dist. 96 CLR 577.

[HIGH COURT OF AUSTRALIA.]

WAR ASSETS PROPRIETARY LIMITED . APPELLANT;
APPELLANT,

AND

FEDERAL COMMISSIONER OF TAXATION . RESPONDENT.
RESPONDENT,

H. C. OF A. 1952-1954.

1952, MELBOURNE, *June* 2, 3, 4, 6, 10, 11; SYDNEY, *July* 28.

Fullagar J.

MELBOURNE, 1953, *Feb.* 23, 24, 25, 26, 27; 1954, *March* 3.

Dixon C.J., Williams and Kitto JJ.

Income Tax (Cth.)—Assessable income—Arrangements &c. to avoid tax—Goods in Papua purchased by Victorian company—Formation of Papuan company to take assignment of contract of sale and to sell the goods and retain the profit—Papuan company beneficially owned as to two-thirds of shares by Victorian company—Sale of goods by Papuan company without assignment from Victorian company—Profit arising therefrom—Whether income of Victorian company—Avoidance of arrangement for sale &c. of goods by Papuan company—Effect of—Whether to leave profit in the hands of Victorian company—Income Tax Assessment Act 1936-1947 (*No.* 27 *of* 1936—*No.* 63 *of* 1947) *s.* 260.

W. A., a company incorporated and carrying on business in Victoria, the beneficial interest in the shares of which was owned by three interests, Mr. P. F. Cody and his brothers, Mr. W. J. Wren and his brother and Mr. Westhoven, on 4th August 1947 agreed with one Lord that he would obtain, and make over to W. A., an option to purchase a large quantity of surplus war material owned by the Vacuum Oil Co. Pty. Ltd. and situated at Milne Bay, Papua. Prior to the exercise of the option representatives of the Cody and Wren interests decided that they would not be interested in entering into the venture unless the profits therefrom would be free of taxation. In order to see whether this could be done they consulted an accountant who suggested the formation of a company in Papua to handle the war material and make the profit on the sale thereof. Also prior to the exercise of the option one Baker had become interested in the venture and he agreed to purchase a one-third interest, the remaining two-thirds to be owned by W. A. The option was exercised on 16th October 1947. A short time after that date the beneficial owners of the shares in W. A. agreed with Baker to form a new company in Papua, M. B. M., which would take an assignment from W. A. of its contract with the Vacuum Oil Co. and would sell the war material and make the profit on the sale thereof. It was agreed that the shares in M. B. M. should be beneficially owned as to two-thirds thereof by W. A. and as to one-third thereof by Baker. M. B. M. was formed in Papua and took possession

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of, and sold, the war material as owner, although the contract between W. A. and Vacuum was never formally assigned to it. No money was paid at any time by M. B. M. to W. A.

Held that the profit on the sale of the war material was not part of the assessable income of W. A. because, if property in the goods had passed from W. A. to M. B. M., the profit on their sale was not derived by W. A., while, if property had not passed, M. B. M. had committed a conversion for which W. A. had merely a right of action in damages, which it had never claimed to assert.

Held, further, that s. 260 of the *Income Tax Assessment Act* 1936-1947 could not apply so as to leave W. A. taxable in respect of the profit. If the arrangement attacked were "annihilated" under the section, still there was no profit in the hands of W.A. *Clarke* v. *Federal Commissioner of Taxation* (1932) 48 C.L.R. 56, at p. 77 and *Bell* v. *Commissioner of Taxation* (1953) 87 C.L.R. 548, at pp. 572, 573 applied.

Decision of *Fullagar* J. reversed.

APPEAL from *Fullagar* J.

War Assets Pty. Ltd. appealed to the High Court from the decision of the Commissioner of Taxation disallowing its objections to the inclusion of the sum of £50,823 2s. 4d. in its assessable income for the year ended 30th June 1948 and of the sum of £28,210 in its assessable income for the year ended 30th June 1949.

The appeal was heard by *Fullagar* J., in whose judgment hereunder the material facts are set forth.

J. B. Tait Q.C., and *C. A. Sweeney*, for the appellant.

J. D. Holmes Q.C., and *E. J. Hooke*, for the respondent.

Cur. adv. vult.

FULLAGAR J. delivered the following written judgment:—

July 28, 1952. I have before me two appeals by a company named War Assets Pty. Ltd. against assessments of income tax on income alleged by the commissioner to have been derived by it in the years ended 30th June 1948 and 30th June 1949. A large sum is involved, the taxable income assessed in respect of the former year being £50,354 0s. 0d., and in respect of the latter year £28,413 0s. 0d. The assessments include additional tax claimed under s. 226 (2) of the *Income Tax Assessment Act* 1936-1947. The commissioner's figures are not challenged as such, and no question of assessable

income or allowable deductions is raised. The objection taken by the appellant company is, in effect, that the income in question was derived not by it, but by another company named Milne Bay Merchants Pty. Ltd. Because of the nature of the case and because it is one which is obviously likely to go on appeal in any event, I think it desirable to set out the facts in considerable detail. It will be convenient to refer to the two companies respectively as " War Assets " and " The Milne Bay company ".

After the termination of hostilities in 1945, vast quantities of material, which had been used by the armed forces, were left abandoned in various parts of Australia and in islands to the north of Australia. Because it was handled by the Commonwealth Disposals Commission under the *National Security* (*Disposal of Commonwealth Property*) *Regulations*, it became usual to refer to such material as " disposal material " or " disposal goods ". In particular, there was in the country at the head of Milne Bay, in the extreme south-east of the Territory of Papua, a very large quantity of machinery, military equipment and other disposal material. The profit which is in question in this case was realized by the purchase and re-sale of a large part of this disposal material in the Milne Bay area. In the transactions which will have to be examined, four individual persons were active, and—although it will be seen that they fit into the structure in different ways—it is in these four persons that, on any view of the present case, the ultimate beneficial interest in the profit lies. These four persons are Mr. P. F. Cody, Mr. John Wren, Mr. A. M. Westhoven and Mr. A. E. Baker. Actually what may be called the " Cody interest " and the " Wren interest " are divided among certain members of the families of Mr. P. F. Cody and Mr. John Wren respectively, but nothing turns on this.

In the early part of 1947 Mr. Westhoven was in the employ of the Commonwealth Disposals Commission. About the middle of the year, when the term of his employment was about to end, he was brought into contact with Mr. Cody and suggested the formation of a company to buy and sell disposal material. He said that he had only £250 of his own to invest. On 24th June 1947 the appellant company, War Assets, was incorporated in Victoria under the *Companies Act* 1938. Its nominal capital was £25,000, divided into shares of £1. Immediately after its incorporation certain allotments and certain transfers from signatories to the memorandum were made, the result of which was that 625 shares were held by a Mr. R. J. C. Burns and 625 shares by a Mr. D. G. Randall. Messrs. Burns and Randall were members of the firm, or of the

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staff, of Buckley & Hughes, a Melbourne firm of accountants. These shares, which still stand in the names of Messrs. Burns and Randall, were paid for in cash by Messrs. Cody, Wren and Westhoven. Share certificates were issued to Messrs. Randall and Burns, who, on 13th August 1947, executed declarations of trust of the shares, the effect of which was that the shares were held as to 500 in trust for the Cody interest, as to 500 in trust for the Wren interest, and as to 250 in trust for Westhoven. Each declaration contained an undertaking to transfer the shares to the beneficial owner on demand. No further shares were ever allotted. According to these declarations of trust Mr. Westhoven had a one-fifth beneficial interest in the company. It is convenient to mention here that in October or November 1947 it was agreed that Mr. Westhoven should have a one-fourth interest in the company instead of a one-fifth interest. Nothing was done about this at the time, but at a much later date, on 14th June 1950, new declarations of trust were made, the effect of which was that 469 shares were owned beneficially by the Cody interest, 469 by the Wren interest and 312 by Mr. Westhoven. The new declarations of trust also involved what may be called internal redistributions of the Cody interest and the Wren interest, but this is of no present importance. The directors of War Assets have at all times been Messrs. Burns and Randall.

I am not satisfied as to whether or not it was originally intended that War Assets should handle directly disposal material in Papua. Mr. Westhoven had knowledge and experience in connection with disposal material in Papua. At any rate what War Assets did immediately was to rent a store and office in Brighton Road, St. Kilda, and it seems to have dealt directly in a quite small way with disposal material situate at Bandiana and Tottenham in Victoria. By so doing it made, according to its accounts, a loss of £468 in the year ended 30th June 1948, a profit of £203 in the year ended 30th June 1949, and a loss of £302 in the year ended 30th June 1950. Whatever the original intention may have been, almost immediately after the incorporation of War Assets Mr. Cody was introduced by his solicitor, Mr. Nolan, to a Mr. Lord, who was a client of Mr. Nolan and who was connected in some way with the Vacuum Oil Co. Pty. Ltd. This latter company (which it will be convenient to call "Vacuum") had acquired a large mass of disposal material in the Milne Bay area, had sold or used part of it, and was contemplating selling the balance. Mr. Cody communicated with Mr. Westhoven, and on 22nd July 1947, a conference was held at Mr. Cody's office, at which Messrs. Cody, Westhoven

and Lord were present. The proposal discussed seems to have been that a syndicate should be formed to purchase the Milne Bay material, in which syndicate War Assets should hold five or six of ten shares.

On 4th August 1947 a document described as " heads of agreement " was executed by War Assets and by Lord. This document could have no effect as an option, because the matter of price is left entirely at large, but it contemplates the obtaining of an option by Lord from Vacuum and the taking over and exercise of the option by War Assets. If these events take place, War Assets is to pay the expenses of Lord to be incurred in going to Milne Bay to make an inspection and valuation. If War Assets sells outright the rights which it acquires, Lord is to receive ten per cent of any profit realized. If it does not, it is to deliver to Lord certain items of the material at Milne Bay to the value of £8000. The agreement thus imposes on War Assets in certain events, definite obligations to Lord.

It would appear that about this time Westhoven and Lord proceeded to Papua and made a preliminary inspection of material lying in the Milne Bay area. It is clear from a letter from Mr. J. I. Cromie, a solicitor practising at Port Moresby, that Mr. Westhoven was at Port Moresby on 8th August. Before his departure Mr. Cody had seen Mr. Wren and discussed the whole matter with him. Both Mr. Cody and Mr. Wren were wealthy men, and already subject to income tax at the maximum rate. The conclusion of their discussion may be stated in Mr. Cody's own words. He said in evidence : " We both agreed that the proposition would not be of any use to us unless we could get it free of taxation. It was in a wild part of New Guinea, and we agreed that we would not go into this unless any profits that might be made would be free of taxation." As a result of this discussion Mr. Buckley of Buckley & Hughes was consulted. Mr. Buckley ultimately gave his advice in a letter to Mr. Wren of 22nd September 1947. I think it probable that he had given oral advice considerably earlier. In his letter he called attention to s. 7 (1) of the *Income Tax Assessment Act*, which provides that the Act extends to the territories of Papua, Norfolk Island and New Guinea, but does not apply to " any income derived by a resident of those Territories from sources within those Territories ". On the question of the residence of a company, Mr. Buckley referred to the *Koitaki Para Rubber Estates Ltd.* v. *Federal Commissioner of Taxation* (1) as deciding that a company resides where its real business is carried on, and that the real business is

(1) (1941) 64 C.L.R. 241.

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carried on where the central management and control actually abides. He understood, he said, that it was possible to form companies in Papua, and would endeavour to obtain copies of the relevant ordinances. He pointed out that sums distributed to an Australian resident by a company resident in Papua would be subject to Australian income tax. On 23rd October 1947 Mr. Buckley followed up his former letter by a letter which referred to the *Companies Ordinances* of Papua, and explained that there would be no difficulty in incorporating a company in that Territory.

In late August and early September matters appear to have been held up because the quotation of a definite price could not be obtained from Vacuum, and at some time in September Mr. Cody left Australia on a proposed visit to America. On arrival in Fiji en route he received from his brother a cable with regard to the Papuan proposal, which caused him to return to Melbourne. On or about 26th September Mr. Rabling, managing director of Vacuum, made a definite offer to sell the disposal material at Milne Bay for £65,000, payable as to £5,000 forthwith, as to £25,000 on the execution of a contract, and as to the balance of £35,000 three months thereafter.

In the meantime, Mr. Baker had entered on the stage. Mr. Baker was the proprietor of a garage business at Albury, but had many other interests, and in particular had dealt, on a fairly large scale, in disposal material. In connection with these dealings he had made the acquaintance of Mr. Westhoven, and it was through Mr. Westhoven that he was introduced to Mr. Cody and became interested in the Milne Bay venture. It may have been that this resulted (as Mr. Westhoven rather suggested) from a fortuitous meeting between Mr. Westhoven and Mr. Baker at Scott's Hotel. On the other hand, it may have been that Mr. Baker was in effect sought out, because it was thought that the introduction of a third party, who was not interested in War Assets, would strengthen the taxation position. I am not prepared to say which was the true position. At any rate, Mr. Baker was introduced to the venture, probably in September, and it was agreed that he should have a one-third interest in the venture if it were proceeded with. Mr. Cody said : " I told him at that time that we would be prepared to come in on a share basis, that we would want two-thirds and he would get one-third ". Asked what he meant by " we " Mr. Cody said : " That was War Assets Pty. Ltd. At that time anything I was doing was War Assets." After the receipt of the definite offer from Vacuum, Messrs. Baker and Westhoven proceeded to Milne Bay to make a final inspection of the site and the material before

a final decision was reached. Before leaving, Mr. Baker wrote on 4th October a letter enclosing a draft for £1666 13s. 4d. and saying: "Re Milne Bay. Just in case the report on above is O.K., and the preliminary deposit of £5,000 has to be paid before my return, herewith please find bank draft for £1666 13s. 4d., covering my 'corner'."

On 15th October Mr. Westhoven sent from Samarai, on behalf of himself and Mr. Baker, a radiogram to Mr. Cody which commenced with the word "Advanx" (a code word agreed on as meaning "position here satisfactory"), and which recommended the acceptance of Vacuum's offer. On 16th October Mr. Nolan wrote to Lord, saying that War Assets exercised its option of purchase and asking him to exercise his option as against Vacuum. The letter suggested that Vacuum should deal henceforth direct with War Assets. On the same date Lord wrote to Vacuum enclosing a copy of Mr. Nolan's letter. By his letter Lord accepted his option as against Vacuum, and said that he was agreeable to the arrangement that Vacuum should henceforth deal direct with War Assets. On 17th October Mr. Cody paid £5,000 to Vacuum by means of a cheque drawn on his private bank account, one-third being in fact provided by himself, and one-third by Mr. Wren. The remaining one-third had been received from Mr. Baker with his letter of 4th October. The receipt given for this payment of £5,000 was headed "Deposit on acceptance of offer—purchase of Milne Bay property", and stated the amount as being received from "War Assets Ltd., Melbourne".

On 24th October 1947 a conference was held at Mr. Nolan's office, at which Messrs. Cody, Nolan and Burns were present. At this conference Mr. Nolan made a note of various matters to be attended to, which included "Assignment of agreement between Vacuum and War Assets to Milne Bay Merchants Ltd." From this the intention to form a new company is apparent. On 3rd November a further conference was held at Mr. Cody's office, at which Mr. Cody, his brother, and Messrs. Westhoven and Baker were present, with Messrs. Nolan and Burns "in attendance". A clear and careful note made by Mr. Cody at the time records the decisions made. These had most probably been informally discussed at an earlier date. They need not be set out in full because most of them were, in substance, later carried out. It is to be observed, however, that, subject to the approval of Mr. Buckley, a new company known as Milne Bay Merchants Ltd. was to be registered in Papua for the purpose of taking over the contract of sale between Vacuum and War Assets. The shares were to be

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held as to two-thirds by War Assets and as to one-third by Baker. The memorandum was to be signed by seven persons at Port Moresby. One share of £1 was to be issued to each of the subscribers, who were to execute deeds of trust showing that the shares issued were held as to two-thirds for War Assets and as to one-third for Baker. It was also decided that, to enable the Milne Bay company to finance " its commitments, more particularly in respect of (a) preliminary expenses of Westhoven, Lord and Baker in connection with visits to Milne Bay, (b) assignment of the contract between Vacuum Oil Co. and War Assets Pty. Ltd., (c) working expenses for a period of three months ", loans were to be provided, as and when required, by Messrs. Cody, Wren and Baker in equal proportions. It was anticipated that each would be required to provide £2,000. On 7th November 1947 Mr. Nolan wrote to Mr. Cromie at Port Moresby a letter enclosing a memorandum and articles of association of the proposed company. He also enclosed declarations of trust of the shares. He requested that the company be registered as soon as possible. It is interesting to note, from Mr. Cromie's acknowledgment of these documents on the 11th, that there was some " congestion " in the office of the Registrar of Companies at Port Moresby.

On 10th November 1947 Mr. Cody opened an account known as the " P. F. Cody No. 2 Account " in the Richmond branch of the Bank of New South Wales. This account was opened by the deposit of a cheque for £2,000 drawn on Mr. Cody's personal account at the same bank. On 12th and 13th November two further sums of £2,000 were paid in, these sums being provided respectively by Messrs. Wren and Baker. The purpose of these deposits was to provide working capital for the Milne Bay venture in pursuance of the decision as to finance reached at the conference of 3rd November. It will be necessary to refer later in more detail to this account, but it may be mentioned here that Mr. Cody kept a record of deposits into and withdrawals from this account in a small book with a blue cover which he entitled " Milne Bay Merchants Ltd.—P. F. Cody (No. 2 Account) Receipts and Disbursements ". This book was referred to at the hearing as the " blue book ".

On 13th November 1947 a contract was executed by War Assets and Vacuum. The contract recites the title of Vacuum to certain goods and chattels in the Milne Bay area. It should be mentioned that the company named in the recitals as Milne Bay Traders Ltd. is a company which had no connection with Milne Bay Merchants Ltd. and does not figure in this case at all except as a person through

whom title to the goods in the Milne Bay area is traced. By the contract Vacuum agrees to sell to War Assets, and War Assets agrees to buy from Vacuum, all those goods and chattels situate at Milne Bay which have been acquired by Vacuum, with certain specified exceptions, including certain goods which have been sold to Thiess Bros. (a Queensland firm) and not yet delivered. The consideration for the sale is £65,000, of which £5,000 has been already paid. A further sum of £25,000 is to be paid on the execution of the agreement, and the balance of £35,000 within three months of the execution of the agreement. There is a proviso for the reduction of the price in the event of the delivery of certain specified goods to Thiess Bros. Certain spare parts and provisions and other goods which have been ordered by Vacuum and arrived at Milne Bay after payment of the deposit of £5,000 are to be taken over by War Assets and paid for by it at landed cost. War Assets is to take over and indemnify Vacuum against guarantees given by Vacuum (presumably under the *Labour Ordinances* of the Territory) relating to certain European employees and native labour. War Assets is to permit Vacuum to use all facilities at its disposal in the area to assist Vacuum in the removal and shipping of goods belonging to Vacuum in the area and not sold to War Assets, and is to provide employees of Vacuum engaged in the area at the cost of Vacuum with such accommodation, transport and provisions as may be available. The due performance by War Assets of its part of the contract was guaranteed by Messrs. Cody, Wren and Baker. The guarantee refers to the main agreement as an agreement to sell to War Assets or its assigns. This, however, is incorrect. There is no mention of assigns in the contract of sale.

It is to be observed that certain definite obligations, apart from the obligation to pay the price, are imposed by this agreement upon War Assets. Primarily, however, the contract appears to be a contract for the sale of specific goods, and, the contract being made in Victoria and governed by the law of Victoria (which is to be found in the *Goods Act* 1928 (Vict.)), the property in the goods would presumably pass to War Assets on the making of the contract.

The sum of £25,000 which was payable on the execution of the contract was paid by Mr. Nolan to Vacuum by bank cheque, the amount being again actually provided as to one-third each by Cody, Wren and Baker. It is convenient to depart from chronology at this point and mention how the remainder of the price was paid. The balance of £35,000, which was payable in three months time, was not in fact paid on the due date, the reason being that a dispute had arisen as to the goods which had in fact been sold by Vacuum

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to Thiess Bros. A sum of £25,000 was paid to Vacuum on 16th February 1948. This was paid, as had been the deposit of £5,000, by cheque drawn by Mr. Cody on his own private account. Mr. Baker found it inconvenient to contribute, or at any rate did not in fact contribute, to this sum, and it was provided as to £12,500 by Mr. Cody and as to £12,500 by Mr. Wren. The contract balance of £10,000 remained in dispute for a time, but a final payment of £4,500 was made in full settlement on 30th April 1948. This sum was paid to Vacuum by cheque drawn by Mr. Cody on his No. 2 account, to which reference has already been made. Receipts for these payments are not produced, but it is plain that in each case the debt which was discharged by the payment was a debt owing by War Assets to Vacuum.

Milne Bay Merchants Ltd. was incorporated in Papua on 26th November 1947, the relevant documents being dated 15th November. The memorandum and articles of association were signed by Messrs. Westhoven and Baker before these documents left Melbourne on the 7th. The *Companies Ordinance* of the Territory of Papua requires seven signatories to the memorandum and articles, and the other five were provided by Mr. Cromie for the purpose and signed at Port Moresby on 15th November. Each of the seven signatories subscribed for one share. On the same date (15th November) share certificates for one share each were issued, purporting to be sealed by the still non-existent company. A common seal for the company had been brought to Port Moresby by Mr. Westhoven. No amount is shown by the certificates as paid up on any of the shares, and in fact no amount was paid up on them until a considerable time later. Each certificate, except the one issued to Baker, was indorsed with a transfer in blank signed by the person named in the certificate as the holder. Also on the same day declarations of trust of the shares (other than Baker's share) were signed. Again it will be convenient to depart from chronology and to mention that these declarations of trust appear not to have carried out the original intention that the beneficial interest in the Milne Bay company should belong as to two-thirds to War Assets and as to one-third to Baker. Mr. Baker held one share out of seven in his own right, while the other six appear to have been declared as held in trust for War Assets and Baker. This would appear to have given to Baker a four-sevenths interest and to War Assets a three-sevenths interest, which, of course, was never at any time intended by anybody. Nothing was done to remedy this until as late as February 1952. As to what was then done, the evidence is probably incomplete, but two new shares were issued to Baker with the

authority of a meeting of directors, so that he became legal and beneficial owner of three of the nine shares now issued. This gave him his one-third interest, and certain new declarations of trust were then signed, with the final result that the remaining six shares are held in trust for War Assets.

The nominal capital of the Milne Bay company was £25,000 divided into shares of £1, but no more than the nine shares (the last two issued in February 1952) were ever issued. The directors were Messrs. Westhoven and Baker, Mr. Westhoven being chairman. The articles provided that at meetings of directors the chairman should have a casting vote. Each received a salary of £500 per annum for the first three months and £1,000 per annum thereafter. It is not clear exactly when the employment of either ended, but that of Baker probably came to an end in April or May 1948, and that of Westhoven about the middle of 1949.

No document was ever executed, and no formal act was ever done, by way of transferring from War Assets to the Milne Bay company the property in the goods bought by War Assets from Vacuum under the agreement of 13th November 1947 or the rights of War Assets under that agreement. Since War Assets by that agreement undertook obligations to Vacuum to pay money and to do other things, it would not have been possible to put the Milne Bay company in the place of War Assets under the agreement except by means of a novation, to which Vacuum would have been a necessary party, but there seems to have been no legal reason why the property in the goods bought should not have been transferred from War Assets to the Milne Bay company. Mr. *Holmes* (for the commissioner) pressed upon me the view that the omission to make a formal transfer of the property in the goods was deliberate. Mr. Nolan said in evidence that he gave instructions to a conveyancing clerk in his office to prepare an " assignment ", and implied, I think, that it was only through an oversight on the part of this clerk that no such document was ever prepared. I shall refer further to this matter later. Mr. Cody's notes of the conference of 3rd November 1947 seem clearly to show that it was intended at that stage by the individuals concerned that any rights acquired by War Assets should be transferred to the Milne Bay company when formed. Mr. *Tait* (for the appellant taxpayer) contended that, in spite of the absence of any document or formal act, the property actually passed to the Milne Bay company by virtue of what happened subsequently.

Early in November 1947 Messrs. Westhoven and Baker proceeded to Papua. Before leaving Melbourne Mr. Westhoven sold his house,

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and he took his wife and young child with him. For some twenty months he remained in Papua, living for the most part at Milne Bay in a " Quonsett hut " which he described, for my enlightenment, as a " round tin thing which the troops used to live in ". He had an office in another hut. He visited Port Moresby from time to time, and came down to Melbourne for short periods on two or three occasions. His wife and child were compelled by ill-health to return to Melbourne in April or May 1948. There was no regular means of communication between Milne Bay and the outside world, and there was little in the way of civilized amenities. It is not, of course, material for the purposes of the present case, but I should think that Mr. Westhoven became a resident of Papua for a substantial period. He was faced with many difficulties of many and various kinds. I cannot say that I have an entirely clear picture of what was going on, but I am left with a strong impression that over a substantial period he worked diligently for the success of the venture, as indeed it was in his interest to do. Mr. Baker also remained in Papua for a period of some eight or nine months attending to the interests of the venture, though he appears (to use Mr. Westhoven's word in a letter to Mr. Cody) to have " panicked " at an early stage and flown back to Melbourne, where he remained for a short time. It may be because of some such fit of " panic " that Mr. Baker did not contribute to the £25,000 which was paid to Vacuum in February 1948. When he left Papua on the first occasion a Mr. Cotman was appointed as an alternate director for him. Before Mr. Baker's final departure a good deal of friction had developed between the two directors.

Up to this point a fairly detailed examination of everything that was done has seemed to me to be unavoidable. The rest of the story can be told in a more summary way. Regular meetings of directors of the Milne Bay company were held in Papua up to April 1949. Full minutes were kept by a Mrs. Stanley, who was appointed secretary of the company. Certain employees were engaged and wages and salaries paid. An account was opened in the Bank of New South Wales at Port Moresby. The company appears to have had the use of an office in a building occupied by one of its agents at Port Moresby. Messrs. P. A. Trouchet & Co. of Melbourne were appointed general agents for the sale of the material, though I gather (but I may be mistaken in this) that Westhoven dealt directly with buyers who resided in the Territory, or who visited the Territory for the purpose of buying. All sales were made ostensibly by the Milne Bay company as seller. The buyer was in all cases responsible for the transport of the goods bought

from the Milne Bay area to wherever he wanted them. Many sales involving large sums of money were made. Towards the close of the financial year 1947-1948 two very large shipments were made in vessels named the *River Norman* and the *Trienza*. The latter vessel was owned by the British Phosphate Commission, and took a large quantity of material to Nauru. On 20th September 1948 what has been called a "joint venture agreement" was made between the Milne Bay company and a company named Excavators (Papua) Ltd., in which Thiess Bros. of Queensland were interested. The substantial effect of this agreement was that the profits made by sales of the material in the financial year 1948-1949 were divisible between the two companies in the proportion of fifty-five per cent to the Milne Bay company and forty-five per cent to Excavators. The advantage to the Milne Bay company was that it obtained expert assistance in the selection and loading of material, which had become very much more difficult to handle, since what remained was now some distance away from the shores of the Bay.

In April 1949, a large part of the material having been disposed of, it was considered that the best course was to dispose, if possible, of what was left as a whole, and a meeting of directors resolved to negotiate with the Union Manufacturing & Export Co. Ltd., a company incorporated in New Zealand, which was interested in purchasing what remained. On or about 31st May 1949, an agreement with the New Zealand company was executed, whereby the remainder of the material in the Milne Bay area, with certain exceptions, was sold by the Milne Bay company to the New Zealand company for £16,500. With the execution of this contract and payment of the purchase price the Milne Bay venture came to an end.

I must mention two other matters before I proceed to consider the arguments of counsel. The first is that, while Mr. Westhoven was in Papua, a regular correspondence took place between him and Mr. Cody in Melbourne. Mr. Cody was kept fully informed from time to time of what was being done in the Territory, and from time to time made comments and expressed opinions, to which I would infer that effect was generally given. This correspondence is contained in Exhibit C1, which comprises over seventy letters, most of them of considerable length. It does, I think, show Mr. Cody exercising a considerable degree of control over what is going on. If the commissioner had assessed the Milne Bay company, the question would or might have arisen as to whether the company was a resident of Papua, and this question might have turned on where its central control and management lay. The commissioner,

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however, has assessed not the Milne Bay company, but War Assets, which is clearly not a resident of Papua, and I have not been able to see that this correspondence between Messrs. Westhoven and Cody throws very much light on any problem which arises in this case, although I shall refer to it in one connection later.

The second matter is this. I have already referred, in passing, to the " P. F. Cody No. 2 Account ", which was opened in the Bank of New South Wales at Richmond on 10th November 1947, but it is necessary, before proceeding, to examine it in more detail. I have mentioned that three sums of £2,000 were deposited in that account on 10th, 12th and 13th November, and that these sums were provided respectively by Messrs. Cody, Wren and Baker. This was, of course, before the incorporation of the Milne Bay company. Also before the incorporation of that company, sums totalling £1,058 were withdrawn from the account. These were sums for the travelling expenses of Messrs. Westhoven and Baker and for certain purchases and other expenses incurred in Melbourne (including solicitors' fees) in connection with the Milne Bay venture. The largest sums were one of £300 and another of £500, which were transferred by telegraph on 21st November to the credit of Mr. Baker at Cairns and Port Moresby respectively. In December 1947 two sums of £2,000 were transferred by telegraph to the Milne Bay company at Port Moresby. On 27th February 1948 and 1st March 1948, sums of £5,000 and £1,000 were paid to the credit of the account. These represented the first proceeds of the operations at Milne Bay remitted from Port Moresby. The payment of these sums into the account enabled Mr. Cody to make thereout on 5th May 1948 (as I have already related) the final payment of £4,500 due by War Assets to Vacuum under the contract between the two companies. The account was at all times in credit.

Various charges and expenses payable in Melbourne in connection with the Milne Bay venture were from time to time throughout its existence paid out of the account. Most of these were comparatively small sums, the larger cheques being mostly drawn to pay commission due to P. A. Trouchet & Co. In June 1948 two large sums totalling over £57,000 were paid into the account. These represented the proceeds of the *River Norman* and *Trienza* shipments and came from Trouchet in Melbourne, Mr. Cody having given instructions that the money should be paid by Trouchet in Melbourne " in order to avoid the double exchange " which would have been involved if the money had been sent to Port Moresby and then remitted to Melbourne. On 29th July 1948, Mr. Cody drew a cheque on the account for £22,500, and repaid to himself

the total of the sums which he had provided towards the payments (other than the final sum of £4,500) made to Vacuum under the contract with War Assets. A day or two later he repaid out of the account the sums, totalling also £22,500, which had been provided by Mr. Wren towards the payments made to Vacuum under the contract. It will be remembered that Mr. Baker had made no contribution to the payment of £25,000 which was made to Vacuum in February 1948. His total contribution had been £10,000, and this sum was repaid to him out of the P. F. Cody No. 2 account on 6th July 1948. In that month a remittance of £6,000 was received from Port Moresby and paid into the account, and in August Mr. Cody, by cheque drawn by him on the account, repaid to himself and Messrs. Wren and Baker the three sums of £2,000 which had been paid in for working expenses in November 1947. All "advances" provided by the three individuals had now been repaid in full. Further large sums were paid in from time to time, being either received from Trouchet in Melbourne or remitted from Port Moresby, and payments were made out for commission and various expenses incurred in Melbourne in connection with the venture. A large remittance from Port Moresby was a sum of £23,700 paid into the account in February 1950, and the final payment into the account was a sum of £9,962 6s. 5d., which came from an account kept in Brisbane. In May 1951 the account showed the large credit balance of £117,435 18s. 7d., and the operations in the Milne Bay area had been concluded. On 18th May 1951 a meeting of the directors of the Milne Bay company was held in Melbourne, at which Messrs. Westhoven and Baker were present. In accordance with a resolution passed at that meeting, which is recorded in the minutes, the balance in the P. F. Cody No. 2 account was transferred to a new account opened in the same bank in the name of the Milne Bay company, and the P. F. Cody No. 2 account was closed. With the money now standing to the credit of the new account Commonwealth bonds were purchased to the face value of £118,180, and these bonds are now held by the bank, which has acknowledged that it holds them in safe custody on behalf of the Milne Bay company. No dividend was ever declared by that company, and no step has been taken to wind up either of the companies.

If I understand the position aright, as explained to me by counsel, what the commissioner has done is this. He has taken the profit ostensibly realized by the Milne Bay company in the financial year 1947-1948 and has assessed two-thirds of that profit as income derived by War Assets in that year. I was informed that he had

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assessed Mr. Baker in respect of the remaining one-third of that profit as income derived by Mr. Baker in that year. In respect of the financial year 1948-1949 he has proceeded on the same basis, but has had regard to the "joint venture", which was instituted in that year under the agreement between the Milne Bay company and Excavators (Papua) Ltd. Accordingly he has taken the profit ostensibly derived by the "joint venture" in that year, and has assessed two-thirds of fifty-five per cent of that profit as income derived by War Assets in that year, and one-third of that profit as income derived by Mr. Baker in that year. Only the assessments of War Assets are before me on these appeals. Mr. *Holmes* advanced two main arguments in justification of the course adopted by the commissioner. For the purposes of his first argument, he accepted everything that was done at its full face value, but, laying stress on certain things that were not done, he contended that the Milne Bay company handled the material in Papua as a mere agent of War Assets, which owned the material throughout until it was sold to the various purchasers. It followed, he said, that the proceeds of sale, less all proper charges, belonged to War Assets. In other words, what was put forward as the income of the Milne Bay company was really the income of War Assets. Mr. *Holmes's* second argument was that, if there was a transfer of the property in the goods to the Milne Bay company, that transfer amounted to an "arrangement" of one or more of the kinds mentioned in s. 260 of the *Income Tax Assessment Act* 1936-1947. Then, he said, the avoidance of that arrangement as against the commissioner by s. 260 created a notional position identical with that which is put by the first argument as the actual position.

It will be observed that the arguments, as I have so far stated them, leave Mr. Baker out of the picture, and he cannot be left out of the picture. Actually, I think, his position was put in two ways. It was said, firstly, that the Milne Bay company handled the goods on behalf of War Assets *and Baker*. There are serious, and, to my mind, insuperable, difficulties about this view, because the whole basis of the argument is the ownership of the goods, and Mr. Baker was never an owner of the goods. It was said, secondly and alternatively, that, while War Assets was the legal owner of the goods, it held them on trust, as to a one-third interest for Baker. But there are serious difficulties about this view also. Mr. Baker's ostensible interest in the venture was as a shareholder in the Milne Bay company. If the true view is that that interest is worthless as such because the Milne Bay company is merely an agent for the owner of the goods (War Assets), then it does not seem possible to

me to find any contract or trust brought into existence as between War Assets and Baker. No such contract or creation of trust was ever authorized by the directors of War Assets. Mr. Baker's rights seem to me to rest on the agreement made on 3rd November 1947 and on certain implications from that agreement. Those rights were not direct rights against War Assets but rights against Messrs. Cody, Wren and Westhoven, as individuals. I think, however, that those rights were enforceable and could be the subject of specific relief, which would, in the last resort, result in War Assets being compelled to give effect to Mr. Baker's agreed one-third interest in the venture: cf. *Marriott* v. *General Electric Co. Ltd.* (1). If, therefore, Mr. *Holmes's* first argument, as I have stated it, is found to be sound, it would appear that the commissioner will have been right in attributing one-third of the income in question to Mr. Baker, although his interest is enforceable only indirectly against War Assets.

I think I should begin by saying that I accept generally the evidence given on behalf of the appellant company. There may have been a little reticence here and there, which counsel for the commissioner could have probed if he had wished, but I have seen no reason to suspect that anything of any importance has been concealed, or that anything untrue or misleading has been said. It was frankly admitted—I should rather say it was asserted—that the course adopted was adopted for the purpose of escaping taxation as far as possible. The dramatist who conceived Utopia Ltd. and the Duke of Plaza-Toro Ltd. might have found material for satire in the highly artificial structure which was erected. But I have to treat it as presenting a serious legal problem, and I am strongly of opinion that it is not a court's business to criticize what was done in such a case as the present.

Mr. *Tait's* primary argument was clear and simple. He said that the Milne Bay company was a corporate person duly constituted under the laws of Papua, that it actively engaged in Papua in collecting and selling disposal goods, that it made a profit by so doing, and that that profit, unless and until distributed in accordance with its articles, belongs to it and does not belong to its shareholders. In substance, Mr. *Tait* said, the case was one in which the commissioner was seeking to tax the shareholder in respect of his company's profits as such. If War Assets and Mr. Baker had played no part in the drama except that of shareholders in the Milne Bay company, it might have been difficult for Mr. *Holmes* to find an answer to Mr. *Tait's* argument. He might have had

(1) (1935) 53 C.L.R. 409, at p. 426.

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recourse to s. 260 of the *Income Tax Assessment Act* 1936-1947, but it might have been difficult to apply that section. These matters, however, need not be considered, because neither in form nor in substance is the case nearly so simple as Mr. *Tait* suggested. It is necessary, I think, to begin at the beginning and attempt to arrive at the correct legal analysis of the situation actually created by virtue of what was done—a situation which may be found to be different from that which it was desired to create. It must be a strict and formal analysis. The appellant cannot rely on " form " for one purpose and on " substance " for another. In particular, we cannot treat a company as having done an act, which it did not in fact do, merely because those who were in a position, by taking certain steps, to place themselves in control of the company desired and intended that the company should do the act.

The first step that need, I think, be mentioned is the execution of the " heads of agreement " of 4th August 1947 by War Assets and Lord. The sealing of this document by War Assets was authorized, according to the minute book, by a meeting of directors held on that date, at which Messrs. Burns and Randall were present. At this stage, so far as appears, the plan of forming a Papuan company had not been suggested. The proposal at the conference on 22nd July had been that a syndicate should be formed in which War Assets should hold five or six out of a total of ten shares.

The next steps were the acceptance by War Assets of Lord's option on 16th October and the payment on 17th October by Mr. Cody to Vacuum out of his own pocket of the sum of £5,000. This was the amount required as a deposit by the terms of Mr. Rabling's offer. The receipt was given as for a payment by War Assets to Vacuum, and the payment cannot, to my mind, be regarded otherwise than as a payment by Mr. Cody on behalf of War Assets and as constituting a loan by him to War Assets. If it is suggested that War Assets did not " officially " know of the payment, the answer seems to be that by authorizing the execution of the final agreement of 13th November, which recites the payment, it must be taken to have ratified it. In fact the sum of £5,000 had been contributed in equal shares by Mr. Wren, Mr. Baker, and Mr. Cody himself. Therefore, if and when the loan were repaid by War Assets, Mr. Cody would be bound to repay to Mr. Wren and Mr. Baker the amounts respectively contributed by them.

The next important event is, I think, the conference which was held at Mr. Cody's office on 3rd November 1947. This was a conference between certain individual persons, at which certain decisions were reached, but what was said and done had probably no

immediate contractual or other legal effect, though I have already suggested that, in certain events and with the help of certain implications, Mr. Baker would be protected by the agreement reached in respect of his one-third interest in the venture. War Assets, as a corporation, was not a party to any such agreement and was not bound by it, but Cody and Westhoven were in a position in the last resort to exercise complete control over War Assets, and I have stated my view that they could have been compelled in the last resort to exercise the powers given by the declaration of trust, and then their voting power, in order to give effect to what was agreed to by the individuals concerned.

The next step is the opening by Mr. Cody on 10th November 1947 of the " P. F. Cody No. 2 Account " in the bank at Richmond and the deposit therein of the three sums of £2,000. This account was undoubtedly a trust account. It was put by Mr. *Tait* that it was a trust account for the Milne Bay company. The sums of £2,000 must be taken to be the three sums of that amount which it had been agreed on 3rd November should be advanced by Messrs. Cody, Wren and Baker to the Milne Bay company for " working expenses for a period of three months ". But it seems impossible to maintain that this account was, at its inception, a trust account for that company, for that company was not in existence. Before the company came into existence Mr. Cody paid out sums totalling £1,058 in connection with the Milne Bay project. The only possible inference seems to me to be that, at its inception, the moneys standing to the credit of the account were held on trust for payment thereout at Mr. Cody's discretion of expenses in connection with the Milne Bay project and, subject thereto, on trust for War Assets and Mr. Baker in equal shares. Whether the trust changed its character on the incorporation of the Milne Bay company or at some later stage is a matter which I will leave for the moment.

The next important event is the execution on 13th November 1947 of the contract of sale between Vacuum and War Assets. The execution of this agreement on behalf of War Assets was (according to the minute book of that company) authorized at a meeting of directors held on 10th November, at which Messrs. Burns and Randall were present. On the execution of the agreement the sum of £25,000 was paid to Vacuum. It seems clear that the position in respect of this sum was in substance the same as the position in respect of the sum of £5,000, which was paid as a " deposit ", on 17th October. That is to say, it represented a loan to War Assets. The money had been provided in equal shares by Messrs. Cody, Wren and Baker, and was repayable to them. By the contract of

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13th November War Assets undertook certain definite obligations, including an obligation to pay a further sum of £35,000 on 13th February 1948, to Vacuum. The due performance of those obligations by War Assets was guaranteed by Messrs. Cody, Wren and Baker.

It is convenient to pause here to emphasize the legal position which existed on 13th November after the execution of the contract of sale of that date. It seems to me to be quite clear. The Milne Bay company simply does not exist. Certain steps have been taken by Messrs. Cody, Wren and Baker towards bringing it into existence, but it may or may not come into existence. If it does come into existence, there can be no suggestion that it can simply ratify and take over the contract. Apart altogether from the doctrine of *Kelner* v. *Baxter* (1), War Assets has not purported to make the contract on behalf of any Milne Bay company or on behalf of anybody but itself. The position is purely and simply that War Assets has bought certain goods from Vacuum for £65,000, that it has paid £30,000 on account of the purchase price, and that it has promised to pay the balance of £35,000 on 13th February 1948. I can see no possible escape from this position.

It is clear, in the next place, that no property or right acquired by War Assets under its contract with Vacuum passed to the Milne Bay company by virtue of the mere fact of the incorporation of that company. Nor am I able to find on the evidence that any such property or right ever passed at any stage to the Milne Bay company. There is no evidence of a novation. On the contrary, we find Vacuum, as late as June 1948, when a large part of the material has been realized, and a dispute with third parties as to the ownership of certain goods has arisen, writing to Mr. Nolan and saying (Exhibit C2) :—" Our opinion is that it is the responsibility of War Assets Pty. Ltd. to protect their own interests in this matter." No deed transferring the property from the one company to the other was ever executed. There was no sale to the Milne Bay company of anything acquired by War Assets, and no agreement to sell anything so acquired. It seems impossible to suggest, and it was not suggested, that a sale in consideration of the allotment of shares to nominees of War Assets should be implied. The only shares originally issued were issued to the signatories of the memorandum as such and for a cash consideration. The two shares issued long afterwards to Mr. Baker were also for a cash consideration, and in any case obviously could not affect the position.

(1) (1866) L.R. 2 C.P. 174.

Novation, deed and sale, being out of the way as possible ways in which property could be transferred from War Assets to the Milne Bay company, the only remaining possibility seems to be delivery by way of gift. And I understood Mr. *Tait* to put it that delivery of the goods had been made by Vacuum to the Milne Bay company with the consent of War Assets, and that this effected a transfer of the property therein.

I am prepared to assume that delivery of the goods was effected by a Mr. Queen, acting on behalf of Vacuum at Milne Bay, to Mr. Westhoven who was in fact acting on behalf of the Milne Bay company. Even this is not clear, because I think that Mr. Westhoven had met Mr. Queen for the purpose of " taking over " at Milne Bay before the actual incorporation of the Milne Bay company. I think it probable, however, that what may be called the " handing over ", the ascertainment and acceptance of the goods which had been bought, was not complete until early in December 1947.

There is, I think, no affirmative evidence whatever that War Assets ever consented to the physical or constructive delivery of the goods to the Milne Bay company. The curious fact is that, although the directors of War Assets appear to have met on 10th August 1947 and authorized the sealing of the contract with Vacuum— a contract which, on the one hand, vested in their company what might prove a very valuable asset, and, on the other hand, committed their company to an expenditure of £35,000, they never thereafter gave a moment's thought to the matter. In preparing and presenting their accounts, they entirely ignored both the asset and the liability. There is no mention in the accounts of War Assets of this quite important transaction with Vacuum, and there is no mention of it in the minutes of meetings held subsequently to 10th August 1947. Nor is there the slightest suggestion of any transaction of any kind with the Milne Bay company. For that matter, an equal silence on the subject is preserved in the minutes of meetings of the directors of the Milne Bay company, and an equal silence in the accounts of that company until in 1950 an attempt is made by Mr. Burns to audit the accounts of that company, and Mr. Burns, by direction of Mr. Buckley (see Exhibits C5 and C6) makes entries which purport to show a purchase by the Milne Bay company not from War Assets but from Vacuum, and loans by Messrs. Cody, Wren and Baker to enable the Milne Bay company to discharge a liability not to War Assets but to Vacuum. Legally speaking this seems to me, as I have said, not to be a possible view of what happened. However, in spite of this initial silence and ultimate confusion, I am prepared to assume also that War Assets

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must be taken to have assented to the delivery of possession by Vacuum to the Milne Bay company. But it by no means follows that the property in the goods passed by that delivery to the Milne Bay company.

This " silence ", as I have called it, this omission not only to effectuate a clear formal assignment of the property but to record in accounts and minutes things which one would certainly expect to find recorded, has puzzled me a good deal in this case. Mr. *Holmes* strongly pressed upon me the view that at least the omission to have a formal assignment executed was not accidental but deliberate. I was disposed to scout this suggestion, largely because I accepted (as I still accept) Mr. Nolan's evidence that he gave instructions to have a document prepared, and also because I think it clear that the individual persons concerned originally intended to have an assignment of some kind executed. After consideration, however, I think that there may be something in the view put by Mr. *Holmes*. The reason suggested was that an actual transfer of the property to the Milne Bay company would have weakened the control which Mr. Cody was determined to retain, and Mr. *Holmes* relied on Exhibit C1 (to the general nature of which I have referred above) as showing that Mr. Cody was exercising a degree of control over the operations in Papua. This argument seemed to me to be somewhat far-fetched, but it is not impossible that Mr. Cody wished to " have it both ways ", so to speak, and in this connection what I shall have to say in a moment about the " P. F. Cody No. 2 Account " is material. And other considerations occur to me. What was contemplated, according to Mr. Nolan's notes of the conference of 24th October 1947 (Exhibit T22), was an " assignment of agreement between Vacuum and War Assets to Milne Bay Merchants Ltd." The assignment is to include (see Exhibit T23) a " covenant by Milne Bay company to carry out War Assets agreement to Lord ". The nature of the document thought to be needed is thus referred to in general terms, but to anybody who actually sat down to draft such a document quite serious questions must have occurred. What is to be the consideration for the assignment ? Mr. Burns said in evidence that he never knew, and did not know now, what the consideration was supposed to be. Having regard to the purpose in hand, and to the structure of the two companies, is there really *any* consideration for this assignment ? What is wanted then is a deed of gift ? What about stamp duty and gift duty ? If the property assigned is in Papua, neither will be payable. But we are supposed to draw an assignment of a contract, and may not the rights constituted by the

contract be held to be situate in Victoria ? At this point a very dangerous point might occur to the draftsman. Is not the real position this, that what War Assets has to dispose of is goods in Papua of which it is the legal owner ? And is it not very likely that a disposal of these goods to the Milne Bay company will be a disposal of trading stock, which may well sooner or later involve War Assets in trouble under s. 36 of the *Income Tax Assessment Act* 1936-1947 ? All or some of these considerations may have occurred to somebody at some stage. I think it was fully realized by all concerned that War Assets was in fact and in law acquiring property from Vacuum, and that it was originally intended that there should be a formal document, of such a nature as the legal and accountancy advisers of those concerned thought appropriate, the effect of which would be to transfer the property in question to the Milne Bay company. I accept Mr. Nolan's evidence that he instructed his clerk to prepare such a document. I have not, however, felt convinced that in the end the omission to make any record in the books of War Assets and the omission to make any formal transfer were mere accidents.

It is not, I think, of decisive importance whether these things were accidents or not. Whether they were or not, the fact is that there is no record in the minutes or in the books of account of War Assets, and no other evidence of any kind, so far as I can see, from which it is possible to infer any intention on the part of War Assets, as a corporation, to transfer any property or any right to the Milne Bay company. The fact (if fact it be) that four individual persons, not one of whom was even a shareholder in War Assets, desired and intended that War Assets should develop and give effect to such an intention, appears to me to be irrelevant. It appears to me to be equally irrelevant that, by taking certain steps, those persons could have placed themselves in control of War Assets and caused War Assets to do their will. The fact is that no such steps were ever taken. It may indeed be said that the one essential fact in the whole case is that the Milne Bay company was selling goods which were owned by War Assets.

The taking possession of the material by the Milne Bay company and the subsequent disposal of it by that company, considered by themselves, are entirely equivocal. Considered by themselves, they are perfectly consistent with an assumption by the Milne Bay company of the character of agent for the owner, War Assets. It is enough to say that the appellant taxpayer carries the burden of establishing that a transfer took place, and that there is no sufficient evidence of such a transfer. One or two letters passed between War Assets and the Milne Bay company and one or two adjustments

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of account took place, but these again seem to me entirely equivocal. But I am disposed to go further than saying that the appellant taxpayer has failed to establish that any transfer of the property to the Milne Bay company took place. I think myself that the proper inference from the whole of the evidence is that the Milne Bay company handled and disposed of the material in Papua as agent for and on behalf of War Assets. It may be that not much help can be got by the commissioner from the shadowy nature and remarkable capitalization of the Milne Bay company, though it may, of course, be said that its nature does not suggest that it was really intended by its shareholders or by anybody to own a large quantity of valuable property. I do think, however, as I have thought from the beginning, that importance attaches to the "P. F. Cody No. 2 Account" in the Bank of New South Wales at Richmond. I made the suggestion during the hearing that moneys remitted from Port Moresby and paid into this account might really represent distributions of profit made by the company—in effect dividends. The commissioner's assessment was apparently not made on this basis, and in any case I do not think that my suggestion was sound. But this account cannot, in my opinion, properly be regarded as a mere trust account for the Milne Bay company, kept for convenience in another name. I have said that it was opened before the incorporation of that company, and that sums totalling £6,000 were paid into it and sums totalling £1,058 drawn out of it before the incorporation of that company. I have also said that I think that, at its inception, it can only be regarded as a trust account under the control of Mr. Cody, and that the moneys therein were subject to a trust for their application at Mr. Cody's discretion to meet expenses of the Milne Bay venture and, subject thereto, for War Assets and Baker in the proportion of two-thirds and one-third. No other trust, as it seems to me, can be inferred at that stage.

I can see no reason for saying that the nature of the trust changed after the incorporation of the Milne Bay company. I would infer that Mr. Cody remained in exclusive control of that account throughout, and that the directors of the Milne Bay company had no right at any time to say what should be done with moneys standing to its credit. No authority, retrospective or prospective, was ever given by the directors as such in connection with the opening or continuance of the account. Mr. Westhoven was informed on at least three occasions (the letters are in Exhibit C1) of the state of the account, but this means nothing. The account is not referred to in the minutes of the company: the reference to "the No. 2

Account " in the minutes of 23rd August 1948 is to a No. 2 Account in the bank at Port Moresby, which was opened when the " joint venture " with Excavators (Papua) Ltd. was contemplated. It is, to my mind, significant that this minute reads :—" The chairman reported that he had received *written instructions* to remit moneys from Papua at present held in No. 2 account to Melbourne ". The only other reference to the remittance of moneys to Melbourne, which I have found in the minutes, is in those of 6th August 1948, and this seems to me to be neutral. There is no evidence that the directors authorized, or were ever consulted about, the repayment out of the account of the three sums of £2,000 originally paid into it by Messrs. Cody, Wren and Baker, or the final payment out of the account of £4,500 to Vacuum in May 1948, or the payment out of the account to Messrs. Cody, Wren and Baker of the sums which they had paid out of their own pockets to Vacuum before the incorporation of the Milne Bay company—though Mr. Westhoven was informed that they had been made. None of these amounts represented debts owing by the Milne Bay company. The sum of £4,500 was owing by War Assets. The other payments seem to me really to be in the nature of repayments out of a pool of contributions made to the pool. Both the use which was made of the account and the control by Mr. Cody over the account seem to me to compel the inference that the trusts affecting it were as I have already indicated. I must not be understood as criticizing in any way the use made of the account, which seems to me to have been scrupulously correct and proper. I am concerned only with the inferences to be drawn. I do not think that moneys remitted from Papua and paid into the P. F. Cody No. 2 account should be regarded as profits distributed by the Milne Bay company, but I do think that the correct view of them is that they represented payments by an agent of the net proceeds of sales of goods into a trust account, the beneficial interest in which belongs to the principal on whose behalf the agent has sold the goods and a person with whom that principal has agreed to share those proceeds—or, to put it perhaps quite accurately, a person with whom that principal may be ultimately compelled to share those proceeds. If this is correct, the beneficial interest was not, of course, changed when in May 1951 the balance at the credit of that account was transferred to a new account in the name of the Milne Bay company itself.

If the view which I have expressed is correct, it seems to follow that the challenged assessments by the commissioner of the appellant company, War Assets, are correct. They are correct because

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the proceeds of realization, less all proper charges, belonged beneficially to War Assets and Mr. Baker. They did not belong to the shareholders, who (apart from Messrs. Westhoven and Baker) were chosen at random, and who served no useful function except to confer corporate existence upon the Milne Bay company. The view which I have taken is based, of course, on a strictly technical analysis of a legal situation. The whole structure created was based on technical legal rules, and it demands the close technical examination which I have tried to give to it.

My view of the P. F. Cody No. 2 account is not essential to my decision of this case, though I think it supports it. I should say that I have not overlooked arguments of considerable force against my view of that account. In particular it may be said that, in the absence of any express declaration of trust, everything depends on the inference to be drawn as to Mr. Cody's intention, and that there is no warrant for attributing to him any such intention as my view represents. But one of the difficulties of this case is that it is not easy to attribute any particular intention to any of the actors apart from a general overriding intention to do everything to avoid, and nothing to attract, taxation. I think that moneys standing to the credit of the account in question were intended by Mr. Cody, and intended by the directors of the Milne Bay company, to be completely under Mr. Cody's control and completely out of the control of the directors of the Milne Bay company. And I am of opinion that those facts are inconsistent with a real intention that they should be held in trust for the Milne Bay company. There are a number of references to the account in Exhibit C1. I refer particularly, without citing them, to the letters of 28th July, 25th August, 21st September and 18th October 1948. My view is not affected by the fact that in the last of these letters Mr. Cody tells Mr. Westhoven that surplus funds transmitted to Melbourne " will be paid to the credit of my No. 2 account, and will be duly accounted for when required, until which time they will be the property of Milne Bay Merchants Ltd." I can see no sufficient reason for saying that the character of the account changed at any time after 10th November 1947, when it was opened.

What I have said disposes of the appeals, and makes it unnecessary for me to consider the other argument of Mr. *Holmes*, which was based on s. 260 of the *Income Tax Assessment Act* 1936-1947. I do not wish it to be supposed, however, that in my opinion, the assessability of War Assets has resulted simply and solely from an omission, possibly accidental or merely inadvertent, to see that there was an effective assignment from War Assets to the Milne

Bay company. It seems to me by no means unlikely that any attempt at such an assignment would have fallen within the terms of s. 260, nor does it appear to me that the presence of Mr. Baker in the scheme is necessarily fatal to such a view. On 13th November 1947, when its contract with Vacuum was executed, War Assets had acquired an asset for the purpose of resale at a profit, and an analogy at once suggests itself between the position existing at that date and the position existing in *Clarke* v. *Federal Commissioner of Taxation* (1) when Clarke had agreed to grant a lease to McDonough, and before he interposed his company between himself and McDonough. Any express assignment or contract between War Assets and the Milne Bay company, however, might have taken one of several forms. Since there was, in my opinion, no such assignment or express contract between the two companies, there is nothing to be gained by attempting to imagine what might have been done, and then asking whether anything which might have been done would have been avoided as against the commissioner by s. 260. Such a course is, indeed, impracticable.

In my opinion, the two appeals should be dismissed and the two assessments in question confirmed.

From this decision the appellant appealed to the Full Court.

J. B. Tait Q.C., (with him *C. A. Sweeney*), for the appellant. [He dealt with the facts and the proper inferences to be drawn therefrom.]

J. D. Holmes Q.C., (with him *E. J. Hooke*), for the respondent. [He dealt with the facts and the proper inferences to be drawn therefrom and proceeded as follows :]—Assuming that Milne Bay Merchants were selling the goods with the permission of War Assets, on the terms that the former company was to receive and retain the proceeds of the goods, the arrangement was void for taxation purposes under s. 260 of the *Income Tax Assessment Act* 1936-1947. The arrangement was that War Assets and Baker, as to two-thirds and one-third respectively, would purchase in the name of War Assets from the Vacuum Oil Co. the Milne Bay goods and would re-sell those goods at a profit. It was further arranged that, for the purpose of avoiding tax, the profit would be made by a Papuan company selling the goods and retaining the profit. It is that part of the arrangement contained in the last sentence which is struck at by s. 260. The effect of the cases on s. 260 is that, if there is an arrangement which, whether legal or not, is an effective

(1) (1932) 48 C.L.R. 56.

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business arrangement to be carried out, and then a device is used to do the same thing in a different way, the section may be invoked. But if a taxpayer simply arranges his affairs so as to obtain immunity, or deductions, from tax, without any preliminary arrangement to do it in a particular way, the section will not be attracted. The way in which the Supreme Court of the United States of America put the matter is whether the arrangement is a commercial business way of doing things or whether it is done for some other purpose. The way in which courts deal with these unreal transactions is exemplified by *Gregory* v. *Helvering* (1); *Latilla* v. *Commissioners of Inland Revenue* (2), per Viscount *Simon* L.C. (3). Section 260 operates when a transaction is carried on by some artificial method designed not for any commercial purpose but for the purpose of avoiding tax. [He referred to *Clarke* v. *Federal Commissioner of Taxation* (4); *Jaques* v. *Federal Commissioner of Taxation*, per *Rich* J. (5); per *Knox* C.J. (6); per *Isaacs* J. (7); per *Starke* J. (8); *Deputy Federal Commissioner of Taxation* v. *Purcell* (9); *Molloy* v. *Federal Commissioner of Land Tax* (10); *Tunley* v. *Federal Commissioner of Taxation* (11); *Timaru Herald Co. Ltd.* v. *Commissioner of Taxes* (12).]

J. B. Tait Q.C., in reply. Section 260 of the *Income Tax Assessment Act*, can apply only if after the annihilation of the arrangement, there are existing facts or some other agreement or arrangement to take its place. In the present case the annihilation of the agreement does not leave any profit in the hands of War Assets. No arrangement for the acquisition of any profit was ever made except that which would be annihilated under s. 260. There has been no challenge to the evidence that Cody, Wren and Baker would not have entered into the transaction at all if it had not been free of tax.

Cur. adv. vult.

March 3, 1954. THE COURT delivered the following written judgment:—

These are appeals by War Assets Pty. Ltd. from an order of *Fullagar* J. dismissing appeals by that company from assessments of income tax. The assessments relate to the respective years of

(1) (1935) 293 U.S. 465, at pp. 467 et seq. [79 Law Ed. 596, at pp. 598 et seq.].
(2) (1941) 2 K.B. 162, at p. 167; (1942) 1 K.B. 299, at p. 303; (1943) A.C. 377.
(3) (1943) A.C., at pp. 381 et seq.
(4) (1932) 48 C.L.R. 56, at pp. 77, 79.
(5) (1924) 34 C.L.R. 328, at pp. 337-339.
(6) (1924) 34 C.L.R., at p. 355.
(7) (1924) 34 C.L.R., at pp. 358-360.
(8) (1924) 34 C.L.R., at p. 362.
(9) (1921) 29 C.L.R. 464.
(10) (1937) 58 C.L.R. 352.
(11) (1927) 39 C.L.R. 528.
(12) (1938) N.Z.L.R. 978.

income ending 30th June 1948 and 30th June 1949. They tax the appellant company upon certain sums which the respondent commissioner claims formed profits derived by the company in those years. The sums in dispute are £50,823 2s. 4d. in respect of the year ending 30th June 1948, and £28,210 in respect of the year ending 30th June 1949. The appellant company denies that any part of these sums was profits derived by it or formed part of its assessable income. The sums represent two-thirds of the profit which arose from the sale of certain abandoned war materials in the Milne Bay area, Papua. The claim of the respondent commissioner is that the profits arose from the sale by the appellant company of property which it had acquired for the purposes of resale at a profit and that the appellant company had a two-thirds and a Mr. A. E. Baker a one-third beneficial interest in the profits. The appellant contends that the profits made by the resale of these war materials were not derived by it, but that they were derived by another company, Milne Bay Merchants Ltd. The same question governs the correctness of the assessment for each year. As the appellant would propound it the question is whether the profits made from the realization of these abandoned war materials in the Milne Bay area, Papua, were made by the appellant or on the contrary by another company, Milne Bay Merchants Ltd. Strictly of course the issue is whether the appellant company did or did not derive the profits as part of its income and it is not necessary for the appellant to undertake to show that it was the Milne Bay Merchants Pty. Ltd. that derived the profits. But if in fact the profits were made by the Milne Bay company it must follow that the appellant is entitled to succeed in the appeals. The question by what company the profits were derived so as to form part of its assessable income depends to a very great extent upon the facts but the respondent commissioner invokes also s. 260 of the *Income Tax Assessment Act* 1936-1947.

His Honour has set out the facts in great detail and the argument has proceeded on the basis that these facts, with some minor additions and alterations, can be accepted. It is, therefore, unnecessary to restate the facts at the same length and we set out only those facts which are necessary to explain our opinion.

The appellant was incorporated in Victoria on 24th June 1947. Milne Bay Merchants Ltd. was incorporated in Papua on 26th November 1947. The nominal capital of the appellant is £25,000 but only 1,250 shares have been issued. These shares were issued at the time the company was incorporated and have always been held as to 625 shares by Mr. R. F. C. Burns and as to the other

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625 shares by Mr. D. G. Randall. They are members of the firm or on the staff of Messrs. Buckley & Hughes, a Melbourne firm of accountants. They have never been the beneficial owners of the shares. The shares are fully paid, the whole of the cash for this purpose having been provided by Mr. P. F. Cody and his brothers (who may be conveniently referred to as the Cody interests), by Mr. W. J. Wren and his brother (who similarly may be referred to as the Wren interests) and by Mr. Westhoven. On 13th August 1947, Burns and Randall executed declarations of trust declaring that the shares were held as to 750 in trust for the Cody interests, 250 in trust for the Wren interests and 250 in trust for Westhoven. But when Cody and Wren became two of the guarantors for the performance of the contract entered into between the appellant and Vacuum Oil Co. Pty. Ltd. on 13th November 1947 and the Milne Bay Company was about to be incorporated, the shareholdings were reshuffled and it was agreed that the Cody interests and the Wren interests should each become the beneficial owners of 469 and Westhoven the beneficial owner of 312 of these shares. It was not, however, until 14th June 1950 that new declarations of trust were executed by Burns and Randall to give effect to this agreement.

Westhoven had been in the employment of the Commonwealth Disposals Commission and had acquired knowledge and experience in the disposal of abandoned or surplus war materials. In the middle of 1947 that employment was coming to an end. About this time he met P. F. Cody and suggested the formation of a company to buy and sell such materials. This led to the formation of the appellant. Westhoven had only £250 to spend and this was the money he invested in shares in the appellant. His Honour was not certain whether the appellant was originally formed to handle materials in Papua. But all that it did, apart from entering into the contract with Vacuum Oil Co. Pty. Ltd. on 13th November 1947, was to purchase and sell some small amounts of such materials in Victoria and on that business it made a loss. Whatever the original intention may have been, its connection with the transaction with which we are concerned arose from the fact that, shortly after the incorporation of the appellant, Cody was introduced by his solicitor, Mr. Nolan, to a Mr. Lord who was concerned in some way with the Vacuum Oil Co. This company had acquired a large mass of war materials in the Milne Bay area, had disposed of some of them, and contemplated selling the rest. A conference was held at Cody's office on 22nd July 1947 at which Cody, Westhoven and Lord were present and there it was proposed that a syndicate

should be formed to purchase the materials held by the Vacuum Oil Co. and that the appellant should hold five or six of the ten shares in the syndicate. On 4th August 1947 a document called " Heads of agreement " was executed by the appellant and Lord which contemplated the obtaining of an option by Lord from the Vacuum Oil Co. over these materials and the taking over and exercise of the option by the appellant. A few days afterwards, Westhoven and Lord went to Milne Bay and inspected the materials. Before their departure Cody had seen Wren and discussed the proposed venture with him. They decided that, as they were both wealthy men already subject to taxation at the maximum rates, the venture was not one into which they would enter unless the profits would be free of taxation. Messrs. Buckley and Hughes were consulted to see if this could be done and Buckley gave written advice on 22nd September 1947. He had probably given oral advice considerably earlier. He referred to s. 7 (1) of the *Income Tax Assessment Act* which provides that the Act shall extend to the territories of Papua, Norfolk Island and New Guinea but exempts income derived there by a resident of those territories. He suggested the formation of a company in Papua which would be a resident of that territory and referred to the decision of this Court in *Koitaki Para Rubber Estates Ltd.* v. *Federal Commissioner of Taxation* (1) where it was held that a company is resident where its real business is carried on and that the real business is carried on where the central management and control actually abide.

On or about 26th September 1947, Vacuum offered to sell the materials at Milne Bay to Lord for £65,000, payable as to £5,000 forthwith, £25,000 on the execution of the contract and the balance of £35,000 three months thereafter. Lord in his turn offered to sell the materials to the appellant on the same terms subject to his obtaining certain benefits from the sale. Prior to this offer Baker had been introduced by Westhoven to Cody and had become willing to interest himself in the venture, provided the profits would not be taxable. At some time in September, he agreed to purchase a one-third interest, the remaining two-thirds to be owned by the appellant company. After the receipt by Lord of the offer from Vacuum, Westhoven and Baker went to Milne Bay to make a further inspection of the area and the materials before finally deciding to purchase the materials. Before leaving, Baker wrote Cody a letter on 4th October enclosing a bank draft for £1,666 13s. 4d. " covering my corner " in case the report was favourable and the preliminary deposit of £5,000 had to be paid before his return. On

(1) (1940) 64 C.L.R. 15, 241.

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15th October Westhoven on behalf of himself and Baker sent Cody a radiogram to the effect that the position was satisfactory and on the following day Nolan wrote to Lord stating that the appellant exercised its option to purchase the material from him and requesting him to exercise his option against Vacuum. The letter suggested that Vacuum should henceforth deal direct with the appellant. On the same day, Lord wrote to Vacuum enclosing a copy of Nolan's letter, exercising his option and saying that he was agreeable that Vacuum should henceforth deal direct with the appellant. After this Vacuum dealt direct with the appellant. On 17th October 1947 Cody paid the deposit of £5,000 to Vacuum by a cheque drawn on his private bank account with the Richmond branch of the Bank of New South Wales, the money being provided by Wren, Baker and the Cody interests in equal thirds. The receipt from Vacuum stated that the amount was received from the appellant. Cody noted on the butt of this cheque "Vacuum Oil Co. Pty. Limited. Re Milne Bay. A/c Baker £1,666 13s. 4d., J. W. (that is Wren) £1,666 13s. 4d., M. J. C. £555 11s. 2d., F. B. C. £555 11s. 2d., P.F.C. £555 11s. 2d. (Cody interests) Total £5,000."

On 24th October 1947 a conference was held at Nolan's office at which Cody, Nolan and Burns were present. The proposal to form Milne Bay Merchants Ltd., the directors to be Westhoven (chairman) and Baker, and to assign the contract between Vacuum and the appellant to the new company was discussed and at least tentatively agreed upon. On 3rd November 1947 a further conference was held at Cody's office at which Cody, his brother, Westhoven, Baker, Nolan and Burns were present. At these conferences definite decisons were made. It is desirable to quote the exact language in which the first and second of these decisions were recorded by Cody. "Formation of company: A new company known as Milne Bay Merchants Pty. Ltd. to be registered in Papua, subject to the name being available, for the purpose of taking over the contract of sale between Vacuum Oil Co. Ltd. and War Assets Pty. Ltd. Shareholdings: Two-thirds to be held by War Assets Pty. Ltd. One third to be held by A. E. Baker." It was decided that the memorandum and articles of association of the company were to be signed by seven persons in Port Moresby who were to execute deeds of trust to give effect to these beneficial interests. It was also decided that, to enable the new company to finance its commitments, more particularly in respect of: (a) the preliminary expenses of Westhoven, Lord and Baker in connection with their visit to Milne Bay; (b) the assignment of the contract between Vacuum and the appellant; and (c) working expenses for a period of three

months, loans were to be provided as and when required by Cody, Wren and Baker in equal proportions. It was anticipated that each would be required to provide £2,000 for working expenses. Cody's record notes that it was expected that the proceeds from sales of war materials during the first three months would provide sufficient funds to meet the instalment of purchase money due three months after the signing of the contract, amounting to £35,000. Immediate steps were taken for the registration in Papua of Milne Bay Merchants Ltd. In the meantime, about 5th November 1947, Nolan received cheques from Cody and Wren and a bank draft provided by Baker each contributing £8,333 6s. 8d. In acknowledging to Cody and Wren the receipt of these moneys he described them as advances to Milne Bay Merchants Ltd. He used the proceeds to send a bank cheque for £25,000 to Vacuum on 10th November 1947, in payment of the instalment of purchase money due on the signing of the contract. The contract between the appellant and Vacuum was signed on 13th November 1947. Baker, Cody and Wren, or the interests they represented, contributed £2,000 each for working expenses as contemplated. The money was paid into a bank account opened by Cody and called "P. F. Cody No. 2 A/c." Of this account it will be necessary to say something more later. Nolan in acknowledging to Baker's bank the receipt of his £2,000 described it as "re Baker Milne Bay Merchants Pty. Ltd."

Milne Bay Merchants Ltd. was actually incorporated on 26th November 1947. Its nominal capital was £25,000 divided into 25,000 shares of £1 each. But only seven shares were issued. These shares were issued to the seven signatories of its memorandum and articles of association each of whom signed for one share. They were Westhoven, Baker and five nominees provided by Mr. Cromie, the solicitor who registered the company. These nominees executed declarations of trust of their shares but as the declarations were expressed they did not give effect to the arrangement that the shares should be held beneficially as to two-thirds by the appellant and one-third by Baker. However this was finally remedied in 1952 when two further shares were issued to Baker and he became the holder of three shares and the remaining six were held by nominees on trust for the appellant. The directors of the Milne Bay company were Westhoven and Baker, Westhoven being chairman and having, under the articles, a casting as well as a deliberative vote.

Although the contract made between Vacuum and the appellant company expressly defined the name of the company as including

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its assigns the contract was never assigned by any formal instrument to the Milne Bay company. The latter company, however, proceeded to collect and dispose of the war materials sold under the contract. Westhoven sold his house in Melbourne, took his wife and child to Papua, and for some twenty months remained there living for most of the time at Milne Bay in a quonsett hut. This was done, no doubt, so that the central control and management of the company should be in Papua. His wife and child were compelled by illness to return to Melbourne in May 1948. Baker also spent eight or nine months in Papua on the same mission. Baker returned to Melbourne for a short time at an early stage and a Mr. Cotman was appointed an alternate director.

The Milne Bay company, under the direction of Westhoven and Baker, proceeded to realize the war materials. Regular meetings of directors were held, an account was opened in the Bank of New South Wales at Port Moresby, and Messrs. P. A. Trouchet & Co. of Melbourne were appointed general agents of the company for the sale of the materials. All sales were made in the name of the Milne Bay company as vendor. These sales involved large sums of money and included two large shipments in vessels, named the *River Norman* and the *Trienza*, towards the close of the financial year ending 30th June 1948. For a long time the Milne Bay company conducted the collection and disposal of the abandoned materials alone. But later in respect of certain materials it obtained the co-operation of a company called Excavators (Papua) Ltd. On 20th September 1948 a joint venture agreement was entered into between the Milne Bay company and this company by which it was agreed that the profits made from sales of certain of the materials comprised in the contract of 13th November 1947 should be divided in the proportion of fifty-five per cent to the Milne Bay company and forty-five per cent to Excavators. Then, after a large part of the materials had been disposed of, an agreement was made between the Milne Bay company and a New Zealand company called the Union Manufacturing & Export Co. Ltd. for the sale of the remainder, with some exceptions, for £16,500. The carrying out of this contract concluded the venture. During the whole of the various operations a regular correspondence took place between Cody in Melbourne and Westhoven in Papua in which Cody was kept fully informed of what it was proposed to do and expressed opinions as to which his Honour said he would infer effect was generally given to them. His Honour thought that the property in the war materials vested in the appellant upon the making of the contract with Vacuum. This seems prima facie to be probably

true, but even if there were some obstacle to the immediate passing of property in the physical chattels, clearly enough, as the contracting party, it was in the appellant company that the right to obtain the chattels resided. As has already been said, this contract was never formally assigned by the appellant to the Milne Bay company after the latter was incorporated. In the absence of such an assignment his Honour adopted the view that the proper inference from the whole of the evidence was that the Milne Bay company, in handling and disposing of the war materials in Papua, did so as agent for and on behalf of the appellant. He considered that the bank account which we have mentioned, the P. F. Cody No. 2 account, could not be regarded as a mere trust account for the Milne Bay company kept for convenience in another name and came to the conclusion that, prior to the incorporation of the Milne Bay company, the moneys were held on trust to apply them at Cody's discretion to meet the expenses of the Milne Bay venture and, subject thereto, for the appellant and Baker in two-third and one-third shares and that the nature of the trust did not change after the incorporation of the Milne Bay company. His Honour said that he would infer that Cody remained in exclusive control of the account throughout, and that the directors of the Milne Bay company had no right at any time to say what should be done with the moneys standing to its credit. After the fullest consideration we are unable to agree in either of these conclusions. We think that the proper inference from the whole of the evidence is that the Milne Bay company assumed ownership of the materials and collected and disposed of them as owner and not as agent; on its own behalf and not on behalf of the appellant. We think that the last thing intended was that the Milne Bay company should act as the fiduciary agent or as an agent in any sense for the appellant company or that the appellant conferred upon it any authority to do so and we are unable to see why by construction of law the character of agent should be fixed upon the Milne Bay company. The directors and shareholders in the appellant were Burns and Randall. Burns and Randall of the firm of Buckley & Hughes certainly never meant that the Milne Bay company should act as agents for the appellant. But they had no beneficial interest in the shares and the company was at all times under the real although perhaps remote control of Cody, Wren and Westhoven who represented the beneficial owners of the shares. They could at any time cause the shares to be transferred to them, remove Burns and Randall from the directorate, appoint new directors, and assume direct control of the company. The appellant company was their

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automaton to do their bidding. Cody, Wren, Westhoven and Baker were the promoters of the Milne Bay company. The appellant company had a part to play in that promotion. It was to become the repository of the title of the war materials so that when the Milne Bay company was incorporated it would be certain that these assets would be available for its exploitation. Otherwise there would be no sense in forming the new company. A company can be bound by acts intra vires its memorandum of association by the unanimous consent of its corporators, and such consent can be express or can be inferred from acquiescence: *Parker & Cooper Ltd.* v. *Reading* (1); *Ho Tung* v. *Man On Insurance Co. Ltd.* (2).

We think that the true inference from the evidence is that the beneficial owners as well as the formal owners of the shares in the appellant with full knowledge acquiesced in the Milne Bay company taking possession of the war materials and disposing of them for its own benefit and intended that the Milne Bay company should do so. This was the very purpose for which the company was promoted by these owners in conjunction with Baker. It was the whole foundation upon which the promoters proceeded in interesting themselves. They would not have become interested at all in the venture unless the profit was to be made by the Milne Bay company. It was the agreed manner in which Baker would participate in the profit. His holding of shares in that company gave him his only interest and that was the common intention of all. In the beginning Nolan told Vacuum that they were taking the contract in the name of the appellant company only in the meantime and that they were going to register a company in Papua which would take it over. This explains why the contract between the appellant and Vacuum provided that the expression " War Assets ", by which the appellant is called in the instrument, should include its assigns wherever the context permitted. The guarantee executed by Wren, Cody and Baker stated that, in consideration of Vacuum having agreed at their request to enter into an agreement with the appellant to sell to the purchaser or its assigns certain goods and chattels at Milne Bay for the sum of £65,000, they jointly and severally guaranteed the due payment by the purchaser or its assigns of all amounts payable to Vacuum under the sale agreement and the due performance by the purchaser or its assigns of all the terms and conditions of the sale agreement to be performed by the purchaser or its assigns. When the £6,000 was paid into the No. 2 account it is evident that it was for the purpose of meeting the initial working expenses of the Milne Bay company. It surely was not advanced

(1) (1926) 1 Ch. 975. (2) (1902) A.C. 232.

by Cody, Wren and Baker to War Assets. If the Milne Bay company had not been incorporated or had been unable to repay these advances we cannot see how the moneys expended could have been recovered from War Assets. The payment of the deposit of £5,000 and the first payment of £25,000 to Vacuum were made on behalf of the appellant as the purchaser from Vacuum of the war materials. But they were made out of moneys intended, as the receipts show, to be advances to the Milne Bay company, the liability for which was to be assumed by that company on its incorporation. It is quite clear that it was intended at that time that there should be an assignment of this contract from War Assets to Milne Bay as soon as that company was incorporated. Not only was Vacuum told by Nolan that this would be done but Nolan was instructed to prepare the assignment. There is no reason to doubt that Cody believed for a long time that there had been an assignment. His Honour accepted Nolan's evidence that he gave instructions to his conveyancing clerk to prepare an assignment, implying as that evidence did that it was an oversight that the instructions were not carried out. Nolan also gave evidence that, about a year after the Milne Bay company was incorporated, Cody drew his attention to this oversight and he, Nolan, then said that he did not think it was necessary to have a formal assignment and gave his reasons. Counsel for the commissioner objected to Nolan stating what these reasons were. In view of this objection it would not be right to speculate as to what they were. In particular we do not think that it would be proper to give any weight to the suggestion that Mr. *Holmes* made to *Fullagar* J. that in the end the assignment was not prepared and executed because of the fear that the commissioner might contend that the disposal of the goods by the appellant to the Milne Bay company was a disposal of trading stock which might sooner or later involve the appellant in trouble under s. 36 of the *Income Tax Assessment Act* 1936-1947. If the commissioner wished to place any reliance on this suggestion, Nolan should not have been denied the opportunity of stating his reasons and the suggestion should have been put to Cody as well as to Nolan in cross-examination so that they would have an opportunity of meeting it. We do not doubt that it was intended simply that the Milne Bay company should step into the place of the appellant company in the transaction with Vacuum so that the responsibility for the advances made from which the purchase money already paid was provided as well as the responsibility for the balance of purchase money would pass to the Milne Bay company. That is the simple basis of the intended assignment

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and shows the considerations. In other words it was clearly enough the intention that the appellant should sell the war materials to the Milne Bay company for the same price as the appellant paid to Vacuum. In view of the location of the materials and the hazards attached to recovering and disposing of them, it would have been extremely difficult for the commissioner to say that this was not a proper price. The possibility of the commissioner resorting to s. 36 had not been adverted to by anybody when the adventure was planned and it seems very unlikely that anyone thought of such a thing at a later stage. The intention throughout was that a Papuan company should make the profit because it would not be taxable. The funds required to purchase the war materials from Vacuum were not to be provided by the appellant. In the first instance part was to be advanced by the interests concerned but the advances as well as the balance of purchase money were to be paid from the proceeds of sale of the materials and this was eventually done. In order to pay Vacuum, it was necessary to raise the funds required to pay : (1) a preliminary deposit of £5,000 ; (2) a further sum of £25,000 on the execution of the contract ; and (3) a further sum of £35,000 within three months of the execution of the contract. (This sum was subsequently reduced by certain adjustments to £29,500 and was paid in two instalments, £25,000 on 16th February 1948 and £4,500 on 30th April 1948). The moneys to make these payments were raised as follows : The preliminary deposit of £5,000 and the first payment of £25,000 were made out of the moneys provided by Cody, Wren and Baker in equal shares. The second payment of £25,000 was made out of moneys provided by Cody and Wren in equal shares, Baker then finding it inconvenient to pay his one-third share. The £4,500 was paid by Cody out of the bank account already mentioned, the P. F. Cody No. 2 account. Prior to this payment the Milne Bay company had paid £6,000 into the account, £5,000 on 27th February and £1,000 on 1st March 1948. All these payments, as his Honour said, were payments on account of a debt owing by the appellant to Vacuum. But they were payments out of moneys advanced or out of moneys to be provided by Milne Bay Merchants Ltd. out of the proceeds of sale of the war materials. So far as intention governs the matter, we do not think it was ever the intention of any of the parties that the advances should be made to the appellant company. It was intended that they should be advanced to the Papuan company. If by some chance Milne Bay Merchants Ltd. had never been incorporated and the appellant company had enjoyed the benefit of the advances from which payments of purchase money were made, it might have

been made liable to recoup it as money paid to its use but hardly, we think, as money lent.

This leads us to say something about the P. F. Cody No. 2 account. This account was opened by Cody with the Richmond Branch of the Bank of New South Wales on 10th November 1947. Three sums of £2,000 each were deposited in this account on 10th, 12th and 13th November 1947, these sums being provided by Cody, Wren and Baker respectively. That was of course about a fortnight before the Milne Bay company was actually incorporated. Sums totalling £1,058 were withdrawn from the account before the incorporation to pay the travelling expenses of Westhoven and Baker and for certain purchases and other expenses incurred in Melbourne (including solicitors' fees) in connection with the Milne Bay venture. In December 1947 two sums of £2,000 each were transferred to the bank account of the Milne Bay company at Port Moresby. Commencing with a payment of £5,000 on 27th February 1948, large sums were deposited in the No. 2 account representing the net proceeds of the sales of the war materials made by the Milne Bay company. The deposit of £5,000 and a further deposit of £1,000 on 1st March 1948 were made by cheques drawn by the Milne Bay company on its account at Port Moresby. These moneys and all subsequent deposits, including large sums paid by Trouchet & Co. to Cody at the request of the Milne Bay company, were paid into the account as the moneys of the Milne Bay company. They were, clearly enough, we think, moneys held on trust by Cody for that company, subject, however, to his right to repay to Wren, Baker and himself the amounts they had advanced to finance the venture. Cody, as and when funds were available, repaid these amounts to Wren, Baker and himself. On 18th May 1951, a meeting of directors of the Milne Bay company was held in Melbourne at which Westhoven and Baker were present. In accordance with the resolution passed at this meeting the balance to the credit of the No. 2 account £117,435 18s. 7d. was transferred to a new account opened in the same bank in the name of the Milne Bay company and the No. 2 account was closed. There is ample evidence to show that the P. F. Cody No. 2 account was an account opened and operated as a trust account for the Milne Bay company. There is Cody's evidence that he opened the No. 2 account as a trust account for the Milne Bay company (incorporated only a fortnight later) and that it was used for no other purpose except the purposes of that company. There is the evidence that the moneys Trouchet & Co. paid to Cody representing the proceeds of sale of war materials were paid to Cody under the authority of the Milne

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Bay company on account of that company and were paid into the No. 2 account and used, in addition to other moneys received from the Milne Bay company, to repay the advances Wren, Baker and Cody had made to the Milne Bay company. There is Cody's letter to Westhoven of 18th October 1948 in which he requested Westhoven to remit to him any surplus funds over and above those required to complete payments owing by the Milne Bay company prior to commencing operations under the joint venture with Excavators Papua Ltd. In this letter Cody said " if and when received here, these funds will be paid to the credit of my No. 2 account and will be duly accounted for when required, until which time they will be the property of M. B. M. Limited." At a meeting of directors of the Milne Bay company following the receipt of this letter held at Milne Bay on 23rd October 1948, Westhoven as chairman reported that he had received written instructions to remit from Papua moneys at present held in the company's No. 1 account (at Port Moresby) to a No. 2 account in Melbourne. "After discussion it was suggested (? decided) that moneys from No. 1 account would be transmitted to Melbourne provided sufficient moneys were retained here to cover the interests of the chairman, Mr. Cotman, Mr. Baker, if he so desires, and the normal working expenses of the area until the next ship." Then Cody himself kept an account book showing receipts and disbursements and the dates of payments in and drawings out of the bank. This book he entitled " Milne Merchants Ltd. P. F. Cody (No. 2 Account) Receipts & Disbursements ". Finally at a meeting of directors of the Milne Bay company held at Melbourne on 18th May 1951, Westhoven and Baker being present, it was resolved to open an account in the Bank of New South Wales, Richmond, in the name of the Milne Bay company and to transfer the amount standing to the credit of the P. F. Cody No. 2 account at the Bank of New South Wales, Richmond, £117,435 18s. 7d., to the credit of the new account. At this meeting Baker produced a cheque for this amount signed by P. F. Cody and it was resolved to pay this amount to the credit of the Milne Bay Merchants' new account forthwith.

What the commissioner did was to take the profit ostensibly earned by the Milne Bay company in the relevant years and assess the appellant and Baker respectively on the basis that two-thirds of this profit was assessable income derived by the appellant company and one-third assessable income derived by Baker. He seeks to justify these assessments on two alternative bases. In the first place he contends that the Milne Bay company, although ostensibly acting as principal in disposing of the war materials,

was in law the agent of the appellant and Baker. Alternatively he relies on s. 260 of the *Income Tax Assessment Act*.

We shall now proceed to discuss the first of these contentions; for it is the ground upon which his Honour decided in favour of the commissioner. The alternative case made by the commissioner his Honour found it unnecessary to consider.

To appreciate the reasoning by which the learned judge reached the conclusion that the profits were assessable income of the appellant company his elaborate judgment must be studied in detail. But the ultimate steps leading to the conclusion may, we think, be stated thus. His Honour was of opinion that, because there had been no formal assignment of the materials from the appellant to the Milne Bay company, they remained the property of the appellant company; the Milne Bay company must be taken to have disposed of the materials as the appellant's agent accountable to it for the net proceeds with the consequence that the profit from their sale was the profit of the appellant. That means necessarily that the money in the No. 2 account which represented that profit was money to which the appellant was beneficially entitled and, further, beneficially entitled in such a sense that the money had been "derived" by the appellant as assessable income. Our consideration of the case has led us to an opposite conclusion. We do not think that the appellant can be regarded as having "derived" assessable income consisting of these profits. On the contrary we are of opinion that the proper conclusion from the facts is that the money was the money of the Milne Bay company. The P. F. Cody No. 2 account was opened before the date of the incorporation of that company but it was opened as an account into which its promoters could pay the necessary moneys to finance the preliminary expenses of the company and in the expectation, which the promoters knew would be realized because they were in a position to control the company, that the new company would assume the responsibility after incorporation, as it did, for moneys expended on its behalf prior to its incorporation. The sum of £6,000 was paid into the account to finance the working expenses of the new company. Of that money £2,000 belonged to Baker and it was never intended that Baker should have any interest in the appellant company; he was to acquire a one-third interest in the venture by becoming the holder of one-third of the shares in the Milne Bay company. Cody, Wren and Westhoven were to benefit from the venture through their beneficial ownership of the shares in the appellant, which was to become the beneficial owner of two-thirds of the shares in the Milne Bay company. Not only

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was the Milne Bay company to sell the war materials but it was to do so to make the profit for itself. This was the very essence of the transaction. Only in this way could the immediate assessment of income tax be avoided. If the residence of the company as well as the place of incorporation was Papuan, no income tax would be incurred by the real beneficiaries in respect of the profits until this company should declare a dividend, a declaration that could be delayed indefinitely. The conclusion seems inevitable that the Milne Bay company entered into possession of the war materials and sold them on its own behalf. No doubt the question whether it did so with the assent of War Assets involves matter of law as well as of fact. But we think that, constituted and controlled as the appellant company was, the knowledge and intention which animated all parties to the transaction must be imputed to the appellant company. That in substance means that the benefit of the contract between the appellant and Vacuum was made over by the appellant to the Milne Bay company. If the goods were vested in the appellant, they passed to the Milne Bay company. The inference that the benefit of the contract was made over to that company arises from a combination of facts. The persons who really controlled the appellant intended that the contract should be assigned and knew that the Milne Bay company was selling the war materials as owner. In furtherance of this intention the Milne Bay company took possession of the materials as owner and of the proceeds as its own. It was only in this manner that effect could be given to Baker's interest in the venture. As assignee, the Milne Bay company would be bound to indemnify the appellant against the payment of the purchase money owing by the appellant to Vacuum. The appellant never made any payments to Vacuum out of its own funds and never had any funds to do so. The moneys to pay the deposit and purchase moneys to Vacuum were all provided by Cody, Wren and Baker or out of the proceeds of sale of war materials by the Milne Bay company. The moneys provided by Cody, Wren and Baker were regarded as advances to the Milne Bay company which were to be repaid by that company out of the proceeds of sale of the war materials. These considerations appear to us to be enough to show that the first contention of the commissioner should fail.

But there is a somewhat different path by which the same conclusion may be reached. It is not illogical to begin from that point which the commissioner's case treats rather as the last step; in other words to ask how it can be said that any of these profits have so come home to the appellant company that they can be

held to have been derived by it as assessable income. Clearly they never came into the possession of the appellant company. They were never held subject to its direction or expressly on its account. Suppose a case could be made out for the appellant's right to recover the profits either from the Milne Bay company before they were paid into the P. F. Cody No. 2 account or from Cody after they were so paid or from the Milne Bay company after they were paid in May 1951 into the bank account in its name in the Richmond branch of the Bank of New South Wales. The case could at best be made out only on the footing that they were so recoverable notwithstanding an intention on the part of the Milne Bay company or of Cody to hold them otherwise than on account of the appellant; in other words, notwithstanding that they were received and held by those parties inconsistently with the supposed right of the appellant. That is to say the appellant could not make out a case for the recovery of the profits except by showing that the Milne Bay company or Cody, as the case may be, was a constructive trustee of the moneys.

The reasoning upon which the judgment of *Fullagar* J. proceeds seems in the end to place the case for the commissioner upon a legal basis that amounts to a constructive trust of the profits for the appellant. For in the final analysis the agency is imputed to the Milne Bay company because the property in the abandoned war materials remained in the appellant company; and from these two elements, the imputed agency and the continuance of the proprietary right in the materials, the appellant's supposed title to the money is made to accrue, and not from any intention of any of the parties to the transaction. Stated in the abstract the proposition is that because there is found to be a right in a party to have a constructive trust of a fund declared in his favour he can on that ground without more be considered to have "derived" the moneys constituting the fund. This may be so, but it is not very convincing. It is hardly a situation within s. 19 of the *Income Tax Assessment Act* 1936-1947. But passing that question by, there is still the question whether there is a sufficient foundation for treating the Milne Bay company as an agent of the appellant company liable because of a fiduciary character to account for the profits. The supposed agency at least was an agency by construction of law imputed because without that relationship the Milne Bay company's dealings with the materials seemed to lack any warrant. But the profits were the result rather of the exertions of the Milne Bay company in an enterprise than of the mere disposal of the appellant's property. The whole thing was an adventure

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and the profits are the fruits of the adventure. It is certain at least that the appellant took no part in the adventure, was never intended to do so, and that it never received any part of the proceeds. Even if we were wrong in the view we have expressed that the Milne Bay company became entitled to deal with the materials we would still be of opinion that none of the profits were ever received by or on account of the appellant company. If the Milne Bay company did not derive the profits it seems to us that there is still no sound ground for saying that it was the appellant company that did so. When all is said and done the profits never came into the possession, order or disposition of the appellant or under its direction.

To state it in another way, if the property in the goods passed from the appellant to the Milne Bay company before being disposed of by the transactions which yielded the profits now in question, those profits must have been derived by the new owner of the goods and not by the appellant; and if, on the other hand, the property remained in the appellant until disposed of by those transactions and all authority, consent or acquiescence on the part of the appellant were denied, the disposal was nothing but a wrongful conversion from which profits were derived by the party committing it, and only a right of action for damages accrued to the appellant, damages which the appellant never for a moment claimed.

As we are of opinion that the primary case of the commissioner fails his alternative case must now be considered. The commissioner contends that he can justify the assessments under s. 260 of the *Income Tax Assessment Act* 1936-1947. This difficult section, and its predecessor, s. 93 of the *Income Tax Assessment Act* 1922-1925, have been considered on more than one occasion in the judgments of this Court. It is sufficient to refer to two passages, one in *Clarke* v. *Federal Commissioner of Taxation* (1) and the other in *Bell* v. *Federal Commissioner of Taxation* (2). The former passage is as follows: "In its application perhaps it can do no more than destroy a contract, agreement, or arrangement in the absence of which a duty or liability would subsist. Where circumstances are such that a choice is presented to a prospective taxpayer between two courses of which one will, and the other will not, expose him to liability to taxation, his deliberate choice of the second course cannot readily be made a ground of the application of the provision. In such a case it cannot be said that, but for the contract, agreement or arrangement impeached, a liability under the Act would exist. To invalidate the transaction into which the prospective taxpayer in fact entered is not enough to impose upon him a liability which

(1) (1932) 48 C.L.R. 56. (2) (1953) 87 C.L.R. 548.

could only arise out of another transaction into which he might have entered but in fact did not enter. Where, however, the annihilation of an agreement or arrangement so far as it has the purpose or effect of avoiding liability to income tax leaves exposed a set of actual facts from which that liability does arise, the provision effectively operates to remove the obstacle from the path of the Commissioner and to enable him to enforce the liability " (1). The latter passage is as follows: " The section is, of course, an annihilating provision only. It has no further or other operation than to eliminate from consideration for tax purposes such contracts, agreements and arrangements as fall within the descriptions it contains. It assists the commissioner, in a case like the present, only if, when all contracts, agreements and arrangements having such a purpose or effect as the section mentions are obliterated, the facts which remain justify the commissioner's assessment " (2). Applying these principles to the present case we are unable to see how s. 260 can assist the commissioner. Cody, Wren, Westhoven and Baker could, of course, have agreed that the war materials should be purchased and sold by the appellant so that the appellant would have a two-thirds and Baker a one-third beneficial interest in the profits, but no such agreement was ever made. Such an agreement was not made for the simple reason that the profits of the venture would then have been part of the assessable income of the appellant and Baker in the years of income in which they were derived. Mr. *Holmes* submitted that the agreement or arrangement that was come to was that the appellant and Baker as to two-thirds and one-third respectively would purchase the war materials in the name of the appellant and would resell these goods at a profit and that it was also agreed or arranged that, for the purpose of avoiding income tax, the profit should be made by a Papuan company selling the goods and retaining the profits. He submitted that if you avoid, or to use the word in the judgments " annihilate ", the latter agreement or arrangement as having any of the purposes or effects referred to in the section you find the profits from the sale of the goods are held by Cody, in accordance with the former agreement or arrangement, on trust for the appellant and Baker in two-third and one-third shares. But the difficulty in the path of Mr. *Holmes* is that there never was any such antecedent agreement or arrangement. If you avoid the latter agreement or arrangement you are left with nothing. Certainly you are not left with the profits in the hands of the appellant. Various plans were discussed but no other agreement or arrangement was ever reached by anyone

(1) (1932) 48 C.L.R., at p. 77. (2) (1953) 87 C.L.R., at pp. 572, 573.

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except that the Milne Bay company should sell the goods and make the profit. The present case is simply one of a choice being presented to the appellant and Baker as prospective taxpayers between two courses one of which would, and the other would not, expose them to liability. As was said in *Clarke's Case* (1) the deliberate choice of the second course cannot readily be made a ground of the application of s. 260. We are of opinion that the second contention of the commissioner also fails.

The appeal should be allowed with costs. The order of *Fullagar* J. should be set aside. The assessments under appeal should be amended by excluding from the assessable income of the appellant the sum of £50,823 2s. 4d. in respect of the year ending 30th June 1948 and the sum of £28,210 in respect of the year ending 30th June 1949. The respondent should be ordered to pay the costs of the proceedings before *Fullagar* J.

Appeal allowed with costs. Order appealed from discharged. In lieu thereof order that the appeals of the appellant company from the assessments of the commissioner be allowed with costs and that the assessments in respect of the year of income ending 30th June 1948, *notices whereof are dated 7th September* 1950, *be amended so as to exclude from the assessable income the amount of* £50,823 2*s.* 4*d. shown in the alteration sheet accompanying such notices of assessment and that the assessments in respect of the year of income ending 30th June* 1949, *notices whereof are dated 7th September* 1950, *be amended so as to exclude from the assessable income the amount of* £28,210 *shown on the alteration sheet accompanying such notices of assessment.*

Solicitor for the appellant, *Bernard Nolan.*

Solicitor for the respondent, *D. D. Bell*, Crown Solicitor for the Commonwealth of Australia.

R. D. B.

(1) (1932) 48 C.L.R. 56.