

[HIGH COURT OF AUSTRALIA.]

HOUGHTON APPELLANT ;

AND

FEDERAL COMMISSIONER OF TAXATION RESPONDENT.

H. C. OF A. *Income Tax (Cth.)—Assessment—Assessable income—Dividend—Company—Payments to shareholders—From moneys resulting from sale of assets—Company not then actively engaged in business—Subsequent dissolution of company—Whether return of paid-up capital or dividend—Income Tax and Social Services Contribution Assessment Act 1936-1952 (No. 27 of 1936—No. 28 of 1952), ss. 6, 44 (1) (a).*

1957.

MELBOURNE, Feb. 28,
Mar. 1 ;

SYDNEY,
Apr. 2.
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In May 1936 a taxpayer H., his father, mother and brother, who owned two picture theatres, sold them to company A. in which all the shares, except two, were held by the same four persons, who were also the only directors. The price paid was £20,000, of which £4,000 was in cash, being the proceeds of the sale of shares to the four persons, the balance being borrowed from company B. in which the same four persons owned nearly all the shares and were the only directors. In 1941 company A. leased the theatres for ten years to H. and his brother who, on the same day with the consent of company A. underleased the theatres to company B. and gave to the latter an option of purchase. In April 1948 this option was exercised, the price paid being £25,000, in instalments, the final instalment being paid on 16th May 1951. Out of the proceeds of sale company A. had a balance of £8,940 after meeting commitments. This sum was paid among the four shareholders as follows : on 17th September 1951 each received £1,000, on 14th December 1951, £80 10s. 0d., on 16th February 1952, £147, and on 3rd March 1952, £1,007 10s. 0d. Although no meetings of company A. were held the minute book of the company was written up by the secretary with the tacit approval of the shareholders and directors as if meetings had taken place. The trial judge found that this was done without any dishonest intent. The minute book contained an entry under date 3rd March 1952 to the effect that the dissolution of the company had been resolved on that day. Shortly after this time the secretary sent to the Registrar-General a declaration stating that the company had ceased to carry on business on 16th May 1951. As a result the company was gazetted as dissolved as from 13th January 1953. In evidence the secretary said that when the balance of purchase money was paid on 16th May 1951 the company had no other assets or business. There was no entry in the minute

book showing that before 3rd March 1952 the secretary had the intention of dividing the surplus assets of the company among the shareholders. The Commissioner of Taxation treated the payments, save as to £1,000 included in the sum paid on 3rd March 1952, as assessable income.

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Held, that the payments other than the sum of £1,000 were not repayments of share capital made in the course of an informal liquidation but were profits detached from and leaving the shares intact, and so were dividends within s. 6 of the *Income Tax and Social Services Contribution Assessment Act 1936-1952* and assessable income within s. 44 (1) (a) of such Act.

APPEAL under the *Income Tax and Social Services Contribution Assessment Act 1936-1952*.

James Sherwood Houghton appealed to the High Court of Australia against an assessment of income tax in respect of the year ended 30th June 1952.

The appeal was heard before *Webb J.* in whose judgment the material facts appear.

Dr. E. G. Coppel Q.C. and *J. McI. Young*, for the appellant.

J. B. Tait Q.C. and *J. A. Nimmo*, for the respondent.

Cur. adv. vult.

WEBB J. delivered the following written judgment:—

Apr. 2.

This is an objection by a taxpayer to an assessment of income tax treated as an appeal under s. 187 (b) of the *Income Tax and Social Services Contribution Assessment Act 1936-1952* and at the taxpayer's request forwarded to this Court under s. 187. More particularly the appeal is against the inclusion of £1,233 in the taxpayer's assessable income for the year ended 30th June 1952. The commissioner contends that this sum was received by the taxpayer as dividends paid by a company out of profits derived by it and is assessable under s. 44 (1) (a); whereas the taxpayer contends that it was paid to him in the course of an informal winding up of the company and is not assessable.

By s. 6 "Dividend" is defined to include "any distribution made by a company to its shareholders . . . but does not include a return of paid-up capital . . .". By s. 44 (1) (a) the assessable income of a shareholder includes "dividends paid to him by the company out of profits derived by it from any source".

In and before May 1936 four persons, being the taxpayer, his father, mother and brother, owned two picture theatres at Mildura in Victoria, and in that month they sold these theatres to a company

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called Thoughton Investments Pty. Limited registered and incorporated under the *Companies Act* 1928 (Vict.) and in which all the shares but two were held by those four persons who were also the only directors. The price paid by the company for the theatres was £20,000. Of this amount £4,000 was paid in cash, being the proceeds of the sale of shares to those four persons who each acquired 1,000 fully paid one pound shares. The balance of the purchase price, £16,000, was paid out of moneys borrowed by Thoughton Investments from Redcliffes Hotel Pty. Ltd. in which, as in Thoughton Investments, the same four persons owned practically all the shares and were the only directors. On 30th September 1941 Thoughton Investments leased the two theatres for ten years to the taxpayer and his brother who on the same day, and with the consent of Thoughton Investments, underleased the theatres to Ozone Theatres Ltd. and gave the latter company an option of purchase of the theatres. In April 1948 this option was exercised, the price being £25,000. As Thoughton Investments had purchased these theatres for £20,000 and had sold them for £25,000 there was then a profit to them on the sale of £5,000 less certain expenses; but it was a capital profit, as Thoughton Investments was not engaged in buying and selling theatres.

Ozone Theatres Ltd. purchased on terms: the price £25,000 was payable in instalments with interest on the balance unpaid from time to time. On 16th May 1951 the final instalment of purchase money was paid by this company to Thoughton Investments. Out of the proceeds of this sale Thoughton Investments after meeting certain commitments, eventually had a balance of about £8,940. This sum was paid in equal shares to the taxpayer and the other three shareholders and directors under the following circumstances. On 17th September 1951 each received £1,000; on 14th December 1951, £80 10s. 0d.; on 16th February 1952, £147; and on 3rd March 1952, £1,007 10s. 0d. The commissioner treats £1,000 of the last payment as a return of capital and not assessable. The company's minute book contains an entry under date 3rd March 1952 to the effect that the dissolution of the company had been resolved upon on that day. All these sums were paid by cheque signed as required by the memorandum and articles of association of Thoughton Investments Ltd. But there had been no meetings of the shareholders or directors of the company and no notice of meetings for some years. With the tacit approval of the shareholders and directors everything had been done by the secretary, Eric Houghton, a brother of the taxpayer and an accountant who had practised as such. However on 12th March 1952

Eric Houghton as secretary of the company made and sent to the Registrar-General in Victoria a statutory declaration stating among other things that the company had ceased to carry on business on 16th May 1951 (which was the date of the payment of the final instalment of purchase money for the theatres by Ozone Theatres Ltd.) and that the date of the last annual general meeting of the company was on 5th November 1951. As a result Thoughton Investments was struck off the Register of Companies and was gazetted as dissolved as from 13th January 1953 in pursuance of s. 295 (3) of the *Companies Act* 1938 (Vict.).

Although, as already stated, there had been no meetings of shareholders or directors of Thoughton Investments for some years still the minute book of the company was entered up by Eric Houghton as secretary as though there had been meetings. An entry under date 5th November 1951 reads:—"Resolved: that a dividend of £322 be and is hereby declared payable as follows". Then £80 10s. 0d. is set out against the name of each of the four shareholders. This is followed by "Resolved: that a dividend of £4,588 0s. 7d. being the profit on realization of the company's assets be and it is hereby declared payable as follows." Then £1,147 0s. 0d. is set out against the name of each of the four shareholders. An entry under date 3rd March 1952 reads:—"Resolved: that the company be wound up and that the secretary write to the Registrar-General notifying him that the company has ceased operations and requesting that it be dissolved." There is no entry referring to the final payment of £1,007 10s. 0d. to each of the four shareholders on 3rd March 1952, although such a payment was then made and, as already stated, it was treated by the commissioner as a return of capital and not assessable to the extent of £1,000. Eric Houghton in his evidence on this appeal sought to explain these entries by saying that they were made on the dates that they bear and that he wrote in those dates to complete the statutory declaration. He added that there was a meeting of Redcliffes Hotel Ltd. on each of these dates but that Thoughton Investments would not have been discussed there. Earlier in his evidence Eric Houghton said that when the balance of the purchase money was paid by Ozone Theatres Ltd. on 16th May 1951 Thoughton Investments had no other assets or business. When his attention was drawn to £4,588 0s. 7d. in the minute book under date 5th November 1951 he said that was the difference between the assets in the company's books and the £25,000 paid by Ozone Theatres Ltd.; that £5,000 was the difference between the £20,000 paid by Thoughton Investments and the £25,000 received by it; that various expenses were put

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on to the £20,000 to build it up ; and that £4,588 0s. 7d. was the actual profit on the sale.

It will be noted that the entry in the minute book under 5th November 1951—of which the material part was sent by Eric Houghton as the public officer of the company to the commissioner on 9th January 1953—states that the whole of this sum was then payable, £1,147 to each of the four shareholders ; whereas £1,000 had already been paid to each on 17th September 1951 and £147 was paid later, i.e. on 16th February 1952. In seeking to explain this entry Eric Houghton said in evidence that £1,000 was sent to each shareholder in September 1951 because there was a large surplus then lying idle in the company's bank account and for a reason he could not recall it was desired "to get some money into their hands quickly".

Having regard to the misrepresentations made by Eric Houghton to the Registrar-General and to the Commissioner of Taxation I am not prepared to accept him as a completely reliable witness. However the entries in the minute book appear to have been made without defeating, and I take it, without the purpose of defeating, the claims of the commissioner or of any other person. No doubt from a practical point of view meetings of the shareholders or directors would have been an unnecessary expense, keeping in mind the part that Eric Houghton had been playing as secretary with the tacit assent of the shareholders, and it was sought to avoid this expense, and yet appear to comply with legal requirements, by making false entries in the minute book of the company. Such conduct deserves severe censure, but no dishonesty was practised. I am prepared then to act on the entries to the extent of determining what intention the secretary had in making payments to the shareholders referred to in a particular entry on the date the entry bears ; but I am not prepared to find that he had that intention at any earlier date. This then is the limit to which I feel I can safely go towards acceptance of Eric Houghton's statements, although I was not unfavourably impressed by his demeanour on the witness stand. Probably the intention was recorded soon after being formed, no meeting being contemplated.

However this restricted acceptance of his statements does not assist the taxpayer. There is no entry earlier than 5th November 1951 which bears on the payments in question here, and there is no entry which shows that on or after 16th May 1951, or indeed before 3rd March 1952, he had the intention of dividing the surplus assets of the company among the shareholders. I am taking the secretary's intention as being the company's intention and I am

treating these payments as made by the company, and not as illegally made, as they were claimed to be in the taxpayer's notice of objection. Naturally the commissioner is not setting up that these payments were illegal in which event they would not be capital or income in the taxpayer's hands but something to which he was not entitled. However I understand that the taxpayer is not now setting up that these payments to him were illegal, but, for income tax purposes at all events, relies on all the payments having been not unlawfully made to him in the course of an informal liquidation in which the first payment was made on 17th September 1951. As Dr. Coppel conceded, rightly I think, the informal nature of the liquidation, if there were one, would not affect the income tax aspect though it could be important for the purposes of company law.

Then taking the payments in question to have been authorised—and, seeing that everyone concerned, shareholders and directors, tacitly consented to them, it might well be difficult to establish the contrary—and relying exclusively on the entries in the minute book to discover with what intention these payments were made, as to which intention Eric Houghton alone can testify, I conclude that they were not part of the share capital, which was not repaid to any extent until 3rd March 1952 and then was fully repaid; but on the contrary I conclude that they were profits detached from and leaving the shares intact, and so were dividends within s. 6 and assessable income within s. 44 (1) (a): see *Webb v. Federal Commissioner of Taxation* (1), per Knox C.J., Gavan Duffy J. and Starke J.; and *Commissioner of Taxation (N.S.W.) v. Stevenson* (2), per Rich, Dixon and McTiernan JJ.

For these reasons I think the appeal should be dismissed and the assessment confirmed.

*Appeal dismissed and assessment confirmed.
The appellant will pay the respondent his
costs of the appeal. Certify for counsel.
Liberty to apply.*

Solicitors for the appellant, *Arthur Phillips & Just.*

Solicitor for the respondent, *H. E. Renfree*, Crown Solicitor for the Commonwealth of Australia.

R. D. B.

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(1) (1922) 30 C.L.R. 450, at p. 461.

(2) (1937) 59 C.L.R. 80, at p. 99.