Foll *Cripps & Jones Holdings v DCT (NSW)* 82 ALR 243

Foll *Risby v FCT* 20 FCR 439

Appl *Henry Comber Pty Ltd v Comr of Taxation* 82 FLR 154

Appl *Risby Forest Industries Pty Ltd v Federal Commissioner of Taxation* 19 ATR 1663

Foll *Midland Metals Overseas Ltd v C-G of Customs* (1991) 24 ALD 424

Foll *A A T Case 23/94: No 9483* (1994) 28 ATR 1166

Appl *Lenowry & Aust Maritime Safety Authority, Re* (1994) 34 ALD 789

Foll *Nation & Repatriation Commission, Re* (1994) 35 ALD 218

Cons *Walker & Dept of Social Security (No2), Re* (1995) 43 ALD 685

Discd *Jebb & Repatriation Commission, Re* (2005) 86 ALD 182

Dist *Lambidis v Commissioner of Police* (1995) 37 NSWLR 320

[HIGH COURT OF AUSTRALIA.]

W. J. & F. BARNES PROPRIETARY LIMITED APPELLANT;

AND

FEDERAL COMMISSIONER OF TAXATION RESPONDENT.

H. C. of A. 1957.

MELBOURNE, *Feb.* 22, 25;

SYDNEY, *April* 16.

Dixon C.J., Fullagar and Kitto JJ.

Income Tax (Cth.)—Assessment—Amendment—Change of opinion by commissioner—Private company—Payment of retiring allowances—Opinion that not allowable deduction because not to any extent reasonable—Disallowed as deduction in ordinary assessment—Treated as dividend in Div. 7 *assessment—Amendment of Div.* 7 *assessment by deleting dividend after expiration of time for appeal against ordinary assessment—Function of opinion—Not to determine allowability of deduction but reasonableness of amount—Whether amendment to correct erroneous opinion or misconception of law—Scope of power to amend—To remove from assessment every effect flowing from existence of former opinion—Income Tax Assessment Act* 1936-1946 (*No.* 27 *of* 1936—*No.* 6 *of* 1946), *ss.* 109, 170 (8).

Section 109 of the *Income Tax Assessment Act* 1936-1946 provided that " So much of any sum paid or credited by a private company and being, or purporting to be—(*a*) remuneration for services rendered by any person being a shareholder or director of the company or being a relative of any such shareholder or director ; or (*b*) an allowance, gratuity or compensation in consequence of the retirement of that person from any office or employment held by him in that company, or upon the termination of any such office or employment, as exceeds an amount which, in the opinion of the Commissioner, is reasonable, shall not be an allowable deduction and the excess shall, for all purposes of this Act, be deemed to be a dividend paid out of profits derived by it to the recipient and received by him as a shareholder of the company." Section 170 (8) of the Act provided : " Where—(*a*) any provision of this Act is expressly made to depend in any particular upon a determination, opinion or judgment of the Commissioner ; and (*b*) any assessment is affected in any particular by that determination, opinion or judgment, then if, after the making of the assessment it appears to the Commissioner that the determination, opinion or judgment was erroneous, he may correct it and amend the assessment accordingly in the same circumstances as he could under this section amend an assessment by reason of a mistake of fact."

A private company paid certain retiring allowances to three directors all of whom were of advanced age and had served it for an average period of forty-five years. In assessing the company for income tax the Commissioner of Taxation purporting to act under s. 109 disallowed the amount of the allowances as a deduction "his opinion being that it was not to any extent reasonable" and by a Div. 7 assessment, treated the amount as a dividend paid. On appeal against the ordinary assessment to a board of review, the disallowance was affirmed. Subsequently, after the time for appeal against the decision of the board of review had expired, the commissioner relying on s. 170 (8) purported to amend the Div. 7 assessment by striking out the amount of the notional dividend, it appearing to him that the opinion which he formerly held was erroneous.

Held that the amendment was incompetent on the grounds: *per Dixon* C.J. and *Fullagar* J. that the commissioner had not at the time of the original assessment formed an opinion satisfying the true requirement of s. 109 as to how much of the sum paid was reasonable but had considered a matter not open to him, namely whether the outgoing ought or ought not to be allowed as a deduction, and consequently was not correcting an opinion within s. 170 (8) as to reasonableness but a subtraction which was the result of a legal misconception; *per Fullagar* J. that if the commissioner's opinion had originally been that the deduction was allowable but was not to any extent reasonable s. 170 (8) would not authorise an amendment giving effect both to a changed opinion that the amount was reasonable and a changed opinion that apart from s. 109 the amount was not allowable as a deduction; *per Kitto* J. that the opinion on which s. 109 was made to depend was one as to some amount which actually was an allowable deduction apart from the section and on the material before the Court that could not be affirmed; and, further, that if the amount was an allowable deduction, the original assessment to Div. 7 tax was affected at two points by an erroneous opinion, the two points being the exclusion of the amount from allowable deductions and the treatment of it as a dividend, and the power to amend under s. 170 (8) could not be so exercised as to eliminate from the assessment one only of the two effects of the opinion.

Per Kitto J.—The decision of a board of review could not create an issue-estoppel.

Case Stated.

In an appeal by W. J. & F. Barnes Proprietary Limited from a decision of a taxation board of review *Kitto* J., on 19th November 1956, at the request of the parties and pursuant to s. 18 of the *Judiciary Act* 1903-1955, stated a case for the opinion of a Full Court, the material paragraphs of which are as follows:

1. The appellant company (hereinafter called "the company") was incorporated in Victoria on 14th March 1912, and in the year 1945 it carried on the business of manufacturers and merchants of honey and cereal food. Throughout the said year the company

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was a private company within the meaning and for the purposes of Div. 7 of Pt. III of the *Income Tax Assessment Act* 1936-1946.

2. On 17th January 1947, the company furnished to the respondent a return of its income for the twelve months ended 31st December 1945, that being a period adopted with the leave of the respondent as an accounting period in lieu of the financial year ended 30th June 1946. In its said return the company claimed as an allowable deduction the sum of £9,450, describing it as " retiring allowances ".

3. The said sum was the total of three amounts each of which was an allowance paid during the said year in consequence of the retirement of a person from the office of a director of the company. The payments were the subject of a resolution of the board of directors of the company passed on 27th May 1946, as follows: " It was resolved that in view of the long and faithful services rendered to the company by Mr. J. B. Barnes, Mr. F. Barnes and Miss S. Barnes, these services extending over periods averaging approximately 50 years and having been rendered during periods of depression, bad trading conditions, etc., at very low rates of remuneration they should be granted retiring allowances to make due provision for their years of old age and retirement equal to three years salary in each case the full allowance being:

Mr. J. Barnes	£4,500
Mr. F. Barnes	4,500
Miss S. Barnes	450
	£9,450 "

5. On the 30th January 1948 the respondent made an assessment of the ordinary income tax and social services contribution payable by the company in respect of income derived during the year ended 31st December 1945. In doing so he treated the said sum of £9,450 as being, by reason of the provisions of s. 109 of the said Act, not an allowable deduction, his opinion being that it was not to any extent reasonable as an allowance, gratuity or compensation in consequence of the retirement of the above-mentioned persons or any of them from the offices held by them respectively in the company. Thereupon the respondent issued to the company a notice of assessment accompanied by an adjustment sheet.

6. The company by its public officer duly lodged with the respondent an objection in writing against the said assessment.

7. Before the respondent had completed his consideration of the said objection, namely on 22nd December 1948, he made an

assessment of the additional tax and contribution on undistributed income under Div. 7 of Pt. III of the said Act and s. 16 of the *Social Services Contribution Act* 1945-1946. In doing so he treated the said sum of £9,450 as deemed, by reason of the said s. 109, to be dividends paid by the company out of profits derived by it to the persons referred to in par. 3 of this case and received by them as shareholders of the company, being still of the opinion mentioned in par. 5 hereof. Thereupon the respondent issued to the company a notice of the said last-mentioned assessment.

8. Prior to the making of the said last-mentioned assessment the company had made to the respondent a full and true disclosure of all material facts necessary for the said assessment.

9. On 9th February 1949 the respondent disallowed the said objection to the assessment of ordinary income tax and contribution, and at the request of the company he referred his decision thereon to a board of review for review. In a statement to the board, which was required to be furnished in accordance with *Income Tax Regulation* 35 (1), the respondent's reasons for disallowing the company's claim were stated as follows:

"1. That in the opinion of the commissioner the sum in question is in excess of an amount which is reasonable in the circumstances and has been disallowed as a deduction in pursuance of the provisions of s. 109 (*b*) of the *Income Tax Assessment Act* 1936-1946.

2. That the amount in question is not an allowable deduction in pursuance of the provisions of the *Income Tax Assessment Act* 1936-1946."

On 23rd April 1951, a board of review having reviewed the said decision affirmed it and confirmed the said assessment of ordinary income tax and contribution.

10. On 2nd October 1951 the respondent amended his said assessment of additional tax on undistributed income, treating the said sum of £9,450 as not being deemed to be dividends paid by the company as aforesaid. This he did because it appeared to him that the opinion which he formerly held, as stated in par. 5 hereof, was erroneous; and for the purpose of correcting it and making consequential alterations the respondent issued to the company a notice of the amended assessment.

11. On 29th November 1951 the company by its public officer duly lodged with the respondent an objection in writing against the said amended assessment.

12. The last-mentioned objection was disallowed by the respondent, and at the request of the company he referred his decision

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thereon to a board of review for review. In a statement to the board dated 27th March 1953, which was required to be furnished in accordance with *Income Tax Regulation* 35 (1), the respondent's reasons for disallowing the company's claim were stated as follows :

"1. That the undistributed amount of the taxpayer's income in the year of income ended 31st December 1945, was not less than the sum of £10,938 in pursuance of s. 103 (1) of the *Income Tax Assessment Act* 1936-1946.

2. That the amended Div. 7 assessment in question was correctly raised in pursuance of s. 104 of the said Act.

3. That the amended Div. 7 assessment of the year of income ended 31st December 1945, was lawfully made in pursuance of the provisions of s. 170 of the *Income Tax Assessment Act* 1936-1946."

On 1st April 1955 a board of review, having reviewed the decision, affirmed it and confirmed the said amended assessment.

13. The company duly appealed to this Court from the decision of the said board.

The question of law stated for the consideration of a Full Court of the High Court was : On the facts hereinbefore stated, was the said amended assessment authorised by the provisions of s. 170 of the *Income Tax Assessment Act* 1936-1946 ?

J. McI. Young, for the appellant. The board of review was in error in holding that s. 170 (8) of the *Income Tax Assessment Act* justified the amendment in question. The circumstances under which the commissioner might amend an assessment by reason of a mistake of fact are set out in sub-ss. (2), (3) and (4). Sub-sections (2) and (4) are not relevant. The power given by sub-s. (3) is excluded if at the date of the original assessment it was, in the state of facts then existing the only assessment which could lawfully be made. [He referred to *Foster* v. *Federal Commissioner of Taxation* (1).] When the commissioner made the original assessment to Div. 7 tax on 23rd December 1948 he had formed the opinion that the whole of the amount of £9,450 exceeded a reasonable amount under s. 109 and the original assessment was the only assessment he could have made, holding that opinion. He could not have made a Div. 7 assessment which did not treat the amount as dividends paid. Alternatively the amendment is for the purpose of correcting a mistake of law, namely the view of s. 109 which the board held was wrong.

K. A. Aickin, for the respondent. In making a Div. 7 assessment the only starting point committed to the commissioner by the Act is

(1) (1951) 82 C.L.R. 606, at pp. 615, 617.

the taxable income as assessed. As between the commissioner and the taxpayer the process of assessment establishes what s. 177 of the Act states to be conclusive evidence of the assessment subject to a proviso. Coming from that starting point, the assessment sought to be amended was affected in one particular only by an opinion formed under s. 109. Having corrected that opinion, the amendment could lawfully be made under s. 170 (8). The change of opinion is to be treated in effect as if it had been a matter of fact about which the commissioner had made a mistake. *Foster* v. *Federal Commissioner of Taxation* (1) is not authority for the proposition that, if there has been a mistake of fact, it cannot be corrected, if the assessment was correct on the facts existing at the time it was made.

J. McI. Young, in reply.

Cur. adv. vult.

April 16.

The following written judgments were delivered :—

Dixon C.J. This case stated concerns an appeal by a private company from a decision of a board of review given on 1st April 1955 affirming an amendment made on 22nd October 1951 of an assessment on the appellant company dated 22nd December 1948 with respect to additional tax payable under Div. 7 of Pt. III of the *Income Tax Assessment Act* 1936-1946 by the company upon undistributed profits derived in the year of income of the appellant company ending 31st December 1945.

During that year the company paid retiring allowances to three of its directors who had filled that office for an average period of forty-five years and whose average age was nearly eighty years. In its ordinary return the company treated the retiring allowances as deductions from the assessable income. The commissioner, however, purporting to act under s. 109, disallowed the deductions. Since s. 109 says that whatever amount ceases to be an allowable deduction as a result of his invoking that section " shall, for all purposes of this Act, be deemed to be a dividend ", this meant that in the personal assessment of each retiring director the amount he received on retirement would be included in his assessable income as income from property and he would not have the benefit which s. 26 (*d*) would otherwise confer of being taxed only on five per cent of the lump sum. It also meant that in ascertaining the undistributed amount of income within the meaning of s. 103 for the purpose of tax under Div. 7 (s. 104) it was necessary for the

(1) (1951) 82 C.L.R. 606.

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commissioner to deduct the amount disallowed in respect of retiring allowances on the footing that dividends aggregating that amount had been distributed. The commissioner made his assessment of tax under Div. 7 on that basis. He took the company's ordinary assessment of taxable income as supplying the point of commencement, namely the taxable income, and deducted the aggregate amount of the three retiring allowances as if they were distributions of dividend. In the company's ordinary assessment, of course, he disallowed the retiring allowances as deductible outgoings. Whether, if the commissioner had not acted under s. 109, a case existed for deducting the retiring allowances under s. 51 is a question on which we can form no opinion. Under that section the inquiry would be whether they constituted outgoings incurred in gaining or producing the assessable income, or necessarily incurred in carrying on a business for the purpose of gaining or producing such income, and perhaps whether they were of a capital nature: cf. *Maryborough Newspaper Co. Ltd.* v. *Federal Commissioner of Taxation* (1); *Mitchell* v. *B. W. Noble Ltd.* (2). The necessary facts are not before us. But when the company challenged its ordinary assessment before a board of review on the ground that the retiring allowances ought to be deducted in ascertaining its taxable income, the company does not seem to have contended that s. 51 applied. At all events the board of review decided that the retiring allowances were not so deductible. The board in giving its reasons excluded the application of s. 51 because that had been abandoned by the company and excluded the application of s. 78 (1) (*c*) because on the facts the directors were not employees and s. 78 (1) (*c*) applied only to the case of employees. The board rightly treated that part of s. 109 which concerns deductibility as possessing only a negative, restrictive or privative effect, but, although they upheld the disallowance of the deduction on grounds which are independent of the operation of that section, they thought it better to add in effect that, had they been called on to say under that section whether the amounts of the allowance were unreasonable they would, differing from the commissioner, have said that they were not unreasonable. Apparently because of this expression of the board's view, the commissioner decided to abandon the application he had given to s. 109. We are told in the reasons of the board given in the present proceedings that the commissioner decided to treat the respective amounts not as dividends but as retiring allowances in the hands of the recipients and that they benefited accordingly. He also made the amendment now under consideration in his

(1) (1929) 43 C.L.R. 450.

(2) (1927) 1 K.B. 719.

assessment of the company to additional tax under Div. 7. The amendment struck out the deduction of the notional dividends into which the commissioner had sought to convert the retiring allowances by using s. 109. The result was, of course, greatly to increase the amount of the company's undistributed profit in respect of the year of income ending on 31st December 1945 and the additional tax thereon for the year of tax 1946-1947.

The company does not say that support can be found for the commissioner's initial view that by the use of s. 109 the whole of the retiring allowances to the three directors could be transformed into notional dividends. The company does not say that the changed view of the commissioner about his use of s. 109 is wrong in substance. All along the company's contention has been that the retiring allowances were outgoings to be deducted from the company's assessable income in arriving at its taxable income in its ordinary assessment. If the company had made that contention good, of course, the taxable income would have been reduced accordingly and the reduction, when reflected in its undistributed income, would have had the same result upon its assessment to additional tax under Div. 7 as was produced by the method initially adopted by the commissioner of deducting the retiring allowances as notional dividends from the taxable income in order to arrive at the undistributed income. The objection of the company is that the commissioner's power of amendment did not extend to giving effect in the assessment of additional tax under Div. 7 to his changed view concerning the use of s. 109.

The company had made to the commissioner a full and true disclosure of all the material facts before the original assessments were made and consequently the case falls under s. 170 (3) which, besides limiting the time within which an amendment can be made to three years (a period not exceeded in this case) provides that no amendment of the assessment increasing the liability of the tax-payer in any particular shall be made except to correct an error in calculation or a mistake of fact. These words will not fit the case. The course the commissioner took in the use he made of s. 109 cannot be corrected as " an error in calculation or a mistake of fact ". But sub-s. (8) of s. 170 is relied upon by the commissioner as extending the power of amendment in a manner which covers this case. Sub-section (8) is as follows :—" (8) Where—(*a*) any provision of this Act is expressly made to depend in any particular upon a determination, opinion or judgment of the Commissioner ; and (*b*) any assessment is affected in any particular by that determination, opinion or judgment, then if, after the making of the

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assessment it appears to the Commissioner that the determination, opinion or judgment was erroneous, he may correct it and amend the assessment accordingly in the same circumstances as he could under this section amend an assessment by reason of a mistake of fact."

It will be seen that the first condition of the application of this extension of the power of amendment is that some provision of the *Assessment Act* is expressly made to depend in a particular upon a determination, opinion or judgment of the commissioner. This, of course, means that his determination, opinion or judgment must be made the test or measure, or at all events the primary or presumptive test or measure, of the operation or application of the provision. The second condition is that the original assessment must be affected in some particular by that determination, opinion or judgment and that means that a factor or component must have been governed by or must to some extent be attributable to the actual determination, opinion or judgment which the commissioner formed. The third condition is that subsequently it must appear to the commissioner that the determination, opinion or judgment which he so formed was erroneous.

No one would doubt that s. 109 affords an illustration of the kind of " opinion " which would satisfy the first of the foregoing conditions and the operation of which upon an assessment would satisfy the second of them. The subject with which s. 109 deals is any sum paid or credited by a private company and being or purporting to be (*a*) remuneration for services rendered by any person, being a shareholder or director of the company or being a relative of any such shareholder or director ; or (*b*) an allowance, gratuity or compensation in consequence of the retirement of that person from any office or employment held by him in that company or upon the termination of any such office or employment. Clearly the retiring allowances paid in the present case are of the description stated in par. (*b*). The function which the section entrusts to the commissioner is to form an opinion as to how much of the sum so paid is " reasonable ". If the commissioner addressed his mind to that and decided, for example, that of £X paid in a given case (£X-Y) was reasonable, his opinion would be completely within the first condition of s. 170 (8) and, once an assessment followed based thereon, it would satisfy the second condition. Section 109 provides that so much of any such sum paid or credited by a private company as exceeds an amount which, in the opinion of the commissioner, is reasonable, shall not be an allowable deduction and the excess shall for all purposes of the Act be deemed to be a dividend paid out of profits derived by it to the recipient and received by him as a shareholder of the company.

It will be seen that the function of the commissioner under this provision is limited ; it is to form an opinion on nothing but a matter of quantum. The payment or crediting of sums of money is assumed. The fact is assumed that they are or purport to be of the given description. These are not matters which the commissioner's opinion can touch, much less govern. The supposition is implied that being of that description the payments will constitute allowable deductions. It is unnecessary for us to consider whether this implication involves a necessary condition of the application of the section or even of so much of it as relates to allowability. It is enough to say that it is an obvious presupposition. All that is of consequence is that the question whether, independently of s. 109, a payment forms an allowable deduction also falls outside the ambit of the function assigned to the commissioner of forming an opinion. Again the remainder of the section operates of its own force on the " excess " and deprives that amount of its allowability as a deduction and clothes it with its artificial character of dividend. Clearly the section does not confer upon the commissioner a discretion to decide whether or not an outgoing in respect of retiring allowance ought or ought not to be allowed as a deduction. The concern of the section is with the excessiveness of remuneration and of retiring allowances etc. It does not deal with the title to deduct expenditure of that character but seeks to place a restraint on the amount deductible under that heading and to do so by reference to the commissioner's opinion of what is a reasonable amount. Having placed that restraint upon the quantum it directs how the excess is to be dealt with. But what the commissioner did seems to me to go beyond and outside such a limited power of judgment. He appears to me, when he assessed the company to ordinary tax and additional tax under Div. 7, simply to have decided that the payments to three directors on their retirement ought not to be allowed as deductions at all. He must have deserted the assumption that the payments were in character allowable deductions ; he could not have accepted that assumption and then turned his attention to the simple question of quantum. Nothing else will explain the total disallowance of the deduction. According to the first decision of the board of review he was right in saying that the payments were not allowable as deductions but, of course, for reasons quite outside s. 109. It may be difficult to draw the line between quantifying the reasonable amount of a specified payment and saying no such payment should reasonably be made at all. (Cf. *Eastern*

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Extension Australasia and China Telegraph Co. Ltd. v. *The Commonwealth* (1) with respect to the distinction between "reducing" and "abolishing" a charge.) But in the case of s. 109 it is clear enough that it was never intended that his opinion should go beyond the fairness or reasonableness of the amount and extend to concluding the question whether the outgoing was deductible at all. What the case stated says about it is that he treated the sum in question as being "by reason of the provisions of s. 109 of the said Act, not an allowable deduction, his opinion being that it was not to any extent reasonable as an allowance, gratuity or compensation in consequence of the retirement of the above-mentioned persons or any of them from the offices held by them respectively in the company." This language supports the conclusion that the commissioner did not apply his mind to that question which under s. 109 is made a matter of his opinion. But independently of his statement in the case stated the conclusion is the necessary result of the facts. It appears to me that the commissioner did not really apply his mind to the formation of the opinion as defined by s. 109, but to a different thing, namely the allowability of the deduction. When he came, in the amendment under consideration, to correct his conclusion he was correcting a subtraction from the taxable income of a sum as a dividend which was no dividend. The subtraction was the result of a legal misconception. He was not correcting an opinion, which appeared erroneous, as to the reasonableness of a sum paid or credited, the opinion the formation of which was his province and his only province under s. 109. For that reason I think that we have not here a case in which an opinion formed in compliance with s. 109 is revised by the commissioner as erroneous under the authority of sub-s. (8) of s. 170.

I am therefore of opinion that the amendment was incompetent.

The question in the case stated should be answered: No.

FULLAGAR J. This case comes before the Full Court on a case stated by *Kitto* J. in an appeal by a taxpayer, which is a company incorporated in Victoria, from a decision of a board of review. The board upheld an amended assessment of income tax by the commissioner, to which the company had objected. The relevant year of income is the calendar year ended 31st December 1945, the calendar year being the company's accounting period under the *Assessment Act*. In that year the company paid to three directors, all of whom were of advanced age and had served the company for many years, certain sums on their retirement from the board.

(1) (1908) 6 C.L.R. 647.

These sums appear to have been paid without the authority of any formal resolution, but they have been treated as retrospectively authorised by a resolution of the board passed on 27th May 1946. That resolution is in the following terms : " It was resolved that in view of the long and faithful services rendered to the company by Mr. J. B. Barnes, Mr. F. Barnes and Miss S. Barnes, these services extending over periods averaging approximately fifty years and having been rendered during periods of depression, bad trading conditions, etc., on very low rates of remuneration, they should be granted retiring allowances to make due provision for their years of old age and retirement equal to three years' salary in each case, the full allowance being : Mr. J. B. Barnes £4,500, Mr. F. Barnes £4,500, Miss S. Barnes £450." The total amount paid was thus £9,450.

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The company was a private company within the meaning of Div. 7 of Pt. III of the *Assessment Act*. As such it was subject not only (like all other companies) to " ordinary " income tax at a flat rate, but also under Div. 7 to a further tax on " undistributed income ". That is to say, if it did not within a prescribed time after the close of an accounting period make to its shareholders a sufficient distribution (as defined in the Act) of its taxable income of that accounting period, it became liable to pay the amount of tax which its shareholders would have been liable to pay if a sufficient distribution had been made to them by way of dividend. The present case is concerned with the company's assessment to tax under Div. 7, but it is necessary to refer first to the circumstances connected with its assessment to ordinary tax.

For the purpose of ascertaining its taxable income, whether for the purpose of " ordinary " company tax or for the purpose of Div. 7, the company was, of course, entitled to make all deductions which are allowable deductions under the Act. In its return of income derived in the relevant period the company claimed as a deduction the amount of £9,450 which had been paid to the three retiring directors. Prima facie the deduction might have been supported either under s. 51 or under s. 78 (1) (*c*). Section 51, so far as material, provides :—" All losses and outgoings to the extent to which they are incurred in gaining or producing the assessable income, or are necessarily incurred in carrying on a business for the purpose of gaining or producing such income, shall be allowable deductions except to the extent to which they are losses or outgoings of capital, or of a capital, private or domestic nature, or are incurred in relation to the gaining or production of exempt income." Section 78 provides :—" The following shall, subject to this section,

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be allowable deductions . . . (*c*) Sums which are not otherwise allowable deductions, and which are paid by the taxpayer during the year of income as retiring allowances or pensions to persons who are or have been employees or dependants of employees, where such persons are residents, to the extent to which in the opinion of the commissioner those sums are paid bona fide in consideration of the past services of the employees in any business of the taxpayer." The commissioner made inquiries as to the circumstances attending the making of the payment in question, and on 30th January 1948 made an assessment of the *ordinary* income tax payable by the company in which he disallowed the deduction of those payments. The notice of assessment was accompanied by an adjustment sheet in which the commissioner, after stating that the deduction of the sum of £9,450 was disallowed, said : " The question of allowance of this amount will receive further consideration. If, however, the company wishes to protect its legal rights an objection should be lodged within the prescribed time."

The case states that in disallowing the deduction of the sum of £9,450 the commissioner " treated the said sum of £9,450 as being, by reason of the provisions of s. 109 of the said Act, not an allowable deduction, his opinion being that it was not to any extent reasonable as an allowance, gratuity or compensation in consequence of the retirement of the above-mentioned persons or any of them ". Section 109 of the Act was at the material time in the following terms : " So much of any sum paid or credited by a private company and being, or purporting to be—(*a*) remuneration for services rendered by any person being a shareholder or director of the company or being a relative of any such shareholder or director ; or (*b*) an allowance, gratuity or compensation in consequence of the retirement of that person from any office or employment held by him in that company, or upon the termination of any such office or employment, as exceeds an amount which, in the opinion of the commissioner, is reasonable, shall not be an allowable deduction and the excess shall, for all purposes of this Act, be deemed to be a dividend paid out of profits derived by it to the recipient and received by him as a shareholder of the company." It is to be observed at this stage that s. 109 appears to assume that there is an amount otherwise deductible under s. 51 or s. 78 (1) (*c*), and to authorise the commissioner, if he forms a certain opinion, to reduce the amount of the deduction in a case where the paying of the sum in question is to a shareholder or director of the company or a relative of a shareholder or director. It will be necessary to return to this point later. It would appear that the commissioner at or about the same time assessed the income of the recipients of the three sums which made up the amount of £9,450 and treated those sums as dividends, i.e. income from property in their hands.

The company objected to the assessment, and on disallowance of its objection caused the matter to be referred to a board of review. The board confirmed the commissioner's assessment. It is said that the claim for a deduction under s. 51 was abandoned at the hearing. There may have been an unfortunate misunderstanding about this. It is far from obvious that the claim for a deduction under s. 51 was not sustainable. At any rate, s. 51 being supposed to be out of the way, the board held that the case did not fall within s. 78 (1) (*c*) because " on the facts the directors were not employees of the company ". That, of course, disposed of the case, but the board went on to say that in its opinion " no part of the £9,450 should be brought within the operation of s. 109, as it did not regard the amounts comprising it as unreasonable amounts of retiring allowances ". This appears to have been no more than an *obiter dictum* to the effect that, if the sum in question had been deductible either under s. 51 or under s. 78 (1) (*c*), it ought not to have been disallowed under s. 109. The company did not appeal against this decision of the board, which was given on 23rd April 1951.

What has been so far narrated relates only to the company's assessment of *ordinary* income tax and is of indirect importance only. In the meantime, however, and in fact before he had completed his consideration of the company's objection to its ordinary assessment, the commissioner had made an assessment of the tax payable by the company under Div. 7, and notice of this assessment was given to the company on 22nd December 1948. In this assessment he treated the company as having distributed the sum of £9,450 by way of dividend. The effect of this was, of course, to reduce by that amount the undistributed profits on which the company was taxable under Div. 7. The case says that he " treated the said sum of £9,450 as deemed, by reason of the said s. 109, to be dividends paid by the company out of profits derived by it to the persons referred to . . . and received by them as shareholders of the company, being still of the opinion mentioned in par. 5 hereof." The opinion mentioned in par. 5 is the opinion that *by reason of the provisions of s.* 109 the said sum was not an allowable deduction.

On 2nd October 1951 (i.e. some six months after the board of review had given its decision on the company's objection to its ordinary assessment, and long after the time for appealing from

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that decision had expired) the commissioner, doubtless inspired by the *obiter dictum* of the board which has been quoted, amended the company's Div. 7 assessment, treating the sum of £9,450 as *not* being deemed to be dividends paid by the company. The effect of the amendment was that the company did not receive credit for the £9,450 either as dividends or as an allowable deduction. The case states that the commissioner made the amendment " because it appeared to him that the opinion which he formerly held, as stated in par. 5 hereof, was erroneous, and for the purpose of correcting it and making consequential alterations ". The company objected to this amended assessment, and, the objection being disallowed, required its objection to be referred to a board of review. The board confirmed the amended assessment, and it is from that decision that the company has appealed to this Court. It should be mentioned that the commissioner, in addition to amending the company's Div. 7 assessment in the manner stated, also amended the assessments of the three recipients of the £9,450. In these amended assessments he treated the sums received as income from personal exertion.

The only question raised by the case stated is whether this amended assessment of 2nd October 1951 is authorised by the *Assessment Act.* The question turns on s. 170 of the Act, by which the power of the commissioner to amend an original assessment is delimited. The section draws a primary distinction between cases where the taxpayer has, and cases where the taxpayer has not, " made to the Commissioner a full and true disclosure of all the material facts necessary for his assessment ". Here the company had, before the original assessment, made such a full and true disclosure. The sub-section of s. 170 which deals generally with such cases is sub-s. (3), which provides : " Where a taxpayer has made to the Commissioner a full and true disclosure of all the material facts necessary for his assessment, and an assessment is made after that disclosure, no amendment of the assessment increasing the liability of the taxpayer in any particular shall be made except to correct an error in calculation or a mistake of fact ; and no such amendment shall be made after the expiration of three years from the date upon which the tax became due and payable under that assessment." It is common ground that the amendment in the present case was not made to correct an error in calculation or a mistake of fact, and sub-s. (3) therefore does not authorise the amended assessment. Sub-section (8), however, provides : " Where— (*a*) any provision of this Act is expressly made to depend in any particular upon a determination, opinion or judgment of the Commissioner ; and (*b*) any assessment is affected in any particular by that determination, opinion or judgment, then, if, after the making of the assessment it appears to the Commissioner that the determination opinion or judgment was erroneous, he may correct it and amend the assessment accordingly in the same circumstances as he could under this section amend an assessment by reason of a mistake of fact." It is on sub-s. (8) that the commissioner relies as justifying the amendment of the original assessment. If that subsection is applicable, then, a full and true disclosure having been made by the taxpayer, and the amendment having been made within the three years mentioned in sub-s. (3), that amendment was authorised. Sub-section (8) is somewhat obscurely expressed, but it has been assumed—rightly, I think—that that is its effect. The question is whether sub-s. (8) is applicable to the case.

The first step must be to consider the operation of s. 170 (8). The commissioner is called upon, in the making of almost any assessment, to form an opinion upon such matters as whether a particular receipt is assessable income and whether a particular expenditure is an allowable deduction. Opinions on such matters are, of course, altogether outside s. 170 (8) : if they were not, that sub-section would simply stultify all the rest of s. 170. It applies only where we find a provision in the Act which expressly attaches legal consequences to the formation of an opinion by the commissioner upon some matter. There is a number of provisions of this character in the Act. If, in any such case, the commissioner forms an opinion on the relevant question and assesses the taxpayer accordingly, he may (subject, in cases of full disclosure, to sub-s. (3)) later revise his opinion, and amend the taxpayer's assessment so as to make that assessment accord with his revised opinion. But it is of great importance to bear two things in mind. The first is that an opinion of the commissioner cannot be revised under s. 170 (8) unless it is an opinion formed on the precise matter which is committed to him for the formation of an opinion. The second is that a revision of the commissioner's opinion does not throw the whole assessment open, and leave the commissioner at large to amend it in any way that seems correct to him. He can only amend it so far as its incorrectness depends upon, and arises out of, the opinion which he originally formed and which now seems to him to be erroneous. In other words, sub-s. (8) does not apply unless it necessarily follows from the revision of opinion that the original assessment was wrong in some particular respect, and then it is only in that particular respect that it may be amended.

Section 109 contains one of the provisions of the Act under which the assessment of a taxpayer may be affected by an opinion formed

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by the commissioner. It is clearly one of the provisions referred to in s. 170 (8). It is, however, apparent on its face that it is concerned only with the *quantum* of a particular class of allowable deduction. It is aimed at a well-known type of case, which is exemplified in *Aspro Ltd.* v. *Commissioner of Taxes* (1). It first made its appearance in the Act (in a somewhat simpler form) in 1934 as s. 31H. A private company, having two or three directors who hold all the shares, and making large profits, would naturally desire to pay to its directors and shareholders as much as possible under the name of remuneration, and as little as possible under the name of dividends. The advantage was, of course, twofold. There was advantage to the company, because remuneration paid for services was deductible in arriving at its taxable income: and there was advantage to the shareholders, because remuneration received for services was taxed at personal exertion rates, whereas dividends were taxed at property rates. Section 109 requires the commissioner in such cases to form an opinion as to how much of any sum ostensibly paid by a private company to a director or shareholder or relative as remuneration is reasonable in relation to services rendered. When he has formed his opinion on that matter, he must disallow as a deduction in the company's assessment any excess over what he thinks is reasonable, and must treat that excess for all purposes as a dividend paid by the company to a shareholder. The important point is that s. 109 presupposes a payment which, apart from s. 109 itself, would be an allowable deduction to the company. Unless there is a payment of that character, the commissioner is neither commanded nor authorised to form any opinion under that section. It is the reasonableness of the payment *as a reward for services* that he must consider, and it would be absurd to require him to consider that question if the amount paid were, as a matter of law and apart altogether from its reasonableness, not deductible. On the one hand, s. 170 (8) can operate only with respect to a change in an original opinion, the formation of which is authorised by the Act and made by the Act a criterion of liability to tax. On the other hand, when s. 170 (8) does operate, it authorises *only* such an amendment as will make the assessment what it necessarily must have been if the commissioner's changed opinion had been the opinion originally held by him.

The case states that the commissioner treated the sum in question as being " by reason of the provisions of s. 109 not an allowable

(1) (1932) A.C. 683.

deduction, his opinion being that it was not to any extent reasonable ". It thus appears, in my opinion, that the commissioner did not apply his mind to the question on which s. 109 requires him to form an opinion. He ran, so to speak, two questions into one, misconceiving his function under s. 109. The question of the allowability of a payment as a deduction is one question, and it is a question as to which s. 109 does not authorise the commissioner to form an opinion binding on the taxpayer or an opinion to which s. 170 (8) applies. The question whether an otherwise allowable deduction should be reduced because it is unreasonable in amount is another question. It is a distinct and different question, and it is on that question alone that the commissioner is authorised by s. 109 to form an opinion binding on the taxpayer. Since he never really formed an opinion on that question, there could be no such subsequent change of opinion as would justify an amendment of the assessment under s. 170 (8).

It may be objected that the view above expressed holds the commissioner too strictly and literally to the language of the case stated. It appears to me to treat the case as meaning just what it says. But, in any case, the only other possible alternative interpretations of the commissioner's process of reasoning leave him in no better position. He may have refrained from considering whether the payments in question were, apart from s. 109, allowable deductions, and said that, whether they were otherwise allowable deductions or not, they were unreasonable in amount. But, on this view again, he has not addressed himself to the question committed to him by s. 109. For that section does not authorise him to form an opinion as to the reasonableness of a payment unless that payment is, apart from his opinion as to its reasonableness, an allowable deduction. The only other possible view seems to be that the commissioner did regard the payments in question as otherwise allowable deductions, but was of opinion that it was not reasonable to make any payment at all. On this view, if it be assumed that he could form an opinion resulting in total disallowance as distinct from reduction, it may be said that he did form an opinion which was authorised by s. 109 and an opinion to which s. 170 (8) applied. He could then change that opinion, and amend the assessment under s. 170 (8). But s. 170 (8) would authorise only such an amendment as would give effect to a new opinion that the amounts paid were reasonable in whole or in part. It would not authorise an amendment giving effect *both* to a changed opinion that the payments were reasonable in amount *and* a changed opinion that, apart altogether from s. 109, they were not allowable deductions

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under the Act. In other words, the only amendment which s. 170 (8) would justify would be an amendment allowing the deduction of the whole or part of the sum of £9,450 from the company's assessable income.

In my opinion, the amendment of the company's Div. 7 assessment was not authorised by s. 170 (8), and the question asked by the case stated should be answered : No.

Kitto J. The question before us is whether an amended assessment of the additional tax payable by a private company under Div. 7 of Pt. III of the *Income Tax Assessment Act* 1936-1946 (Cth.) was authorised by the provisions of s. 170 of that Act.

The relevant year of income was the twelve months ended 31st December 1945. The original assessment of Div. 7 tax was made by taking the following steps. (1) The company's taxable income of the year of income was taken to be " as assessed " (as the notice of assessment expressed it), that is to say it was taken from the assessment of ordinary income tax. The figure was £15,618. (2) From that figure the deductions required by the definition of " distributable income " in s. 103 were made. They came to £4,680 ; so that the " distributable income " was taken to be £10,938. (3) A sum of £9,450 was then deducted as being the amount of dividends paid by the company out of its taxable income within the prescribed period. The " undistributed amount " was thus ascertained, in accordance with the definition of that expression in s. 103, at £1,488. (4) To that amount the appropriate rates of tax and contribution were applied.

No dividend, in the sense attributed to that word by the definition in s. 6 (1), had in fact been paid by the company in the prescribed period, but amounts aggregating £9,450 had been paid in that period to three retiring directors. The commissioner's reason for treating each of these amounts as a dividend paid out of the company's taxable income was that he held the opinion that the amount was not to any extent reasonable as an allowance, gratuity or compensation in consequence of the retirement of the recipient from his office in the company, and he considered that by reason of the provisions of s. 109 of the Act a consequence of his holding this opinion was that the whole amount was to be deemed a dividend paid out of the company's profits and received by the recipient as a shareholder.

The section is in these terms : " So much of any sum paid or credited by a private company and being, or purporting to be—

(*a*) remuneration for services rendered by any person being a shareholder or director of the company or being a relative of any such shareholder or director; or (*b*) an allowance, gratuity or compensation in consequence of the retirement of that person from any office or employment held by him in that company, or upon the termination of any such office or employment, as exceeds an amount which, in the opinion of the Commissioner, is reasonable, shall not be an allowable deduction and the excess shall, for all purposes of this Act, be deemed to be a dividend paid out of profits derived by it to the recipient and received by him as a shareholder of the company."

Some time before making the assessment of Div. 7 tax, the commissioner had assessed the ordinary income tax payable by the company, and in doing so, since he then held the opinion abovementioned concerning the £9,450, he had treated the whole of that sum as excluded by s. 109 from the category of allowable deductions.

Within three years from the date upon which the Div. 7 tax became due and payable under the original assessment which has been described, the commissioner came to the conclusion that his opinion as to the reasonableness of the payments made to the retiring directors was erroneous. He did not thereupon proceed to amend the assessment of ordinary income tax so as to allow the payments as deductions in ascertaining taxable income. He was right in not doing so, for a board of review had affirmed that assessment, and in doing so had decided that, even if the amounts were (as the board thought they were) wholly reasonable, they were not allowable deductions under s. 51 or under s. 78 (1) (*c*), and that s. 109 should not itself be construed as creating by implication an additional head of deductibility. But the commissioner, upon altering his opinion as to the reasonableness of the amounts, did proceed to amend the assessment of Div. 7 tax. The amendment that he made was to omit step (3) from the process; and the result, of course, was that the "undistributed amount" became the full amount of the "distributable income", namely £10,938, and the taxes payable were increased accordingly.

The power of amendment which the commissioner purported to exercise was that conferred by sub-s. (8) of s. 170, and it is clear that if the amendment was not within that power it was not authorised by the Act at all. The provision is as follows: "Where—(*a*) any provision of this Act is expressly made to depend in any particular upon a determination, opinion or judgment of the Commissioner; and (*b*) any assessment is effected in any particular by that determination, opinion or judgment, then if, after the making of the

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assessment it appears to the Commissioner that the determination, opinion or judgment was erroneous, he may correct it and amend the assessment accordingly in the same circumstances as he could under this section amend an assessment by reason of a mistake of fact."

Condition (*a*) was fulfilled, for s. 109 is a provision of the Act which is expressly made to depend (i.e. for its application to a particular payment) upon an opinion of the commissioner. But was condition (*b*) fulfilled ? True it is that the original assessment of Div. 7 tax was affected by the opinion which the commissioner formed on the question of the reasonableness of the payments made to the directors. But was that opinion such an opinion as s. 109 requires for its application ? It was, on either of two hypotheses : first, that the section applies to any sum paid by a private company and falling within one of the descriptions given, whether the sum is or is not an allowable deduction under other provisions of the Act ; or, secondly, that the section applies only to a sum which is an allowable deduction according to other provisions of the Act and the sums here in question were such allowable deductions. The first hypothesis, however, must be discarded, for the sense of s. 109 is that it operates to convert a portion of a payment which would otherwise be an allowable deduction into a notional dividend paid to a shareholder. As to so much of any sum falling within the given descriptions as the commissioner thinks reasonable, the plain implication of the language used is, not (as the commissioner seems to have thought at one stage) that it is made an allowable deduction by force of the section itself, but that it retains the quality of deductibility which it is assumed to have by force of some other provision of the Act.

The opinion upon which s. 109 is made to depend is therefore an opinion as to some amount, not of a sum which the commissioner or a board of review thinks is an allowable deduction apart from the section, but of a sum which actually is an allowable deduction apart from the section. (I do not stay to consider whether the opinion may be that no portion at all of the sum is reasonable ; I assume that the commissioner was right in thinking that it might be.) Accordingly it cannot be said that the opinion upon which the commissioner acted in making his original assessment of Div. 7 tax in the present case was an opinion upon which s. 109 operates unless it can be affirmed that the payments to which it related were allowable deductions under s. 51 or s. 78 (1) (*c*). On the material before us, that cannot be affirmed. We know that the board of review, when considering the company's assessment to ordinary income tax, considered that the payments were not allowable deductions on any ground. The board's decision was not, of course, an adjudication; it was administrative in character, and could not create an issue-estoppel. But everything that we know points to its being correct; and if it was correct the conclusion is inevitable that the original assessment was not affected by such an opinion as s. 109 depends upon, and that accordingly the amended assessment was not authorised by the Act.

Suppose, however, that the payments were allowable deductions, either under s. 51 or s. 78 (1) (*c*). If they were, both the conditions of sub-s. (8) of s. 170 were fulfilled, and the power of amendment conferred by that sub-section was accordingly exercisable. But the question then arises whether the power supports the amendment which was made. It is a power to correct an opinion formerly held, and to "amend the assessment accordingly". That must mean that it is a power to remove from the assessment every effect which flowed from the existence of the former opinion. It is not a power to make a partial correction by amending the former assessment as to some or one only of several particulars in which it was affected by the erroneous opinion. In what particular or particulars, then, was the original assessment of Div. 7 tax affected by the opinion that no part of the payments to the directors was reasonable? The commissioner's answer is: in one particular only, viz. the deduction of the payments to the directors on the footing that they were dividends. The reason that is given on his behalf in justification of this answer is that he was bound, in making the original assessment of Div. 7 tax, to accept as correct the amount of taxable income which had been assessed for the purposes of ordinary income tax, and that therefore his determination of the taxable income in the course of assessing the Div. 7 tax was not affected by his opinion as to the deductibility of the relevant payments.

In my opinion, however, it is not correct to say that he was bound to accept the figure of taxable income as conclusively established by the assessment of ordinary income tax. Section 177 was referred to in argument, but I do not think it has any application to the problem. No doubt in practice the sensible course in assessing Div. 7 tax is to start with the taxable income as already assessed for ordinary income tax. It would ordinarily be foolish to go through the process again. But when the commissioner does start with the taxable income as assessed, he is not obeying any positive requirement of the Act that he shall do so; he is simply adopting, for the purpose of the assessment which he is engaged in making, that which he has already done for another purpose. This means that if

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his working out of taxable income for ordinary tax purposes was affected in any particular by an opinion upon which a provision of the Act is expressly made to depend, it is still so affected when he uses it for the purposes of Div. 7 tax, and therefore his Div. 7 assessment is affected in that particular by the opinion.

In my opinion the true view in the present case, if the £9,450 was an allowable deduction apart from s. 109, is that the original assessment of Div. 7 tax was affected at two points by the opinion which the commissioner formed under that section, the two points being the exclusion of the sum from allowable deductions and the treatment of it as a dividend ; and if that be so no amendment was authorised by s. 170 (8) in consequence of the alteration of the opinion unless it was an amendment making the assessment one which treated the payments to the directors as allowable deductions and not as dividends. (Such an amendment would not affect the "undistributed amount", and therefore it would not affect the amount of tax payable. For that reason, even such an amendment may be unauthorised having regard to the words which follow "accordingly" in sub-s. (8), read with sub-ss. (3) and (4). But it is not necessary to form a concluded view on this point.) If the payments were allowable deductions apart from s. 109, the amendment which the commissioner made, since although it eliminated one of the effects of the erroneous opinion it proceeded upon the view that the other could not be eliminated, was not such an amendment as s. 170 (8) empowered him to make.

For these reasons I am of opinion that, whether the payments to the directors were or were not allowable deductions under s. 51 or s. 78 (1) (*c*), the amended assessment of Div. 7 tax was not authorised by the Act, and the question in the case stated should be so answered.

Question in the case stated answered : No. Costs of the case stated reserved for the judge disposing of the appeal.

Solicitors for the appellant, *Hedderwick, Fookes & Alston.*

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

R. D. B.