App. 111 C.L.R. 318 Dist. 156 C.L.R. 447
See 112 " 630
App. 13 A.L.R. 142.



[HIGH COURT OF AUSTRALIA.]

FEDERAL COMMISSIONER OF TAXATION APPELLANT;

AND

BLAKELY . . . . . RESPONDENT.

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MELBOURNE, *March* 19-21.

SYDNEY, *April* 27.

Latham C.J., Dixon and Fullagar JJ.

Referred to:- 86 C.L.R. 412

*Income Tax (Cth.)—Assessment—Shareholder in company—Company ceasing to carry on business—No formal liquidation—Assets appropriated by shareholders—Accumulated profits—Capital or income—"Dividend" paid by company out of profits—Distributions to shareholders by a liquidator in the course of a winding up—Income Tax Assessment Act* 1936-1942 (*No.* 27 *of* 1936—*No.* 50 *of* 1942), *ss.* 6, 44, 47.

A company of which B. and his wife were sole directors and shareholders was incorporated in Victoria. It carried on business for a time and made profits but did not declare any dividend. It then ceased to carry on business, and thereafter B. and his wife carried on in partnership the business which the company had previously conducted. The partners appropriated the assets of the company and discharged its liabilities. No action was taken to put the company into liquidation, and no liquidator was appointed. Notice was given to the Registrar-General under s. 295 of the *Companies Act* 1938 (Vict.) that the company had ceased to carry on business, and it was dissolved pursuant to that section. On the basis that it represented accumulated profits of the company, the Federal Commissioner of Taxation assessed B. to income tax in respect of a proportion of the amount B. had received as a result of the appropriation of the assets.

*Held* that no part of the amount was assessable income under the *Income Tax Assessment Act* 1936-1942. There had been no distribution by the company by way of dividend out of profits of the company within s. 44 of the Act, because (by *Latham* C.J.) an appropriation by shareholders of the assets of a company by their own act could not be regarded as a distribution by the company; (by *Dixon* and *Fullagar* JJ.) what was received by B. was not an income receipt but was of a capital nature. Section 47 of the Act did not apply, because there had been no distribution by a liquidator in a winding up of the company.

*Commissioner of Taxation (N.S.W.)* v. *Stevenson*, (1937) 59 C.L.R. 80, and *Thornett* v. *Federal Commissioner of Taxation*, (1938) 59 C.L.R. 787, applied.

APPEAL under *Income Tax Assessment Act.*

On an appeal by the Federal Commissioner of Taxation from the decision of a Board of Review upholding an objection by Robert Blakely to an assessment to Federal income tax *Kitto* J. stated for the Full Court of the High Court a case which was substantially as follows :—

1. An objection was lodged by the respondent, Robert Blakely, against an amended assessment of which notice was issued on 20th November 1945 in respect of income derived by him during the period of twelve months ended 30th June 1942. The objection was disallowed by the commissioner, and the respondent, being dissatisfied with the decision of the commissioner, requested in writing that the decision be referred to a Board of Review. The Board of Review upheld the respondent's claim and the commissioner appealed to the High Court.

2. Bob Blakely Pty. Ltd. (hereinafter referred to as the company) was incorporated on 1st July 1936 under the *Companies Act* 1928 (Vict.). In 1941 the name of the company was changed to Bob Blakely Transports Pty. Ltd.

3. The nominal capital of the company was at all material times £5,000 divided into 5,000 shares of £1 each.

4. By agreement in writing made on 16th July 1936 the company purchased from the respondent and his wife a business of produce merchants and transport agents theretofore carried on by them and the assets of the said business as described in the said agreement.

5. Pursuant to the said agreement the company duly allotted 3,000 shares in its capital to the respondent and 2,000 shares in its capital to his said wife, all the said shares being duly credited as fully paid. From the incorporation of the company until its dissolution as hereinafter mentioned the respondent and his said wife were the only shareholders and the only directors of the company.

6. The company carried on business and made profits, but no dividends were declared, and income tax under Div. 7 of Part III. of the *Income Tax Assessment Act* 1936 (as amended from time to time) was paid in respect of its distributable income. There stood to the credit of the company's Profit and Loss Appropriation Account at 30th June 1941 an amount of £2,520 5s. 2d. The assets of the company at that date were shown in its balance sheet at a total of £9,849 7s. 4d. (goodwill being shown at £2,478 17s. 11d.), while its external liabilities totalled £2,329 2s. 2d. The difference, £7,520 5s. 2d., equalled the total of paid-up capital (£5,000) and the

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credit balance in the Profit and Loss Appropriation Account (£2,520 5s. 2d.) referred to above.

7. On 15th August 1941 a deed was executed by the respondent and his wife. The deed witnessed that the parties mutually covenanted to become partners in the business of transport agents and produce merchants upon and subject to the conditions therein set out.

8. Without any resolution of the company or the directors or other formality, the company ceased to carry on business on 19th August 1941, and thereafter the respondent and his wife carried on in partnership under the said deed the business which the company had previously conducted. The partners took possession of the company's tangible assets, collected and retained the debts owing to it, and discharged all its external liabilities. The bank account of the company was transferred into the name of the said partnership on 30th October 1941. The registration of the motor vehicles used in the business was changed from the name of the company to the name of the partnership in October 1941. No action was ever taken to put the company in liquidation in accordance with the provisions of the *Companies Act* 1938 (Vict.), and no liquidator was appointed pursuant to the provisions of that Act.

9. On 5th September 1941 the Registrar-General was notified by letter signed by D. R. Casey & Co., Consulting Accountants, that the company had ceased to carry on business on 19th August 1941. On 26th July 1944 a notice was published in the Government Gazette pursuant to sub-s. (5) of s. 295 of the said Act, and the company was thereupon dissolved by force of the said section.

10. Between 1st July 1941 and the date as from which the Registrar-General was notified that the company had ceased to carry on business, viz., 19th August 1941, the company made a net profit of £63 10s. 5d. (after allowing for certain taxation).

11. By an agreement under seal dated 12th February 1943 the respondent and his wife sold to Phillip Farrar, John James Henderson and Edward Cooper the assets therein described, which included the goodwill of the said partnership business. In computing the amount to be set out in the agreement as the consideration for the sale, the parties to the agreement did not include any sum for the goodwill of the business.

12. The respondent was at all material times a "resident" within the meaning of the *Income Tax Assessment Act* 1936-1942.

13. The respondent having made a return in respect of income derived by him during the twelve months ended 30th June 1942,

the commissioner issued to him a notice of assessment dated 6th January 1944.

14. At a later date the commissioner issued to the respondent a notice of amended assessment dated 20th November 1945, by which it was stated that the assessment had been "amended on account of inclusion of final dividend from Bob Blakely Transport Pty. Ltd., Add £1,299 Property."

15. The amount of £1,299 thus included in the assessment was arrived at by the commissioner in the following manner. He took the net value of the assets of the company at 19th August 1941, when the company ceased to carry on business, as being £7,520 5s. 2d., in accordance with the balance sheet referred to in par. 6. He treated the respondent and his wife as having received from the company assets of that value, including goodwill of the value of £2,478 17s. 11d. Of the total of £7,520 5s. 2d., he treated £5,000 as having been received by way of a return of paid-up capital within the meaning of the definition of "dividend" in s. 6 (1) of the *Income Tax Assessment Act* 1936-1942. To the balance, £2,520 5s. 2d., he added the sum of £63 10s. 5d. being the net profit made by the company between 30th June 1941 and 19th August 1941 as mentioned in par. 10 of this case. The total thus arrived at was £2,583 15s. 7d., of which sum he treated the amount of £1,686 as distributable income in respect of which the company had paid tax under Div. 7 of Part III. of the *Income Tax Assessment Act* 1936 as amended, and the sum of £897 as distributable income in respect of which the company had not paid tax under Div. 7. If his other steps were correct, this apportionment was also correct. Taxes payable by the company upon the total sum of £2,583 15s. 7d., to the extent that they were not already charged in the Profit and Loss Account to 19th August 1941, amounted to £417 16s. 10d.; and the commissioner deducted this sum from the total figure of £2,583 15s. 7d., deducting £273 from the taxed amount of £1,686, and deducting £145 from the untaxed amount of £897. Thus he arrived at £2,165 as an amount received by the respondent and his wife otherwise than by way of a return of capital, and as consisting of £1,413 in respect of which Div. 7 tax had been paid by the company and £752 in respect of which such tax had not been paid by the company. The commissioner then treated three-fifths of the said £2,165, i.e., £1,299, as a dividend paid to the respondent by the company, within the meaning of s. 44 (1) of the *Income Tax Assessment Act* 1936-1942, during the year ended 30th June 1942 and included it in the respondent's

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assessable income as income from property, without allowing any rebate in respect of tax paid by the company under Div. 7.

The following questions were stated for the opinion of the Full Court:—

(*a*) Whether the said sum of £1,299, or any, and if so what, part thereof, was rightly included by the commissioner in the assessable income of the respondent by reason of s. 44 (1) or s. 47 of the *Income Tax Assessment Act* 1936-1942.

(*b*) If so, whether the respondent is entitled, by reason of such inclusion, to any and what rebate under the provisions of s. 107 of the *Income Tax Assessment Act* 1936-1942.

*J. B. Tait* K.C. (with him *A. H. Mann*), for the appellant. Sections 44 and 47 of the *Income Tax Assessment Act* 1936 (read with the definitions in s. 6 of "dividend", "liquidator" and "paid") provide a complete scheme for the taxation of the profits of companies, s. 44 dealing with a company which is a going concern and s. 47 with the case of a winding up. The principle differs from that of the Act in force before 1936. The later Act is directed to taxing the profits of the company. It is true that they are taxed in the hands of the shareholders, but it is as income of the company that they get their taxable character. Accordingly, cases such as *Commissioner of Taxation (N.S.W.)* v. *Stevenson* (1) and *Thornett* v. *Federal Commissioner of Taxation* (2) do not govern the present Act. The words referring to payment or distribution "out of profits" of the company, which appear in s. 44 (1) (*a*), (*b*), and s. 47 (1), are important as showing the principle on which the sections proceed. If the company here concerned is to be regarded as not in liquidation because the regular processes of company law were not followed to put the company into liquidation, then it must be regarded as at the relevant time a going concern to which s. 44 applies. In that event the amount in question is within the words "dividends paid" (having regard to the definitions in s. 6) in s. 44 (1) (*a*). Within the definition of "dividend" in s. 6 of the Act, there was necessarily involved in the appropriation of the assets by the shareholders a distribution of the accumulated profits so that—to that extent—the shareholders received a dividend within the meaning of s. 44.

(1) (1937) 59 C.L.R. 80: see particularly pp. 88, 96, 98, 99.

(2) (1938) 59 C.L.R. 787.

On the other hand, if the company is to be regarded as having been in the process of winding up, the amount in question was undoubtedly a distribution in the course of the winding up. It is true that s. 47 is expressed in language which is more appropriate to a case in which a company is wound up in accordance with the established processes of company law than to a case such as the present. No doubt the persons concerned here, the respondent and his wife, proceeded irregularly—probably in breach of the relevant *Companies Act*; but the *Income Tax Assessment Act*, it is submitted, is not concerned with such irregularities. It is the substance of the matter that should be regarded; and, the matter being regarded in that way, the respondent and his wife received what was in effect a distribution of the kind to which s. 47 applies, notwithstanding that it was not actually made by a "liquidator" in the strict sense of that word. It may be that the result of the view which has been submitted would be to treat as income what would not ordinarily be regarded as such, but that, it is submitted, is not beyond the power of Parliament (*Colonial Gas Association, Ltd.* v. *Federal Commissioner of Taxation* (1)).

*O. J. Gillard* K.C., for the respondent. Neither s. 44 nor s. 47 of the Act, whether read together or separately, contains any provision or scheme which covers the facts of the present case. There is nothing in the Act to show any departure from the statutory scheme which was under consideration in *Stevenson's Case* (2), and that case is precisely applicable here. There was no "distribution" here, either within the meaning of the word "dividend" (as defined in s. 6) in s. 44 or within s. 47. Still less was there a distribution *by the company*. There was certainly no distribution by the company out of its profits. All that happened was that the respondent and his wife appropriated the property of the company. No doubt that property consisted in part of profits that had been made by the company, but they had with the passage of time lost their identity as such and had become merely part of the assets which passed to the respondent and his wife in the same way as they might have passed on assignment to strangers. That is to say, it is of no significance here, for the purposes of s. 44 or s. 47, that the respondent and his wife were shareholders in the company. The company simply ceased to exist, and the respondent and his wife—so far as is relevant here—ceased to have the capacity of shareholders. They took nothing from the company in their capacity as shareholders. Indeed, it may be doubted whether, on

(1) (1934) 51 C.L.R. 172. (2) (1939) 59 C.L.R. 80.

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the facts, anything took place to which the word " distribution " could have any real application. There is nothing here which is comparable with the allocation of profits as between shareholders which s. 44 can be regarded as contemplating. So far as s. 47 is concerned, its words do not permit of its extension beyond a winding up in accordance with the accepted processes of company law. The whole of the amount received by the appellant was a capital receipt (*Stevenson's Case* (1); *Thornett's Case* (2); *I.R.C.* v. *Blott* (3); *I.R.C.* v. *Burrell* (4)). No part of it was income for the purposes of s. 44, s. 47 or any other provision of the Act.

*J. B. Tait* K.C., in reply.

*Cur. adv. vult.*

April 27. The following written judgments were delivered :—

LATHAM C.J. This is a case stated by *Kitto* J. in an appeal by the Commissioner of Taxation from a decision of a Board of Review constituted under the *Income Tax Assessment Act* 1936-1942.

Bob Blakely Transports Pty. Ltd. was a private company within the meaning of s. 104 of the Act. The respondent Robert Blakely and his wife were the only shareholders and directors of the company. The respondent owned 3,000 and his wife 2,000 fully-paid shares. No dividends were declared by the company. Income tax was duly paid by the company under Div. 7 of Part III. of the Act in respect of its undistributed but distributable income. On 19th August 1941 the company ceased to carry on business and the respondent and his wife then carried on in partnership the business which the company had previously conducted. They simply appropriated all the company's assets, paid off its liabilities, and retained and subsequently disposed of the assets of the company. On 5th September 1941 a notice was sent to the Registrar-General under the *Companies Act* 1938 (Vict.) by accountants acting on behalf of the company stating that the company had ceased to carry on business on 19th August 1941. The procedure prescribed by s. 295 of the *Companies Act* was followed, and the company was dissolved on 26th July 1944.

The commissioner assessed the respondent to income tax in respect of a " dividend " received by the respondent from the company. The commissioner treated £5,000 as having been received by way of return of paid-up capital. The balance he treated as representing the profits of the company. The respondent's share

(1) (1937) 59 C.L.R. 80.
(2) (1938) 59 C.L.R. 787.
(3) (1920) 2 K.B. 657, at p. 675.
(4) (1924) 2 K.B. 52, at p. 64.

of that balance (after adjustment in respect of taxes payable by the company but not recorded in the accounts of the company) was £2,165, of which the respondent was treated as entitled to three-fifths, namely £1,299. This amount, it is contended for the commissioner, is a dividend paid to him by the company out of profits derived by the company and is therefore claimed to be taxable under s. 44 (1) of the *Income Tax Assessment Act* 1936-1942.

The respondent objected to the assessment and the objection was referred to a Board of Review which, relying upon *Commissioner of Taxation (N.S.W.)* v. *Stevenson* (1), set aside the assessment. The commissioner now appeals to this Court and *Kitto* J. has stated a case whereby the opinion of the Full Court is sought upon the question whether the sum of £1,299 was rightly included by the commissioner in the assessable income of the respondent by reason of s. 44 (1) or s. 47 of the *Income Tax Assessment Act* 1936-1942. If this question is answered in the affirmative it will be necessary to answer a further question, viz., whether the respondent is entitled to any and what rebate under the provisions of s. 107 of that Act.

The Commonwealth *Income Tax Assessment Act* 1936-1942, s. 47, expressly makes provision with reference to distributions by the liquidator of a company. Section 47 (1) is as follows:— "Distributions to shareholders of a company by a liquidator in the course of winding up the company, to the extent to which they represent income derived by the company (whether before or during liquidation) other than income which has been properly applied to replace a loss of paid up capital, shall, for the purposes of this Act, be deemed to be dividends paid to the shareholders by the company out of profits derived by it." The commissioner, however, cannot rely upon this provision in the present case because the company was not wound up and no distribution was made by any liquidator. The commissioner relies upon s. 44 (1) of the Act, which is in the following terms:—"(1) The assessable income of a shareholder in a company (whether the company is a resident or a non-resident) shall, subject to this section—(*a*) if he is a resident—include dividends paid to him by the company out of profits derived by it from any source." Section 6 of the Act provides that "'paid' in relation to dividends includes credited or distributed". Section 6 also provides—"'Dividend' includes any distribution made by a company to its shareholders, whether in money or other property, and any amount credited

(1) (1937) 59 C.L.R. 80.

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to them as shareholders, and 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; but does not include a return of paid-up capital or a reversionary bonus on a policy of life-assurance."

The contention of the commissioner is that the amount of £1,299, which was calculated after making full allowance for return of capital, represents profits derived by the company. This sum, it is argued, was distributed by the company to persons who were in fact its shareholders, either in money or in other property, and was therefore a dividend within the meaning of the Act, and formed part of the assessable income of the respondent shareholder.

In *Stevenson's Case* (1) shareholders possessed themselves of the assets of a company, realized them, paid its debts, and retained the balance. An attempt was made to put the company into liquidation after the payments had been made to the shareholders, but necessary formalities were not observed, and the result was that there was no lawful liquidation of the company in accordance with the New South Wales *Companies Act*. The commissioner sought to tax the shareholders upon such portion of the moneys which they received as represented the profits as distinct from the capital of the company. The *Income Tax (Management) Act* 1928 (N.S.W.) defined "dividend" (so far as relevant) as including profit. Section 11 of the Act provided that the assessable income of any person should include (b) in the case of a member or shareholder (other than a company) of a company which derived income from a source in the State all dividends (with an immaterial exception) "credited, paid or distributed to the member or shareholder from any profit derived from any source by the company". It was held by the court that income tax was not payable under this Act in respect of that portion of the moneys received by the shareholders which represented the profits of the company. The New South Wales Act did not tax distributions made in a regular liquidation; that is, the rule in *Inland Revenue Commissioners* v. *Burrell* (2) applied. It was held that the general words of the Act in s. 11 should not be construed as applying to an irregular liquidation where, as it was held, what was paid to a shareholder did not represent a profit detached from a share which continued to exist as a piece of property, but really represented a distribution "in retirement or extinguishment of the share interest itself". In other words, it was held that what was paid to the shareholders represented not the proceeds of property but the property itself,

(1) (1937) 59 C.L.R. 80.

(2) (1924) 2 K.B. 52.

so that, as the property, as a share, ceased to exist, there could be no dividend thereon or income derived therefrom. Thus an irregular liquidation was placed upon the same footing for the purposes of tax payable under the New South Wales Act as a regular liquidation. As *Evatt* J. said, there was a *de facto* liquidation, and the substance of the matter was that the shareholders received the same share of the company's assets as they would have received in a valid winding up.

The facts of the present case correspond very closely with the facts in *Stevenson's Case* (1), except that in the present case the parties concerned did not even make an attempt to observe the provisions of the *Companies Act* in relation to liquidation. *Stevenson's Case* (1) was followed in *Thornett* v. *Federal Commissioner of Taxation* (2).

It is contended for the commissioner that under the applicable Commonwealth Act it is irrelevant to inquire whether moneys (or other property) received by a shareholder represent "the fruit" of the share, the "detachment" of which leaves the share standing as a piece of property. It is argued that the only question which arises under the Commonwealth Act is whether what was received represented profits of the company. Such receipt may or may not represent a profit to a shareholder; for example, a shareholder may have paid a full market price for his shares, representing the estimated value not only of the capital assets of a company, but also of a shareholder's interest in undistributed profits of the company. But that fact would be immaterial to the liability of the shareholder to pay tax on dividends received in respect of such shares. In the case of a company which is a going concern all dividends paid as such represent the fruit of the share and under the Commonwealth Act are taxable as income in accordance with s. 44. But it is contended for the commissioner that under the relevant provisions of the applicable statute they are made taxable only because what the shareholder has received is a profit of the company and not because they represent something detached from the proprietary interest of a shareholder which is represented by his share. I agree with the argument for the commissioner that the criterion of assessability under s. 44 is not whether what is received by a shareholder is income to him in the sense of something detached from his capital asset consisting in his shares: the relevant question to ask is whether what is received comes from the profits of the company. Here, what was got or taken by the shareholders did come in part from the profits of the company. But this fact does not conclude the case in favour of the commissioner.

(1) (1937) 59 C.L.R. 80. (2) (1938) 59 C.L.R. 787.

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For the respondent it is contended, in the first place, that there was no distribution of the money in question. It was argued that distribution involves apportionment between several recipients, and that where all the assets of the company in a mass went to one person or to two persons as joint owners there was no distribution of anything. In my opinion the word "distributed" in s. 6 should not be construed in this narrow manner. If money or assets are passed out by a company to a shareholder or shareholders they should, in my opinion, be regarded as distributed by the company. The argument for the respondent would lead to surprising results. There might, for example, be only one preference shareholder in a company. He would be entitled to all dividends upon preference shares. It appears to me that it would be absurd to hold that because he was the only shareholder nothing had been distributed to him.

It is further argued, however, that what the respondent and his wife took was not received by them as shareholders. In fact they appropriated the assets simply because they were shareholders, and it was only because they were shareholders that they could even suggest that they had any right to the assets.

But, in my opinion, an appropriation by shareholders of the assets of a company by their own act cannot be regarded as a distribution by the company. The shareholders would be subject to estoppels *inter se*, but this would not alter the fact that the company did nothing. It did not make any distribution of anything to anybody. The shareholders took, and wrongfully took, the assets of the company.

I cannot agree that this action of the shareholders resulted in the extinguishment of their shares in the company. They remained shareholders after they took the assets. They were entitled to all the rights of shareholders. Meetings of shareholders and directors could have been held, and if, for example, some unexpected asset had come to the hands of the company, the company would have been entitled to deal with it. Further, after the shareholders took the assets, but before they had discharged the liabilities of the company, it was the company which still owed its debts. If the shares had not been fully paid up a creditor would have been able to put the company into liquidation and the shareholders would have become contributories. But all these considerations leave untouched, in my opinion, the conclusion that no distribution was made by the company itself. There was a mere appropriation of the property of the company by the shareholders—an appropriation which completely ignored the provisions of the *Companies Act*.

I am therefore of opinion that no part of what was received by the respondent can be described as a dividend paid to him by the company, although part of it does represent profits derived by the company.

The commissioner is, in my opinion, really seeking to tax the respondent upon the basis of what the company ought to have done if the law contained in the *Companies Act* had been observed, and not upon the basis of what the shareholders of the company have in fact done. The position is that all the creditors of the company have been paid, and the shareholders are quite satisfied with the position as it now stands. There is no-one left, except the commissioner, to complain of anything, and the commissioner has no claim against the company, which has paid all tax due. The *Companies Act*, s. 295 (6), provides that where a company has been dissolved the company or any member or creditor thereof who feels aggrieved by the company being struck off the register may at any time within fifteen years after the name of the company has been struck off apply to the Supreme Court for an order for restoration of the name of the company to the register. I have some difficulty in understanding how a non-existent company can make any application to a court. But no member or creditor of the company feels aggrieved by anything, and accordingly this provision is not applicable.

But the position disclosed by the facts in this case shows that perhaps some further provisions are required to prevent persons evading the revenue laws by disregarding the provisions of the *Companies Act* with respect to liquidation. In this case, as the shareholders have taken the property of the company without any transfer to them by the company, it may be that the commissioner could interest the Registrar-General and invite him to act under ss. 297 and 299 of the *Companies Act* to recover the property of the company of which the respondent and his wife have assumed the disposition. But it is not one of the functions of this Court upon this case to determine whether steps can be taken to revive the company for the purpose of requiring, not the company itself, but the shareholders in the company, to discharge taxation liabilities which would have existed if the law had been observed.

In my opinion, upon the facts as stated in the case, the first question should be answered—No; that is to say, no part of the sum of £1,299 was rightly included by the commissioner in the assessable income of the respondent. The second question in the case requires an answer only in the event of the first question being

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answered in the affirmative. Therefore no answer is required to the second question.

DIXON J. In my opinion question (*a*) in the case stated should be answered that no part of the sum of £1,299 was rightly included by the commissioner in the assessable income of the respondent taxpayer by reason of s. 44 (1) or of s. 47 of the *Income Tax Assessment Act* 1936-1942 or at all. Question (*b*) is asked contingently upon a contrary answer being given to question (*a*) and therefore does not arise and should not be answered.

I have had the advantage of reading the reasons prepared by *Fullagar* J. and agree in them.

FULLAGAR J. This is a case stated by *Kitto* J. in an appeal by the Commissioner from a decision of the Board of Review. The case is concerned with income derived by the taxpayer during the financial year ended 30th June 1942. The taxpayer's objection was upheld by the Board of Review.

A company named Bob Blakely Pty. Ltd. was incorporated on 1st July 1936 under the Victorian *Companies Act* 1928. In 1941 the name of the company was changed to Bob Blakely Transports Pty. Ltd. The company purchased from the respondent and his wife a business of produce merchants and transport agents, which they had previously carried on. The consideration for the transfer was the allotment of 3,000 fully-paid shares to the respondent and 2,000 fully-paid shares to his wife. From the incorporation of the company until its dissolution the respondent and his wife were the only shareholders and the only directors.

The company carried on business and made profits. No dividends, however, were declared, and additional income tax under Div. 7 of Part III. of the *Income Tax Assessment Act*, as amended from time to time, was paid in respect of these profits. On 30th June 1941 a sum of £2,520 was standing to the credit of the company's profit and loss appropriation account. The balance sheet of the company at that date showed the assets of the company as of a total value of £9,849. Goodwill was shown at £2,479, while external liabilities totalled £2,329. The difference of £7,520 equalled the total of paid-up capital, £5,000, and the balance of £2,520 standing to the credit of profit and loss appropriation account.

On 15th August 1941 a deed of partnership was executed between the respondent and his wife whereby they agreed to become partners in the business of transport agents and produce merchants.

Without any resolution of the company or of the directors, and without any other formality, the company on 19th August 1941 ceased to carry on business, and thereafter the respondent and his wife carried on in partnership under the deed the business which the company had previously conducted. They took possession of the company's tangible assets, collected and retained the debts owing to it, and discharged all its external liabilities. The bank account of the company was transferred into the name of the partnership on 30th October 1941, and about the same time the registration of the company's motor vehicles was transferred into the name of the partnership. No action was ever taken to put the company in liquidation in accordance with the provisions of the *Companies Act* 1938, and no liquidator was appointed in pursuance of those provisions. On 5th September 1941 the Registrar-General was notified that the company had ceased to carry on business on 19th August 1941. On 26th July 1944 the Registrar-General caused to be published in the Government *Gazette*, in pursuance of s. 295 (5) of the Act, a notice, publication of which had under that section the effect of dissolving the company. On 12th February 1943 the respondent and his wife sold the assets of the partnership business, including goodwill.

The original assessment of the respondent in respect of income derived during the year ended 30th June 1942 was issued on 6th January 1944. At a later date the Commissioner issued a notice of amended assessment, whereby he added to the respondent's assessable income a sum of £1,299 as income from property. The notice stated that the assessment had been "amended on account of inclusion of final dividends from Bob Blakely Transports Pty. Ltd." It is unnecessary to consider the steps by which the Commissioner calculated the sum of £1,299. It is sufficient to say that that is the sum which the Commissioner regards as representing that proportion of the respondent's share of the total value of the assets taken over from the company by the partnership which he regards as representing accumulated profits of the company.

There was some discussion during argument as to the precise legal effect of the various steps which were taken between the formation of the partnership and the dissolution of the company, and which I have outlined above. I do not think it is necessary to inquire what the exact position was at each stage. The formalities required by the *Companies Act* 1938 for the protection of creditors and shareholders were not observed. But all the creditors of the company were in due course paid, and the only shareholders were Mr. and Mrs. Blakely themselves. The creditors

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having been paid, there was nobody who could challenge, or seek to undo, what was done, and it seems to me that in the end the partners received from the company, and became owners of, all the assets of the company, the interest of each corresponding to his or her shareholding interest in the company.

The Commissioner's argument may be stated shortly thus. When you look at the relevant balance sheet of the company, you see that the assets received by the shareholders represent in part capital originally paid up and in part accumulated profits of the company. What was received by each shareholder, therefore, represents in part profits made by the company, and to the extent to which it does represent those profits it is assessable income in his or her hands. To ascertain the extent to which what was received represents profits, it is necessary, of course, to make an apportionment. The method of apportionment adopted by the Commissioner is not challenged as such, but his argument is attacked at its foundation. It is said that what was received does not possess at all the character of income in whole or in any severable part.

Apart from some statutory provision dealing specially with the case, it is well settled that distributions to shareholders in the liquidation of a company cannot be treated as income in any part, however clear it may seem that what the shareholders are receiving represents in part profits made by the company in the past. The position was put shortly by *Scrutton* L.J. in *Inland Revenue Commissioners* v. *Blott* (1), in a passage quoted by *Pollock* M.R. (as he then was) in *Inland Revenue Commissioners* v. *Burrell* (2). *Scrutton* L.J. said :—" A company is liquidated during the year of assessment, and the liquidator returns to the shareholders, (1) their original capital, (2) accretions to capital due to increase in the value of the assets of the company, (3) the reserve fund of undivided profits in the company, (4) the undivided profits of the last year of assessment. Heads (3) and (4) will have paid income tax through the assessment of the company; but it appears to me that none of the heads will be returnable to super tax as assessment; they are not income from property, but the property itself in course of division." *Pollock* M.R. added: " No doubt this opinion was expressed obiter in the course of the judgment, but I agree with it ". *Atkin* L.J. and *Sargant* L.J. were of the same opinion. The same view was applied in *Webb* v. *Federal Commissioner of Taxation* (3), a case decided under the Commonwealth *Income Tax*

(1) (1920) 2 K.B. 657, at p. 675.
(2) (1924) 2 K.B. 52, at p. 64.
(3) (1922) 30 C.L.R. 450.

*Assessment Act* 1915-1918. In that case there had been a " reconstruction ", which involved a transfer of all the assets of an old company to a new company and the issue of shares in the new company to shareholders in the old company. The assets of the old company represented, to a very large extent, accumulated profits. It was held that no part of the shares in the new company represented income in the hands of the recipients. In a joint judgment *Knox* C.J., *Gavan Duffy* J. and *Starke* J. said (1) :—" If the old company had detached any part of its profits and distributed that part among shareholders, the portion received by each shareholder would have become part of the income of such shareholder, but until such detachment every shareholder's interest in the whole of the undistributed assets of the company remained part of his capital." It followed, of course, that what was received by a shareholder on a distribution of assets in satisfaction and extinguishment of the interest represented by his share was capital in his hands and not income.

Both in *Burrell's Case* and in *Webb's Case* there had been a formal liquidation complying with the relevant *Companies Act*. But the same principle was applied in *Commissioner of Taxation (N.S.W.)* v. *Stevenson* (2), where, as in the present case, the assets of a company were distributed to shareholders without any formal liquidation. That case arose under the *Income Tax (Management) Act* 1928 (N.S.W.). The assets of a company consisted of the freehold and goodwill of a hotel and certain undistributed profits. The property was sold, and, after payment of all the company's debts, one of the directors, with the approval of the others, distributed the proceeds and the other moneys of the company among the shareholders in proportion to their holdings. Actually, after the distribution had been completely made, a meeting was held which purported to pass a resolution for voluntary liquidation and to appoint a liquidator, but it would appear that notice of this meeting had not been duly given in accordance with the articles. It was held by a majority of this Court that no part of the money received by any shareholder was income in his hands. In a joint judgment *Rich, Dixon* and *McTiernan* JJ. (3) stated the general principle thus :—" In a liquidation the excess of . . . assets over . . . external liabilities is distributed among shareholders in extinguishment of their shares. The shareholders, in other words, as contributories receive nothing but the ultimate capital value of the intangible property constituted by the shares.

(1) (1922) 30 C.L.R., at p. 461.
(2) (1937) 59 C.L.R. 80.
(3) (1937) 59 C.L.R., at p. 99,

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The *res* itself ceases to exist. The profits are not detached, released or liberated, leaving the share intact as a piece of property. There is no dividend upon the share. There is no distribution of profits because they are profits. The shareholder simply receives his proper proportion of a total net fund without distinction in respect of the source of its components and he receives it in replacement for his share. Both in the British and American systems of taxation such a transaction is acknowledged to be of a capital nature and to involve no receipt of income". A little later (1) their Honours considered the question whether it made any difference that the distribution had been made without complying with the relevant provisions of the *Companies Act*. They said (2):—"In our opinion the fact that the distributions were not authorized by law does not operate to make any part of the sum distributed taxable." That fact did not affect the character of the receipt, which character had been indicated in the passage (3) which I have quoted above. *Stevenson's Case* (4) was applied in *Thornett* v. *Federal Commissioner of Taxation* (5), a case which arose under the Commonwealth *Income Tax Assessment Act* 1922-1929.

That a due proportion of receipts of the nature in question could be brought into charge by special statutory provision is not open to question. Nor would such an artificial extension of the notion of income involve a contravention of s. 55 of the Constitution: cf. *Colonial Gas Association Ltd.* v. *Federal Commissioner of Taxation* (6). It was accordingly argued for the Commissioner that the legislation relevant to the present case did, on its true construction, bring into charge a proportion of the value of the assets received or "taken over" by Mr. and Mrs. Blakely, and that the present case was therefore not covered by *Stevenson's Case* and *Thornett's Case*.

The Act relevant to the present case is the *Income Tax Assessment Act* 1936-1942. I understood Mr. *Tait*, for the Commissioner, to maintain in the first place that the Commonwealth Act had since 1936 adopted, with regard to the taxation of the income of companies and their shareholders, a basic principle different from that which had found expression in the earlier Acts. He said, if I followed him correctly, that the present scheme was to tax the profits of a company in the hands of its shareholders, whereas the Acts in question in *Stevenson's Case* and *Thornett's Case* set out to tax the income of the shareholder as such. I do not think

(1) (1937) 59 C.L.R., at pp. 103, 104.
(2) (1937) 59 C.L.R., at p. 103.
(3) (1937) 59 C.L.R., at p. 99.
(4) (1937) 59 C.L.R. 80.
(5) (1938) 59 C.L.R. 787.
(6) (1934) 51 C.L.R. 172.

that anything can be made of any such general proposition, which seems to represent a conclusion rather than a premiss. The relevant Act must simply be construed according to ordinary principles, and we must see whether it does, so construed, subject to tax that which was held not to be taxed under the legislation considered in *Stevenson's Case* and *Thornett's Case*.

Section 47 of the *Income Tax Assessment Act* 1936-1942, which corresponds to s. 16B of the Act which applied to *Thornett's Case*, was obviously designed to tax distributions in the liquidation of a company to the extent to which they represented undistributed profits of the company. It is, however, limited in terms to distributions " by a liquidator in the course of winding up the company ", and what is envisaged seems clearly to be the normal process of winding up, compulsory or voluntary, which is prescribed by the Companies Act of each State. Here there was no liquidator and no winding up in the sense contemplated by the Victorian *Companies Act* 1938. There was simply a handing over of assets by a company to its shareholders, who subsequently discharged the company's debts. The word " liquidator " is defined by s. 6 of the Assessment Act as meaning " the person who, whether or not appointed as liquidator, is the person required by law to carry out the winding up of a company ". But in the present case there was no person in that position, and in any case, as I have said, there was no winding up in any real sense. It is not, in my opinion, possible to bring the case within the terms of s. 47.

The main argument for the Commissioner was based on s. 44 (1) of the Act, read in the light of the definitions of the word " dividend " and the word " paid " in s. 6. Section 44 (1) provides that the assessable income of a shareholder in a company shall (*a*) if he is a resident, include dividends paid to him by the company out of profits derived by it from any source, (*b*) if he is a non-resident, include dividends paid to him by the company to the extent to which they are paid out of profits derived by it from sources in Australia. It is par. (*a*) that is relevant here. Section 6 provides (omitting matter irrelevant to the present case) that the word " dividend " includes any distribution made by a company to its shareholders, whether in money or other property, and any amount credited to them as shareholders, but does not include a return of paid-up capital. Section 6 also provides that the word " paid " in relation to dividends includes credited or distributed. The argument was that in the present case there had been a distribution made by a company to its shareholders in property other than money, and that the effect of s. 44, read with

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the definitions, was to include in the assessable income of the shareholders so much of what was distributed as represented profit of the company and to exclude so much as represented a return of paid-up capital.

It is true that the Act under which *Thornett's Case* (which applied *Stevenson's Case*) was decided was in different terms from those of the Act now under consideration. That Act was the Act of 1922-1929, s. 16 (*b*) (i) of which provided that the assessable income of any person should include, in the case of a member or shareholder of a company which derives income from a source in Australia, dividends, bonuses or profits credited paid or distributed to the member or shareholder from any profit derived from any source by the company. The Act contained no definition of the word "dividend". Section 44 (1) of the Act of 1936-1942 first appeared as s. 16AA of the Act of 1922-1934. It was inserted by the Act of 1934, which also added to s. 4 of the Act then in force a definition of the word "dividend". It provided (omitting matter not here relevant) that the word "dividend" should mean any distribution made by a company to its shareholders, whether in money or other property, out of its profits. The Act of 1936 omitted from the definition the words "out of its profits" and added the words "but does not include a return of paid-up capital". The words "out of profits" were still retained, in s. 44 (1). It is unnecessary to consider in detail the terms of the New South Wales Act under which *Stevenson's Case* was decided. It is sufficient to say that it was indistinguishable in effect from the Commonwealth legislation considered in *Thornett's Case*.

Now it is possible that, when the Commonwealth legislation assumed in 1936 the form which it has since retained, it was intended to cover, and was believed to cover, such cases as *Stevenson's Case* and *Thornett's Case*. I should seriously doubt this myself. One would have expected such a result to be sought rather through the medium of s. 47 than through the medium of s. 44, and s. 47 would seem to be unnecessary if s. 44 has the meaning contended for. But, if this was the intention behind the new form which the legislation took, I think that the draftsman missed, as I think the argument for the Commissioner in this case misses, the whole point of the decisions in *Stevenson's Case* and *Thornett's Case*—and, for that matter, in *Burrell's Case*. And I do not think that the Act of 1936-1942 brings into charge any part of what the taxpayer received in this case.

I would not be prepared to deny that there was a "distribution" in this case. There was clearly a "distribution" in *Stevenson's*

*Case*. But the point in this case is, as it was in *Stevenson's Case*, as to the nature of the receipt. There was not a distribution of profits, or a distribution out of profits. What was received was capital. There was no detachment or severance from the funds of the company of money or other assets as representing a profit made by the company. There was simply a realization of a share investment (per *Starke* J. in *Thornett's Case* (1) ). "The shareholders . . . receive nothing but the ultimate capital value of the intangible property constituted by the shares . . . The shareholder simply receives his proper proportion of a total net fund without distinction in respect of the source of its components, and he receives it in replacement for his share" (per *Rich*, *Dixon* and *McTiernan* JJ. in *Stevenson's Case* (2) ). There is, in my opinion, nothing in the Act which gives the character of income to this receipt, which was according to general principles a capital receipt.

In my opinion the decision of the Board of Review was correct. Question (*a*) in the case stated should be answered "No". It is unnecessary to answer question (*b*).

*Questions in case answered as follows :—*

(*a*) *No.*

(*b*) *Unnecessary to answer.*

*Case remitted to Kitto J. Costs of case to be costs in appeal.*

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

Solicitor for the respondent, *A. R. Sacks*.

E. F. H.

(1) (1938) 59 C.L.R., at p. 799.

(2) (1937) 59 C.L.R., at p. 99.