Ref to & d/f 382. 50 ALJR 43.
Appl. (1988) 80 ALR 95
C. 81 ALR 25
Discussed. 94 ALR 153



[HIGH COURT OF AUSTRALIA.]

HOBART BRIDGE COMPANY LIMITED . APPELLANT;

AND

FEDERAL COMMISSIONER OF TAXATION . RESPONDENT.

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MELBOURNE, *May* 30, 31; *June* 1.

BRISBANE, *June* 22.

Kitto J.

Referred to:- 87 I.L.R. 462.

*Income Tax (Cth.)—Assessment—Company—Profit on shares in subsidiary company—Capital or income—Company formed to construct bridge under statutory authority—Undertaking acquired by State—Compensation for acquisition of shares in subsidiary company—Income Tax Assessment Act* 1936-1949 (*No.* 27 *of* 1936—*No.* 66 *of* 1949), *s.* 26 (*a*).

The appellant company was formed for the purpose of constructing a bridge over a river in the State of Tasmania under the authority of legislation of the State. The D. company was formed as a subsidiary of the appellant for the purpose of dealing in land which, it was anticipated, would be enhanced in value by the existence of the bridge. The appellant held the majority of the shares in the D. company, and it appeared from the evidence that the appellant had acquired these shares solely for the purpose of holding them as a capital asset for the production of dividends. By further legislation of the State of Tasmania, the State acquired the whole of the undertaking of the appellant, including its shares in the D. company, and the appellant received compensation for those shares in accordance with the terms of the legislation. The result was that in its accounting period being the year ending 31st March 1949 it received a profit of £31,859 in respect of its shares in the D. company. The Federal Commissioner of Taxation claimed to treat this amount as an income profit of the appellant in the accounting period.

*Held* that the amount was a capital increment. It was not, within the meaning of s. 26 (*a*) of the *Income Tax Assessment Act* 1936-1949, a profit arising from the sale by the appellant of any property acquired by it for the purpose of profit-making by sale or from the carrying on or carrying out of any profit-making undertaking or scheme, nor was it otherwise of an income nature according to ordinary usages and concepts.

APPEAL from assessment to Federal income tax.

This was an appeal by the Hobart Bridge Co. Ltd. from an assessment to Federal income tax. The facts appear in the judgment hereunder.

*D. I. Menzies* K.C., *S. C. Burbury* K.C. and *F. M. Neasey*, for the appellant.

*P. D. Phillips* K.C. and *R. R. Nettlefold*, for the respondent.

*Cur. adv. vult.*

KITTO J. delivered the following written judgment:—

This is an appeal against the assessment by the respondent commissioner of the income tax payable by the appellant company in respect of income derived during the twelve months ended 31st March 1949.

The company furnished a return showing its taxable income for that period as nil. The commissioner issued a notice of assessment in which the company's taxable income was stated at £31,849. It was accompanied by an alteration sheet which showed, *inter alia*, that the commissioner had treated as a net profit of the company a sum of £31,859, described on the alteration sheet as follows:—

"Add proceeds—Sale of shares in Derwent Investments Pty. Ltd. .. £62,799
Deduct cost of shares .. £16,700
,, expenditure incurred £14,240 30,940
£31,859."

The company objected to the assessment on five grounds. The commissioner disallowed the objection, and the company requested that it be treated as an appeal and forwarded to this Court. On the appeal coming on to be heard, the company abandoned the fifth ground of its objection, namely that the company derived no taxable income in the relevant period, and its abandonment of this ground removes the necessity to consider any of the items shown on the alteration sheet other than that which has been mentioned.

The shares to which the alteration sheet referred were 16,700 out of a total of 18,600 shares of £1 each, all fully paid, comprising the issued share capital of Derwent Investments Pty. Ltd. (which I shall call the Derwent Company). The appellant company had acquired its 16,700 shares by application and allotment, and it had paid for them in full in cash. There was no "sale" of these shares in the strict sense, but on 15th January 1949, they, together with all other shares in the capital of the Derwent Company became vested in "the Minister" on behalf of the State of Tasmania, by force of the *Hobart Bridge (Acquisition and Administration) Act*

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1948 of that State. The amount of compensation payable to the shareholders was fixed by the Act at £70,000, and the appellant company's proportion of this sum was £62,799. The Act provided that the amount of compensation should be payable in accordance with the terms and conditions of an agreement, substantially to the effect of the form set out in the schedule to the Act, entered into between the Minister, the shareholders and the Derwent Company. Such an agreement was in fact entered into on 24th December 1948. Its provisions, which will be referred to in detail hereafter, included a provision whereby the shareholders and the Derwent Company jointly and severally undertook that before completion all debts and liabilities (if any) of the Derwent Company would be discharged and that they would indemnify the Minister against all debts and liabilities incurred or accruing due before completion. The debts of the Derwent Company included a sum of £15,860 owing to the appellant company as a result of a number of transactions consisting for the most part of the making of cash advances. The shareholders other than the appellant company contributed a ratable proportion of this sum, namely £1,620, and the appellant company wrote off the remaining £14,240, in order to comply with the agreement.

The view taken by the commissioner in making his assessment, and his contention on this appeal, was that the profit consisting of the excess of the compensation moneys received by the appellant company over the sum of the amount paid in cash for the shares and the amount written off in compliance with the agreement, constituted an income profit forming part of the appellant company's assessable income. The appellant company's contention, expressed in the first four grounds stated in its notice of objection, was that the shares were not acquired by it for the purpose of profit-making by sale, that there was no sale of the shares by it at all, and that the sum in question was not a profit arising from the carrying on or carrying out of any profit-making undertaking or scheme and was a capital profit. In order to determine the controversy it is necessary to go into some historical detail. The facts to which I shall refer were established partly by documents tendered in evidence, partly by admissions made by counsel, and partly by the oral evidence of Mr. H. S. Barnett whom I accept as a completely reliable witness.

On 9th December 1936 the *Hobart Bridge Act* 1936 (Tas.) was assented to, and it was amended on five occasions. I shall refer to its provisions as amended. The Act recited that one H. S. Barnett proposed to form a company to be registered in Tasmania

for the purpose of constructing a bridge across the River Derwent to connect the city of Hobart with the suburbs on the eastern shore of that river. It provided (s. 2) that upon the Governor being satisfied that such company as aforesaid, having for its principal object the building of a bridge across the River Derwent at Hobart, had been incorporated in Tasmania on or before 31st May 1938, had available at that date and for the object aforesaid a sum of not less than £250,000 and had complied with certain other conditions, the Governor might authorize the company to construct the bridge. By s. 4 the company was required to proceed within a stated time to construct the bridge and to complete it to the satisfaction of the Governor, the design, plans and specifications being prepared by State officers. By s. 6 the Governor was authorized, upon completion of the bridge to his satisfaction to grant to the company a franchise giving the company (i) an exclusive right to transport passengers for hire between the City of Hobart and certain areas on the eastern shores of the river at such fares, not in excess of prescribed rates, as the company should think fit; (ii) the exclusive right for twenty years to transport for hire across the bridge certain parcels and goods; (iii) the exclusive right to transport for hire passengers from any part of the eastern suburbs to any other part thereof; and (iv) the right to charge, levy and collect tolls in respect of all persons, goods, vehicles and animals passing over the bridge (with certain exceptions). By s. 8 the company was required, so soon as the bridge should be opened for traffic, and at all times during its franchise, to provide and maintain adequate transport services to the satisfaction of the Governor between Hobart and the eastern suburbs. By s. 10 it was required, during its franchise and at its own cost to maintain the bridge and all approaches thereto. Section 12 provided that from and after the expiration of twelve months after the opening of the bridge for traffic, the Treasurer and the company should each make certain annual payments into a sinking fund, and upon the expiration of twenty-eight years from the date as from which the sinking fund payments were to become payable and upon a certificate of the Director of Public Works as to the structural soundness of the bridge and its satisfactory state of repair, the Treasurer should pay to the company £373,000, and thereupon the franchise should cease and determine. Section 16 provided that upon the determination of the franchise, all property and interest in the bridge should vest in and belong to His Majesty.

The appellant company was incorporated on 22nd March 1938 as a public company, under the *Companies Act* 1920 of Tasmania,

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H. S. Barnett being a promoter of the company and one of its first directors. On the same day the Derwent Company was formed under the same Act as a proprietary company. In connection with the flotation of the appellant company a prospectus was issued, and a copy of it was put in evidence on this appeal as containing sufficient information as to the appellant company's objects, the proposals that were placed before the public and the relationship of the two companies. The authorized capital of the appellant company was £200,000 divided into 200,000 shares of £1 each of which 65,000 preference shares and 85,000 ordinary shares were offered for subscription and the remaining 50,000 ordinary shares were held in reserve. The points of importance in the prospectus are as follows.

The company was to operate the bridge as a toll bridge and was also to operate a transport service. It would have a threefold source of revenue: (a) tolls on the bridge, (b) profits from the transport service, and (c) profit from the subdivision and sale of land on the eastern shores. In relation to the last-mentioned of these sources of revenue it was stated that prior to the project for the construction of the bridge becoming known to the public, the promoter secured options of purchase at low prices over land in the eastern suburbs adjacent to the bridge head and to the main arteries of traffic connecting with the bridge. This land, it was said, would be acquired by the company through the Derwent Company. The cost of the undertaking was set out in itemized form, one item being "Purchase of 16,700 shares of £1 each in Derwent Investments Pty. Ltd. . . . £16,700". An itemized estimate of profit was also given, including as one item "Annual profits from Company's holding in Derwent Investments Pty. Ltd. for twenty years, based on valuation of Mr. E. C. Tregear . . . £7,690". Under the heading "Return of Capital", it was said that on the termination of the franchise it was reasonable to assume that certain moneys, including "Derwent Investments Pty. Ltd. (undistributed proceeds) . . . £16,700", would be available for repayment of borrowed capital and the return of capital to shareholders. Under the heading "Subsidiary Land Company" it was said that the Derwent Company would be operated and controlled as a subsidiary company of the appellant company, and that Mr. H. S. Barnett and his brother were to be allotted 950 shares each in the Derwent Company, while 16,700 shares were to be held by the appellant company. It was stated that the Derwent Company was acquiring 535 acres at a low price, and that the net profits from this land were conservatively estimated at £170,930 or £8,546

per annum for twenty years, the probable realization period. As practically nine-tenths of the shares in the Derwent Company would be held by the appellant company, the net profit to that company, spread over twenty years, would be £7,690 per annum. In addition to these profits there would be £250 per annum from rents in the early years of the company's operations. The directors anticipated that more than half the land could be disposed of in five to eight years at the low price at which it had been valued. This large amount of profit being quickly available, would not all be distributed immediately, but could be re-invested, and, in addition to consolidating the whole position, would provide added income. The shareholders of the appellant company would derive a double advantage from the operations of the Derwent Company: (1) direct profits resulting from sales of land, and (2) increased revenue from tolls and transport from the greater movements of people consequent upon the subdivision and settlement of the eastern suburbs accentuated by speedy transport and water brought by the bridge.

Thus, so far as the prospectus bears upon the purpose with which the appellant company was to acquire shares in the Derwent Company, its whole tenour supports the view that these shares were to form capital assets of the appellant company. They were to be the source of profits to be derived in the form of dividends, and the dividends were to be made possible by the profitable sale by the Derwent Company of its lands in the eastern suburbs plus a small amount from rentals. At the expiration of the franchise period it was expected that the realization of the Derwent Company's lands would be practically completed, but the shares would still have a value equal to the amount paid up on them. Nowhere is there any suggestion that sale or other dealing with the shares was contemplated.

A perusal of the appellant company's memorandum of association confirms the impression thus conveyed by the prospectus. Clause III. contains a lengthy miscellany of objects. The first object is to construct the bridge in accordance with the provisions of the *Hobart Bridge Act* 1936, and then follow other objects more or less incidental to the first, and objects which relate to the operation of a transport service and the collection of tolls as well as objects of a more general character. Low in the list (pars. 19, 37, 43 and 45), are objects which would authorize the sale or other disposition of the appellant company's shares in the Derwent Company, but those shares are the subject of a special provision (par. (31)), which provides for the purchase or other acquisition of shares in

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the Derwent Company, but makes no reference to selling or otherwise disposing of them.

The Derwent Company immediately after its formation issued 18,600 shares of £1 each, the appellant company taking up in its own name or in the names of nominees 16,700 shares, and Mr. H. S. Barnett and his brother each taking up 950 shares. All these shares were fully paid, and no change in the shareholdings took place at any material time.

Shortly after its incorporation the Derwent Company purchased lands on the eastern side of the river for a total sum of £22,532. It proceeded to have these lands surveyed, contour plans prepared, and a plan for the development of the area prepared by a town-planning expert. It entered into a contract for the sale of a small portion of these lands to one James, and this contract was later assigned to Sunnylands Pty. Ltd. The latter company paid to the Derwent Company sums totalling £7,600 under the contract, and the contract was then cancelled by mutual agreement upon the Derwent Company paying £2,260 to Sunnylands Pty. Ltd., and transferring to it certain lots which were the subject of contracts of sale made by the latter. The Derwent Company also purchased from James 500 shares in Sunnylands Pty. Ltd. and 500 shares in another company, Tasmania Trust Co. Ltd., paying apparently £237 10s. 0d. for them. There is no need to go into the details of these transactions, beyond mentioning that the appellant company put the Derwent Company in funds to make these payments of £2,260 and £237 10s. 0d., as well as making a number of other cash advances. No sales of land were made by the Derwent Company. It retained the whole of its land, except the lots transferred to Sunnylands Pty. Ltd., contenting itself with preparatory work with a view to making sales when a favourable market should exist after the completion of the bridge.

But events took a completely unexpected turn. The appellant company entered upon the construction of the bridge, and it was substantially completed, when, towards the end of 1943, a storm occurred which caused considerable structural damage. Disputes immediately arose between the appellant company and the Government as to the responsibility for executing additional works for the protection of the bridge from further damage, and the appellant company found itself in a serious position in relation to obtaining its franchise under s. 6 of the Act. Negotiations then took place between the appellant company and the Government for a new arrangement with respect to the bridge. These negotiations, however, did not relate in any way to the appellant company's

shareholding in the Derwent Company or to the lands owned by the Derwent Company. On 2nd November 1944, the appellant company's managing director (Mr. H. S. Barnett) wrote to the Premier asking him to confirm that the final arrangement between the Government and the company was (1) that the Government would introduce a Bill giving effect to certain terms of acquisition of the company's undertaking (excluding any shares held by it in any other company), and (2) that if during the passage of the Bill through Parliament any amendments should be made, the Government would refer the amendments to the company, and if they were not acceptable to the company the Government would abandon the Bill.

The Government introduced into Parliament a Bill containing in Part II. provisions substantially in accordance with the terms mentioned, and the Premier by letter of 21st November 1944 confirmed the arrangement made in regard to amendments. The Bill was assented to on 11th December 1944 and became the *Hobart Bridge* (*Acquisition and Administration*) *Act* 1944. Part II., as already mentioned, contained provisions for the acquisition by the State of the undertaking of the appellant company, and " the undertaking " was defined to include all the property and assets of the company and the rights of the company under the *Hobart Bridge Act* 1936, but not to include any shares held by it in any other company, or any moneys payable to it by any person or any securities therefrom. Compensation was provided for, the amount to be determined by the Chief Justice in proceedings to be conducted as a reference to a single arbitrator. Part III. of the Act related to the administration, control and management of the bridge after its acquisition by the State. Part IV. dealt with a matter which had not been the subject of negotiation or agreement with the Government, namely the acquisition of all land owned by the Derwent Company or agreed to be purchased from it by James and Sunnylands Pty. Ltd. (excluding any land which had been agreed to be sold by the latter). It was provided that this land should be acquired by the Governor in accordance with the *Lands Resumption Act* 1910, the value to be taken to be the value thereof on 1st December 1944. The Governor was empowered to convey the land to the Board of Management of the Agricultural Bank of Tasmania to be used for the purpose of the *Homes Act* 1935. The appellant company went into voluntary liquidation on 1st May 1946.

The arbitration proceedings before the Chief Justice for the determination of the compensation to be paid for the acquisition of the appellant company's undertaking under Part II. of the Act then proceeded, and were not concluded until some date in 1947.

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On 24th June 1947 the Chairman of the Board of Management of the Agricultural Bank wrote to Sunnylands Pty. Ltd. and to the Derwent Company offering to settle the claim for compensation for the acquisition of the land under Part IV. of the Act by a payment of £32,670. The liquidator of the appellant company replied on 26th June 1947 stating that his company was not prepared to accept the offer. The Board answered that steps would be taken to have the acquisition of the land gazetted, and that the settling of compensation would then follow the procedure laid down under the *Lands Resumption Act*. Only two small areas (of seventeen acres and five acres respectively) were resumed before conferences took place, at one of which the Premier made the suggestion that instead of the Government acquiring the Derwent Company's land it might acquire the whole of the shares in that company's capital. This suggestion, which was an entirely new one, commended itself to the appellant company and the individual shareholders in the Derwent Company for three reasons: (1) it would bring the whole matter to a conclusion and enable the winding up of the appellant company to be completed; (2) it was thought that an income tax advantage would ensue; and (3) if the land were resumed the delay, cost and uncertainty of result involved in proceedings to determine the amount of compensation would have to be faced. On 22nd April 1948 Mr. Barnett as manager of the Derwent Company wrote to the manager of the Agricultural Bank setting out conditions which he described as "the conditions on which my Company is prepared to settle the compensation payable to it under the Acquisition Act." These terms provided (*inter alia*) that the Government should acquire the whole of the shares in the Derwent Company for £80,000. This sum was ultimately reduced to £78,000, and the Government introduced a bill to amend the *Hobart Bridge (Acquisition and Administration) Act* 1944 by repealing Part IV. and substituting for it a new Part IV. dealing with the acquisition of the shares. The Bill was referred to a select committee which recommended a reduction of the amount of compensation to £70,000. The Government informed the Derwent Company that if its shareholders objected to the Bill providing for this compensation the Bill would be dropped, but they decided not to object to it, and it became the *Hobart Bridge (Acquisition and Administration) Act* 1948.

By this Act, the whole of the shares in the capital of the Derwent Company (i.e. 16,700 held by or on behalf of the appellant company, 950 held by Mr. H. S. Barnett and 950 held by his brother), were acquired by and became vested in the Minister on behalf of the

State as on and from 15th January 1949, the amount of compensation payable to the shareholders being fixed at £70,000. This amount was made payable in accordance with the terms and conditions of an agreement to be entered into between the Minister, the shareholders and the Derwent Company, substantially to the effect of a form of agreement set out in the schedule to the Act. It was also provided that the Derwent Company should, as soon as practicable after the acquisition of the shares by the Minister, transfer or convey to the Board of Management of the Agricultural Bank of Tasmania all the land owned by the Derwent Company or agreed to be purchased from it by James and Sunnylands Pty. Ltd. (excluding any land agreed to be sold by the latter).

An agreement dated 24th December 1948 was duly entered into in accordance with the Act. It recited that the shareholders held all the shares in the Derwent Company and that they had agreed to accept the total sum of £70,000 as fair and reasonable compensation in respect of the acquisition of the shares by the Minister. It provided (1) that the amount of compensation payable to the shareholders should be £70,000 which on completion should be paid to the shareholders in accordance with their respective shareholdings; (2) that the agreement should be completed on 14th January 1948 (apparently a mistake for 1949); (3) that the shareholders and the Derwent Company jointly and severally warranted that on completion the Derwent Company would own free from encumbrances and have a good marketable title to all the lands which the company was obliged to transfer and convey to the Board of Management of the Agricultural Bank, and would on completion deliver to the Minister all title deeds to the lands and survey plans and other documents; (4) that the shareholders would on completion deliver to the Minister their share certificates; (5) that the shareholders and the Derwent Company jointly and severally undertook that before completion all debts and liabilities (if any) of the company would be discharged, and would indemnify the Minister against all debts and liabilities incurred or accruing due before completion; and (6) that the Derwent Company thereby released to the Minister its claims for compensation in respect of the acquisition under the 1936 Act of the two areas of land of seventeen acres and five acres respectively.

Of the compensation moneys paid under this agreement, the appellant company received its due proportion, namely £62,799 1s. 6d. The amount owing to it by the Derwent Company on a balance of account for financial assistance provided was written off pursuant to clause (5) of the agreement, and the other two

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shareholders paid to it their proportion of that amount. The net figure written off was £14,240; and as £16,700 had been paid up on the shares there was an excess of compensation money over outgoings in respect of the shares amounting to £31,859.

This amount was a profit to the appellant company, but it does not follow that it must be included in the appellant company's assessable income. If the commissioner's assessment is to be upheld, it must be either because the profit is brought by s. 26 (*a*) of the *Income Tax Assessment Act* 1936 into the category of assessable income as being profit arising from the sale by the appellant company of property acquired by it for the purpose of profit-making by sale, or from the carrying on or carrying out of a profit-making undertaking or scheme, or because the profit should be treated for some other reason as being of an income nature according to "the ordinary usages and concepts of mankind": *Colonial Mutual Life Assurance Society Ltd.* v. *Federal Commissioner of Taxation* (1); *Scottish Australian Mining Co. Ltd.* v. *Commissioner of Taxation* (2).

The profit arose to the appellant company from a compulsory acquisition of shares. Nothing turns, I think, upon any distinction between a conversion of shares into cash by means of compulsory acquisition and a similar conversion by means of an ordinary sale: cf. *Smith* v. *Federal Commissioner of Taxation* (3). If the shares formed part of the stock-in-trade, as it were, of a business of dealing in shares in which the appellant company was engaged, the profit arising on their realization would be an income profit according to ordinary usages and concepts. If they were acquired by the appellant company for the purpose of profit-making by sale, the profit would be assessable income under the first limb of s. 26 (*a*). If their realization brought to fruition the carrying on or carrying out of a profit-making undertaking or scheme, the profit would be assessable income under the second limb of s. 26 (*a*).

On the evidence, however, I have no hesitation in finding that the appellant company never had a business of or including dealing in these or any shares, that it did not acquire these shares for the purpose of profit-making by sale, and that the profit in question did not arise from the carrying on or carrying out of any profit-making undertaking or scheme on the part of the appellant company. I am satisfied that the appellant company acquired the shares wholly and solely for the purpose of holding them as a capital asset for the production of dividends.

(1) (1946) 73 C.L.R. 604.
(2) (1951) 81 C.L.R. 188, at p. 191.
(3) (1932) 48 C.L.R. 178.

The dividends were expected to become payable out of the profits arising from the sale by the Derwent Company of its lands in the eastern suburbs, and an attempt was made by counsel for the commissioner to establish that the quantum of the compensation moneys had some relation to the amount of the anticipated profits. In this I do not think he was successful, but even if he had been, the decision of this case would not be affected, because "there is no relation between the measure that is used for the purpose of calculating a particular result and the quality of the figure that is arrived at by means of the application of the test": *Glenboig Union Fireclay Co.* v. *Commissioners of Inland Revenue* (1); *Californian Oil Products Ltd.* v. *Federal Commissioner of Taxation* (2); *Commissioner of Taxes (Vict.)* v. *Phillips* (3); *Van den Berghs Ltd.* v. *Clark* (4). Moreover, this is not a case in which a payment is received as compensation for nothing more than the cesser of a right to future profits. The compensation payment in this case was made in respect of the loss of all the rights comprised in the shares. In order to decide the capital or income quality of those compensation moneys, it is necessary to have regard to the nature of the appellant company, the character of the assets realized, the nature of the business carried on by the company and the particular realization which produced the profit: *Ruhamah Property Co. Ltd.* v. *Federal Commissioner of Taxation* (5). The company, I am satisfied, was not one which existed for the purpose of dealing in shares. The shares it held in the Derwent Company were assets with which it had equipped itself in order to participate, by means of dividends, in the anticipated profits of the Derwent Company. The business of the appellant company did not include the making of a profit by the disposition of those shares. The particular realization which produced the profit was one consented to or acquiesced in as an expedient method of realizing assets as a step in the winding up of the company, and acquiescence in it by the appellant company involved an abandonment of the purpose with which it had acquired the shares. This being the situation, the case appears to me to be a clear case of the realization of capital assets. In my opinion the receipt of the compensation moneys was a receipt on capital account and the profit which those moneys contained was a capital increment. A long line of cases from *Californian Copper Syndicate* v. *Harris* (6) to *Scottish Australian Mining Co. Ltd.* v. *Commissioner of Taxation* (7), establishes that

(1) (1922) 12 Tax Cas. 427, at p. 464.
(2) (1934) 52 C.L.R. 28, at p. 47.
(3) (1936) 55 C.L.R. 144, at p. 153.
(4) (1935) A.C. 431, at p. 442.
(5) (1928) 41 C.L.R. 148, at p. 154.
(6) (1904) 5 Tax Cas. 159.
(7) (1951) 81 C.L.R. 188.

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such a profit is not within the category of assessable income, either on general principles or by reason of the express provision contained in s. 26 (*a*).

Counsel for the commissioner contended, however, that the findings of fact I have made do not justify this conclusion. He was at pains to establish that the individuals interested in the two companies entertained a profit-making purpose from the inception of the project for the building of the bridge, that that profit-making purpose included the profitable realization of the land which in fact was purchased by the Derwent Company, and that the Derwent Company was, as he put it, a completely subservient subsidiary of the appellant company. He contended that there was a composite commercial enterprise involving the building of the bridge, and that the resulting increase of land values and the annual income arising out of the use of the bridge were lumped together as a joint commercial objective. This being so, he argued, the Derwent Company should be regarded as a mere collecting medium, or a channel through which the profit from the sale of land was to flow, and the appellant company's shareholding in the Derwent Company, though it cannot be disregarded as a matter of law, has little or no real significance in determining the character of the profit now in question. The argument was that the character of that profit must be determined, not upon legal conceptions, but according to economic, business or commercial conceptions, and that, for that reason, no relevant distinction should be drawn between the profit which arose from the realization of the shares in the Derwent Company and the profit that would have arisen if the appellant company itself had owned the land and the State had acquired it for a sum in excess of its cost.

Plainly there was a general profit-making scheme in which the appellant company and the Derwent Company were intended to play their respective parts. It is also true that the appellant company held approximately ninety per centum of the issued shares in the Derwent Company, that they had identical boards of directors, that when the appellant company obtained finance from an insurance company, the Derwent Company gave security for the loan over its lands, and that the Derwent Company depended upon advances from the appellant company to meet its cash requirements. But it is quite fallacious to conclude from such facts as these that the Derwent Company can be treated for present purposes as a mere instrument for the transmission to the appellant company of profits from land-dealing, and that the profit which is now in question is to be conceded the character of income because profit produced by the

realization of the Derwent Company's land would have had that character. The appellant company was not the only shareholder in the Derwent Company; but even if it had been, the argument could not have survived the comment which may best be made by quoting from the speech of Lord *Sumner* in *Gas Lighting Improvement Co. Ltd.* v. *Inland Revenue Commissioners* (1):—"It is said that all this was 'machinery', but that is true of all participations in limited liability companies. They and their operations are simply the machinery, in an economic sense, by which natural persons, who desire to limit their liability, participate in undertakings which they cannot manage to carry on themselves, either alone or in partnership, but, legally speaking, this machinery is not impersonal though it is inanimate. Between the investor, who participates as a shareholder, and the undertaking carried on, the law interposes another person, real though artificial, the company itself, and the business carried on is the business of that company, and the capital employed is its capital and not in either case the business or the capital of the shareholders. Assuming, of course, that the company is duly formed and is not a sham (of which there is no suggestion here), the idea that it is mere machinery for effecting the purposes of the shareholders is a layman's fallacy. It is a figure of speech, which cannot alter the legal aspect of the facts".

Counsel for the commissioner relied, in support of his argument, upon the principle that the income or capital nature of a profit depends, apart from special statutory provision, upon the ordinary usages and concepts of mankind; but the principle does not assist him, for it obviously requires the application of those ordinary usages and concepts to the facts as correctly understood, and not to facts as altered in consequence of a failure to recognise as relevant the distinction between shares in the capital of a company and the trading assets of that company. Mr. *Menzies*, for the appellant company, met the attempted use of the principle very aptly, I think, by quoting words which *Rich* J. used in relation to another principle: "it does not mean that the question is one . . . for economists set free to disregard every legal relation and penetrate into the recesses of the causation of financial results, nor does it mean that the court is to treat contracts, agreements and other acts, matters and things existing in the law as having no significance": *Tariff Re-insurances Ltd.* v. *Commissioner of Taxes (Vict.)* (2).

(1) (1923) A.C. 723, at pp. 740, 741. (2) (1938) 59 C.L.R. 194, at p. 208.

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Kitto J.

In truth, the attempt to assimilate, for the purpose of deciding their income or capital nature, profits which the appellant company derived from the realization of shares in a subsidiary land-dealing company with profits which it would have derived if it had itself conducted operations of land-dealing is an attempt which falls under the condemnation of the *Duke of Westminster's Case* (1). It invites the Court to blur distinctions which are real and significant; and it must be met by an insistence upon the necessity of deciding the case in hand upon its own facts. The assessment which is challenged was an assessment made against the appellant company and not against anyone else. Therefore it is necessary to decide what is the character of the profit which is sought to be taxed, in relation to the appellant company and in relation to it alone. To this end it is necessary to consider the purpose for which the appellant company acquired and held the shares in the Derwent Company from the realization of which the profit arose, and not to any purpose of the individuals behind the appellant company or to the purpose which the Derwent Company existed to effectuate. The appellant company, as I have said, took up and retained the shares, until they were acquired by the State, not as property to be traded with, but as an investment to be held for the sake of the large dividends they were expected to yield. I have pointed out that the profit in question arose because a fundamental and unanticipated change in the entire situation had led to the appellant company going into liquidation and it was considered expedient to acquiesce in the acquisition of the shares by the State, that acquiescence constituting a complete departure from the purpose with which the shares had been acquired and had been held while the appellant company was a going concern. That the profit was a capital profit in the hands of the appellant company and not liable to be included in its assessable income, follows, in my opinion, from the application of the rule recognized in *Commissioner of Taxes* v. *Melbourne Trust Ltd.* (2), and many others, and stated in *Ruhamah Property Co. Ltd.* v. *Federal Commissioner of Taxation* (3) in familiar terms: "The principle of law is that profits derived directly or indirectly from sources within Australia in carrying on or carrying out any scheme of profit-making are assessable to income tax, whilst proceeds of a mere realization or change of investment or from an enhancement of capital are not income nor assessable to income tax". An expanded statement of this principle was made by *Latham* C.J. in

(1) (1936) A.C. 1.
(2) (1914) A.C. 1001.
(3) (1928) 41 C.L.R., at p. 151.

*Western Gold Mines No Liability* v. *Commissioner of Taxation (W.A.)* (1).

I should add that counsel for the commissioner stated that he desired to place some reliance upon s. 260 of the *Income Tax Assessment Act*, but he did not develop any argument on this point. I am unable to see that there is any room for the application of s. 260 in this case, and I need say no more about it.

In my opinion, the appeal should be allowed with costs, and there should be an order that the assessment be amended so that no portion of the moneys received by the appellant company as compensation for the acquisition by the Minister of any shares held by it or on its behalf in the capital of Derwent Investments Proprietary Limited is included in the assessable income of the appellant company.

*Order accordingly.*

Solicitors for the appellant, *Murdoch, Cuthbert, Clarke & Neasey*, Hobart, by *Morgan, Fyffe & Mulkearns*.

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

E. F. H.

(1) (1938) 59 C.L.R. 729, at pp. 732, 733.