

[HIGH COURT OF AUSTRALIA.]

FORREST APPELLANT ;

AND

THE FEDERAL COMMISSIONER OF TAXA- }
TION } RESPONDENT.

*Income Tax—Assessment—Company—Value of assets—Increase on revaluation—
Debentures representing increase issued to shareholders—Dividend—Undis-
tributed income accumulated—Income Tax Assessment Act 1915-1916 (No. 34
of 1915—No. 39 of 1916), sec. 14 (b).*

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June 22, 23.

By virtue of sec. 14 (b) of the *Income Tax Assessment Act 1915-1916* the income of any person includes "dividends, interest, profits, or bonus credited or paid to any member, shareholder, or debenture-holder of a company which derives income from a source in Australia Provided that where a company distributes to its members or shareholders any undistributed income accumulated prior to the first day of July one thousand nine hundred and fourteen the sum so received by the member or shareholder shall not be included as part of his income Provided also that amounts carried forward by a company to the credit of the profit and loss account shall not be deemed to be accumulated income."

SYDNEY,
Aug. 24.Knox C.J.,
Gavan Duffy
and Starke JJ.

A company, on a revaluation made in November 1914, ascertained that the value of its assets on 30th June 1914 exceeded, by £100,000, the amount at which those assets stood in the balance-sheet for the half-year ending on that date. No part of the increase in value appeared in any account or balance-sheet of the company before 1st July 1914. The increased value of the assets was appropriated for the purpose of providing for the issue of debenture-stock to its shareholders. The appellant was assessed to income tax in respect of debenture-stock received by him as a shareholder in the company.

Held, that the £100,000 was undistributed income of the company accumulated prior to 1st July 1914 within the meaning of the proviso to sec. 14 (b) of the *Income Tax Assessment Act 1915-1916*, and, therefore, that the appellant was not liable to income tax in respect of such debenture-stock.

CASE STATED.

On an appeal by Robert Forrest to the High Court from an assessment to income tax for the year 1914-1915, *Starke J.* stated

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a case, which was substantially as follows, for the opinion of the Full High Court :—

1. The South Brisbane Gas and Light Co. Ltd. is a joint stock company duly incorporated and registered under the *Companies Acts* 1863-1913 (Qd.), and has its registered office in Stanley Street, South Brisbane.

2. Since its incorporation the Company has continuously carried on its business in South Brisbane.

3. The Company's ordinary profits are obtained from the production and distribution of gas and sale of the resulting products, such as coke, tar and ammoniacal liquor.

4. The assets of the Company consist principally of buildings, machinery, land and plant, mains, meters, lamps and goodwill.

5. No value had ever been attached to the goodwill of the business, and goodwill has never appeared in any balance-sheet in any form.

6. In or about the month of November 1914 and prior to 28th November 1914 the assets of the said Company were made the subject matter of a revaluation, and on such revaluation the said assets were increased in value. The balance-sheets issued by the said Company for the half-years ending on 30th June 1914 and 31st December 1914 show the said increase in value, namely, a sum of £100,000.

7. It was ascertained by the said revaluation that the said increase in value in fact existed on 30th June 1914; but it was first brought into the balance-sheet of the Company for the half-year ending on 31st December 1914.

8. No part of this increase in valuation of the assets had appeared in any profit and loss account, appropriation account, revenue and expenses account, or any other account similar to any of the foregoing accounts or in any account whatever, or in any balance-sheet of the Company, prior to the balance-sheet for the half-year ending 31st December 1914. Since 30th June 1914 such increase appears in the Company's books and balance-sheets under the head of "Plant, land, buildings and Company's undertaking account." Such increase was first entered in the books of the Company at the close of the half-year ending on 31st December 1914.

9. On or about 27th November 1914 the said Company issued

to its shareholders a circular submitting to the approval of the shareholders certain schemes, one of which was as follows:—

Scheme No. 1.—Pass an ordinary resolution to issue to shareholders debenture-stock to the amount of £100,000—each shareholder to receive, free of cost, stock to the face value of ten shillings for every share (ordinary and/or preference) held by him or her; stock to bear interest from 30th June 1917 at 5 per cent. per annum, but in each half-year that there are profits available this interest to be increased up to 10 per cent. per annum; in the event of a winding up (which is almost inconceivable) stockholders will first be paid twenty shillings in the pound on the face value of their stock, and the balance of assets will then be distributed solely amongst shareholders; the stock will, of course, only be payable after all creditors have been satisfied; the Company may partially redeem the stock from time to time proportionately to the amounts held by the stockholders, and the whole at any time.

10. The said schemes were considered at an extraordinary general meeting of the shareholders of the said Company held for the purpose on 14th December 1914, and a resolution was unanimously carried at the said meeting that the above scheme should be adopted by the said Company.

11. In pursuance of the said resolution in the last preceding paragraph hereof mentioned, debenture-stock to the value of £100,000 was, on 22nd December 1914, issued by the said Company to its shareholders without any payment being made therefor by the said shareholders—each shareholder receiving stock of the face value of ten shillings for every share, ordinary and preference, in the said Company held by him. The increased value of the said assets was appropriated *pro tanto* for the purpose of providing for the issue to the shareholders of the said debenture-stock.

12. The names of the stockholders and the amount of the stock which was issued to each were entered in a stock register of the Company. A number of the shareholders to whom stock was issued as aforesaid have, since the issue of the same, sold and transferred the stock so issued to them, and the transfers have been duly entered in the register of stockholders. The first of such transfers was made on 26th January 1915.

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13. Upon such revaluation being made, the sum of £100,000 was added to the item "Plant, land, buildings and Company's undertaking" on the credit side of the balance-sheet, and upon the issue of the debenture-stock the amount of the stock, £100,000, was carried to the debit side of the Company's balance-sheet.

14. Prior to 30th June 1914 no valuation of the said capital assets had ever been made by the Company.

15. The accretion in value of the said assets was gradual up to 30th June 1914.

16. At the time of the valuation and up to 30th June 1916 the Company paid a dividend of 10 per cent. per annum on the amount paid up on its shares ordinary and preference.

17. From the latter date the Company has paid the following rates of dividend on its shares and interest on the said debenture-stock: for the half-years from June 1916 to December 1920—6 per cent. per annum on preference shares, and from 4 to 8 per cent. per annum on ordinary shares; for the half-years from June 1917 to December 1920—5 per cent. per annum on stock.

18. The appellant as a shareholder had issued to him £2,220 of the said debenture-stock.

19. On 6th October 1920 the Commissioner of Taxation for the Commonwealth of Australia assessed the appellant to income tax in respect of the said debenture-stock issued to him.

20. The appellant served on the Commissioner notice of objection to the said assessment.

21. The Commissioner disallowed the objection, and gave notice of disallowance in accordance with the Income Tax Acts.

22. The appellant was dissatisfied with the decision of the Commissioner, and appealed to this Court in accordance with the said Acts.

23. The said appeal came on for hearing before me on 21st and 22nd June 1921.

The following question arose in the appeal, which in my opinion is a question of law, and is submitted for the opinion of the High Court:

Is the appellant liable for any, and, if so, what income tax in respect of the debenture-stock issued to him?

Feez K.C. and *Douglas*, for the appellant. The increase in value of the assets of the Company represented by the debenture-stock

does not come within the words in sec. 14 (b) of the *Income Tax Assessment Act* 1915-1916. It is not income, but an accretion to capital. Accretion to capital value is not profits. In this case what took place was not a distribution of profits of the Company, but was a distribution of part of its assets. The claim of the Commissioner is really to a tax on capital. [Counsel referred to *Henry v. Great Northern Railway Co.* (1); *Webb v. Australian Deposit and Mortgage Bank Ltd.* (2); *Mooney v. Commissioners of Taxation (N.S.W.)* (3); *Commissioner of Taxes (Vict.) v. Melbourne Trust Ltd.* (4); *Swan Brewery Co. v. The King* (5); *Inland Revenue Commissioners v. Blott* (6); *South Brisbane Gas and Light Co. v. Hughes* (7); *In re Griffith*; *Carr v. Griffith* (8); *Nathan v. Federal Commissioner of Taxation* (9); *Knowles v. Ballarat Trustees, Executors and Agency Co.* (10).] But even assuming the increase in value of the Company's assets is income, it then comes within the first proviso to sec. 14 (b): the income was accumulated before 1st July 1914 and was not distributed before that date. "Accumulated" does not import ascertainment of the amount accumulated. [Counsel referred to *Meares v. Acting Federal Commissioner of Taxation* (11).]

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Stumm K.C. and *Real*, for the respondent. The debenture-stock represent ordinary trading profits of the Company which are distributable (see *South Brisbane Gas and Light Co. v. Hughes* (12)). If they do not come within the meaning of the words "profits" or "dividends," they are within that of the word "bonus." The profits were distributed in December 1914. They were ascertained in November 1914, and should be held to have accrued at that time. Profits are not earned till ear-marked for distribution. (See *Melbourne Trust Ltd. v. Commissioner of Taxes (Vict.)* (13)).

Feez K.C., in reply.

Cur. adv. vult.

(1) 27 L.J. Ch., 1.

(2) 11 C.L.R., 223, at p. 227.

(3) 3 C.L.R., 221; 4 C.L.R., 1439.

(4) 18 C.L.R., 413, at p. 420.

(5) (1914) A.C., 231.

(6) (1920) 2 K.B., 657.

(7) 23 C.L.R., 396.

(8) 12 Ch. D., 655.

9) 25 C.L.R., 183, at p. 194.

(10) 22 C.L.R., 212.

(11) 23 C.L.R., 358; 24 C.L.R., 369.

(12) 23 C.L.R., at pp. 404, 409-410.

(13) 15 C.L.R., 274, at p. 283; (1914) A.C., 1001, at p. 1009; 18 C.L.R., at pp. 420-422.

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AUG. 24.

THE COURT delivered the following written judgment :—

The question submitted by the special case is whether the appellant is liable to income tax in respect of certain “ debenture-stock ” issued to him as a shareholder in the South Brisbane Gas and Light Co. Ltd. The special case states that on a revaluation of the assets of the Company made in November 1914 it was ascertained that the value of the assets on 30th June 1914 exceeded by £100,000 the amount at which those assets stood in the balance-sheet for the half-year ending on that date, and that before 1st July 1914 no part of this increase in value appeared in any account or balance-sheet of the Company. It states further that the increased value of the assets was appropriated for the purpose of providing for the issue to the shareholders of the debenture-stock a portion of which is the subject of this appeal.

The questions involved in the decision may be stated as follows :

(1) Is the amount represented by the debenture-stock “ dividend, interest, profits, or bonus credited or paid ” to the appellant as a shareholder of a Company within the meaning of sec. 14 (b) of the Commonwealth *Income Tax Assessment Act* 1915-1916 ; and (2), if so, does the amount consist wholly or in part of undistributed income of the Company accumulated prior to 1st July 1914 within the meaning of the proviso to that sub-section ?

In order to uphold the assessment the Commissioner must establish that, in respect of the debenture-stock issued to the appellant, he has received or been credited with “ dividends, interest, profits, or bonus.” If he succeeds in this, the appellant can only escape liability by establishing that the fund appropriated for the purpose of providing for the issue of the debenture-stock was undistributed income of the Company accumulated prior to 1st July 1914.

In the view we take of the construction of the proviso to sec. 14 (b) it is not necessary to decide what answer should be given to the former question. But, assuming the Commissioner’s first contention is correct, it seems to us to follow that the transaction must amount to a crediting or payment out of the income of the Company.

The remaining questions are whether this income was (a) undistributed and (b) accumulated prior to 1st July 1914. In

considering these questions it is proper to ascertain from the Act the intention of Parliament in inserting the proviso. By sec. 5 of the *Income Tax Act* 1915 it was provided that income tax should be levied in and for the financial year beginning on 1st July 1915; and the effect of this section, read with sec. 10 (1) of the *Income Tax Assessment Act* 1915, was to render liable to tax income derived by any taxpayer during the year beginning on 1st July 1914 and ending on 30th June 1915. Income derived before 1st July 1914 was not brought within the scope of the tax by that section, but the effect of sec. 14 (b) would, but for the proviso, have been that, although the Company would only be taxable in respect of income derived by it after 1st July 1914, its shareholders would under that section be liable to taxation on so much of the profits of the Company as were distributed among them after that date although the whole or part of those profits might have been derived by the Company before that date. It was in order to exempt the shareholder from liability to tax in respect of so much of his share of the profits of the Company as might have been derived before 1st July 1914, but not distributed until after that date, that the proviso now under consideration was enacted. Considering the object of the proviso, we see no reason for attributing to the expression "undistributed income accumulated" any meaning other than income which had not been in fact distributed and had in fact accrued to the Company before 1st July 1914. Consequently, we are of opinion that this sum of £100,000 was undistributed income of the Company accumulated prior to 1st July 1914 within the meaning of the proviso to sec. 14 (b), and that the question submitted by the special case should be answered in the negative.

The costs will be costs in the appeal.

Question answered accordingly.

Solicitors for the appellant, *Atthow & McGregor*.

Solicitors for the respondent, *Chambers, McNab & McNab*, for *Gordon H. Castle*, Crown Solicitor for the Commonwealth.

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