ORIGINAL

IN THE HIGH COURT OF AUSTRALIA.

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KENT & ANOR

V.

THE COMMISSIONER OF TAXATION

REASONS FOR JUDGMENT.

Delivered at MELBOURNE

on MONDAY, 22nd OCTOBER, 1945

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KENT & ANOR.

v.

THE COMMISSIONER OF TAXATION

JUDGMENT. WILLIAMS J.

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JUDGMENT. WILLIAMS J.

This is an appeal by H.F. Kent and L.W.H. Martin, the executors of the will of Mrs. G.L. Martin, the wife of the second named appellant, who died on the 3rd January 1941, against the assessment of her estate by the respondent for the purposes of federal estate duty. There are two objections to the assessment. In the first place the appellants object that the sum of £8,316 should have been allowed as a debt due and owing by the deceased to her husband at the time of her death within the meaning of sec. 17 of the Estate Duty Assessment Act 1914-1940. In the second place they object that the valuation at 48/4d. per share of 163,141 ordinary shares of £1 each in Paper Products Ltd., in which she had an interest for her life, and which therefore form part of her notional estate for the purposes of death duty under sec. 8(4)(c) of that Act, is excessive, and that the value of the shares at the date of death did not exceed 32/10d. per share. The respondent, who now claims that the sum of 48/4d. was an under value, prior to the hearing gave the appellants notice of his intention to ask the Court to exercise its powers under sec. 26 of the Act, and increase the value to 53/- per share, and during the hearing asked that the value should be further increased to 59/5d. per share.

Mrs. Martin was married on 18th November 1926. On 16th December 1926 she executed an indenture, of which the appellant H.F. Kent was appointed the sole Trustee, whereby, subject to an annuity of £500 to her mother bequeathed by the will of her father, and subject to the payment of an annuity of £500 to her husband, she settled certain property, including the shares, upon trust for herself for life with remainders over. Prior to the marriage the husband had been a salesman without independent means, so that, as he gave up this work upon his marriage, except for the annuity

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of £500, he was dependent on his wife for support. For a considerable time he and his wife lived in a home belonging to her at Turramurra, where four children were born. But he was anxious to go on the land, and spent a considerable part of his time away from home gaining the necessary experience. It was proposed that he should buy a property for which Mrs. Martin would pay. She consulted Mr. Kent, who regarded her as his ward, and he told her that she could afford to pay for such a property, but that she should see that there was a suitable homestead on it, because it was not advisable that husbands and wives should be separated. She told Mr. Kent that if there was not such a homestead she would build one to accommodate the whole family. Mr. Martin and his wife inspected several properties and finally decided to buy Ashleigh, situated near Orange, comprising over 3,400 acres,for the sum of £8 per acre on a freehold basis. The contract of sale was signed by Mr. Martin on 26th March 1940, and completed in May. Mrs. Martin gave her husband the whole of the moneys necessary to purchase the land, plant, and equipment. There was no suitable homestead on the property for Mrs. Martin and the children, so Mr. Martin engaged an architect to prepare plans and specifications, and on 30th August 1940 entered into a contract with a builder named Whitely to have a house built for £5896. The building of the house was commenced but not completed during Mrs. Martin's lifetime. But I am satisfied that, although most of the work was done after her death, she knew and approved of the original plans and specifications, and she requested the alterations and additions which were made to them. During her lifetime two progress payments were made to the builder by Mr. Martin totalling £1140. The balance of the payments for the house were made by Mr. Martin after her death.

The executors, in their return for the purposes of N.S.W. death duty, showed the moneys paid by Mrs. Martin to her husband in connection with the purchase of the land, stock, plant, and equipment, and also the sum of £1140 as gifts made within three

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years before her death. But with respect to the last mentioned sum, I accept Mr. Martin's evidence that this was a mistake, and that he has not been repaid any part of it. I accept Mr. Kent and Mr. Whitely, who gave evidence on the issue under discussion, as truthful and reliable witnesses. I also accept Mr. Martin as a truthful witness, but his evidence lacked clarity. In cross examination he denied the statement that he had made in his examination in chief that his wife had said that if he got the architect and plans for the house, she would pay for them, and later said that she had told him that he would have to get a house built on the property, but that nothing was said about who was to pay for it. Finally he said that after he purchased the property his wife requested him to erect a residence thereon for herself and family, she undertaking to pay the cost. I am unable to ascertain from such evidence the exact nature of the arrangement that was made between Mr. Martin and his wife with respect to her recouping him for the moneys to be spent by him in building the home. But I formed a strong impression from listening to his evidence as a whole, and from his demeanour, that he personally had no desire to build an expensive home on the property, and that the arrangements which he entered into for the purpose were all made at his wife's request. These arrangements took the form of the husband instead of the wife entering into the necessary contracts and the husband mortgaging the title deeds of the land to the bank to raise the necessary finance. They took this form because Mr. Kent had advised that as he owned the land the contract should be in his name, and because until the dividend on the shares for the year ending 30th June 1940 was paid Mr. Kent had no cash belonging to Mrs. Martin available to pay for the work. The house originally planned was expensive enough, but the original cost was considerably increased by the subsequent alterations and additions. I find that it was the intention throughout that the house should be built to Mrs. Martin's requirements, that she should bear the expense, and that the work was to be done in fulfilment of her desire that there should be a home on the property suitable to accommodate the whole family. If she had

engaged the architect and builder her estate would have been liable to them. If she had built the house with the intention of making a gift to her husband and had died within a year, the payments, at any rate to the extent to which they increased the value of the property, would have been gifts within the meaning of sec. 8(4)(a) of the Act. But if she had built the house for her own purposes and as a provision for herself and for her own enjoyment and benefit, and for the proper maintenance of a home for herself and family, the expenditure would have been for her own benefit, and there would not have been in intention or in fact a gift to her husband: Finch v. Commissioner of Stamp Duties, 1929 A.C. 427./ The fact that Mrs. Martin's purpose was implemented by Mr. Martin entering into the contracts instead of herself, is, to my mind, unessential. The debts which he incurred by so doing were incurred expressly or impliedly at her request. It is of course common for a gift of money to be made, where the purchase of a certain asset is the motive for the gift, by the intended donee entering into contracts to purchase the asset pursuant to a promise by the intended donor to give him the money required to meet his obligations: Union Trustee Co. v. Webb, 19 C.L.R., 609; Sargood's Case, 36 S.R. (N.S.W.), 160; Teare's Case, 65 C.L.R., 134; and I have found considerable difficulty in deciding whether there is sufficient evidence that Mrs. Martin intended to enter into a contract to indemnify her husband and not merely to make him a gift of the moneys required to pay for the house. But there are cases both ways; cf. Shaw v. Jones, 94 L.T., 93; Boston v. Boston, 1904 1 K.B., 124; and it is in every case a question of fact. In the present case it was Mrs. Martin who, as between the spouses, had the wealth, and made herself responsible for providing and maintaining the matrimonial home, whether at Turramurra or in the country. When arrangements were being made to build the new house she was in good health and had no cause to suspect that she was soon to suffer a sudden and untimely death at the early age of 38. It seems to me that, as in Finch's case, the object in her mind was simply the provision of a home for herself and family in accordance

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with her means and station in life. If she had not promised to indemnify her husband he would not, I think, have engaged an architect and builder or ordered the expensive alterations and additions. There was already a cottage on the property, and the building of a commodious residence would probably add little to its value as a station. Probably there was, as he appears to say, an express promise of indemnity; but if there was not, a promise should, I think, be implied from the circumstances as a whole. As she was obtaining something which she regarded as of benefit to herself and her children, the promise was given for valuable consideration; Hay v. Commissioner of Stamp Duties, 11 S.R. (N.S.W.), 304, and the debt she incurred was not voluntary. It is agreed that the amount involved in the objection is the sum of £8,316 and the remaining question is whether the debt is one which was due and owing by the deceased at the date of death. The meaning of the words "due and owing" was discussed in Mack v. Commissioner of Stamp Duties, 28 C.L.R., 373. At p. 382 Isaacs J. cites authorities which show that they include all sums certain which any person is legally liable to pay, whether such sums have become actually payable or not. And cf. Bakewell v. Deputy Federal Commissioner of Taxation, 58 C.L.R., 743, at pp. 754, 761 and 768. It is the existence of the debt at the date of death which is essential. Mr. Martin had at that date contracted to pay the whole of the above sum, and Mrs. Martin had therefore rendered herself liable to reimburse him for the same amount. Many of the authorities relating to contracts of indemnity are collected by Innes C.J. in Eq. in Newman v. McNicoll, 38 S.R. (N.S.W.), 609. It was, I think, a debt due and owing at the date of her death.

For these reasons I am of the opinion that the first objection should be upheld.

As to the second objection: evidence relating to this objection was given by several expert witnesses, comprising two members of the Sydney Stock Exchange and six chartered accountants, by H.F. Kent and G.M. Simpson, the joint governing directors of the company, and by W.L.P. Hind, the secretary. There is also

evidence of three sales of shares, two of the sales, of 16,000 and 4,473 shares respectively, being made by one of the directors, E.J. Lonsdale, to H.F. Kent personally and as trustee of the settlement on 1st July 1936 for £1 each, and the third sale of 40,000 shares being made by H.F. Kent as trustee of the settlement to the Colonial Sugar Refining Co. Ltd. on 18th December 1942 for 37/6d. cum dividend, the vendor guaranteeing that the dividend for the year ending 30th June 1942 which was about to be declared should not be less than 4/- per share.

The company was incorporated in 1929. It was an amalgamation of two companies which were then carrying on competing businesses. This explains the unusual provisions contained in articles 64 and 76-80 of the articles of association which appoint H.F. Kent and G.M. Simpson joint governing directors, with power jointly to nominate successors, until they resign or die, and provide that during the continuance of the governing management they shall be the only persons entitled to vote at general meetings, that they may from time to time determine their own remuneration, and that neither of the governing directors nor any successor to either of them who may be chairman of the board shall be thereby entitled to a casting vote, but in the event of any disputes between them on any matter affecting the company a deadlock shall be deemed to have arisen. The articles of association contain the articles usual in private companies, but objected to by the Stock Exchange in the case of listed companies except with respect to shares not fully paid, giving the directors power in their absolute discretion to decline to register any transfer of shares without assigning any reason therefor. It was a condition of the sale of the shares to the Colonial Sugar Refining Co. that the company should alter its articles to provide that the governing management of the company with the rights and privileges attached thereto, as provided by its articles Nos. 76 to 80 inclusive, should, notwithstanding anything contained in those articles, cease upon the attaining of the age of 70 years by G.M. Simpson, or if he should resign or die or become disqualified before the age of 70 years,

then upon the attainment of that age by the vendor, the other governing director, and so that each of them if able and willing to act should have the right to hold office as one of the ordinary directors, and so that no ordinary director should be entitled to hold office after he attained the age of 75 years, and this alteration was subsequently made.

The company, as its name implies, carries on in the main the business of manufacturers of and dealers in a large number of paper products. In an exhibit they are classified under bags, envelopes, trading paper, twines and envelopes, crepe goods, toilet papers, games, card games, corrugated and solid fibre containers, playing cards, tubes, and cartons. The joint governing directors have always worked in harmony and the company has been very successful in business. It has paid, inter alia, the following dividends: for the years ending 30th June 1936 10½%, 30th June 1937 12½%, 30th June 1938 15%, 30th June 1939-1942 21% each year, the dividend for the year ending 30th June 1942 comprising 8¼% tax free and 12¾% taxable dividend. The balance sheet as at 30th June 1940 disclosed assets, including good will which had been purchased for cash, of the value of £512,765. These assets included shares in Paper Products Victoria Pty. Ltd. at cost £17,400. This company is a subsidiary company of the N.S.W. company and has similar articles to those of the parent company. The parent company hold 17,400 of its 25,000 issued shares. The net profits of the parent company for the years ending 30th June 1938-9-40, as appearing in the balance sheets, were as follows; 1938 £59,435, 1939 £50,304, 1940 £71,243. The expert witnesses, except Mr. Wolfenden, all thought that these three years were the most appropriate years from which to estimate the probable future earnings of the company. Mr. Wolfenden thought, for reasons which appear in his evidence, after considering these three years, that because of the war he should take the year ending 30th June 1940 and discount the profits of that year by 10%. All these witnesses considered that certain adjustments should be made to the net profits disclosed in the accounts. These adjustments may be summarised as follows. 1. In respect of taxation, Messrs.

Chancellor and Harris, in view of the probability of increased taxation in the future, considered that a more reliable estimate of the future profits of the company would be obtained if they substituted for the amounts of tax shown in the profit and loss accounts for each year, taxation at the rates payable at the date of death. In December 1940 sec. 103 of the Federal Income Tax Assessment Act was amended to provide that in the case of private companies, which include both the New South Wales and Victorian companies, instead of undistributed profits tax being paid unless a company paid in dividends two-thirds of its distributable income (the Act was intermediately amended by substituting three-fourths for two-thirds but this amendment never operated) this tax should be payable unless the company distributed in dividends the whole of its distributable income. As a result, in making this adjustment, these witnesses, in addition to increased ordinary company tax, also charged additional undistributed profits tax against the profits of the years ending 30th June 1938 and 1939. Messrs. Wolfenden, Bogan and Nelson, on the other hand, substituted shown in the profit and loss accounts the taxes for the taxes/which were actually paid in respect of the years ending 30th June 1938, 1939 and 1940. It seems to me that the latter adjustment, which is the adjustment that has usually been made in the past, is preferable, because it is desirable to work upon actual facts as far as possible, and if the taxation for the years ending June 1938 and 1939 had been on this increased scale, it is probable that prices would have been increased to meet it, and that the net profits of these years would still have been as great. It is difficult to say why, if higher taxes than those actually paid should be charged against the profits of these years, because even higher taxation could be anticipated in the future, higher wages and other increased costs should not also be charged against these profits, because increased costs could also be anticipated in the future. 2. All the accountants agreed that, as the parent company controlled the subsidiary company, the share of the net profits of the latter company (attributable to the parent company as the holder of 17,400 shares), after taxation in

respect of that company had been similarly adjusted, should be substituted for the dividends paid by that company. 3. Whilst the expert witnesses for the appellants in other respects adopted the figures appearing in the accounts for the three years, Messrs. Nelson and Bogan also adjusted the amount deducted for depreciation in excess of the amounts claimed in the company's income tax returns and treated this excess depreciation as additional profit. The reason for so doing is explained in their evidence, and Mr. Weston, without making any formal concession, did not contest its propriety. This excess depreciation was, as pointed out in Edwards v. Saunton Hotel Co., 1943 1 A.E.R., 176, at p. 179, a reserve which could and was, before the date of death, brought into revenue again and made available for profit out of which a tax free dividend could be paid under sec. 107 of the Income Tax Assessment Act. If the profit and loss accounts for the three years are adjusted by substituting for the relevant figures in the accounts the taxes actually paid, and the company's share of the net profits of the Victorian Company, and this excess depreciation is added to the profits, the adjusted figures for the three years which I take from exhibit 8, prepared by Mr. Nelson, are as follows; for the years ending 30th June 1938 £72,392, 30th June 1939 £57,705, 30th June 1940 £62,218, an average of £64,105. This amount,capitalised at 10%, the rate adopted by Messrs. Nelson and Bogan, for 242,094 shares equals 53/- per share. But Messrs. Nelson and Bogan also claim that to this value there should be added a sum, according to Mr. Nelson, of 6/5d. per share, and to Mr. Bogan, of 6/- per share, in respect of the sum of £36,441 additional profit, less an allowance for taxation, which they say was earned but not shown in the profit and loss accounts of the Sydney and Victorian companies for the year ending 30th June 1940. The circumstances relating to this sum are, shortly stated, that it was the practice for each of the companies to value their stock as at 30th June at cost or replacement value, whichever was the lesser. The board of directors then deducted a further arbitrary sum from this amount before finally placing a value on

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the stock for the purposes of the annual accounts. Both Mr. Simpson and Mr. Kent explained in their evidence, and I accept them as truthful and reliable witnesses, that this was done in what the board believed to be the interests of the shareholders to safeguard their funds against various contingencies which experience had shown might cause a sudden fall in prices. For the years ending June 30th 1938 and 1939 the amounts deducted were about £53,000 in the case of the Sydney Company and £2,500 in the case of the Victorian Company, but for the year ending 30th June 1940 the directors, instead of valuing the stocks as at that date at cost or replacement value and then deducting these amounts, valued them at cost or replacement value as at 30th June 1939 and then deducted these amounts. As the market was rising, the amount arrived at on the 1939 basis was,in the case of the Sydney Company, £168,450, instead of £202,622, which would have been the value on the 1940 basis, while in the case of the Victorian Company the value on the 1939 basis was £16,651, instead of £19,639, which would have been the value on the 1940 basis. These two differences total the above sum of £36,441. So long as approximately the same amounts were deducted from the cost or replacement value each year, the profits were not materially affected, but when the cost or replacement value was pegged as at 30th June 1939 it had the effect of materially reducing the profits for the year ending 30th June 1940. For the year ending 30th June 1941 the stock was again valued at cost or replacement value as at June 30th 1939, and in the subsequent years a two years' lag was continued. The governing directors explained that the values were pegged as at 30th June 1939 because of the experiences after the last war,when there was a sudden drop in prices in 1920, and because as a result of the war the local mill had become their sole source of supply for raw materials. As its products were inferior to imported materials, there was a grave risk that the value of the stock would decline sharply when imported materials again became available. There was also a grave risk that this mill would commence to convert its own raw materials

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into manufactured goods and compete with the company,in which case its future would become precarious and its stock of very low value. On 16th April 1942 Mr. Nelson, adopting the same rate of capitalisation, that is, 10%, had valued the shares for the purposes of state death duty at £2:8:4 per share, and after pointing out the difference in the State and Federal Acts and that "the war situation in 1941 was by no means favourable, higher taxes were announced and clearly inevitable, whilst prices were under the control of the Prices Commissioner", recommended that the value placed on the shares by Mr. Harris on behalf of the executors of £2:3:9 should be accepted for federal estate duty. At that time Mr. Nelson, except for minor alterations, accepted the figures in the balance sheet and did not make any adjustment on account of excess depreciation. He did not know the amounts which had been deducted from the value of the stock. All that he was told was that there were small stocks reserves and that these reserves were constant. Subsequently,in October 1944,he was given the amounts for the years 1937 to 1943 by which the values of the stock in both companies had been reduced below cost or replacement values. These figures represented the difference between cost or replacement values at the end of each respective year and the figures in the balance sheets, but he was not told that, in arriving at these amounts, the method of valuation had been altered and the lag already mentioned introduced for the years ending 30th June 1940 to 1943. Having adjusted the net profits in respect of excess depreciation, he then considered that 10% would be a proper rate of capitalisation for estate duty purposes,and valued the shares at £2:13:0. He only became aware of the lag during the hearing of the appeal, and it was this further knowledge which caused him to increase his valuation by 6/5d. a share. Mr. Bogan was in the same position as Mr. Nelson. When he became aware of the lag during the hearing he thought it proper to reduce his rate of capitalisation from 10% to 9%, and this increased his valuation to £2:19:0 per share.

It is necessary to decide upon the importance to be attached to this stock reserve and profit of £36,441. It must be

remembered that the Court is not engaged on this appeal in ascertaining the taxable income of the company for the purposes of income tax. The extent of the net profits made in the years ending 30th June 1938, 1939 and 1940 is only important as supplying a guide to the probable future prospects of the business. The decision to peg the values of the stock for the year ending 30th June 1940 as at 30th June 1939 was made in July 1940 and was not connected with Mrs. Martin's death.

The sum of £36,441 was no doubt a profit (in fact the whole of the stock reserve was a profit) in the strict sense. But it was a book profit which might or might not eventuate. It was apparently found to be necessary in the national interest at a later date that all costs of goods and services should be pegged, and price fixing orders have come before this Court in which the Prices Commissioner has found it necessary, where the cost of goods or services has been made an ingredient in a formula for fixing a price, to keep costs pegged at this date, even where Commonwealth legislation has provided for these costs in certain circumstances to be increased. It is obvious that the decisions to impose, first, a one year's lag in respect to the year ending 30th June 1940, and then a two years' lag in respect of the years ending 30th June 1941 and subsequent years, were decisions which the directors could reach in the sound and prudent management of the companies' businesses. The object was to place a value on the stock which would not unduly increase present profits or unduly reduce future profits and possibly lead to a severe loss if there should be, as they anticipated, a sharp fall in stock values after the war or if the local mill commenced a competitive business. I do not think that, in using the profits of the three relevant years for the purpose mentioned, I should in effect override the decision of the directors and bring in the sum £36,441 (less taxation) as a separate item of profit. The importance of the stock reserve lies, I think, in the fact that it shows that the directors were adopting a conservative policy well calculated, even if values fell steeply, to enable the company to pay a steady dividend, and, if they did not, to create a considerable potential profit.

Evidence /

Evidence was given of the amounts drawn by the directors, and particularly the governing directors, for salaries, fees, and allowances. The amounts were very substantial, particularly in the case of the governing directors, but they gave their whole time and attention to the business of the company, and I do not think, particularly in view of the provisions of the articles of association, that any part of these amounts should, as in McCathie's Case, be treated as profits of the companies: cf. Aspro Ltd. v. Commissioner of Taxation, 1932 A.C., 683.

I shall now proceed to make the best estimate I can of the value that should be placed on the 163,141 shares at the date of Mrs. Martin's death. I have already discussed in Murdoch's Case, 65 C.L.R., 572, McCathie's Case, 69 C.L.R., 1, and Abraham's Case (unreported) the principles which are in my opinion applicable. A number of authorities are cited in Abraham's Case, and,as it has not been reported, in order to make this judgment more complete, I shall repeat the following passages:-

> The "Estate Duty Assessment Act 1914-1928 sec. 8 provides that estate duty shall be levied and paid upon the value as assessed under the Act of the estates of persons dying after the commencement of the Act. In order to comply with the Act it is necessary to ascertain the real value as at the date of death of the assets which form part of the dutiable estate. The Act does not, as in sec. 7(5) of the English Finance Act 1894 which has recently been considered by the House of Lords in Inland Revenue Commissioners v. Crossman, 1937 A.C. 26, and in sec. 71 of the New Zealand Death Duties Act 1921 which has recently been considered by the Supreme Court of New Zealand in In re Harvey, 1942 N.Z.L.R. 150: Tremaine v. Commissioner of Stamp Duties, 1942 N.Z.L.R. 157: McGregor v. Commissioner of Stamp Duties, 1942 N.Z.L.R. 164: In re Crawford, 1942 N.Z.L.R. 170, direct that the value of the shares shall be estimated to be the price which such property would fetch if sold in the open market at time of death of the deceased. In Crossman's case (supra) it was held by the House of Lords, approving Attorney-General v. Jamieson, 1905 2 Ir. 218, and Salvesen's Trustees v. Inland Revenue Commissioners, 1930 S.L.T. 387, that this meant that the value of the shares for the purpose of duty was to be estimated at the price which they would fetch if sold in the open market on the terms that the purchaser should be entitled to be registered and to be regarded as the holder of the shares, and should take and hold subject to the provisions of the articles of association, including those relating to the alienation and transfer of shares in the company. It has been held, however, in the case of other Australian Statutes which, like the Estate Duty Assessment Act, do not direct any particular method of estimating the value of the assets, that it is proper to estimate the value of the shares held by a deceased in a company, the articles of association of which contain restrictions on transfer in the same manner,

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> and that the Court should endeavour to ascertain (as in the case of property compulsorily acquired) the price which a willing but not anxious vendor could reasonably expect to obtain and a hypothetical willing but not anxious purchaser could reasonably expect to have to pay for the shares if the vendor and purchaser got together and agreed on a price in friendly negotiation, the basis of the bargaining being that the purchaser would be entitled to be registered as the owner of the shares but when registered would hold the shares subject to the provisions of the memorandum and articles of association of the company including any restriction on transfer which they might contain: see MacArthur Onslow v. Commissioner of Stamps, 17 S.R. (N.S.W.) 447: Myer v. Commissioner of Taxes, 1937 V.L.R. 106: cf. Deputy Federal Commissioner of Taxes v. Gold Estates of Australia Ltd., 51 C.L.R. 509."

> "Crossman's case is fully reported before Finlay J. and in the Court of Appeal in 152 L.T. 98. The judgment of Finlay J. was reversed by the Court of Appeal (Lord Hanworth M.R.dissenting) but his Lordships's judgment was restored by the House of Lords. Finlay J. said at p. 101 that -
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> > '... enormous difficulty must arise when one has got to apply notionally the principle of the open market to shares which, in fact, by reason of restrictions, could not be sold in the open market.'
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> Further, in applying the test it must be remembered that the value to be ascertained is the value to the seller of the property in its actual condition at the relevant time (in the present case at the date of death) with all its existing advantages and all its possibilities: per Lord Romer when delivering the judgment of the Privy Council in Vyricherla Narayana Gajapatiraju v. Revenue Divisional Officer Vizagapatam, 1939 A.C. 302 at p. 321: per Sir Wilfred Greene M.R. in Horn v. Sunderland Corporation, 1941 2 K.B. 26 at p. 32."

Mr. Nelson said in his evidence (and there is evidence in this and the previous cases to the same effect) that in the case of shares not listed on the Stock Exchange, it is usual to value the whole of the net profits and to fix an appropriate rate of capitalisation; whereas in the case of shares listed on the Stock Exchange, it is usual to take the last dividend and the dividend yield that is expected. In the present case the accountants adopted the former and the sharebrokers the latter method. The latter method was adopted by Finlay J. in Crossman's case and his judgment was approved by the House of Lords. The Court on this appeal is concerned with unlisted shares, the difficulties in valuing which, as Finlay J. pointed out, are enormous, and it seems to me that it assists to consider both net profits and dividends. In this connection the question arises as to the extent of which

evidence is admissible of events subsequent to the date of death. On this point I have nothing to add to what is stated in McCathie's Case at pp. 16 and 17. To the authorities that are there cited there can be added the following authorities: A and B Taxis Ltd. v. Secretary of State for Air, 1922 2 K.B., 328, at p. 343; In re Gordon, 1942 1 Ch., 13; In re Viscount Rothermere, 1945 1 Ch., 72; The Commonwealth v. Huon Transport Pty. Ltd., 1945 A.L.R., 141. In the present case the whole of the evidence relating to the sale to the Colonial Sugar Refining Co. was, in my opinion, admissible. Otherwise I have not relied on any subsequent events, other than those specifically referred to in this judgment, except as confirming the conclusion, which I would have reached in any event, that no sufficient justification existed for reducing the net profits by 10% as Mr. Wolfenden did, or applying the rates of taxation for the year 1940 to the years 1938 and 1939 as Messrs. Chancellor and Harris did.

On the information available in January 1941 it would have been reasonable, I think, for the vendor and a purchaser to have negotiated on the basis that, apart from the invasion of the country, which could not have been anticipated on 3rd January 1941 and which, if it had occurred, would have been destructive of business generally, the future probabilities were that the company would be able to maintain its net profits and continue to pay a dividend of 21%. But it was not a company which had large accumulated profits invested in securities outside its business. On the contrary, all its assets were embarked in the business. The net book value of the tangible assets as at 30th June 1940 was about 26/-, or about 30/- if the stock was valued at cost or replacement value, so that the shares were such that, having regard to the risks, a purchaser could not be reasonably expected to pay a price which would not show a substantial rate of net profit and dividend. (This was conceded by all the expert witnesses.) Mr. Blackmore, who was for many years the chairman of the Sydney Stock Exchange, and Mr. Wolfenden both said, and I accept their evidence, that if it was a company listed on the Stock Exchange and well and favourably known to the public

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an investor in its shares would expect a dividend of at least 8%. There was considerable discussion in the evidence and during the addresses upon the effect which the unusual articles and the size of the parcel would have upon the value of the shares. In Crossman's Case in the Court of Appeal at p. 104 Lord Hanworth, after referring to Lord Fleming in Salvesen's case, taking into account the extent to which the restrictions in the articles might be expected to depreciate the value of the shares, said "if it means that a purchaser would take into account that the property he would be buying would have a closed and small market, I agree with it, for many properties, otherwise attractive, lose some of their value when purchasers consider that they are not readily saleable, or saleable only under certain conditions". Shares were divided into three classes, those of companies listed on the Stock Exchange, those not listed but having articles in such a form that they could be listed and called in the vestibule with the permission of the chairman, and those of companies having articles in such a form that they were ineligible for listing. The present shares are in the third class. So far as transfer is concerned, the only limitation is that the directors have a discretion to refuse to register the transfer. The authorities cited in Abraham's case show that this is a usual article in the case of private companies, and that the power is fiduciary, to be exercised by the directors bona fide for the benefit of the company. This article, apart from the fact that it would prevent shares from being listed on the Stock Exchange, ought not materially to affect the value of the shares. Then there are the articles giving the governing directors for a long period complete control of the companies, and authorising them to fix their own remuneration. The dual control has worked successfully in the past and there is nothing to suggest that it will not continue to do so in the future. The Colonial Sugar Refining Company had, apparently, no misgivings as to the management, because the only alteration that it required was one to ensure that the joint governing directors should not grow too old for the work. Opinions were expressed that the lack of control that the shareholders had over

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the governing directors in general meeting would depreciate the value of the shares, the inference being that they would become more valuable when the governing management ceased. But I find it difficult to see why, when a business is being successfully managed, the cessation of that management should have the effect of increasing the value of the shares. There are always in the background, if a deadlock should occur, or the governing directors should abuse their powers, the statutory rights of the shareholders to apply to the Courts to have the company wound up - referred to in McCathie's Case at pp. 11 and 12. Evidence was also given that it would be difficult to sell such a large parcel of shares,and several of the expert witnesses contended that their value as a whole should be reduced on this account. But the object of estimating the price that would be agreed upon between a reasonably willing vendor and a reasonably willing purchaser is to ascertain the full value of the property to the owner, and the Court therefore assumes a hypothetical purchaser or purchasers who would be ready and willing to purchase the whole parcel. Even if there is only one such purchaser, he must still pay this full value. There is in fact no passing of the property in the shares at the date of death as there is in the case of a resumption. Even if the shares had to be sold, they could be gradually disposed of over a considerable period, and in the meantime the vendor (in the present case the trustee of the settlement) would be receiving the dividends from the unsold shares. If the contention were sound, it would mean that, on a resumption under a statute which provided for the payment of compensation, the resuming authority could acquire the undertaking of a company more cheaply by acquiring all the shares than by acquiring its assets. The essence of the matter is to ascertain the real value of the shares at the date of death, having regard to the existing condition and probable future course of the company's business. The success or failure of that business does not depend in any way upon whether the shares are listed, unlisted, or unlistable on the Stock Exchange. The market for unlistable shares is no doubt strictly limited in comparison with

shares that are listed but a purchaser in a limited market cannot expect to acquire the shares at less than their real value to the owner. The fact that such shares are difficult to mortgage or sell makes them unattractive to buyers, who, like the ordinary investor on the Stock Exchange, attach great importance to negotiability, and they must be regarded as a long term investment. Some discount must, as Lord Hanworth pointed out, be allowed on this account, particularly where the business on which a private company is engaged is hazardous, and the amount paid for the shares is not fully covered by tangible assets. But I am unable to accept the evidence that, taking purchasers as a whole, as opposed to investors on the Stock Exchange, shares in a private company, as compared with shares in a company listed on the Stock Exchange, should be depreciated to the extent suggested by some of the appellants' witnesses when both companies are engaged in carrying on similar businesses and own substantially identical assets.

All these considerations, apart from the sales, would lead me to conclude that a proper rate of capitalisation, accepting the average net profits to be £64,103, might well be 10%, as Messrs. Nelson and Bogan first suggested, although, on the whole of the evidence, I think that I would be more inclined to adopt 11%. This was in effect the rate suggested by Mr. Chancellor. But he adopted this rate on a sum of £49,718, due mainly to the more drastic adjustment of the net profits for the years ending 30th June 1938, 1939 and 1940 which he made in respect of taxation. He also made a deduction because of the difficulty of disposing of such a large parcel of shares. On the other hand, he did not make any adjustments for excess depreciation, or know of the stock reserves. And it does not appear what rate he would have adopted with these alterations. But there is also the fact that Mr. Nelson, in his valuation of 16th April 1942, used a rate of 10% for state purposes, and advised, as I think rightly, that a lower valuation should be made for federal purposes. In that valuation he found the average net profits to be £58,568:17:0, and if this amount is capitalised at 11%, the result is approximately £2:3:9 per share, the sum which he recommended

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should be accepted for federal purposes. The sum of £64,105, capitalised at 11%, gives a value of £2/8/0 per share. The adoption of this rate of capitalisation for the net profits would indicate that a fair rate of dividend would be 9%, which,assuming an annual dividend of 21%, would give the shares a value of £2/6/8. But in the light of the actual sales these values would appear to be too high. Of the three sales the two sales totalling 20,000 shares in 1936 are the most important, as both the vendor and purchaser had a complete knowledge of the company's affairs. At that time the stock reserve stood at £50,000. The dividend for the year ending 30th June 1935 had been 10½% and both vendor and purchaser must have known that for the year ended 30th June 1936 the company was in a position to increase the dividend. The dividend paid for this year was 12¼%. At the date of the sales the country was at peace, and the business was increasing. Mr. Kent was not crossexamined about these sales, and there is nothing to suggest that they were not made between parties at arms length and for full value. On the basis of these sales the market value of the shares would not appear to have been more than £2 in January 1941. Then there is the sale to the Colonial Sugar Refining Company. The price was 37/6d. but this sum must be reduced by the amount of the impending dividend, less taxation, possibly 3/-, which the vendor guaranteed would be 4/- per share, that is, 20% (it was in fact 21%). Mr. Blackmore said that there had been a general fall in the value of shares listed on the Stock Exchange of about 10% between the date of death and the date of the sale, and that the fall would have been greater in the case of other shares. The adjustment of this sale would also give an approximate market value of £2 per share in January 1941. Before this sale there were discussions between Mr. Kent and Mr. Rothe, the managing director of the purchaser. Mr. Mason objected to the contents of these conversations. In view of the emphasis placed on the stock reserves by the respondents, I admitted the evidence that Mr. Kent told Mr. Rothe that the stock was very conservatively valued. Mr. Rothe had the balance sheets for the years ending 30th June 1938 to 1941 before

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him. There is nothing to show that any further information as to the company's affairs would have induced him to pay more for the shares. But the contract contains a recital that Messrs. Kent and Simpson desired that in their interests and in the interests of the company the purchaser should become a shareholder in the company, and they were both cross-examined by Mr. Mason as to the meaning of this recital. Mr. Nelson gave some interesting evidence upon the operation of the undistributed profits tax from which it would appear that most shareholders in a private company would benefit if the company retained and paid tax on all its distributable profits and then declared tax free dividends because, since the amount of tax paid in one year can be deducted from the assessable income of the subsequent year, the average tax for the two years cannot be more than 10/- in the £1. He also pointed out the advantage of having a public company as a shareholder, because the Income Tax Commissioner, on account of the inherent difficulties, does not seek to treat such a company as an interposed company under sec. 105 of the Income Tax Assessment Act, so that the amount of undistributed profits tax attributable to its shareholding is small. But I am satisfied that these advantages were not known to either of the governing directors, and that, so far as they were concerned, apart from the admitted advantage to their company of forming an association with a company having such wide business interests, the recital was, as Mr. Kent said, "legal persiflage". Mr. Mason during his address suggested that Mr. Kent had deliberately sold the shares to the Colonial Sugar Company at an under value because there were appeals against both State and Federal assessments, and the sale would assist to show that the shares had been overvalued. No such suggestion had been put to Mr. Kent in cross-examination. Mr. Weston offered to put him back into the witness box to be cross-examined, but Mr. Mason declined the offer. Mr. Weston then sought to put him back and examine him, but I refused the application because, in the absence of cross-examination on the point, I did not think that I should consider such a suggestion, and also because, without any further cross-examination, I was completely satisfied that it was unfounded, and that Mr. Kent had

endeavoured to obtain the best price that he could for the shares. Further, I do not think that the war situation was as gloomy in December 1942 as Mr. Mason painted it. The battles of the Coral and Sea and Midway had been fought and won several months before, so that the war in the Pacific had passed its supreme crisis, the risk of invasion had passed, and the tide had turned in favour of the United Nations. But the sale was made to pay off an overdraft, and I have the feeling that but for this Mr. Kent would have preferred to keep the shares rather than part with them at the price. The three sales amounted to 60,000 shares, or roughly one quarter of the issued capital. So far as they throw light on the values as at 3rd January 1941 they are entitled to great weight. But two of the sales were made 4½ years before, and the third two years after the date of death, while there is other evidence relating to the value of the shares at the crucial date which is also entitled to great weight. The Court must weigh the whole of the evidence and exercise the best judgment that it can without being too scientific about it. With an average profit of £64,105, after writing down the stock, a dividend of 21%, which would absorb £50,839, was well covered. The contract with the Colonial Sugar Refining Company contemplated a dividend of 20%, and, taking the net purchase price of the shares to be 34/-, this would give a yield to the company of 11-2/3rds%. This is in conformity with the previous sales. But on the whole of the evidence, and especially having regard to the sound and conservative management of the business, the purchaser would in general have to be prepared, I think, to negotiate on a fairer basis than this sooner than fail to obtain the shares. Mr. Kent said that at the date of death the threat of the local mill commencing to convert its own materials was real, and some allowance must be made for this. I think that in respect of net profits a rate of capitalisation of from 11 to 12%, and in respect of dividends a yield of from 9 to 10% would form a reasonable basis of negotiation . Capitalising £64,105 at 12% would give /

give the shares a value of £2:4:0, at 11½% £2:6:0 and at 11% £2:8:0. A dividend yield of 10% would give the shares a value of £2:2:0, of 9½% £2:4:3, and 9% £2:6:8. These figures indicate, it seems to me, that £2:5:0 would be a fair value on 3rd January 1941, and I therefore estimate this sum to be their value on that date.

There remains the question of costs. The appellants have succeeded on their first objection. On the second objection they have succeeded in reducing the value by 3/4d. below the value at which the shares were assessed. This is a small reduction, but the respondent's case at the hearing was that the value should be increased to 59/5d. per share, so that, on the objection and counter objection as fought, the appellants have had a substantial success. I think that I should order the respondent to pay two-thirds of their costs.

The order of the Court is: Appeal allowed. Existing assessment set aside. Remit the matter to the respondent to re-assess the appellants on the basis that the sum of £8,316 was a debt due and owing by Gwendoline Lillian Martin to her husband at the date of her death within the meaning of sec. 17 of the Estate Duty Assessment Act 1914-1940, and that the 163,141 shares held by the appellant H.F. Kent as trustee of the settlement of 16th December 1926 are to be valued at £2:5:0 per share. Respondent to pay two-thirds of the appellants' taxed costs.

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IN THE HIGH COURT OF AUSTRALIA

NEW SOUTH WALES REGISTRY.

Ct Bk Number 9 of 1945

IN THE MATTER OF THE ESTATE DUTY ACT 1914-1940

AND IN THE MATTER of the ESTATE DUTY ASSESSMENT ACT 1914-1940

AND IN THE MATTER of the Estate of GWENDOLINE LILLIAM MARTIN late of Warrawee near Sydney in the State of New South Wales Married Woman deceased

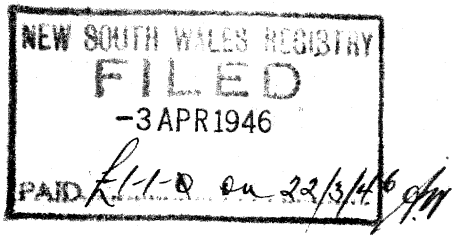
BETWEEN

HAROLD FREDERICK KENT and LAWRENCE WILLIAM HENDERSON MARTIN as Administrators of the Estate of Gwendoline Lillian Martin deceased

and

THE COMMISSIONER OF TAXATION for the Commonwealth of Australia

ORDER



WHITEHEAD FERRANTI & GREEN,
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SYDNEY.

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IN THE HIGH COURT OF AUSTRALIA)
NEW SOUTH WALES REGISTRY) Ct Bk Number 9 of 1945

IN THE MATTER of the Estate Duty Act 1914-1940

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AND IN THE MATTER of the Estate of GWENDOLINE LILLIAN MARTIN late of Warrawee in the State of New South Wales Married Woman deceased

BETWEEN

HAROLD FREDERICK KENT and LAWRENCE WILLIAM HENDERSON MARTIN as Administrators of the Estate of Gwendoline Lillian Martin

Appellants

and

THE COMMISSIONER OF TAXATION for the Commonwealth of Australia

Respondent

BEFORE His Honour Mr. Justice Williams

MONDAY the Twenty second day of October one thousand nine hundred and forty five.

THIS APPEAL coming on to be heard on the 18th, 19th, 20th, 21st, 24th, 25th, 26th and 27th days of September 1945 in pursuance of the Notice of Appeal filed herein on the 23rd day of March 1945 WHEREUPON AND UPON READING the said Notice of Appeal, the exhibits tendered in evidence by the abovenamed Appellants and by the above-named Respondent respectively AND UPON HEARING the oral evidence given by William Erskine Bain, David Walter Blackmore, Harold William Chancellor, William Ingland Joseph Whitely, Edgar Sidney Wolfenden, Aubrey Arnold Grant Harris, William Henry Medlicott Andrews, Lawrence William Henderson Martin, Wilfred Leonard Pogson Hind, George Martin Simpson, Harold Frederick Kent and Raymond Zani de Ferranti called on behalf of the Appellants and by Robert William Nelson and Robert Davis Bogan called on behalf of the Respondent AND UPON HEARING what was alleged by Mr. C.A. Weston and Mr. F.W. Kitto both of King's Counsel with whom was Mr. A.B. Kerrigan of Counsel for the Appellants and by Mr. H.H. Mason of King's Counsel with whom was Mr. E.J. Hooke of Counsel for the Respondent IT WAS ORDERED on

the said lastmentioned day that the said Appeal stand for judgment and the same standing in the list for judgment this day IT IS ORDERED that the said Appeal be and the same is hereby allowed AND IT IS FURTHER ORDERED that the existing assessment for Estate Duty made upon the Appellants under the Estate Duty Assessment Act 1914-1940 and notified to the Appellants by Notice of Assessment dated 19th May 1942 as amended by Notice of Amended Assessment dated 5th June 1942 be and the same is hereby set aside and IT IS FURTHER ORDERED that the matter be remitted to the Respondent to re-assess the amount of Estate Duty payable by the Appellants in respect of the Estate of the said deceased on the basis as follows:-

1. That the sum of Eight thousand three hundred and sixteen pounds (£8316) being moneys expended in and about the erection of a house on the property "Ashleigh" Four Mile Creek Via Orange was a debt due and owing by Gwendoline Lillian Martin to her husband at the date of her death within the meaning of Section 17 of the Estate Duty Assessment Act 1914-1940.

2. That the one hundred and sixty three thousand one hundred and forty one (163,141) ordinary shares of One pound each in Paper Products Pty Limited held by the Appellant Harold Frederick Kent as trustee of a certain Indenture of Settlement executed by Gwendoline Lillian Martin on the 16th day of December 1926 be valued for estate duty purposes at the sum of Two pounds five shillings (£2:5:0) per share.

AND IT IS ALSO ORDERED that it be referred to the proper Officer of this Court to tax and certify the Appellants' costs of and incidental to this Appeal and that two-thirds of such costs when so taxed and certified be paid by the Respondent to the Appellants or to their Solicitors Messieurs Whitehead Ferranti & Green after service of a copy of the Certificate of Taxation.

BY THE COURT

DISTRICT REGISTRAR