[HIGH COURT OF AUSTRALIA.]

FEDERAL COMMISSIONER OF TAXATION APPELLANT;
RESPONDENT,

AND

SIDNEY WILLIAMS (HOLDINGS) LIMITED RESPONDENT.
APPELLANT,

Income Tax (Cth.)—"*Private company*"—*Additional tax—Liability—Preferred ordinary shares—Dividend—Fixed rate of ten per cent on paid-up capital—Right to participate with ordinary shares in any year where dividend on ordinary shares exceeds ten per cent—Additional percentage payable not predetermined—Preferred ordinary shares not* "*shares bearing a fixed rate of dividend only*"—*Company* "*capable of being controlled . . . by one person or by persons not more than seven in number*"—*Presently controllable—Liability to additional tax dependent upon possession of certain characteristics on particular date—Possession of requisite characteristics matter for persons interested in company—Scheme to eliminate characteristics and escape liability to additional tax—Not void as against commissioner—Income Tax and Social Services Contribution Assessment Act* 1936-1953 (*No.* 27 *of* 1936—*No.* 28 *of* 1953), *ss.* 105 (1) (*c*), (*e*), (*f*), 260.

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SYDNEY, 1956, *Dec.* 7; 1957, *Jan.* 10.

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Aug. 28-30; *Dec.* 19.

Dixon C.J., McTiernan, Webb, Kitto and Taylor JJ.

As at 30th June 1953 the paid-up capital of a company was £105,250 divided into 421,000 shares of 5s. 0d. each of which 418,600, were preference shares, 1,400 were preferred ordinary shares and 1,000 were ordinary shares. The preference shares bore a fixed rate of dividend only namely seven per cent per annum on the capital on the time being paid up thereon. The preferred ordinary shares carried a preferential dividend of ten per cent per annum on capital paid up or credited as paid up thereon with the right in conjunction with the ordinary shares whenever in respect of any year a dividend exceeding ten per cent should be paid on the ordinary shares to an additional percentage equal to one-tenth of one per cent for every complete ten per cent paid on the ordinary shares in excess of the first ten per cent. At the relevant date the holders of the preference shares had no voting rights in general meeting in respect of their shares. The articles provided, however, that except between 15th June and 15th July inclusive in any year any preference shareholder might subject to the approval of the directors elect to have his preference shares converted into ordinary shares ranking in all respects *pari passu* with the ordinary shares. If the preference shareholders

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had possessed the same voting rights as the other shareholders not more than seven persons could upon the distribution of shares have in general meeting on the relevant date outvoted all possible opposition. The Commissioner of Taxation assessed the company to Div. 7 tax as being a " private company " within s. 105 (1) (*c*), (*e*) and (*f*) of the *Income Tax and Social Services Contribution Assessment Act* 1936-1953.

Held: (1) By *Dixon* C.J., *McTiernan*, *Kitto* and *Taylor* JJ., *Webb* J. dissenting, that the company was not a " private company " within s. 105 (1) (*c*) and (*e*) because the preferred ordinary shares were not shares " bearing a fixed rate of dividend only " ;

(2) By the whole Court, that the company was not a " private company " within s. 105 (1) (*f*) as there was on 30th June 1953 no right of conversion of the preference shares exercisable immediately on that date and as of right so as to enable not more than seven persons in general meeting to outvote all possible opposition.

Per Dixon C.J., *McTiernan*, *Kitto* and *Taylor* JJ. : The expression " capable of being controlled " in s. 105 (1) (*f*) of the *Assessment Act* refers to a capability existing in law, i.e. a liability to a lawful control by the exercise of legal or equitable rights or powers which persons are shown to possess. It does not refer to a liability to control by a possible wrongful use of power.

Per Webb J. : " Capable " in s. 105 (1) (*f*) means " legally capable " and not " practically capable ". It involves certainty that the control will be exercisable, and not that it would most likely be exercised.

On 9th June 1953 a company fell within one or more of the descriptions of a " private company " in s. 105 (1) of the *Income Tax and Social Services Contribution Assessment Act* 1936-1953. Changes in the company were effected by special resolution passed on 10th June 1953. The specific purpose of the changes was so to alter the capital structure of the company that on 30th June 1953 it would no longer fill any of the descriptions in pars. (*a*) to (*f*) of s. 105 (1) and thus it would be saved from liability to Div. 7 tax on its undistributed profits of the year then ending.

Held by *Dixon* C.J., *McTiernan*, *Kitto* and *Taylor* JJ., *Webb* J. dissenting, that the changes so effected were not rendered void as against the commissioner by the operation of s. 260 of the *Assessment Act*.

Decision of *Williams* J. affirmed.

APPEAL from *Williams* J.

Sidney Williams (Holdings) Limited (hereinafter called the company) was assessed to additional tax as a " private company " under Div. 7 Pt. III of the *Income Tax and Social Services Contribution Assessment Act* 1936-1953 in respect of undistributed income derived by it in the year ended 30th June 1953. The company by notice dated 16th August 1954 objected to the assessment upon the ground that it was not on the last day of the said

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year of income, viz. 30th June 1953, a "private company" within the said division, but this objection was disallowed by the Commissioner of Taxation.

The company being dissatisfied with the decision on the objection requested the commissioner to treat its objection as an appeal and to forward it to the High Court of Australia.

The appeal came on for hearing before *Williams* J. in whose judgment hereunder the material facts are set forth.

Sir *Garfield Barwick* Q.C., *N. H. Bowen* Q.C. and *R. J. A. Franki*, for the appellant.

B. P. Macfarlan Q.C. and *M. H. Byers*, for the respondent.

Cur. adv. vult.

Jan. 10, 1957.

WILLIAMS J. delivered the following written judgment :—

This appeal was argued immediately after *W. P. Keighery Pty. Ltd.* v. *Federal Commissioner of Taxation* (1) and raises the same questions of law as were raised in that appeal but the facts of the two appeals are very different. The appellant company was assessed for additional tax on its undistributed income derived by the company during the year ended on 30th June 1953 on the basis that it was a private company within the meaning of Div. 7 of Pt. III of the *Income Tax and Social Services Contribution Assessment Act* 1936-1953 (hereinafter called the *Assessment Act*). As in *Keighery's Case* (1) the appellant company does not dispute that the amount of the assessment is correct if it was on 30th June 1953 a private company within the meaning of Div. 7 of Pt. III of the *Assessment Act.* But it contends that it was not on that date such a company. The commissioner, on the other hand, contends that it was such a company and alternatively relies on s. 260 of the *Assessment Act.* The relevant provisions of Div. 7 of Pt. III of the *Assessment Act* 1936-1953 are the same as those contained in the *Assessment Act* 1936-1952 in *Keighery's Case* (1) and it is therefore unnecessary to set them out again. The appellant company was not a company in which the public were substantially interested and it was not on 30th June 1953 a subsidiary of a public company. The question is therefore whether it was on that date a private company because it satisfied one or more of the descriptions in pars. (*a*) to (*f*) in sub-s. (1) of s. 105 of the *Assessment Act.* The appellant company was incorporated

(1) (1957) 100 C.L.R. 66.

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on 11th October 1951 as a company limited by shares. Clause 5 of the memorandum of association provided that the capital of the company should be £250,000 divided into one million shares of 5s. 0d. each with power for the company to increase or reduce such capital and to issue any part of its capital original or increased with or without any preference priority or special privilege or subject to any postponement of rights or to any conditions or restrictions; and so that unless the conditions of issue should otherwise expressly declare every issue of shares whether declared to be preference or otherwise should be subject to the power hereinbefore contained. By June 1953, 421,000 ordinary shares of 5s. 0d. each had been issued and paid for in full and were held mainly by members of the family of Sidney Williams deceased. It had been intended to seek listing for the shares of the company on the stock exchange but times had not been propitious. The articles of association which had been drafted with this listing in view complied with the requirements of the stock exchange. Article 69 relates to the votes of members but this article need not be set out because as it will be seen it was replaced by a special resolution of the company passed on 10th June 1953. The special resolutions of which this resolution formed part were passed at an extraordinary general meeting of the company held on that date. By these resolutions the existing ordinary issued shares of the company were divided into 418,600 preference shares of 5s. 0d. each carrying a fixed non-cumulative preference dividend at the rate of seven per cent on the capital for the time being paid up, 1,400 preferred ordinary shares of 5s. 0d. each carrying a cumulative preference dividend at the rate of ten per cent per annum on the capital for the time being paid up and the right to participate with ordinary shares so that whenever in respect of any year a dividend in excess of ten per cent is paid on the ordinary shares of the company such preferred ordinary shares shall be entitled to an additional percentage equal to one-tenth of one per cent for every complete ten per cent paid on the ordinary shares in excess of the first ten per cent and 1,000 ordinary shares of 5s. 0d. each. By the special resolutions any registered holder of preference shares is given the right except during the period from 15th June to 15th July inclusive in any year subject to the approval of the directors to elect to have his preference shares or any of them converted into ordinary shares ranking in all respects *pari passu* with the ordinary shares of the company which may at present or hereafter be issued, such election to be declared by notice in writing to the company signed by such holder and accompanied by the certificate relating to the shares to be converted. If the directors approve of such conversion they shall resolve that such conversion be approved and have effect and the same shall have effect accordingly and thereupon the certificate shall be cancelled and the requisite alteration made in the company's register of members. The shareholders agreed to convert 418,600 of the ordinary shares identified by progressive numbers into the new seven per cent preference shares and to convert 1,400 ordinary shares identified by progressive numbers into the new preferred ordinary shares. The special resolutions provide that the holders of the preference shares shall not as such be entitled to attend or vote at any general meeting of the company but shall have the same rights as the holders of ordinary shares as regards receiving notices and reports and balance sheets. The new art. 69 provides that " Every member present in person or by proxy and being the holder of preferred ordinary shares or ordinary shares of the company shall both on a show of hands and on a poll have one vote for every five of such shares up to 100, one additional vote for every additional ten shares up to 200, one additional vote for every twenty-five shares in excess of 200 up to one-fourth of the total shares issued. The holders of the preference shares in the company shall have no right to vote either in person or by proxy at any general meeting by virtue or in respect of their holding of preference shares in the capital of the company ". Prior to this reorganisation of its capital the appellant company, because of the shareholdings of members of the Williams family was, it is common ground, a company which fell within one or more of the descriptions in pars. (*b*) to (*d*) of sub-s. (1) of s. 105. The purpose of the reorganisation of the share capital was admittedly to convert the company into a non-private company. By the special resolutions the shareholdings of the members of the Williams family were mainly converted into the new seven per cent preference shares. These shares bore a fixed rate of dividend only so that they were not paid-up capital within the meaning of pars. (*c*) or (*e*). They carried no votes so that they were not included in the voting power within the meaning of pars. (*b*) or (*d*). Prior to 30th June 1953 the 1,400 ordinary shares which had been converted into preferred ordinary shares had been sold and transferred by members of the Williams family in parcels of one hundred to fourteen new shareholders. These shareholders became on the evidence the absolute beneficial and legal owners of their shares and they were not the nominees or relatives of any of the other shareholders. The 1,400 preferred ordinary shares were not paid-up capital bearing a fixed rate of dividend only. They bore a fixed rate of dividend but they were also entitled to participate with the ordinary shareholders in a further dividend. This dividend was a fixed proportion of a variable rate of dividend and was therefore itself a dividend at a variable rate. The effect of the reorganisation of capital was to change the appellant into a company which no longer fell within any of the descriptions in pars. (*b*) to (*e*). On 30th June 1953 the number of shareholders was thirty-eight. The appellant company was not therefore a company which fell within the description in par. (*a*).

Mr. *Macfarlan* on behalf of the commissioner did not rely on any of the pars. (*a*) to (*e*). But he did rely on par. (*f*). He contended that the company was a company which was capable of being controlled by persons not more than seven in number on 30th June 1953 because on that date the preference shareholders had a right to reconvert their preference shares into ordinary shares. If the preference shares were reconverted into ordinary shares they would carry voting rights and the total voting rights of seven of the preference shareholders, members of the Williams family, would be 14,371 votes out of a total of 17,597 votes. Accordingly on 30th June 1953 the appellant company was a company capable of being controlled by not more than seven persons because these shareholders by reconverting their preference shares into ordinary shares could immediately obtain a controlling interest in a general meeting. But the preference shareholders could only reconvert their preference shares into ordinary shares subject to the approval of the directors. It was contended that this only gave the directors a right of an administrative character that is to say a right before they approved to satisfy themselves that the conditions subject to which the election could be exercised had been performed, namely that it should be declared by notice in writing to the company signed by the registered holder of the shares and accompanied by the certificate relating to the shares to be converted. Alternatively it was contended that because the directors other than Mr. Dingle were members of the Williams family the preference shareholders had a real and practical capacity to have their shares reconverted into ordinary shares when they chose. I cannot accept either of these contentions. The right to reconvert was subject to the approval of the directors and this provision imposed on the directors a duty in the bona fide exercise of their discretion to consider whether it would be in the interests of the company to grant the application and to refuse to grant it if they thought that it would not: *Australian Metropolitan Life Assurance Co. Ltd.* v. *Ure* (1); *In re Smith and Fawcett Ltd.* (2). There could be many reasons why the directors

(1) (1923) 33 C.L.R. 199. (2) (1942) Ch. 304.

in the exercise of their discretion should consider that it would not be in the interests of the company to approve of the applications. One reason that suggests itself immediately is that if they did approve they would convert the company into a private company again and there is no provision in the special resolution for a second conversion of the ordinary shares into preference shares. It may well be that because the directors were mainly members of the Williams family they would not have been likely to refuse the applications but practical certainty is not enough. The means referred to in par. (*f*) must be legal means: *Himley Estates Ltd. and Humble Investments Ltd.* v. *Commissioners of Inland Revenue* (1). Except where it is proposed to pass a special resolution for which twenty-one clear days' notice is necessary only seven clear days' notice of general meetings need be given under the articles of association, so that on 30th June 1953 the company could only have been capable of being controlled by the seven members of the Williams family if they could have reconverted their preference shares into ordinary shares within seven clear days of this date. But under the special resolution creating the preference shares they could not be reconverted into ordinary shares from 15th June to 15th July inclusive in any year. In *Keighery's Case* (2) I expressed the opinion that a company is only capable of being controlled on the last day of the year of income within the meaning of par. (*f*) where the means exist on that day. In *Keighery's Case* (2) they did so exist because on that day Mr. and Mrs. Keighery could alter the capital structure of the company so as to control the votes in any general meeting that could be subsequently called. But here the seven preference shareholders could not do so because first they had no absolute legal right to reconvert their preference shares into ordinary shares at all and secondly they could not reconvert, even if the directors granted the applications, before a general meeting could be held. Accordingly the appellant company was not, in my opinion, a company which on 30th June 1953 was capable of being controlled by the seven preference shareholders within the meaning of the description in par. (*f*).

The remaining question is whether the assessment can be supported under s. 260 of the *Assessment Act*. This section is in the following terms: " Every contract, agreement, or arrangement made or entered into, orally or in writing, whether before or after the commencement of this Act, shall so far as it has or purports to have the purpose or effect of in any way, directly or indirectly—(*a*) altering the incidence of any income tax; (*b*) relieving any

(1) (1933) 1 K.B. 472, at p. 486.

(2) (1957) 100 C.L.R. 66.

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person from liability to pay any income tax or make any return; (*c*) defeating, evading, or avoiding any duty or liability imposed on any person by this Act; or (*d*) preventing the operation of this Act in any respect, be absolutely void, as against the Commissioner, or in regard to any proceeding under this Act, but without prejudice to such validity as it may have in any other respect or for any other purpose ". The meaning of the section has been discussed in this Court in *Jaques* v. *Federal Commissioner of Taxation* (1); *Clarke* v. *Federal Commissioner of Taxation* (2) and *Bell* v. *Federal Commissioner of Taxation* (3). Mr. *Macfarlan* relied upon the definition of the word " arrangement " in the section given in *Bell's Case* (3) where it was said that " the word extends beyond contracts and agreements so as to embrace all kinds of concerted action by which persons may arrange their affairs for a particular purpose or so as to produce a particular effect " (4). It is clear that the whole purpose of the reorganisation of the capital of the appellant company in June 1953 was to convert the company from a private company within the meaning of Div. 7 of Pt. III of the *Assessment Act* into a non-private company. The two steps that were taken to effect that purpose—the passing of the special resolutions on 10th June 1953 and the transfer of the 1,400 preferred ordinary shares to the new shareholders—could be said to be a form of concerted action by the directors and the old and new shareholders of the company to convert the company into a non-private company which would not become liable to pay additional tax under Div. 7. Mr. Dingle explained that it would have been difficult for the company to have arranged the necessary finance to distribute the whole of the distributable amount of its undistributed income which as a private company it would have to do in order to avoid this tax. But, in my opinion, the reorganisation of its capital by a company which if the capital remained unaltered would, on the last day of the year of income, cause the company to be a private company within one of the descriptions in pars. (*a*) to (*f*) in sub-s. (1) of s. 105 of the *Assessment Act*, even if it amounts to an arrangement, is not an arrangement which has the purpose or effect of doing any of the things struck at by s. 260. Parliament has provided that a company is only taxable as a private company if it is a private company within the meaning of Div. 7 on the last day of the year of income. All companies that are not such private companies are taxable as non-private companies. The Act imposing tax in respect of income derived during the year ended 30th June 1953 in force in June 1953

(1) (1924) 34 C.L.R. 328.
(2) (1932) 48 C.L.R. 56.
(3) (1953) 87 C.L.R. 548.
(4) (1953) 87 C.L.R., at p. 573.

was the *Income Tax and Social Services Contribution Act* 1952. That Act, by s. 10, imposed on companies the rates of income tax and social services contribution set out in the sixth schedule, that is in the case of a company which is not a life assurance company tax at the rate of 5s. 0d. for every pound of so much of the taxable income as does not exceed £5,000 and for every pound of the remainder of the taxable income 7s. 0d. By s. 11 the Act imposed an additional tax of 2s. 0d. in the pound upon the taxable income of companies but this section did not apply to private companies. The sixth schedule also provided that for every pound of the undistributed amount in respect of which a private company is liable under s. 104 of the *Assessment Act* to pay additional tax the rate should be 10s. 0d. Section 104 of the *Assessment Act* provides, so far as material, that a private company which is not, by s. 105A of the Act, to be deemed to have made a sufficient distribution in relation to the year of income is liable to pay additional tax upon the undistributed amount at the rate declared by the Parliament by the Act imposing income tax for the year of tax. The general scheme of the *Assessment Act* and the *Income Tax and Social Services Contribution Act*, in which the *Assessment Act* is incorporated, is that a company shall pay tax on its taxable income at the rates prescribed by par. 1 of the sixth schedule and by s. 11 unless it is on the last day of the year of income a private company within the meaning of Div. 7 of Pt. III of the *Assessment Act.* If it is a private company it has then to pay tax at the rate prescribed by par. 1 of the sixth schedule of the *Income Tax and Social Services Contribution Act* and additional tax on so much of the distributable amount of its undistributed income as it has not distributed within the prescribed period. When s. 260 refers to an arrangement which has the purpose or effect of relieving a person from liability to pay income tax or avoiding any liability imposed on any person by the Act it must be referring to a liability to pay income tax imposed upon that person by the Act. But the Act does not impose any liability on a company to pay additional tax under Div. 7 unless that company is a private company within the meaning of that division on the last day of the year of income. If it is not such a company, the Act does not impose any such liability upon it. To change a company from what would be a private company if nothing was done prior to the last day of the year of income into a non-private company prior thereto does not relieve the company from any liability to pay additional tax because it never becomes liable to pay it. The change could not have the purpose or effect of avoiding any liability to pay this tax because a taxpayer cannot

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avoid a liability which does not exist. The truth is that the Act gives companies a choice of being taxed as non-private companies or as private companies. Each system can have its advantages and disadvantages for the shareholders. Companies are taxed as non-private companies unless on the last day of the year of income they fall within a description of a private company. They are then taxed as private companies. That is the scheme of the Act, the Act provides for this choice, and a company is not relieved from liability to pay income tax under the Act if it prefers to become a non-private company and be taxed as such rather than to remain a private company. Whichever it may be it pays the full tax for companies in that category.

For these reasons I am of opinion that the appeal should be allowed with costs and that the assessment under appeal should be set aside.

From this decision the commissioner appealed to the Full Court of the High Court.

B. P. Macfarlan Q.C. (with him *M. H. Byers*), for the appellant. Adopting the construction put by *Williams* J. on s. 105 (1) (*f*) the respondent was on 30th June 1953 capable of being controlled by the four directors by legal means then available to them. When the inquiry is as to control it is not relevant to consider the manner in which the duties of the office of director are to be exercised. [He referred to *Inland Revenue Commissioners* v. *J. Bibby & Sons Ltd.* (1); *S. Berendsen Ltd.* v. *Inland Revenue Commissioners* (2).] On the construction of s. 105 (1) (*f*) we put the argument advanced in *W. P. Keighery Pty. Ltd.* v. *Federol Commissioner of Taxation* (3). In the present case by resort to the articles and the powers of conversion given, there does exist the means whereby this company could be controlled by less than seven persons and this whether or not it is likely to happen or the directors are likely to give or withhold their approval to any such election. The preference shares are excluded from computation in par. (*c*) of s. 105 (1) because there is a fixed rate of dividend, and the preferred ordinary shares also bear a fixed rate and should equally be excluded from such computation. The rate does not vary, though the percentage may do so. We adopt the argument on s. 105 (1) (*c*) and (*e*) put in *Keighery's Case* (3). *Williams* J. erred in holding that there must first be a liability before it can be said that there is an avoidance of a liability to pay tax. Such a view is contrary to what was said by his Honour in *Federal Commissioner of Taxation* v. *Newton* (4). It is

(1) (1945) 1 All E.R. 667, at pp. 672, 673; (1945) 29 Tax Cas. 167, at pp. 184, 185.

(2) (1957) 3 W.L.R. 164.; (1958) Ch. 1.

(3) (1957) 100 C.L.R. 66.

(4) (1957) 96 C.L.R. 577.

not necessary for the purpose of s. 260 that there should be a liability attaching before the arrangement. Section 260 does not differentiate between kinds of tax or kinds of liability with which it deals and where the liability to tax depends upon the character of the taxpayer, as it does here, then if the character is changed in consequence of what is seen to be an arrangement with a purpose as described in the authorities then there is every reason why s. 260 should apply to that situation. It is sufficient to attract s. 260 that the relevant purpose is only one of several purposes. Division 7 does not in terms confer a choice upon a company to be either a private or a public company but merely sets out various liabilities to tax according to circumstances as they are found to exist in a particular case. No implication is to be taken from s. 260 or from Div. 7 that s. 260 is not applicable to that division. Generally we adopt the arguments on this point advanced in *Keighery's Case* (1).

Sir *Garfield Barwick* Q.C. and *N. H. Bowen* Q.C. (with them *R. J. A. Franki*), for the respondent.

Sir *Garfield Barwick* Q.C. If there was here a purpose running through the various steps taken it was a purpose of altering the organisation of the company as at 30th June 1953 so as not to comply with a description in s. 105. That is not a purpose of defeating a liability imposed on any person. In this case there was no certainty that liability in relation to Div. 7 would be imposed on any person by the Act at all, and it is a confusion of thought to say that a purpose of reorganising a company so as to put it outside a statutory description on 30th June which might have the consequence of imposing a liability is a purpose of defeating a liability imposed on any person by the Act. Section 260 only operates in any case if the purpose is to defeat a liability imposed on any person. Division 7 contemplates that as at 30th June a company may be either a private or public company and acts done to convert a company into one or other of those descriptions do not contravene s. 260. Further, in the present case, there is no arrangement, purpose or effect within *Bell* v. *Federal Commissioner of Taxation* (2). It is not possible to involve the purchasers of the shares in any arrangement here and the shareholders who made the transfers are not found to be in any relationship to the company in any way. There is here more than a fixed rate of dividend payable in respect of the shares in question and it is a fixed plus some variable rate.

(1) (1957) 100 C.L.R. 66. (2) (1953) 87 C.L.R. 548.

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The directors have not the power in their own interests as individuals to effect a conversion for the purpose of giving themselves control to the exclusion of the other shareholders. [He referred to *Ngurli Ltd.* v. *McCann* (1); *Inland Revenue Commissioners* v. *J. Bibby & Sons Ltd.* (2).] Such power as they had is fiduciary in character and cannot be used for their own benefit. Secondly, if the effect of converting and thereby giving control were to attract a large sum of tax to the whole company then in the company's interest the directors would be bound to disapprove the conversion. Paragraphs (*a*) to (*f*) of s. 105 (1) are all descriptive of the company which is to be reckoned a private company for the purpose of the division and such descriptions must be applicable to the company as organised on the last day of the financial year. The method by which control of the company may be effected by external control of the shareholders is dealt with in pars. (*b*) to (*e*) inclusive and that is done by deeming the shareholding to be what it is not: see s. 105 (2) and (3). From this it appears that the control spoken of in the section is control through shareholding on the last day, and the external control of those who do control the company by shareholding is brought in by the deeming provision. In pars. (*b*) and (*d*) the word "capable" is used to call attention to a present power presently to control as distinct from a presently exercised power. Paragraphs (*b*) to (*e*) have covered the quality of the company, its notional shareholding through the deeming provision and its notional voting power, all wrapped up in the organisation of the company. The desire in par. (*f*) is to cover any other legal means of present, i.e. on the last day, control of the company within its organisation. The paragraph is designed as a dragnet to gather in means of control not covered by pars. (*b*) to (*e*). "Capable" is not used in the sense of "possible"; it must on a meaning of the sub-section mean, not merely a present ability, but a present ability presently to control. A company is not organised on the given day so as to be capable of control simply because some persons, by the exercise of some power or by dint of some arrangement derived from or made outside the company's organisation, could control those who do control the company. If that be wrong, the alternative is that some external control of those who do control the company by dint of shareholding or those in power, can result in the company being incapable of being controlled. So to hold is to go outside what is submitted to be an exhaustive list of means of control set out by *Lawrence* L.J. in *Himley Estates Ltd. and*

(1) (1953) 90 C.L.R. 425, at pp. 438, 440.

(2) (1945) 1 All E.R., at p. 671; (1945) 29 Tax Cas., at p. 182.

Humble Investments Ltd. v. *Inland Revenue Commissioners* (1). But even then there must be found a present means of presently controlling the company including the shareholders, and a company is not then capable of being controlled if all that exists is a right of authority to alter the organisation of the company at some future time when, if no other change takes place, the person having such right or authority would be able to control the company as then organised. The existence of such a situation, even on this alternative argument, does not make the company presently capable of being controlled. If all else be not acceptable, then, as *Williams* J. found in this case, there was no present self-executing power of altering the situation because the directors' concurrence had to be obtained and that was a concurrence which could not be compelled by those having the right of conversion.

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N. H. Bowen Q.C. The difficulty about s. 105 is in determining whether the element of futurity has been introduced into it by the use of the word " capable ". Both on context and historically " capable " is used in a present sense. The words " on the last day of the year of income " apply to the description in pars. (*a*) to (*f*) of s. 105 (1) whether they apply to each element of the description or merely to the verb therein. As a result of the decision in *Federal Commissioner of Taxation* v. *West Australian Tanners & Fellmongers Ltd.* (2) the commissioner was unable to take possible combinations into account but was limited to control actually exercised and the word " capable " was introduced in 1948 to overcome that situation. Historically it was not concerned with introducing an element of futurity as suggested by the appellant.

B. P. Macfarlan Q.C., in reply.

Cur. adv. vult.

The following written judgments were delivered : Dec. 19.

DIXON C.J., KITTO and TAYLOR JJ. This is an appeal against an order made by *Williams* J. upholding an appeal from an assessment of additional tax under Div. 7 of Pt. III of the *Income Tax and Social Services Contribution Assessment Act* 1936-1953 (Cth.) in respect of undistributed income derived by the respondent company in the year ended 30th June 1953. The assessment was attacked on the ground that in respect of that year the respondent company was not liable to be assessed under Div. 7 because it was not a

(1) (1933) 1 K.B., at p. 486.

(2) (1945) 70 C.L.R. 623.

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" private company " within the meaning given to that expression by s. 105.

Sub-section (1) of s. 105 prescribes certain characteristics which a company must possess if it is to be a private company for the purposes of the Division. First, it must not be " a company in which the public are substantially interested "—and sub-s. (4) (*a*) explains what is meant by that description. Secondly, it must not be on the last day of the year of income " a subsidiary of a public company "—and sub-s. (4) (*b*) explains that description. Thirdly, on the last day of the year of income it must be a company of one or more of six descriptions set out in paragraphs lettered from (*a*) to (*f*).

It is common ground that the respondent company was not at any relevant time a company in which, in the prescribed sense, the public were substantially interested, and also that on the last day of the relevant year of income, 30th June 1953, it was not in the relevant sense, a subsidiary of a public company. But whether on that day it filled any of the descriptions in pars. (*a*) to (*f*) is in controversy. The commissioner's case is that it was within one or more of the descriptions in pars. (*c*), (*e*) and (*f*), and that, even if it was not within any of those descriptions, s. 260 has an application to the facts which brings it within the description in par. (*f*).

Paragraph (*c*) describes a company in which shares representing more than half of the paid-up capital, " other than capital represented by shares having a fixed rate of dividend only " are held (having regard to the operation of sub-s. (2) as to deeming a person and his nominees to be one person) by one person or by persons not more than seven in number. Paragraph (*e*) describes a company in which shares representing not less than three-quarters of the paid-up capital, " other than capital represented by shares bearing a fixed rate of dividend only ", are held (having regard to the operation of sub-s. (3) as to deeming a person, his relatives, his nominees, and the nominees of his relatives to be one person) by one person or by persons not more than seven in number.

On the relevant day, the paid-up capital of the company was £105,250 divided into 421,000 shares of 5s. 0d. each of which 418,600 were preference shares, 1,400 were preferred ordinary shares and 1,000 were ordinary shares. The preference shares bore a fixed rate of dividend only, namely seven per cent per annum on the capital for the time being paid up thereon. The capital represented by them must therefore be left out of account for the purposes of pars. (*c*) and (*e*). If it were right to say that the preferred ordinary shares also bore a fixed rate of dividend only, so that they too should be left out of account, the company would be within each of the descriptions in pars. (*c*) and (*e*), because 848 out of the 1,000 ordinary shares were held by only seven persons. But the preferred ordinary shares were so held that unless the capital represented by them is to be left out of account neither par. (*c*) nor par. (*e*) applies. The dividend rights attached to those shares are defined by the following paragraph in art. 3A of the company's articles of association, which was added by a special resolution passed on 10th June 1953 : "The Preferred Ordinary Shares shall carry a cumulative preferential dividend at the rate of ten per centum per annum on the capital for the time being paid up or credited as paid up thereon and the right to participate with Ordinary Shares so that whenever in respect of any year a dividend in excess of ten per centum is paid on the Ordinary Shares of the Company such Preferred Ordinary Shares shall be entitled to an additional percentage equal to one-tenth of one per centum for every complete ten per centum paid on the Ordinary Shares in excess of the first ten per centum."

The ten per cent per annum on the capital paid up on the preferred ordinary shares is, of course, a fixed rate. But the rate of dividend which those shares may carry in a particular year over and above the ten per cent is not pre-determined. It is a fixed proportion of a rate which is not fixed but will be automatically determined for the particular year by the declaration or declarations of dividend in respect of the ordinary shares. It is an untenable proposition that a fixed proportion of a rate is a fixed rate whether the rate of which it is a proportion is fixed or not. The appellant's argument fails to recognise that what is referred to in pars. (*c*) and (*e*) as fixed is not a rate in the abstract, but a rate of dividend ; and that necessarily means a proportion to be observed between a dividend and either the capital paid up on the shares or their nominal amounts. It is impossible to say that the preferred ordinary shares in the present case bore a fixed rate of dividend only.

The commissioner relies more strongly, however, upon the description in par. (*f*) : a company which is capable of being controlled by any means whatever by one person or by persons not more than seven in number.

Voting rights at a general meeting of the company were governed, on 30th June 1953, by art. 69 which, in the form which it took as a result of the special resolution above mentioned, provided as follows : " Every member present in person or by proxy and being the holder of Preferred Ordinary Shares or Ordinary Shares of the

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company shall both on a show of hands and on a poll have one vote for every 5 of such shares up to 100, one additional vote for every additional 10 shares up to 200, one additional vote for every 25 shares in excess of 200 up to one fourth of the total shares issued. The holders of the Preference Shares in the company shall have no right to vote either in person or by proxy at any general meeting by virtue or in respect of their holding of Preference Shares in the capital of the Company."

The commissioner concedes that if a general meeting of the company had been held on 30th June 1953 the voting rights exercisable in the state of facts which then existed were not so held that any one person or any group of not more than seven persons could have outvoted all possible opposition. If, however, the holders of preference shares had possessed the same voting rights as the holders of the preferred ordinary and ordinary shares, seven persons could have done so; for the position would then have been—without going into the arithmetic of it—that out of 17,542 votes which could have been cast no fewer than 11,957 would have belonged to five persons, namely three directors who were members of the Williams family and two sisters of one of those directors.

For the commissioner it is contended that although in fact the preference shareholders had no voting rights on 30th June 1953—that is to say that if a general meeting had assembled on that date they could not have voted thereat in respect of their preference shares—yet par. (*f*) is satisfied because they then had a right to convert their preference shares into ordinary shares and thus to acquire full voting rights in respect of them.

This contention would necessarily succeed if the right of conversion referred to had been exercisable on 30th June 1953, immediately and as of right. But it was a right conferred by par. (iii) of art. 3A as inserted by the special resolution of 10th June 1953 in the following terms: "Except during the period from the 15th June to 15th July inclusive in any year the following provision shall have effect namely: any registered holder of Preference Shares may subject to approval of the directors elect to have his Preference Shares or any of them converted into Ordinary Shares ranking in all respects *pari passu* with the Ordinary Shares of the company which may at present or hereafter be issued; such election shall be declared by notice in writing to the Company signed by such holder and accompanied by the certificate relating to the shares to be converted, and if the Directors approve of such conversion they shall resolve that such conversion be approved and have effect and the same shall have effect accordingly and thereupon the certificate aforesaid shall be cancelled and the requisite alteration shall be made in the Company's Register of Members."

On 30th June 1953, therefore, the holders of the preference shares were not in a position to convert those shares into ordinary shares immediately, or indeed at any time before the ensuing 16th July, and even then the conversion would require the approval of the directors expressed in a resolution.

The absence of an immediate right of conversion is enough by itself to make par. (*f*) inapplicable to the case. If it cannot be said of a company on the last day of the year of income that seven persons (or fewer) are presently able to control the company, in the sense of securing the passing of a resolution at a general meeting, the company cannot be described as capable on that day of being controlled by one person or by persons not more than seven in number. If a sufficiently small number of persons then have the means whereby they may obtain in the future an ability to secure the passing of a resolution at a general meeting, all that can be said of the company as at that day is that it is capable of being thereafter made controllable by those persons. And even if it is capable of being made so controllable before the earliest day for which a general meeting can be convened, unless it can be made so controllable on that very day it does not answer the description of a company which on that day is capable of being controlled by those persons.

But the necessity for the directors' approval to any desired conversion provides another answer to the commissioner's reliance upon par. (*f*). Quite clearly the duty of the directors with respect to an application for approval of the desired conversion was not confined, as the appellant's argument suggests, to a mere administrative checking to see that the conditions which a converting shareholder is required by art. 3A (iii) to observe had been performed. It was a duty to give or withhold their approval as the interests of the company as a whole might seem to them to require. But it is contended for the appellant that an answer to this difficulty is to be found in the fact that the directors themselves held large parcels of preference shares, and that even if their preference shares and no others had been converted into ordinary shares they could have controlled the company, because they would have had between them 4,691 out of 5,163 votes at a general meeting. The suggestion is that they would not have been likely to refuse as directors an approval to conversion which they desired as preference shareholders.

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But to give effect to this argument would be to construe the expression " capable of being controlled " as referring, not to a capability existing in law—that is to say a liability to a lawful control by the exercise of legal or equitable rights or powers which persons are shown to possess—but to a possibility of being wrongfully subjected to de facto control by persons acting in breach of the rights of others. That cannot be what the paragraph means. It could not properly have been said on 30th June 1953 that the directors of the respondent company then had the ability to control the company or even to gain control over it by converting their preference shares into ordinary shares. The most that could have been said is that the directors had a power to convert and so gain control if, but only if, when they came to do so they should honestly consider that it was consistent with the interests of the company as a whole that the conversion should take place. And an honest judgment on the point might well be against the conversion ; for, as *Williams* J. has pointed out in his judgment, one consideration to which they would have been obliged to advert was the possibility that by making the company a " private company " for the purposes of Div. 7 they might be prejudicing the interests of other shareholders.

So far the case has been considered on the basis of the facts as they existed on 30th June 1953. But it is contended for the commissioner that even if on those facts it should be held that the respondent company was not a " private company " on that day, the opposite result is to be reached by an application of s. 260. That provision makes void as against the commissioner every contract, agreement, or arrangement so far as it has or purports to have the purpose or effect of in any way, directly or indirectly, (*inter alia*) avoiding any liability imposed on any person by the Act. If the facts concerning the respondent company on 30th June 1953 had been, not as they were then, but as they were on the preceding 9th June, the company would have been a " private company " ; for admittedly it was on 9th June within one or more of the descriptions in pars. (*b*) (*c*) and (*d*) of s. 105 (1). The use which the commissioner seeks to make of s. 260 is to eliminate from consideration the changes that were made between those two dates.

The changes were effected by certain special resolutions passed on 10th June 1953. They were passed, as is freely admitted, for the specific purpose of so altering the capital structure of the company that on 30th June it would no longer fill any of the descriptions in pars. (*a*) to (*f*) of s. 105 (1), and thus it would be saved from liability to Div. 7 tax on its undistributed profits of the year then ending.

The authorised capital of the company immediately before the passing of the special resolutions consisted of £250,000 divided into 1,000,000 shares of 5s. 0d. each. Only 421,000 shares had been issued. These were all fully paid, and the great majority of them were held by members of the Williams family. The principal alterations made by the resolutions were as follows. Of the issued shares, 418,600 (including most of the shares held by members of the Williams family) were converted into preference shares, 1,400 (held by four members of the Williams family) were converted into preferred ordinary shares and 1,000 continued to be ordinary shares. The preference shares were made to carry a fixed non-cumulative preferential dividend at the rate of seven per cent per annum on the capital paid up thereon, certain rights in the event of a winding-up, the right of conversion into ordinary shares to which reference has already been made, and a right to receive notices and reports and balance sheets though no right to attend and vote at general meetings. The preferred ordinary shares were made to carry the cumulative preferential dividend and additional dividend discussed above, a right to rank for dividend next after the preference shares, certain rights in a winding-up, and a right to receive notices, reports and balance sheets and to attend and vote at general meetings. In addition, a new scale of voting rights in respect of preferred ordinary and ordinary shares was prescribed. These resolutions having been passed, one further step was taken before 30th June. The 1,400 preferred ordinary shares were transferred in parcels of one hundred each to fourteen new shareholders, of whom none was a relative or nominee of any other person interested in the company. By these means, if the views expressed earlier in this judgment are correct, the desired result was achieved : when the 30th June arrived the company was not a private company for the purposes of Div. 7.

Williams J. held that the case was untouched by anything in s. 260. His Honour considered that it was the scheme of the Act to give companies a choice of being taxed as non-private companies or as private companies, and to impose no liability to Div. 7 tax on a company not in fact falling within the descriptions of a private company in s. 105 (1). Accordingly he held that a company was not relieved from any liability under the Act if it preferred to become a non-private company and to be taxed as such than to remain a private company. " Whichever it may be," his Honour said, " it pays the full tax for companies in that category " (1).

(1) (1957) 100 C.L.R., at p. 104.

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Reasons have been given in the case of *W. P. Keighery Pty. Ltd.* v. *Federal Commissioner of Taxation* (1) for adopting a similar view. To hold that s. 260 applies in this case would be to give it an operation, not to effectuate an intention appearing from the Act to impose a liability, but to defeat an intention appearing from the Act to impose alternative liabilities according as the persons interested in a company elect to have or not to have a certain state of facts existing on the last day of a year of income. The appellant's contention based on s. 260 must therefore be overruled.

The result is that the judgment of *Williams* J. must be affirmed and the appeal dismissed with costs.

McTIERNAN J. I agree in the order proposed by the majority of the Court.

WEBB J. This is an appeal by the Commissioner of Taxation against the decision of *Williams* J. setting aside an assessment to additional income tax on the undistributed income of the respondent taxpayer as a " private company " made under s. 104 (1) of the *Income Tax and Social Services Contribution Assessment Act* 1936-1953.

Assuming, as *Williams* J. decided, that the changes made in June 1953 in the classes, incidence and distribution of shares in the respondent company did operate to convert it from a private company within the meaning of s. 105 (1) and so render it not liable under s. 104 (1) to pay additional tax on undistributed income, still I think the arrangement that brought about these changes was struck by s. 260. In view of par. (*c*) of s. 260, which speaks of " any duty or liability imposed ", it is perhaps arguable that s. 260 is confined to duties and liabilities either existing when the arrangement is made or subsequently arising out of the operations of the Act in respect of the particular taxation year in which the arrangement is made ; in other words, that the arrangement was not affected by s. 260 as regards taxation on income earned in subsequent years. For the same reason it is perhaps arguable that " the operation of this Act " referred to in par. (*d*) means its operation only in or in respect of the particular taxation year in which the arrangement was made. But this is the only possible limitation on s. 260 that I can see. However, whatever the scope of s. 260 may be, it seems impossible to deny that it had already been in operation in respect of the income of the taxpayer as a private company within s. 105 (1) for the year ended 30th June 1953 when the arrangement was made

(1) (1957) 100 C.L.R. 66.

earlier in June 1953, although no income tax had then been assessed against the respondent taxpayer for that year and in fact no duty or liability had then arisen to make a return of income for that year. It also seems impossible to deny that the arrangement was calculated to terminate that operation of the Act. Then, in my opinion, s. 260 prevented the arrangement from terminating that operation. The only possible argument to the contrary must rest I think on the view that s. 260 is subject to the earlier provisions of the Act which vary the incidence of income tax for different categories of taxpayers. But s. 260 is not expressed to be subject to any other provisions of the Act. If it were expressed to be subject to other provisions of the Act it would be difficult to hold that s. 260 still operated to render ineffective any arrangement entered into with a view to getting the benefit of an exemption from, or a reduction of, or a concession in respect of the income tax by transferring from one category of taxpayer to another, as the respondent taxpayer sought to do by the arrangement in question here. However the Act is just as explicit that capital receipts are not liable to income tax, except in specified instances, as it is that the incidence of the tax varies for different categories of taxpayers. Yet in *Bell* v. *Federal Commissioner of Taxation* (1) it was held that because of s. 260 capital receipts remained taxable as income in the particular year in which the arrangement was made that legally and effectively converted them into capital receipts for all other purposes. I am unable to distinguish this case from *Bell's Case* (1).

If I am wrong in holding that s. 260 is applicable to this arrangement, then I think that, for the reasons given by *Williams* J., namely uncertainty that the directors would consent to the transfer of shares, the respondent taxpayer was not on 30th June 1953 a company capable of being controlled within the meaning of par. (*f*) of s. 105 (1). " Capable " in that context means, I think, " legally capable ", and not " practically capable ". It involves certainty that the control will be exercisable, and not that it would most likely be exercised because of the personal interest of the directors as shareholders, without regard to their duty as directors to the shareholders generally. However, although I think the respondent taxpayer was not a private company of the kind specified in par. (*f*) of s. 105 (1) I think it was a private company within par. (*c*) and (*e*). The preferred ordinary shares had a fixed rate of dividend which is a different thing from a fixed amount of dividend. The rate did not vary, although the amount did ; so these shares were not included in the calculation for the purposes of pars. (*c*) and (*e*).

(1) (1953) 87 C.L.R. 548.

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Then as 848 shares held by seven persons represented more than half of the paid-up capital for the purposes of par. (*c*), and not less than three-quarters of the paid-up capital for the purposes of par. (*e*), the respondent taxpayer was a private company within each paragraph. There were no nominees or relatives of shareholders to be considered as required by sub-ss. (2) and (3) of s. 105.

In my opinion the respondent taxpayer was rightly assessed for the additional tax.

I would allow the appeal.

Appeal dismissed with costs.

Solicitor for the appellant, *H. E. Renfree*, Crown Solicitor for the Commonwealth.

Solicitors for the respondent, *Garland, Seaborn & Abbott.*

R. A. H.