revenue Commissioners* (3). And since the trade marks and trade names are in the nature of monopolies granted or conceded by the laws of the several countries in which they are recognized, the capital which is treated as invested in them cannot be regarded as wholly employed in Australia : (*ibid*). The appellant sets out to demonstrate, by the two alternative methods it proposes, that with a due observance of the principle established by the *Bankers and Traders' Case* (1) its " capital employed " is in excess of £150,000. If that be so, it is common ground that no tax is payable.

The first method suggested is this : You add together (a) the paid-up capital of the holding company (the paid-up capital of the subsidiaries being ignored as they are regarded as non-existent) ; (b) the aggregate of the accumulated profits disclosed by the

(1) (1946) 73 C.L.R. 39.
(2) (1901) A.C. 217.
(3) (1932) A.C. 238.

accounts of the holding company and each of its notional branches; and (c) the reserve of the holding company created out of premiums received on the issue of shares (neither of the subsidiaries having had any such reserve). There is neither any addition to be made under par. (*d*) nor any deduction to be made under par. (i) in respect of goodwill, trade marks or trade names, for no value for those assets appears in the accounts, and none was purchased. Paragraph (ii) is inapplicable. There is no deduction to be made under par. (iii), because *ex hypothesi* neither the operating company nor the Australian subsidiary is " any other company ". It remains only to exclude any of the capital included under (a), (b) or (c) which is not employed in Australia. For this purpose, the argument proceeds, you must consider the combined assets of the holding company and its " branches " as if they were all assets of the " holding company " ; and the only capital which you may treat as not employed in Australia is capital which, having regard to the local situation of the assets, is found to be employed elsewhere. Among the assets are the goodwill, trade marks and trade names of the " branch " which in fact is the operating company. It is said that the capital which these assets represent is to be regarded as employed in Australia, either wholly or as to an apportioned part. If it is to be apportioned, the evidence, it is said, supports only one basis of apportionment, namely, the basis of turnover. If " capital employed " be calculated in accordance with this method, then, even excluding the amount for goodwill &c., employed abroad, which is arrived at by apportionment, an ultimate figure in excess of £150,000 is produced.

Even if the basic assumption as to the meaning of s. 17 were correct, this first method of calculating " capital employed " could not be accepted. For reasons already given it cannot be said that the capital represented by goodwill &c. was wholly employed in Australia, and in our opinion the evidence does not establish that an apportionment on the basis of turnover provides a satisfactory foundation for a conclusion as to the amount of capital employed in Australia in the form of goodwill &c. It may be assumed in favour of the appellant that the value of the entire goodwill &c. of the operating company at the date when its shares were purchased by the holding company was £2,089,853, and that there was employed in Australia in the relevant accounting periods so much of that amount as bears to the whole of it the same proportion as the value of the goodwill &c. in Australia bore to the whole of the goodwill &c. But it is necessary for the appellant's purpose to make the further assumption that that proportion corresponds with the proportion which Australian turnover bore to total turnover;

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and for this assumption we can see no justification. The value of goodwill depends upon the expectation of future profits, and factors which enter into that expectation may vary from country to country in a manner which past turnover does not reflect. Clearly goodwill existing in two countries in which turnover has been equal may not be of equal value in each of these countries, for there may be important differences between them with respect to such matters as the probability of effective competition in the future, the existence of markets unexploited or not fully exploited, and the cost of advertising and of distribution. A comparison of turnover in several countries therefore provides no safe guide for determining the relative values of goodwill in those countries; and, that being so, when a single sum is paid for a goodwill existing in several countries, it is impossible to conclude, from a comparison of the turnover in one of those countries with the total turnover, what portion of the single sum should be regarded as paid for the goodwill in that country. Moreover, in this case the sum paid allowed for the value of trade marks and trade names as well as for goodwill, and the evidence does not disclose any facts upon which an estimate could be made as to the portion of that sum which should be attributed to Australian trade marks or trade names.

The appellant seeks to meet this difficulty by contending that the geographical limitation upon "capital employed", which the definition imports into s. 24 according to the decision in the *Bankers and Traders' Case* (1) requires only that there shall be excluded from the shareholders' funds so much thereof as is affirmatively shown to be employed outside Australia, and that in this case no ascertained portion of those funds is shown to be so employed. Reliance is placed upon the statement of *Dixon* J. in the *Bankers and Traders' Case* (2) that "as a practical test there cannot often be much wrong in . . . deducting the value of the assets which are known to be employed abroad". The truth of this statement may be recognized at once, but it provides no support for the view that, where some part of the shareholders' funds is employed abroad but the quantum of that part is unascertained, the whole of the shareholders' funds is to be treated as employed in Australia. The principle which the *Bankers and Traders' Case* (1) must be taken to have established is that "the 'funds' enumerated are to be taken into account only in so far as they are employed in Australia or a Territory": (3). In the present case, since some part of the shareholders' funds is employed, according to the hypothesis which the appellant derives from s. 17, in the form of

(1) (1946) 73 C.L.R. 39.
(2) (1946) 73 C.L.R., at p. 63.
(3) (1946) 73 C.L.R., at p. 62.

goodwill &c., spread over many countries, it is necessary for the appellant to show what portion of them is employed in Australia. As the evidence does not enable this portion to be ascertained, the appellant does not succeed in showing, by the first method it puts forward, what is the correct amount of its " capital employed ", even if its construction of s. 17 is accepted.

The second method suggested by the appellant is identical with the first, except as to the manner of determining what deduction should be made in order to restrict the " capital employed " to capital employed in Australia. The difference on this point is that, instead of looking to the aggregated assets of the holding company and its " branches ", including goodwill &c., attention is confined to the assets (other than shares in the subsidiaries) appearing in the accounts; and in the accounts there is no mention of goodwill &c. The suggestion is that the only amount to be deducted in this connection is the balance remaining after subtracting, from the book value of the ex-Australian assets shown in the accounts, the external liabilities which are out of Australia. By this method, as by the first, a figure in excess of £150,000 is produced.

Even if the appellant's construction of s. 17 is correct, this method must be rejected as failing to achieve its aim of complying with the decision in the *Bankers and Traders' Case* (1). The assumption that the subsidiary companies are to be considered as merged in the holding company and that references to accounts in s. 24 are to be treated as references to consolidated accounts, would not justify resort to those accounts as the sole source of information as to where the shareholders' funds are employed. The question whether they are wholly employed in Australia, and, if not wholly, then to what extent they are so employed, is a question of fact; and there is no justification for ignoring an asset (in this case goodwill &c.) which is known to be employed partly out of Australia or for deducting from ex-Australian assets debts regarded in law as outside Australia which are not secured specifically upon those assets. The second method, therefore, cannot be accepted as leading to the result which the appellant seeks to establish by using it.

For these reasons, the appeals should be dismissed.

Appeals dismissed with costs.

Solicitors for the appellant, *Clayton Utz & Co.*

Solicitor for the respondent, *K. C. Waugh*, Crown Solicitor for the Commonwealth.

J. B.

(1) (1946) 73 C.L.R. 39.