[HIGH COURT OF AUSTRALIA.]

W. P. KEIGHERY PROPRIETARY LIMITED APPELLANT;
APPELLANT,

AND

FEDERAL COMMISSIONER OF TAXATION RESPONDENT.
RESPONDENT

H. C. OF A. 1956-1957.

SYDNEY, 1956, *Dec.* 5, 6; 1957, *Jan.* 10.

Williams J.

Aug. 21, 22, 23, 26; *Dec.* 19.

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

Income Tax (Cth.)—"*Private company*"—*Additional tax—Liability—Company* "*capable of being controlled . . . by one person or by persons not more than seven in number*"—*Presently controllable—Redeemable preference shares—Dividend a fixed proportion of dividend paid on ordinary shares—Not referable to nominal or paid-up amount of shares—Not* "*shares bearing a fixed rate of dividend*"—*Company's 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* 1936-1952 (*No.* 27 *of* 1936—*No.* 90 *of* 1952), *ss.* 105 (1) (*c*) (*e*) (*f*), 260.

A company had an issued capital of four fully paid £1 ordinary shares and twenty fully paid £1 redeemable preference shares. The directors, K. and his wife held three and one ordinary shares respectively; twenty other persons each held one redeemable preference share. Under the articles of association and a special resolution authorising the issue of the redeemable preference shares, each of the twenty-two shareholders was entitled both on a show of hands and on a poll to one vote for each share held. The preference shares ranked for dividend according to their terms of issue "to the extent of one two-thousandth part of the rate per annum of any dividend paid upon the ordinary shares in the same year ending on 30th June." By the terms of the issue of the redeemable preference shares the company had reserved the power, subject to s. 149 of the *Companies Act* 1936 (N.S.W.) at any time on or before 31st December 1977 to pay off any part of the capital paid up on the redeemable preference shares provided that not less than seven days' notice of any such payment should be given and that no such payment should be made between 24th June and 7th July (both inclusive). The company was in a position to satisfy the conditions imposed by s. 149 of the *Companies Act* 1936. K. and his wife had by virtue of the articles authority as the

directors of the company to exercise its powers with respect to redemption. No notices had been given convening a general meeting of the company for 30th June 1952 or for any date thereafter, and although on 30th June 1952 the power to redeem the preference shares was not immediately exercisable, it was exercisable by virtue of the articles so as to forestall any general meeting for which K. and his wife should not be willing to accept short notice. For the year ended 30th June 1952 the Commissioner of Taxation assessed the company to tax as a " private company " within s. 105 (1) (*f*) or alternatively within s. 105 (1) (*c*) and (*e*) of the *Income Tax and Social Services Contribution Assessment Act* 1936-1952.

Held, by *Dixon* C.J., *McTiernan*, *Kitto* and *Taylor* JJ., *Webb* J. dissenting, that the company was on 30th June 1952 not a " private company " (i) within par. (*f*) because there was at that date no existing power then exercisable vested in K. and his wife, their power to redeem the preference shares being inoperative until 7th July and then subject to conditions on its exercise; (ii) within pars. (*c*) and (*e*) as the preference shares were not shares " bearing a fixed rate of dividend ".

Per Dixon C.J., *McTiernan*, *Kitto* and *Taylor* JJ.: (1) To describe a company as " capable of being controlled " by a person or group of persons is to attribute to that person or group a presently existing power of control. The natural sense of that expression as used in s. 105 (1) (*f*) is that of possessing as a then present attribute at the relevant date, a liability to be controlled. The words " capable of being exercised " in s. 105 (1) (*b*) and (*d*) should be similarly interpreted.

(2) A power in a person to provide shareholders with an incentive or inducement to exercise their voting power as that person may wish is not aptly described as making the company capable of being controlled by that person. The person must be able to dictate the decisions of a general meeting, through a preponderance of voting power which either is vested in him or is subject to his command.

(3) It would be contrary to usage to refer to shares as having a fixed rate of dividend only, unless the only dividend that can be declared upon them in respect of a period is a fixed proportion of either their nominal amount or the amount of capital paid up upon them.

A. S. Pty. Ltd. being a " private company " within s. 105 (1) (*a*) of the *Income Tax and Social Services Contribution Assessment Act* had a considerable amount of profits available for distribution. If it were to distribute its profits while K., his wife and son held its shares any dividend declared out of the profits would be largely absorbed by income tax assessed against those persons individually. If such profits were to remain undistributed in the hands of A. S. Pty. Ltd. they would attract Div. 7 tax and that again would absorb a large proportion of them. K. Pty. Ltd. was accordingly incorporated on 20th June 1952 so that it might be interposed between A. S. Pty. Ltd. and its then shareholders, and its affairs were so regulated that the dividends which it would receive from A. S. Pty. Ltd. might be retained by it and be

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immune from Div. 7 tax. At the first meeting of the directors of K. Pty. Ltd. it was resolved that the company purchase from K., his wife and son their shares in A. S. Pty. Ltd. and it was further resolved that an extraordinary general meeting be convened and held two days later on 27th June 1952 to pass a special resolution for the issue of 100 redeemable preference shares. The general meeting was held. K. and his wife, then the only shareholders, agreed to the resolution being proposed and passed as a special resolution notwithstanding that less than twenty-one days' notice had been given. The resolution was accordingly passed. Thereafter on the same date K. and his wife met as the board of directors and resolved to allot one redeemable preference share to each of twenty persons whose applications for shares they had before them. Such persons were either friends of K., employees of A. S. Pty. Ltd. or members or employees of the firm of accountants who recommended the scheme. K. Pty. Ltd. did not pay the amounts for which it had purchased the shares in A. S. Pty. Ltd. By 30th June 1952 A. S. Pty. Ltd. had declared a dividend which entitled K. Pty. Ltd. to £29,804 and this amount constituted the whole of the net profit shown by K. Pty. Ltd. in its return of income derived in the year ended on that date.

Held, by *Dixon* C.J., *McTiernan*, *Kitto* and *Taylor* JJ., *Webb* J. dissenting, that the applications for and allotments of the redeemable preference shares were not rendered void as against the Commissioner of Taxation by virtue of s. 260 (c) of the *Income Tax and Social Services Contribution Assessment Act* 1936-1952.

Per Dixon C.J., *McTiernan*, *Kitto* and *Taylor* JJ.: Whatever difficulties there may be in interpreting s. 260, one thing at least is clear: the section intends only to protect the general provisions of the *Assessment Act* from frustration, and not to deny to taxpayers any right of choice between alternatives which the Act itself lays open to them. The very purpose or policy of Div. 7 of Pt. III of the *Assessment Act* is to present the choice to a company between incurring the liability it provides and taking measures to enlarge the number capable of controlling its affairs. To choose the latter course cannot be to defeat, evade or avoid a liability imposed on any person by the Act or to prevent the operation of the Act, the choice being one which the Act contemplates and allows.

Decision of *Williams* J. reversed.

APPEAL from *Williams* J.

W. P. Keighery Pty. Limited (hereinafter called the company) was incorporated on 20th June 1952. In its return of income for the year ended 30th June 1952 the company disclosed a taxable income of £29,804 subject to rebate on dividends received. Together with its said return of income the company lodged a statement claiming that at 30th June 1952 the company was not a " private company " within the meaning of Pt. III Div. 7 of the *Income Tax and Social Services Contribution Assessment Act* 1936-1952. On 4th

January 1954 the Commissioner of Taxation assessed the company to tax as a " private company " within Pt. III Div. 7 of the Act and by notice dated 9th February 1954 the company objected to the assessment so made. By letter dated 22nd February 1954 the commissioner gave notice of his disallowance of the objection, whereupon the company on 25th February 1954 notified the commissioner that it was dissatisfied with his decision on the objection and requested him to treat the objection as an appeal and to forward it to the High Court of Australia.

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

Sir *Garfield Barwick* Q.C., *N. H. Bowen* Q.C. and *R. J. Ellicott*, 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 is an appeal by W. P. Keighery Pty. Limited from an assessment of this company for additional tax as a private company under the provisions of Pt. III Div. 7 of the *Income Tax and Social Services Contribution Assessment Act* 1936-1952 (hereinafter called the *Assessment Act*). The company was assessed for this tax in respect of its income for the year ended 30th June 1952. The amount of the assessment is not in dispute if the company is liable to be assessed for this tax. But it contends that it is not liable to be assessed for this tax because it was not on 30th June 1952 a private company within the meaning of Pt. III Div. 7 of the *Assessment Act*. The commissioner's primary contention is that the company is liable because it was on 30th June 1952 a private company within the meaning of Pt. III Div. 7 of the *Assessment Act*. If the commissioner fails in this contention he then relies on s. 260 of the *Assessment Act*.

The company was incorporated as a proprietary company under the provisions of the *Companies Act* 1936 (N.S.W.) on 20th June 1952. Its nominal capital is £100,000 divided into 100,000 shares of £1 each with power to divide the shares in the capital for the time being into several classes and to attach thereto respectively any preferential deferred qualified or special rights privileges conditions or stipulations. The subscribers to the memorandum of association of the company are W. P. Keighery for three shares and his wife

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M. E. Keighery for one share. The articles of association of the company are the regulations contained in Table in Schedule two to the *Companies Act* 1936 with certain substitutions and alterations. The following substitutions should be noticed : 2. (In lieu of reg. 2 Table " A "). The shares of the company for the time being unissued (whether forming part of the original capital or of any increase in capital) shall be under the control of the directors who may allot or otherwise dispose of the same to such persons on such terms and conditions and at such times as the directors think fit and with full power to give to any person the call of any shares either at par or at a premium during such time and for such consideration as the directors think fit. 2a. (Additional Article). Subject to the provisions of s. 149 of the *Companies Act* the company may by special resolution issue preference shares which are or at the option of the company are to be liable to be redeemed. 54. (In lieu of reg. 54 Table " A "). Subject to any special rights or restrictions for the time being attaching to any special class of shares in the capital of the company (a) on a show of hands every member (not being a corporation) present in person shall have one vote and every member being a corporation present by a representative authorised pursuant to s. 96 of the *Companies Act* or by a proxy shall have one vote ; (b) on a poll every member (not being a corporation) present in person or by proxy shall have one vote for every share held by him and every member being a corporation present by a representative authorised pursuant to s. 96 of the *Companies Act* or by a proxy shall have one vote for every share held by it. 64. (In lieu of reg. 64 Table " A "). Until otherwise determined by a general meeting the number of the directors shall not be less than two or more than five. The first directors shall be appointed by the subscribers to the company's memorandum of association. Regulation 42 of Table A is amended by substituting twenty-one days' notice of general meetings at the least for the seven days' notice at the least provided in the regulation. Regulation 67 of Table A which is unaltered provides that the business of the company shall be managed by the directors, who may . . . exercise all such powers of the company as are not, by the Act or by these articles, required to be exercised in general meeting (subject to certain qualifications which it is unnecessary to refer to).

Pursuant to art. 64 of the articles of association Mr. and Mrs. Keighery appointed themselves the first directors of the company. The first meeting of directors was held on 25th June 1952. At this meeting it was resolved that the subscribers to the company's memorandum and articles of association be registered in the register

of members, W. P. Keighery for three shares, nos. 1 to 3 inclusive and M. E. Keighery for one share, no. 4. It was also resolved that the company should purchase the following shares in the Aquila Steel Company Proprietary Limited :

Transferor	*No. of Shares*	*Consideration*
W. P. Keighery	12,500	£33,125 0 0
M. E. Keighery	8,750	23,187 10 0
P. Keighery	5,000	13,250 0 0

The chairman reported that it was desirable that the company should issue redeemable preference shares and tabled a draft notice convening the necessary extraordinary general meeting of the company for the purpose of considering and if thought fit passing the relevant special resolution. It was resolved that such draft notice be approved and if possible the meeting be convened and held on short notice pursuant to the provisions of s. 97 of the *Companies Act*. Following upon this resolution an extraordinary general meeting of the company was held at 10.30 a.m. on 27th June 1952, Mr. and Mrs. Keighery as the only shareholders agreeing to the meeting being held at short notice. At this meeting Mr. and Mrs. Keighery were present, the quorum for a general meeting being two. It was resolved as a special resolution " That the company issue at par 100 shares of £1 each numbered 5 to 104 inclusive as redeemable preference shares that such shares be called ' redeemable preference shares ' and that (a) The said redeemable preference shares shall rank as regards return of capital in priority to all other shares in the company. (b) the said redeemable preference shares shall confer on the holders the same right of voting at general meetings as shall for the time being be conferred by the ordinary shares of the company. (c) the said redeemable preference shares shall rank for dividend to the extent of one two-thousandth part of the rate per annum of any dividend paid upon the ordinary shares in the same year ending on the thirtieth day of June. (d) subject to the provisions of s. 149 of the *Companies Act* the company reserves the power at any time to pay off the whole and from time to time to pay off any part of the capital on the said redeemable preference shares provided that not less than seven days' notice of any such payment or payments shall be given, also that any such payment or payments shall be made on or before the thirty-first day of December 1977 and that no such payment or payments shall be made between the twenty-fourth day of June and seventh day of July (both days inclusive) in any year." At a meeting of directors held on the same day at 3.30 p.m. applications were received from each of twenty persons for

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one of these preference shares accompanied in each case by £1 or a cheque for £1. It was resolved that one share be allotted as fully paid to each applicant. It was also resolved that the common seal of the company should be affixed to share certificates nos. 3 to 22 inclusive covering twenty redeemable preference shares.

As a result of the allotment of the shares at the meetings of directors held on 25th June and 27th June 1952 and the consequential entries in the register of members of the company, there were on 30th June 1952 twenty-two shareholders, each of whom had on a show of hands one vote and on a poll one vote for each share he or she held in the company. By 30th June 1952 the appellant company had received dividends from the Aquila Steel Co. Pty. Ltd. amounting to £29,804 2s. 11d. It is this sum which the commissioner claims should have been distributed under the provisions of Pt. III Div. 7 of the *Assessment Act* and on which he has assessed additional tax at 10s. 0d. in the pound amounting to £14,902. Sub-section (1) of s. 149 of the *Companies Act* 1936 provides that, subject to the provisions of this section, a company limited by shares, if so authorised by its articles, may by special resolution issue preference shares which are, or at the option of the company are to be liable, to be redeemed: Provided that (a) no such shares shall be redeemed except out of profits which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of the redemption; (b) no such shares shall be redeemed unless they are fully paid; (c) where any such shares are redeemed otherwise than out of the proceeds of a fresh issue, there shall out of profits which would otherwise be available for dividend be transferred to a reserve fund, to be called "the capital redemption reserve fund", a sum equal to the amount applied in redeeming the shares, and the provisions of this Act relating to the reduction of the share capital of a company shall, except as provided in this section, apply as if the capital redemption reserve fund were paid-up share capital of the company. Sub-section (3) of s. 149 provides that subject to the provisions of this section the redemption of preference shares thereunder may be effected on such terms and in such manner as may be provided in the articles of the company. It is clear that on 30th June 1952 the appellant company had sufficient profits which would otherwise have been available for dividend with which to redeem the twenty preference shares and to create the capital redemption reserve fund required by s. 149 of the *Companies Act* 1936. By the special resolution creating the preference shares the company reserved the power at any time prior to 31st December 1977 to pay off the whole of the capital

of the preference shares provided that not less than seven days' notice of any such payment or payments should be given and that no such payment or payments should be made between the twenty-fourth day of June and the seventh day of July (both dates inclusive) in any year. On 30th June 1952 therefore the company was in a position to pay off the whole of the issued preference capital by giving not less than seven days' notice that it would be paid off expiring on any day later than 7th July 1953. Under the articles of association of the company the directors could exercise this power. Mr. and Mrs. Keighery were the only directors. The preference shareholders could not have prevented them exercising this power by removing them as directors because they could only do this by passing an extraordinary resolution under reg. 80 of Table A and such a resolution could only have been passed at a duly convened general meeting of the company. In order to convene a general meeting, if called by the directors, twenty-one days' notice would have to be given. If called by requisitionists pursuant to s. 94 of the *Companies Act* 1936, the same length of notice would be required and that notice could only be given after twenty-one days had elapsed since the deposit of the requisition at the registered office of the company. Accordingly on 30th June 1952 Mr. and Mrs. Keighery could not have been removed as directors before they could have resolved to redeem the issued preference capital and have completed the redemption thereby eliminating the preference shareholders as members of the company. The powers conferred on the directors of the company are fiduciary powers to be exercised bona fide for the benefit of the company and not of themselves: *Ngurli Ltd.* v. *McCann* (1). But in the present case the shareholders in the company consisted of Mr. and Mrs. Keighery who held all the ordinary shares and the preference shareholders and it could not be considered to be a breach of trust for Mr. and Mrs. Keighery to decide as directors to exercise the power of the company to redeem the preference shares when these shares were by the very terms of their creation made redeemable by the company.

Part III Div. 7 of the *Assessment Act* contains ss. 103 to 109 inclusive. Section 103 (1) provides that in this division, unless the contrary intention appears, " private company " means a company which is a private company under s. 105 of this Act. Section 105 (1) provides that for the purposes of Div. 7 but subject to this section, a company is a private company if it is not a company in which the public are substantially interested (the appellant is not a company in which the public are substantially interested) and, on the last

(1) (1953) 90 C.L.R. 425.

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day of the year of income (in this case 30th June 1952), it is not a subsidiary of a public company (the appellant is not such a subsidiary) and is a company of any one or more of the six descriptions in pars. (*a*) to (*f*). These descriptions are: (*a*) a company all the issued shares of which are held by not more than twenty persons; (*b*) a company in which more than half of the voting power is capable (having regard to the operation of the next succeeding sub-section) of being exercised by one person or by persons not more than seven in number; (*c*) a company in which shares representing more than half 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 the next succeeding sub-section) by one person or by persons not more than seven in number; (*d*) a company in which not less than three-quarters of the voting power is capable (having regard to the operation of sub-s. (3) of this section) of being exercised by one person or by persons not more than seven in number; (*e*) 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) of this section) by one person or by persons not more than seven in number; and (*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. Paragraph (*a*) describes a company all the issued shares of which are held by not more than twenty persons. On 30th June 1952 the appellant did not fall within this description. It then had twenty-two shareholders. Paragraphs (*b*) to (*e*) describe companies in which either a certain proportion of the voting power is capable of being exercised by one person or by persons not more than seven in number or a certain proportion of the shares representing the paid-up capital, other than capital represented by shares bearing a fixed rate of dividend only, are held by one person or by persons not more than seven in number. For the purposes of pars. (*b*) and (*c*) a person and his nominees (nominees being defined by s. 103 (2)) are deemed to be one person. Sub-section (3) of s. 105 provides that for the purposes of pars. (*d*) and (*e*) a person (whether or not he holds shares in the company concerned) and his relatives (relatives being defined by s. 6) and (in relation to any shares in respect of which they are such nominees) his nominees or nominees of any of his relatives shall be deemed to be one person.

These paragraphs provide certain artificial tests which are to be applied in order to determine whether a company is a private company because it is deemed to be under the control of a limited

number of persons. The forerunners of these paragraphs in the *Income Tax Assessment Act* 1936 s. 103 were quite brief. Sub-section (1) of that section defined private company to mean "a company which is under the control of not more than seven persons, and which is not a company in which the public are substantially interested or a subsidiary of a public company". Sub-section (2) provided that for the purpose of Div. 7 "(*c*) a company shall be deemed to be under the control of any persons where the major portion of the voting power or the majority of the shares is held by those persons or is held by those persons and nominees of those persons or where the control is, by any other means whatever, in the hands of those persons". These provisions were discussed by this Court in *Adelaide Motors Ltd.* v. *Federal Commissioner of Taxation* (1) and *Federal Commissioner of Taxation* v. *West Australian Tanners & Fellmongers Ltd.* (2). It was held in these cases that a company is not a private company within their meaning unless there exists a group or groups of not more than seven persons holding the major portion of the voting power, or the majority of shares, and unless there is in addition, actual control of the company exercised by one of such groups; there is such an actual control whenever there is only one such group. The commissioner had contended that it was sufficient if any group of shareholders could be found having a major portion of the voting power or holding the majority of the shares whether that group was in fact exercising control of the company or not. In the later case the Court was asked to overrule the decision in the earlier cases but refused to do so. The Court said, referring to the earlier case: "If the law as there laid down does not carry out the intention of the legislature, the desirability of amending the provisions will no doubt receive the consideration of the appropriate authorities" (3). The Court was careful to point out on the same page that neither case dealt in any way with that part of par. (*c*) of sub-s. (2) of s. 103 which referred to a case where the control is by any other means in the hands of a group of persons. The commissioner evidently disapproved of these decisions and Parliament amended the law. Amendments were made by the *Income Tax Assessment Act* 1948 and the *Income Tax and Social Services Contribution Assessment Act* 1951 and finally by the *Income Tax and Social Services Contribution Assessment Act* 1952 (No. 3), s. 17 (1). Division 7 of Pt. III of the principal Act was thereby repealed and the division as it there appears inserted in its stead. Section 1 (4) of this Act provided

(1) (1942) 66 C.L.R. 436.
(2) (1945) 70 C.L.R. 623.
(3) (1945) 70 C.L.R., at p. 634.

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that the principal Act as amended by this Act might be cited as the *Income Tax and Social Services Contribution Assessment Act* 1936-1952. Section 24 of this Act provided, *inter alia*, that the amendments effected by s. 17 should apply to assessments in respect of the year of income that commenced on 1st July 1951 and in respect of the income of all subsequent years. It is in Div. 7 of Pt. III as introduced by s. 17 of the *Income Tax and Social Services Contribution Assessment Act* 1952 (No. 3) that we find s. 105. It is true I think, as Mr. *Macfarlan* suggested, that pars. (*b*) and (*d*) as they now appear are framed so as to give effect to the commissioner's argument rejected by this Court in the two cases mentioned and that under these paragraphs it is now clear that if the requisite voting power is capable of being exercised by one person or by persons not more than seven in number, whether that voting power is exercised by them or not so as to control the company, the company satisfies the descriptions in these paragraphs. In the case of pars. (*c*) and (*e*) it is also sufficient that the requisite number of shares are held by one person or by persons not more than seven in number, whether these shareholders are in fact exercising their voting powers derived from these shares to control the company or not. To be exact pars. (*b*), (*c*), (*d*) and (*e*) say nothing expressly about control. Control is mentioned for the first time in par. (*f*). Paragraph (*f*) refers to "any means whatever". It does not adopt the original expression in the *Income Tax Assessment Act* 1936 "where the control is, by any other means whatever, in the hands of those persons" (that is not more than seven persons). But pars. (*b*), (*c*), (*d*), and (*e*) and particularly (*b*) and (*d*) appear to describe companies which should be classed as private companies because their shareholdings are such that they can be controlled by one or by not more than seven persons. Sub-section (3) of s. 105 includes a person who does not hold shares in the company concerned in the composite person consisting of himself and his relatives and his and their nominees. But votes at a general meeting of a company are only capable of being exercised by the shareholders or their proxies. A person who is not a shareholder could not vote. He could only have a controlling interest in the company if he could control the votes of sufficient shareholders to give him through them control of the company. In order to ascertain the number of votes such an outsider could control for the purpose of pars. (*d*) and (*e*) it would be necessary to find out how many shares his relatives and his and their nominees held in the company. The voting powers attributable to all these shares would then be deemed to be capable of being exercised by one person and all those shares

would be deemed to be held by one person. "Controlling interest" said *Rowlatt* J. in *B. W. Noble Ltd.* v. *Inland Revenue Commissioners* (1), cited with approval by Viscount *Simon* L.C. in *British-American Tobacco Co.* v. *Inland Revenue Commissioners* (2), "had a well known meaning, and referred to the situation of a man 'whose shareholding in the company is such that he is the shareholder who is more powerful than all the other shareholders put together in general meeting'" (3). It is impossible, in my opinion, to bring the appellant company within any of the descriptions in pars. (*b*), (*c*), (*d*) or (*e*). Upon the evidence all the twenty preference shareholders were the absolute legal and beneficial owners of their shares on 30th June 1952. None of them were relatives or nominees of Mr. or Mrs. Keighery or of each other. The only shareholders who were related to one another were Mr. and Mrs. Keighery. Only twenty-four shares had been issued. Each of these shares had the same voting power and twenty of them were held by independent and unrelated persons. It was sought to bring the appellant company within pars. (*c*) and (*e*) by contending that the preference shares were shares bearing a fixed rate of dividend only. They were shares which were entitled to a dividend of one two-thousandth part of the rate per annum of any dividend paid upon the ordinary shares in the same year ending on the 30th day of June. It was said that the rate of dividend was fixed because the preference shares were entitled to a fixed proportion of the dividend paid on the ordinary shares but a fixed proportion of a variable rate cannot be other than a variable rate itself. The twenty preference shares are not, in my opinion, shares bearing a fixed rate of dividend only within the meaning of these paragraphs.

The crucial question is whether the appellant company was on 30th June 1952 a company within the description in par. (*f*) of sub-s. (1) of s. 105, that is to say whether the appellant was on that day a company capable of being controlled by any means whatever by one person or by persons not more than seven in number. It is unnecessary and it would be unwise to attempt to define what means could qualify as means under the wide expression "any means whatever". It will be sufficient for the purpose of the present case to examine the means relied upon by the commissioner. He relies on the capacity to control the appellant company residing in Mr. and Mrs. Keighery on 30th June 1952 because they then had the power to redeem the preference capital and thereby eliminate the votes of the preference shareholders before the preference

(1) (1925) 12 Tax Cas. 911, at p. 926.
(2) (1943) A.C. 335.
(3) (1943) A.C., at pp. 339, 340.

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shareholders could convene a general meeting. Accordingly on 30th June 1952 it was entirely a matter for their discretion to determine whether at any general meeting that could be subsequently convened they alone or the preference shareholders as well would have a vote. Mr. *Macfarlan* contended that it did not matter that if a general meeting had been held on 30th June 1952 Mr. and Mrs. Keighery would have had on a poll only four votes out of twenty-four. No general meeting had been called for that day and none could have been called except with the consent of all the shareholders to accept short notice. The company was nevertheless capable of being controlled on that day by Mr. and Mrs. Keighery because on that day they had the means of preventing any shareholders except themselves exercising any control over the company. The only control the shareholders could exercise would be such control as their votes would give them at a general meeting. But Mr. and Mrs. Keighery had the power to prevent the preference shareholders exercising their votes at a general meeting and to limit the voting at a general meeting to their own votes. Sir *Garfield Barwick* on the other hand contended that the question whether the company was capable on 30th June 1952 of being controlled by one person or not more than seven persons depended upon whether, if there had been a general meeting of the company on that day, the majority of the votes would have been exercisable by one person or by not more than seven persons. He contended that the expression " capable of being controlled " means controllable or, in other words, that the paragraph describes a company which is capable of being controlled on the last day of the year of income by one person or by persons not more than seven in number because on that day the structure of the company is such that it is capable of control by him or them on that day. The company must be capable of being controlled on that particular day by such person or persons by means actually existing on that day. As there were twenty-four issued shares in the capital of the appellant on 30th June 1952, each of which on a poll carried one vote, and Mr. and Mrs. Keighery were the holders of only four of these shares, the company was not capable of being controlled by them by any means existing on that day. Sir *Garfield* contended that a company cannot be said to be capable of being controlled by a person or persons on a particular day if that control does not exist in the instant circumstances but depends upon the power of that person or those persons to alter the company's capital structure in the future. No one, he said, could foretell what changes might occur in this structure in the meantime. But this possibility does not appear to me to

matter when the question is whether on a given day the company is capable of being controlled by a person or persons not more than seven in number because on that day that person or those persons have the means of destroying that part of the capital structure of the company from which any opposition to their own voting power in general meeting could emanate before a general meeting could be held. This capacity of a company to be controlled by this means may disappear in the future but the question is whether it exists on a particular day and not whether it will continue to exist on some future day. It is, of course, the company which on the last day of the year of income must be capable of being controlled by some means by one person or by persons not more than seven in number. But a company can only be capable of control in a passive sense. If that person or those persons on that day possess means by which he or they are capable of controlling the company, the company must be a company which on that day is capable of being controlled by that person or those persons. To give a shareholder or a limited number of shareholders of a company the power to eliminate all the other shareholders before they could vote at a general meeting seems to me to be to provide a very efficient means of making the company capable of being controlled by that shareholder or limited number of shareholders. Mr. and Mrs. Keighery had this very power on 30th June 1952. On that day the capital structure of the appellant and the factual position were such that they could eliminate the preference capital before there could be a general meeting and it was only in general meeting that the preference shareholders could by their votes exercise any control over the company. The appellant company was, in my opinion, a company which on 30th June 1952 was capable of being controlled by Mr. and Mrs. Keighery by these means.

Having reached this conclusion the commissioner's contention based on s. 260 of the *Assessment Act* need not be considered.

The appeal must be dismissed with costs.

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

Sir *Garfield Barwick* Q.C. (with him *N. H. Bowen* Q.C. and *R. J. Ellicott*), for the appellant. The words " on the last day of the year of income " are to be read as applicable to each of pars. (*a*) to (*f*) of s. 105 (1) and in relation to par. (*f*) they are to be read as applying to the whole of the expression " capable of being controlled " and not as applying to the word " capable " only. Such expression

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should be read as " controllable " and the time factor should be annexed to the composite meaning of the expression and not to any individual word in it. The existence on the named date of a power to exercise control at some subsequent date is not within the scheme of par. (*f*). In the present case the capacity of the Keigherys to redeem the preference shares is a right the exercise of which is antecedent to control. It is only after they have redeemed the shares that they will exercise control over the affairs of the company and they will then do that through the shareholding. On the history of these legislative provisions see *Income Tax Assessment Act* 1915, s. 16 (2), *Income Tax Assessment Act* 1918, s. 10, *Income Tax Assessment Act* 1922, s. 21, *Income Tax Assessment Act* 1930, ss. 9, 10, *Income Tax Assessment Act* 1934, s. 13, *Income Tax Assessment Act* 1936, s. 103, *Income Tax Assessment Act* 1948, s. 9. This latter Act followed upon the decisions in *Adelaide Motors Ltd.* v. *Federal Commissioner of Taxation* (1) and *Federal Commissioner of Taxation* v. *West Australian Tanners & Fellmongers Ltd.* (2) and introduced for the first time the idea of the last day of the year in connexion with the control by shareholding or otherwise. Then followed the *Income Tax and Social Services Contribution Assessment Act* 1952 (No. 90), s. 17. The development of s. 105 shows that once the legislature departed from the test of actual control and turned to the idea of potential control it was necessary to peg that idea to a specific date in order to bring some certainty into the administration of the statute. " Control " is used in the Act in the sense given in *Himley Estates Ltd. and Humble Investments Ltd.* v. *Inland Revenue Commissioners* (3). The earlier paragraphs of s. 105 (1) look to the direct means by which a company may be controlled within its constitution, such as voting power and shareholding, and in par. (*f*) control of the company by some other means still within its constitution is sought. What is sought by the statute is a quality of the company and the only way the company can be controlled in the relevant sense is through the shareholding. If on the named date the shareholding is spread beyond the limited number of persons mentioned in the statute then the company is not caught. It is quite irrelevant that the shareholding may be susceptible of change so that on another date it will be subject to control by a less number of persons. [He referred to *S. Berendsen Ltd.* v. *Inland Revenue Commissioners* (4); *Adelaide Motors Ltd.* v. *Federal Commissioner of Taxation* (1), and *Federal Commissioner of Taxation* v. *West Australian Tanners & Fellmongers Ltd.* (2)]. It is not a quality of the

(1) (1942) 66 C.L.R. 436.
(2) (1945) 70 C.L.R. 623.
(3) (1933) 1 K.B. 472.
(4) (1957) 3 W.L.R. 164; (1958) Ch. 1.

company that some person can control the shareholding, though in the present case as at the pegged rate there is no suggestion that any person had this power.

B. P. Macfarlan Q.C. (with him *M. H. Byers*), for the respondent. The appeal should be dismissed for the reasons given by *Williams* J. in accepting the arguments addressed below on behalf of the commissioner and also because of the arguments rejected by his Honour in relation to s. 105 (1) (*c*) and (*e*). By the 1948 amendment the legislature abandoned the idea of factual control and accepted that of capacity to control. [He referred to *Federal Commissioner of Taxation* v. *West Australian Tanners & Fellmongers Ltd.* (1)]. The appellant's argument requires not only capacity to control existing on the named date but also actual control so existing. The several paragraphs of s. 105 (1) look at the company passively. So far as par. (*f*) is concerned the inquiry is whether having regard to the organisation and constitution of the company, its articles of association, share register and its board, it is capable on the last day of the year of income of being controlled by the limited number of persons. The paragraph does not demand control on the named date ; capacity alone is pegged to that date. The criterion is really one of possibility of control from power existing at the named date. That argument is wider than the view taken by *Williams* J. which is also here respectfully adopted. Paragraph (*f*) embraces every case where the articles of association or the general constitution of the company enables any group of seven or less to acquire the power of actual control in the future. The introduction of the phrase " by any means whatever " is designed to meet that situation. The appellant is a " private company " because it answers the description in pars. (*c*) and (*e*) of s. 105 (1). The preference shares bear a fixed rate of dividend and are thus excluded from consideration, leaving only the shares held by the two Keigherys. Paragraph (*c*) requires merely that there should be a fixed rate—not a rate fixed in relation to nominal or paid-up capital, profits or other particular sums of money available. The rate may be fixed in relation to anything and here it is fixed in relation to other classes of shares, and the provisions of pars. (*c*) and (*e*) in this respect are fulfilled. What was done in this case after 20th June 1952 constituted an arrangement within s. 260 and was thus rendered void as against the commissioner. The allotment of preference shares is considered for the purpose of tax as not having been made. Section 260 uses the word " tax " generally and it is wide enough to include

(1) (1945) 70 C.L.R., at pp. 631-633, 637.

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undistributed profits tax, the payment of which was here sought to be avoided by the arrangement. The Act does not confer a choice upon companies to be taxed as private or non-private companies. The Act is self-executing and operates upon the existing facts irrespective of the choice of the companies concerned. [He referred to *Bell* v. *Federal Commissioner of Taxation* (1); *Federal Commissioner of Taxation* v. *Newton* (2)]. The passage lastly cited shows that there can be an arrangement within s. 260 (*c*) where the facts constituting the arrangement relate to the alteration in the character of a company from a private to a public company. If the arrangement here is removed by s. 260 there is found in the coffers of the appellant a sum of money on which it should have paid Div. 7 tax and it has not done so. The assessment to tax should therefore be supported.

Sir *Garfield Barwick* Q.C., in reply. With respect to the argument on s. 260 it is clearly permissible under the Act for the company to assume the character which the Act allows it to assume and at a particular date to follow that up by taking advantage of what the Act offers in that new character. This case is quite different from others on s. 260, depending as it does on a change in the character of the taxpayer, and what was here done was within the contemplation of the statute and not an attempt at circumventing the statute. The respondent's argument would strike down part only of the scheme, and there is no warrant for doing that. The non-distribution did not follow upon the adoption of the scheme but was itself an integral part thereof. On s. 105 (1) (*f*) the directors' capacity or ability to exercise the powers of the company, in this case to redeem the preference shares and alter the situation, was not a means of control within the paragraph, either in itself or added to anything else. It is not right to conclude from the fact that a person has a present ability some day to do a thing in relation to a company that the company has a present capacity of having that thing done to it. If, however, the person can do such a thing to the company today, then it is exact to say that today the company is capable of having such thing done to it. The former is the way in which the respondent's case is put and can be seen to be a *non sequitur*. In pars. (*c*) and (*e*) of s. 105 (1) what is contemplated is not a relatively fixed rate of dividend but an absolutely fixed rate of dividend, a nominated fixed rate. A fixed rate cannot be obtained by finding a rate bearing a fixed relationship to a variable.

Cur. adv. vult.

(1) (1953) 87 C.L.R. 548, at pp. 571, 572.

(2) (1957) 96 C.L.R. 577, at pp. 630, 631, 645-654.

The following written judgments were delivered :—

DIXON C.J., KITTO and TAYLOR JJ. : The appellant company appealed to this Court against an assessment of additional tax under Div. 7 of Pt. III of the *Income Tax and Social Services Contribution Assessment Act* 1936-1952 (Cth.) in respect of its income derived in the year ended 30th June 1952. The appeal, having been heard and dismissed by *Williams* J., has been carried to the Full Court.

The only question in dispute is whether the company was liable to be assessed as a " private company " within the meaning given to that expression for the purposes of Div. 7 by sub-s. (1) of s. 105. That sub-section begins by prescribing two negative conditions which must be satisfied if a company is to be a private company for the purposes of Div. 7. It must not be " a company in which the public are substantially interested ", and, on the last day of the year of income, it must not be " a subsidiary of a public company ". There are, in sub-s. (4), provisions explanatory of these descriptions, but they need not be set out, for it is common ground that the appellant company was not within either description. Then the sub-section provides that for the purposes of the Division (though subject to provisions in the section which have no application here) a company is a private company if, on the last day of the year of income, it is a company of any one or more of six descriptions contained in paragraphs lettered from (*a*) to (*f*). The description mainly relied upon by the commissioner in this case is that which is contained 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 ".

The last day of the relevant year of income was 30th June 1952. On that day the appellant company, which was incorporated under the *Companies Act* 1936 (N.S.W.), had an issued share capital consisting of four fully paid ordinary shares of £1 each and twenty fully paid redeemable preference shares of £1 each. The directors, a Mr. and Mrs. Keighery, held three and one ordinary shares respectively. Twenty other persons each held one redeemable preference share. Under the articles of association and a special resolution authorising the issue of the redeemable preference shares, each of the twenty-two shareholders was entitled on a show of hands to one vote, and on a poll to one vote for every share held. It is clear, therefore, that if there had been a general meeting of the company on 30th June 1952, no one shareholder, and no group of not more than seven shareholders, could have outvoted all other

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shareholders. There is nothing to suggest that any shareholder had the power by any means to govern the voting of another.

If there were nothing else in the case the appellant company would clearly not be of the description in par. (*f*). The controlling authority of a company is its general meeting, and accordingly it has always been recognised in the cases in this Court to which reference will be made and in the line of English decisions which the Court of Appeal has recently reviewed in *S. Berendsen Ltd.* v. *Inland Revenue Commissioners* (1) that the only way in which a company can be controlled, in the relevant sense of the word, is by the carrying of a resolution at a general meeting. But the situation in which the appellant company stood on 30th June 1952 included two additional features. The first was this. By the terms of issue of the redeemable preference shares, the company had reserved the power, subject to s. 149 of the *Companies Act* 1936 (N.S.W.), at any time on or before 31st December 1977 to pay off any part of the capital paid up on the redeemable preference shares provided that not less than seven days' notice of any such payment or payments should be given and that no such payment or payments should be made between 24th June and 7th July (both days inclusive) in any year. Section 149 imposed certain conditions upon the power of a company to redeem such shares. One was that they must be fully paid ; and that condition was satisfied in the case of the appellant company's redeemable preference shares. Another was that they could not be redeemed except out of profits which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of the redemption ; and the appellant company had profits available for dividend which were sufficient for this purpose. A third condition was that there should be transferred out of profits available for dividend to a " capital redemption reserve fund " a sum equal to the amount applied in redeeming the shares ; and the profits available were sufficient for this purpose also. Mr. and Mrs. Keighery had authority as the directors of the company to exercise its powers with respect to redemption, as the company had adopted the articles of association contained in Table A in Schedule Two to the Act, with certain alterations but without any alteration of art. 67, and had made no contrary regulation. On 30th June 1952, therefore, Mr. and Mrs. Keighery had power to effect the redemption of the redeemable preference shares at any time after 7th July 1952 on giving seven days' notice ; and it was a power which, although it belonged to them as directors, they could exercise as they might see

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

fit, since they were themselves the only persons who would be interested in the company if the redemption should be effected.

That was one feature of the situation. The second was that no notice had been given convening a general meeting of the company for 30th June 1952 or for any date thereafter. The company's adoption of the articles of association in Table A had been subject to (*inter alia*) the substitution of twenty-one days for seven days in art. 42. Therefore, although on 30th June 1952 the power to redeem the preference shares was not exercisable immediately, it was exercisable so as to forestall any general meeting for which Mr. and Mrs. Keighery should not be willing to accept short notice.

The commissioner's primary contention is that because the power resided in Mr. and Mrs. Keighery on 30th June 1952 to redeem the preference shares at any time after the ensuing 7th July, and because the conditions to which the power was subject either were satisfied or could be satisfied if Mr. and Mrs. Keighery should choose to satisfy them, it is right to say that on the former day the company was capable of being controlled by those two persons. He does not suggest that it was capable of being controlled by them on that day, in the sense that if a general meeting had then assembled they would have been able to impose their will on the meeting against any opposition. It is, of course, nothing to the point that the existence of the power of future redemption might conceivably have made the holders of the redeemable preference shares more willing than otherwise they would have been to comply with the wishes of Mr. and Mrs. Keighery. Clearly enough, the description of a company as "capable of being controlled" is not satisfied by the mere fact that a majority of shareholders, while not under any legal or equitable obligation to obey the directions of other persons, may possibly prove so anxious to retain shares which those other persons are able to eliminate that they will obey those directions against their own desires. A power in a person to provide shareholders with an incentive or inducement to exercise their voting power as that person may wish is not aptly described as making the company capable of being controlled by that person. The person must be able to dictate the decisions of the general meeting, through a preponderance of voting power which either is vested in him or is subject to his command.

But the commissioner does contend that a company should be held to have been "capable" of being controlled by particular persons on a given day if an examination on that day of its constating instruments, of its share register and other books, and of all the then existing circumstances would have revealed that there

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was a possibility of those persons thereafter acquiring control of the company. The expression " capable of being controlled ", it is said, is satisfied by a possibility or a potentiality of being controlled, and does not require an existing amenability to control. If so, it is clear that the description was applicable to the appellant company on 30th June 1952.

It must be acknowledged, of course, that it is the capability, and not the control, which must exist on the last day of the year of income. But to describe a company as capable of being controlled by a person or group of persons is to attribute to that person or group a presently existing power of control. " Capable of being controlled " in this context cannot be interpreted so widely as to be satisfied whenever a possibility of obtaining control over the company exists by reason of something in its constitution or its special circumstances. The natural sense of the expression is that of possessing, as a present attribute, a liability to be controlled. And a liability to be controlled by one person or not more than seven persons involves either that there is one person who holds, or has a right to command, the major portion of the existing voting power, or that there are several persons, not more than seven in number, whether they form an existing group or not, who between them hold or can command a major portion of the existing voting power.

It is said for the commissioner that to accept this construction of par. (*f*) is to give insufficient weight to the history of the legislation. Before the Act was amended in 1948, the interpretation of the expression " private company " was found in s. 103. Under that section, a company could not be a private company for the purpose of Div. 7 unless it was " a company which is under the control of not more than seven persons " ; and par. (*c*) of sub-s. (2) provided that a company should be deemed to be under the control of any persons where the majority of the shares was held by those persons or nominees of those persons, or where the control was, by any other means whatever, in the hands of those persons. It was held in *Adelaide Motors Ltd.* v. *Federal Commissioner of Taxation* (1), as explained in *Federal Commissioner of Taxation* v. *West Australian Tanners & Fellmongers Ltd.* (2) that par. (*c*) applied where a group or groups existed holding the major portion of the voting power of a company or the majority of the shares, provided that in addition there was an actual control of the company by one of the groups and that there was such an actual control whenever there was only one such group who held the major portion of the voting power.

(1) (1942) 66 C.L.R. 436.

(2) (1945) 70 C.L.R., at p. 634.

or the majority of the shares. In 1948, by Act No. 44 of that year, s. 103 was replaced by a new provision, and amongst other changes was the enactment of a new definition of " private company ". Three descriptions were provided, relating to share holding and voting power on the last day of the year of income. None mentioned control of the company. No longer, therefore, had actual control of the company to be found in any case. The definition which is now in s. 105 is but a fuller development. It first appeared as s. 103A by the Act No. 44 of 1951, and it became s. 105 in the substituted Div. 7 which was enacted by s. 17 of the Act No. 90 of 1952. The policy adopted in the 1948 Act is adhered to, in that actual control of the company is not required by any of the descriptions.

The contention is that to read " capable of being controlled " in par. (*f*) of s. 105 (1) as meaning presently liable to be controlled is to revert, contrary to the clear policy of the legislation, to the former requirement of actual control. But this is not so. To understand par. (*f*) as applying only where, on the specified day, a sufficiently small number of persons can control the company by joining forces, whether or not they are already linked together in any manner and whether or not they form the only grouping of persons who together could outvote opposition, is a very different thing from confining it to the case where on that day a sufficient number of persons is found actually united in controlling the company. The truth is that " capable of being controlled " connotes the existence of either one person whose enforceable and immediately exercisable rights enable him to control, or a number of persons whose enforceable and immediately exercisable rights enable them, if they act in concert, to control.

Attention was called, in the course of the argument, to the fact that the word " capable " appears also in pars. (*b*) and (*d*) of s. 105 (1); and the suggestion was made that in those paragraphs the word has so wide a meaning that unless it is to be given a completely different force in par. (*f*) the commissioner's construction of that paragraph must be preferred. But a consideration of pars. (*b*) and (*d*) supports rather than weakens the conclusion which has been indicated. Paragraph (*b*) describes a company in which more than half of the voting power is capable (having regard to the operation of sub-s. (2)) of being exercised by one person or by persons not more than seven in number. Paragraph (*d*) describes a company in which not less than three-fourths of the voting power is capable (having regard to the operation of sub-s. (3)) of being exercised by one person or by persons not more than seven in number.

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In each paragraph the words in brackets modify the word "capable". The effect in par. (*b*) is that in determining the capability referred to a person and his nominees shall be deemed one person; and their effect in par. (*d*) is that in determining the capability a person, his nominee, his relatives and the nominees of any of his relatives shall be deemed to be one person. Clearly each of these paragraphs refers to voting power existing and immediately exercisable on the specified day. "Capable of being exercised", in relation to that day, means presently exercisable on that day. Similarly, in par. (*f*), "capable of being controlled" in relation to that day must mean presently controllable on that day.

As an alternative submission, it was put for the commissioner that the view should be adopted which the learned primary judge made the ground of his decision. It has already been mentioned that no general meeting of the appellant company had been convened for 30th June 1952, and that none could be convened for any date so soon thereafter that Mr. and Mrs. Keighery could not anticipate it by a redemption of the redeemable preference shares. The submission is that in the state of things, it is beside the point to consider what could or could not have been done by Mr. and Mrs. Keighery at a general meeting on 30th June if there had in fact been such a meeting. It is enough that on that day they had in their hands the power to eliminate all voting power but their own before any general meeting could be held; so that they could decide what they liked concerning the company's affairs and no one could prevent them from giving effect to their decision. They had, as the learned judge said, "the means of destroying that part of the capital structure of the company from which any opposition to their own voting power in general meeting could emanate before a general meeting could be held".

The position in which Mr. and Mrs. Keighery stood on the material date, however, was not like that of persons who, though holding only a minor part of the voting power themselves and having no rights enabling them to direct the voting of other shareholders, yet have a power exercisable at will to disallow or disqualify the votes of other shareholders. If the case had been of that kind, it would clearly be right to describe the company as capable of being controlled by Mr. and Mrs. Keighery, for an opposition which can be precluded at will from opposing is no opposition at all. But the case is really very different. On 30th June 1952 the power to redeem the preference shares was incapable of immediate exercise. All that Mr. and Mrs. Keighery could do on that day towards bringing about a redemption was to give the requisite

preliminary notice. It could not have been affirmed on that day that they would certainly be the repositories of the power when it should become exercisable, nor could it even have been affirmed that the power would certainly become exercisable before the next general meeting. Mr. and Mrs. Keighery might die, or become bankrupt, or become otherwise disqualified as directors. Even if they continued to be the directors, there was no certainty, however great the probability may have seemed, that at the expiration of the period specified in the requisite notice the company would still be in a position to satisfy the conditions laid down by s. 149 of the *Companies Act*. For example, the profits required for the redemption itself and for the "capital redemption reserve fund" might by then have been lost, or the company might have been forced into liquidation. Mr. and Mrs. Keighery therefore had no absolute power to eliminate the votes of the preference shareholders. The company was capable of being made controllable by them in certain eventualities; but that is not to say that the company was then capable of being controlled by them.

The commissioner's contentions in relation to par. (*f*) of s. 105 (1) therefore cannot be sustained. He relied also, however, on pars. (*c*) and (*e*). Paragraph (*c*) describes "a company in which shares representing more than half 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 the next succeeding sub-section) by one person or 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-section (3) of this section) by one person or by persons not more than seven in number". Neither paragraph can apply here unless the redeemable preference shares were "shares bearing a fixed rate of dividend only". In fact they ranked for dividend, according to their terms of issue, "to the extent of one two-thousandth part of the rate per annum of any dividend paid upon the ordinary shares in the same year ending on the thirtieth day of June". Such a rate, it is contended, was a fixed rate: the figure to which it would have to be applied would no doubt vary from year to year, but the rate itself was not variable. It is pointed out that neither of the two paragraphs speaks of a fixed rate in relation to the paid-up capital, or to the nominal capital, or to the profits, or to any other particular sum of money, so that a fixed rate in relation to anything at all would suffice.

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The answer is sufficiently obvious. It would be contrary to usage to refer to shares as having a fixed rate of dividend only, unless the only dividend that can be declared upon them in respect of a period is a fixed proportion of either their nominal amount or the amount of capital paid up on them. The appellant company's preference shares carried a dividend being a fixed proportion of a variable proportion of the amount paid up on the ordinary shares: see art. 92 in Table A. That is, of course, a variable proportion of the paid-up amount. Every determination of a rate of dividend on the ordinary shares operated, because of the terms of issue of the preference shares, to fix automatically the rate of dividend on the preference shares. And that means that the rate of dividend on the latter was as variable as, because it must vary *pari passu* with, the former. The case is clearly outside pars. (*c*) and (*e*).

Finally, the assessment is supported by an argument based upon s. 260 (*c*), which 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, defeating, evading, or avoiding any liability imposed on any person by the Act. The argument is that the allotment of the redeemable preference shares formed part of an arrangement having the purpose of avoiding the liability to Div. 7 tax which the appellant company would otherwise have been under, that the allotment is therefore to be disregarded as against the commissioner, and that as a consequence the appellant company is to be treated as a "private company".

The relevant facts are these. In June 1952, Mr. and Mrs. Keighery were and had been for some time, interested in a company called Aquila Steel Pty. Ltd. which had a considerable amount of profits available for distribution. Its issued capital consisted of £35,000 divided into 35,000 shares of £1 each, of which Mr. Keighery held 12,500, Mrs. Keighery held 8,750, their son Patrick held 5,000, and a man named White held 8,750. The public were not substantially interested in the company, in the sense given to that expression by s. 105 (4) (*a*). It was not a subsidiary of a public company in the sense of s. 105 (4) (*b*). In this state of things it was a private company for the purposes of Div. 7, falling within the description contained in par. (*a*) of s. 105 (1). It may be said without discussing in detail the application of Div. 7 to Aquila Steel, that it would have to pay additional tax under that Division unless it should make a distribution of the relevant profits before 30th April 1953 or pay Div. 7 tax. It was with this in view, and on the recommendation of the accountants and solicitors who were

advising Mr. and Mrs. Keighery and Aquila Steel on taxation matters, that steps were taken to form the appellant company and make it a non-private company. It was incorporated on 20th June 1952 with a memorandum and articles so framed as to allow for what was afterwards done. At the first meeting of the directors the business transacted included the passing of resolutions for the purchase from Mr. and Mrs. Keighery and their son Patrick of their shares in Aquila Steel, and for the convening of an extraordinary general meeting, to be held two days later, on 27th June 1952, to pass a special resolution for the issue of 100 redeemable preference shares. The general meeting was held. Mr. and Mrs. Keighery, who were then the only shareholders, agreed to the resolution being proposed and passed as a special resolution notwithstanding that less than twenty-one days' notice had been given, and it was passed accordingly. Afterwards, but on the same day, Mr. and Mrs. Keighery met as the board of directors. They had before them applications from twenty persons for one redeemable preference share each, and resolved to allot the shares applied for. Some of the applicants were friends or acquaintances of Mr. Keighery, and had made their applications for the sake of obliging him; some were employees of Aquila Steel; and some were members or employees of the firm of accountants which recommended the procedure. The appellant company did not pay the amounts for which it had purchased the shares in Aquila Steel. By the 30th June 1952 Aquila Steel had declared a dividend which entitled the appellant company to £29,804 2s. 11d., and this amount constituted the whole of the net profit shown by the appellant company in its return of income derived in the year ended on that date. Being subject to rebate under s. 46, the profit entailed no liability to income tax under any of the provisions of the Act other than those in Div. 7. It might have entailed some liability, notwithstanding the rebate, if Aquila Steel had deferred declaring its dividend until after 30th June 1952. Whether for that or another reason, it was considered more advantageous to the appellant company that Aquila Steel should make its distribution before than after 30th June 1952.

It is beyond question that the whole plan was carefully designed as a means of dealing with a problem of a familiar kind. If Aquila Steel were to distribute its profits while Mr. and Mrs. Keighery and their son held their shares in that company, the £29,804 2s. 11d. would be largely absorbed by income tax assessed against those persons individually. If, on the other hand, it were to remain undistributed in the hands of Aquila Steel, it would attract Div. 7

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tax, and that again would absorb a large proportion of it. The course adopted was planned mainly, though perhaps not exclusively, with the object of enabling Aquila Steel to distribute its profits, so as not to incur Div. 7 tax, without causing any consequential increase in the assessable incomes of Mr. and Mrs. Keighery and their son. The appellant company was brought into being so that it might be interposed between Aquila Steel and the Keigherys, and its affairs were so regulated that the dividend which it would receive from Aquila Steel might be retained by it and yet might be immune from Div. 7 tax. Mr. Keighery was cross-examined before the learned primary judge, and he was quite candid about the plan. He agreed with a suggestion that was made to him, that care was taken by the appellant company to ensure that the preference shares were allotted before 30th June 1952, and that the reason for his concern, as chairman, that this should be done was that he believed the maximum tax benefits should be achieved by the company in respect of its income of the then current year. He was asked: "The object of the company (in) making the allotment (of the preference shares) was so that the company would not be required, in your understanding, to pay Div. 7 tax, or further tax on its undistributed profits; is that right?" And he replied: "That is so. We attempted to attain public company status."

No case was made by the commissioner, either before the learned primary judge or before this Court, that there was any pretence or unreality about the applications for and allotments of the preference shares. It would be a fair inference from the evidence that all the persons who took those shares, and not only those of them who were acquaintances of Mr. Keighery, did so by way of obliging him by assisting him to bring about a tax result that he desired. There was nothing dishonest in it, from anyone's point of view; but all concerned must have realised that they were participating in a course of action which had no substantial practical significance apart from its effect on income tax (and possibly, as Mr. Keighery suggested in cross-examination, on probate duties). Still, so far as appears, the applications for shares were genuine, and the allotments were genuine. Hence the commissioner's need to rely upon s. 260.

Whatever difficulties there may be in interpreting s. 260, one thing at least is clear: the section intends only to protect the general provisions of the Act from frustration, and not to deny to taxpayers any right of choice between alternatives which the Act itself lays open to them. It is therefore important to consider whether the result of treating the section as applying in a case such as the

present would be to render ineffectual an attempt to defeat etc. a liability imposed by the Act or to render ineffectual an attempt to give a company an advantage which the Act intended that it might be given.

It is the outstanding feature of Div. 7 that it makes a company's liability to be assessed for additional tax depend upon the company's possessing certain characteristics on a particular day, the characteristics being such that whether the company possesses them on that day is a matter within the antecedent control of shareholders or other persons interested. The liability to tax is imposed contingently on the company having, on the relevant day, the two negative attributes and one or more of the positive attributes which s. 105 (1) mentions. If the contingency occurs, the liability arises—although it depends on events whether any tax will become payable. If the contingency does not occur, the liability is not imposed. Whenever, as the end of a year of income approaches, it is found that facts exist in relation to a company which will make it a " private company " if they persist on the last day of the year, the persons interested in the company are presented by the Act itself with an opportunity to decide whether the consequences of its being a " private company " will be incurred or a sufficient change will be made to prevent its being incurred. If they do not wish the company to be placed in the position of having either to make a sufficient distribution or to pay Div. 7 tax, they may so act with respect to shares in the company that the public become substantially interested in it (within the definition in par. (*a*) of sub-s. (4) of s. 105), or they may turn it into a subsidiary of a public company (within the definition of par. (*b*) of that sub-section) or they may bring about a sufficiently less concentrated holding of the shares or the beneficial interests therein, or of the voting power, or of rights by reason of which the company is capable of being controlled. It is only if they do not take any of the courses thus thrown open to them that Div. 7 creates a liability. If they so alter the relevant facts that, when the last day of the year of income arrives, the company will not be a " private company ", their action cannot be regarded as tending to defeat a liability imposed by the Act; it is one which the Act contemplates and allows.

Because this is so, an attempt by the commissioner to rely upon s. 260 in the present case in order to avoid only the applications for and allotments of the redeemable preference shares would be an attempt to deny to the appellant company the benefit arising from an exercise which was made of a choice offered by the Act itself. The very purpose or policy of Div. 7 is to present the choice to a company between incurring the liability it provides and taking

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measures to enlarge the number capable of controlling its affairs. To choose the latter course cannot be to defeat evade or avoid a liability imposed on any person by the Act or to prevent the operation of the Act. For that simple reason the attempt must fail, and the commissioner cannot rely upon s. 260 in order to treat as void any more extensive set of facts, for an attempt to do so could not stop short of including the incorporation of the appellant company itself. We have not to consider whether he might have done that in order to uphold an assessment against Aquila Steel on the footing that the company should be deemed not to have distributed the £29,804 2s. 11d. at all. The commissioner's reliance upon s. 260 in the present case cannot succeed.

For these reasons, the present appeal should be allowed, the order under appeal should be discharged, and in lieu thereof there should be an order allowing the appeal against the assessment and setting the assessment aside.

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

WEBB J. For the reasons given by me in my judgment in *Commissioner of Taxation of the Commonwealth of Australia* v. *Sidney Williams (Holdings) Ltd.* (1) that is to say, because I think that s. 105 (1) (*c*) and (*e*) and s. 260 of the *Income Tax and Social Services Contribution Assessment Act* 1936-1952 apply also to the facts of this case, I would dismiss this appeal by the appellant taxpayer from a decision of *Williams* J. upholding an assessment of the respondent to additional tax on undistributed income as a private company under s. 104 (1). As to the application of par. (*f*) of s. 105 (1) I am not prepared to differ from the opinion of *Williams* J. that the negative control on which his Honour relied rendered the company "capable of being controlled", although there is much to be said for the view that the expression contemplates only absolute and positive control.

Appeal allowed with costs. Order appealed from discharged. In lieu thereof order that the appeal from the assessment of the Commissioner of Taxation be allowed with costs and the assessment set aside.

Solicitors for the appellant, *Clayton, Utz & Co.*

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

R. A. H.

(1) (1957) 100 C.L.R. 95.