Foll *FCT v Galland* 68 ALR 403

Cons *Glenfield Estates Pty Ltd v FCT* 19 ATR 1426

Foll *Federal Commissioner of Taxation v Galland* 18 ATR 33

Cons *Glenfield Estates v FCT* (1988) 80 ALR 671

Cons *Taxation, Federal Commissioner of v Sahhar.* (1985) 59 ALR 98

Foll ***A A T Case 23/95; No 10,116*** **(1995) 30 ATR 1269**

Cons *A Raptis & Sons Holdings v Comr of Stamp Duties (No2)* [1999] 1 QdR 462

Foll *Case [1999] AATA 1025* (1999) 44 ATR 1131

[HIGH COURT OF AUSTRALIA.]

ROSE . . . . APPELLANT;

AND

FEDERAL COMMISSIONER OF TAXATION RESPONDENT.

H. C. OF A.
1951.

PERTH,
Sept. 10;
MELBOURNE,
Nov. 5.

Dixon,
Fullagar
and
Kitto JJ.

Income Tax (Cth.)—Assessable income—Disposal of assets of business—" Dispose " —Assets of business transferred by sole owner to partnership consisting of himself and others—Income Tax Assessment Act 1936-1948 (*No.* 27 *of* 1936—*No.* 44 *of* 1948), *ss.* 36 (1), 59 (1) (2).

Property in the assets of a business moving under a partnership deed from the sole ownership of one person to the co-ownership of that person and two others as partners in equal shares is not " disposed of " within the meaning of s. 36 (1) or s. 59 (1) of the *Income Tax Assessment Act* 1936-1948; therefore, the commissioner in computing the assessable income of the disponor, is not entitled to apply either s. 36 (1) in respect of livestock, or s. 59 (2) in respect of such assets as had been the subject of allowances for depreciation.

CASE STATED.

On an appeal to the High Court by Arnold Jeffes Rose against an assessment to tax under the *Income Tax Assessment Act* 1936-1948 *Kitto* J. stated for the opinion of the Full Court a case which was substantially as follows:—

1. The appellant is a pastoralist and carried on the business of a pastoralist at Quanbun Downs Station near Fitzroy Crossing, West Kimberley, in the State of Western Australia, for many years before 8th July 1948. He was on that date and at all material times before that date the holder of the leasehold lands comprising the said station and the owner of the livestock, plant and other chattel property on the said station or belonging to and used in connection with the said business.

2. Prior to the execution of the deed of partnership hereinafter mentioned, it was agreed by and between the appellant and his two sons, Richard Jeffes Rose and Augustus Jeffes Rose, that

as from and including 15th April 1948 the appellant would take his said sons into partnership with him in the said business on the footing that the three partners should be entitled to the capital and net profits of the said business in equal shares and that he would contribute to and so as to constitute the initial capital of the partnership the said leasehold lands and the livestock, plant and other chattel property being thereon or belonging to and used in connection with the said business, thereby making a gift to each of his said sons of an undivided one-third share or interest in such initial capital.

3. On 30th June 1948 the appellant and his said sons executed a deed of partnership.

4. The gifts so agreed to be made by the appellant took effect on 8th July 1948, and on that date the livestock referred to in the schedule to the said deed (being assets of the said business of the appellant within the meaning of s. 36 of the *Income Tax Assessment Act* 1936-1948) and the plant and machinery mentioned in the said schedule (being property of the appellant in respect of which depreciation had been allowed or was allowable under the said Act) became assets of the partnership in accordance with the provisions of the said deed.

5. Pursuant to the exercise by the appellant of the option in that behalf conferred upon him by the Income Tax Assessment Acts in force from time to time the amount taken into account at the end of each year of income during a period of many years up to and including the year ended 30th June 1948 as the value of livestock of the said business for income tax purposes was the cost price of such livestock. The amount so taken into account as the value of the livestock mentioned in the schedule to the said deed of partnership at 30th June 1948 was £4,026. The market value of the said livestock on 8th July 1948 was £11,144.

6. The depreciated value of the plant and machinery mentioned in the schedule to the said deed of partnership at 8th July 1948, as ascertained in accordance with s. 62 of the said Act, was £7,835, and its value as at that date was £8,851. The sum of the amounts allowed in assessments for income tax under the said Act in respect of depreciation of the said plant and machinery exceeded the difference between these two figures.

7. By notice of assessment dated 21st April 1950, the Deputy Commissioner of Taxation in the State of Western Australia notified the appellant of an assessment of the income tax and social services contribution payable by the appellant in respect of income derived during the year ended 30th June 1949, and he

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disclosed by an alteration sheet attached to the said notice that in making the said assessment he had included as income of the appellant derived during the said year, subject to certain deductions, the sum of £7,118 (being the difference between the amounts mentioned in par. 5 of this case) and the sum of £1,016 (being the difference between the amounts mentioned in par. 6 of this case).

8. The appellant, being dissatisfied with the said assessment, duly lodged with the said deputy commissioner on 13th June 1950 an objection in writing against the said assessment.

9. By letter dated 14th August 1950 the said deputy commissioner informed the appellant that his said objection had been disallowed.

10. By letter dated 16th August 1950 the appellant requested the said deputy commissioner to treat the said objection as an appeal and forward it to the High Court for determination.

11. On 24th July 1951 the said deputy commissioner duly caused the said objection to be forwarded to the High Court accordingly.

The questions for the opinion of the Full Court were as follows :—

1. Was the market value of the whole, or of two-thirds, or of any part of the said livestock on 8th July 1948 included, by virtue of s. 36 of the *Income Tax Assessment Act* 1936-1948, in the appellant's assessable income derived during the year ended 30th June 1949 ?

2. Was the whole, or two-thirds, or any part of the excess of the value of the said plant and machinery at 8th July 1948 over its depreciated value at that date included, by virtue of s. 59 of the said Act, in the appellant's assessable income derived during the said year ?

O. J. Negus, for the appellant. Section 36 must be construed strictly as otherwise a mortgage could be treated as a disposal. The section applies only to a disposal of the whole of the assets whereas in this case there was merely a disposal of an undivided part which is not either the whole or a part of the whole. An interest in the whole differs from a part thereof. If this was not the intention the words " or any interest therein " would have been inserted. Furthermore, the mention of growing crops, cropstools and trees indicate that a mere interest as distinct from the asset itself is not included. If an interest is included the disposal of a trifling fraction would give an absurd result. The section contemplates complete disposal. The section is designed primarily to cover disposal sales : *Commissioner of Taxation for W.A.* v.

Newman (1). There was no disposal of the assets of a business as such. There was no disposal within any of the three classes referred to in *Farnsworth* v. *Federal Commissioner of Taxation* (2). The assets disposed of did not include any property being trading stock, because, in spite of the definition in s. 6, trading stock cannot include anything which cannot be sold in trade. A mere interest in an article is not trading stock according to ordinary usage. The section contemplates a disposal of property of which the market value can be ascertained. An undivided interest in a sheep has no market value as generally understood. If the section is applicable the disponor is deprived of his right of election to value either at cost or market price and difficulties arise regarding the partnership returns. If the section does apply there is a disposal of only two-thirds of the livestock. Regarding plant s. 59 is applicable merely to units of property, not to interests in such units.

L. D. Seaton K.C. (with him *A. B. Gleadman*), for the respondent. The phrase " disposed of ", as used in ss. 36 and 59, has a wide meaning. A transaction resulting in the creation and transfer of fractional interests is a disposal. Such a disposal was effected by the deed of partnership. The *Income Tax Assessment Act* 1936-1948 purports to deal with a partnership as a separate entity for taxation purposes (s. 90). This view, as distinct from the accepted legal conception of a firm, has received recognition by the courts: *Commissioners for General Purposes of Income Tax for City of London* v. *Gibbs* (3); *Latilla* v. *Inland Revenue Commissioners* (4). Each partner holds a proportionate share of the assets transferred (s. 33 of *The Partnership Act*, 1895 (W.A.)). If the partnership is not to be regarded as an entity for taxation purposes, there can be no commencing value for its livestock. If it is not itself the owner of its livestock or trading stock, it cannot have assessable income under s. 48, nor would it be entitled to any deductions pursuant to s. 51. Any attempt to treat a partnership other than as a separate entity would have the effect of making the partnership provisions of the Act meaningless. [He referred to: *Hickman* v. *Federal Commissioner of Taxation* (5); *N.S.W. Land and Agency Co. Ltd.* v. *Commissioner of Taxation* (6); *Lindley* on *Partnership*, 10th ed. (1935), vol. 1, ch. 1, s. 4; *Resch* v. *The Federal Commissioner of Taxation* (7).]

O. J. Negus, in reply.

Cur. adv. vult.

(1) (1921) 29 C.L.R. 484.
(2) (1949) 78 C.L.R. 504.
(3) (1942) A.C. 402.
(4) (1943) A.C. 377.
(5) (1922) 31 C.L.R. 232.
(6) (1926) 26 S.R. (N.S.W.) 560; 43 W.N. 168.
(7) (1941) 66 C.L.R. 198, at p. 226.

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The Court delivered the following written judgment:—

The taxpayer had for many years before 8th July 1948 carried on business as a pastoralist near Fitzroy Crossing, West Kimberley. He resolved to take his two sons into partnership on the footing that the capital of the partnership should belong to the three partners in equal shares and that profits should be divided equally. The capital was to consist of the assets of the business which the taxpayer carried on. A partnership deed was executed by which the taxpayer's resolve was carried out. The date upon which the transaction took effect and the assets of the taxpayer's business actually became assets of the partnership was 8th July 1948, although the deed bore the date of 30th June 1948 and according to its terms the partnership was to be deemed to have commenced at an earlier date. In assessing the taxpayer's taxable income derived during the year commencing 1st July 1948 the commissioner treated the transaction as a disposition by the taxpayer of the assets of his business to the partnership. On this footing he applied s. 36 (1) of the *Income Tax Assessment Act* 1936-1948 to the livestock and s. 59 (2) to such of the assets as had been the subject of allowances for depreciation. Section 36 (1) provides that where the whole or any part of the assets of a business carried on by a taxpayer is disposed of by sale or otherwise howsoever, whether for the purpose of putting an end to the business or any part thereof or not and the assets include any property being (amongst other things) trading stock the value of that property shall be included in his assessable income and any person acquiring it shall be deemed to have purchased it at the amount of that value. By virtue of the definitions of "trading stock" and "live stock" in s. 6, the sheep and horses upon the taxpayer's station were comprised in the trading stock of the business for the purposes of s. 36. The value of the livestock taken into account at the end of the previous year of income pursuant to s. 32 was the cost price and that under s. 29 was the value at which they must be taken into account at the beginning of the year of income in which the transaction took place. Section 36 (8) (*a*) (i) provides that for the purposes of the section the value of any livestock shall be the market value on the day of disposal. The market value of the livestock as at 8th July 1948 exceeded the cost by £7,118.

The effect of s. 59 (2) is to include in the assessable income of a taxpayer any amount by which the consideration for which the property is disposed of exceeds its depreciated value, when depreciation has been allowed or is allowable under the Income Tax Assessment Acts. By sub-s. (3) (*d*), where property is disposed of

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otherwise than by sale, the consideration is to be taken as the value, if any, of the property at the date of disposal. Among the assets becoming partnership property were certain things upon which depreciation had been allowed and their value on 8th July 1948 exceeded their depreciated value by £1,016.

In the assessment the two figures of £7,118 and £1,016 were included as part of the taxpayer's assessable income and the question for decision is whether ss. 36 and 59 respectively afford a justification for so including these sums or any part of them. In the case of each provision the question depends upon the expression " disposed of ". Does the transmutation of the property in the assets from the sole property of the taxpayer to the co-ownership of him and his two sons as partners in equal shares involve a disposal of the livestock and of the depreciated property for the purposes of ss. 36 (1) and 59 (2) respectively ?

As the objects of the two provisions are not the same it is desirable to deal with the question in relation to each of them separately. The central purpose of s. 36 was to alter the law laid down in such decisions as *Commissioner of Taxation for W.A.* v. *Newman* (1) ; *Hickman* v. *Federal Commissioner of Taxation* (2) ; and *N.S.W. Land & Agency Co. Ltd.* v. *Commissioner of Taxation* (3). It was thought necessary to go beyond sales for a money consideration and to include all alienations *inter vivos* and to employ value as the test of what should go into the assessable income, even where there was a price. Devolutions upon death were dealt with by s. 37. In employing the words " dispose of " s. 36 doubtless meant to include every alienation of trading stock. " Disposition " and " dispose of " are expressions of the widest import. But the subject of the disposition must be considered as well as the ambit of the expression " dispose of ". Section 36 is concerned with the disposal of the whole or part of the assets of a business when trading stock is included in the disposition. Now it seems quite clear that, unless the partnership can for the purposes of s. 36 be considered as a distinct entity to which the assets were transferred, the disposition by the taxpayer consisted in imparting to his two sons equal undivided shares in the assets as co-owners with himself. Further, the admission of the sons into partnership with him may be regarded as an entire transaction of which the alienation to each of them of an equal undivided third share in the assets of the business was only a legal consequence or incident. When s. 36 speaks of disposing of the assets of a business it is

(1) (1921) 29 C.L.R. 484.
(2) (1922) 31 C.L.R. 232.
(3) (1926) 26 S.R. (N.S.W.) 560; 43 W.N. 168.

speaking of a transfer of the proprietor's ownership of the assets, including the immediate right to their possession, subject of course to any encumbrance, whether existing or newly created. But it is not speaking of the transfer of an undivided fractional interest in the assets. It is not speaking of the vesting in another or others of an undivided share or shares in the business including the assets. Plainly it is directed at the disposal of the entirety of ownership in the assets and not the conversion of single ownership into collective ownership.

The commissioner's case must therefore depend on making good the proposition that for the purpose of s. 36 a partnership is to be considered a separate entity distinct from the individuals who compose it, so that when the taxpayer vested what was his as an entirety in himself and his two sons as partners having co-ownership, he is to be considered for the purposes of s. 36 as having " disposed of " the property as an entirety in the assets to a distinct legal entity. A partnership is not a distinct legal entity according to English law. In Scots law a firm is a legal person distinct from the partners of whom it is composed. But in our law it is far otherwise with partnerships. " The members of these do not form a collective whole, distinct from the individuals composing it ; nor are they collectively endowed with any capacity of acquiring rights or incurring obligations " : *Lindley* on *Partnership*, 11th ed. (1950), vol. 1, ch. 1, s. 4. If, therefore, a partnership is to be treated for the purpose of s. 36 as a distinct legal entity, it must be because of an assumption which the *Income Tax Assessment Act* requires, not because of the general law. But an examination of that Act discloses no ground for construing it as requiring that such an assumption should be made. By s. 6 the word " partnership " is defined to mean an association of persons carrying on business as partners or in the receipt of income jointly but not to include a company. Division 5 of Part III, which deals with partnerships, is based upon the view that the collective income earned by the partnership belongs according to their shares to the partners regardless of its liberation from the funds of the partnership, that is, its actual distribution. There appears to be no foundation for importing into s. 36 a conception of a partnership varying from that adopted by the general law.

It follows from what has been said that the formation of the partnership was a transaction falling outside s. 36 (1) and that the consequent investing of the three partners with property in the assets of the business belonging to the taxpayer did not involve a disposition of those assets within that section.

Although the object to which s. 59 is directed is not the same as that of s. 36, the considerations governing the decision of the question whether the transaction is within the words " dispose of " in s. 59 are not very different. The subject of s. 59 is the place which should be given, in the ascertainment of taxable income, to an excess or deficiency in the real value of an asset upon which depreciation has been allowed when the trader or manufacturer disposes of it or it is lost or destroyed. The section goes much further than taking into account the excess or deficiency in the actual proceeds of realization. But nevertheless it is clear enough that it is concerned with the disposal, loss or destruction of the property as an entirety and not with the creation or transfer of an undivided share in the asset. That being so the reasoning which has been pursued above in relation to s. 36 applies equally to s. 59 and leads to the conclusion that it does not cover the transaction by which the taxpayer made his sons equal partners with himself in his business and the assets thereof.

For these reasons both questions in the case stated should be answered—No.

Order that questions 1 *and* 2 *in the case stated be answered—No.*
The commissioner to pay the appellant's costs of the case stated.
Cause remitted to Kitto J.

Solicitors for the appellant, *Parker & Parker.*
Solicitor for the respondent, *D. D. Bell*, Crown Solicitor for the Commonwealth.

F. T. P. B.