IN THE HIGH COURT OF AUSTRALIA

ADMIN EXPLORATION PTY. LTD.
(IN LIQUIDATION)

v.

COMMISSIONER OF TAXATION

REASONS FOR JUDGMENT

Judgment delivered at SYDNEY

on 15th DECEMBER 1972 FRIDAY

RM.72/20133

ADMIN EXPLORATION PTY. LTD.
(IN LIQUIDATION)

v.

THE COMMISSIONER OF TAXATION
OF THE COMMONWEALTH OF AUSTRALIA

ORDER

Appeal allowed with costs. Assessment set aside. Direct the Commissioner to re-assess the tax payable by the taxpayer without including in the assessable income any part of the proceeds of the sale by the taxpayer of 55,000 options to subscribe for shares in North Flinders Mines N.L. Order that the Commissioner pay the taxpayer's costs.

Usual order as to exhibits.

ADMIN EXPLORATION PTY. LTD.
(IN LIQUIDATION)

v.

THE COMMISSIONER OF TAXATION
OF THE COMMONWEALTH OF AUSTRALIA

JUDGMENT MASON J.

ADMIN EXPLORATION PTY. LTD.
(IN LIQUIDATION)

v.

THE COMMISSIONER OF TAXATION
OF THE COMMONWEALTH OF AUSTRALIA

This is an appeal by the taxpayer against an assessment to income tax for the year ended 30th June 1970 by which the respondent included in the taxpayer's assessable income a sum of $298,267, being part of a sum of $313,267 which the taxpayer received as consideration for the sale in that year of 55,000 options to subscribe for the shares in North Flinders Mines N.L. The respondent's case was that the profit of $298,267 made on the sale was assessable income of the taxpayer by virtue of s. 26(a) of the Income Tax Assessment Act 1936-1970. The taxpayer contended that it was a capital profit, that it did not fall within the ordinary concept of income, or within s. 26(a). Alternatively, it claimed that the sum was exempt income under s. 23(p) of the Act. Finally, in the event of the failure of its principal submissions the taxpayer submitted that the sum of $15,734 was deductible as expenditure on exploration and prospecting.

The taxpayer was incorporated with a nominal capital of 50,000 $1 shares on 13th June 1968. Its promoters were Norman Shierlaw, a sharebroker carrying on business under the name "N. C. Shierlaw and Associates" and formerly an experienced mining engineer and mine manager, Ross Grasso, a consulting geologist, and Graham John Robertson, a sharebroker who became an employee of Mr. Shierlaw on 1st October 1968.

They became directors of the company and were its principal shareholders.

The principal object of the company as set forth in its Memorandum of Association was to search for, prospect and develop minerals of all kinds excluding only gold and petroleum or oil. Mr. Shierlaw and Mr. Robertson said in evidence that the company was formed to investigate further the known mineral occurrence in an area in the North Flinders Range in the vicinity of the Lady Lehmann mine and the Ivy Queen mine. They said that the company was formed to search for base minerals generally, in particular copper, in view of its known presence in the area.

Mr. Grasso was familiar with the area by reason of having written his thesis for his M.Sc. degree on the geology of the area. He believed that the area, which had been the site of copper mining operations in earlier days, held promise of having economic mineral deposits and warranted further investigation. Before the incorporation of the taxpayer he communicated with the Department of Mines (S.A.) with a view to securing a mining lease in the area. Correspondence continued after the company was incorporated, resulting in a letter dated 5th July 1968 from the Director of Mines stating that approval had been given to the grant of Special Mining Lease No. 206 to the taxpayer. There is some doubt as to whether a Special Mining Lease actually issued, but it is accepted by the parties that the taxpayer acquired an interest in the nature of a Special Mining Lease over an area of 350 square miles in the North Flinders Range. The approval of S.M.L. 206 was on the conditions that it should be for a term

of twelve months from 1st July 1968, that the lessee would so explore the area, that a minimum of $20,000 would be expended on geochemical and geophysical surveys, sampling and drilling, that technical reports would be submitted at intervals of six months and that the lease would not be transferred without the consent of the Minister for Mines.

The three directors of the taxpayer, Messrs. Shierlaw, Robertson and Grasso, decided to raise $25,000 by way of share capital to finance exploration expenses in the vicinity of $20,000. Fully paid shares were allotted to the three directors and friends whom they induced to take up shares. In all, $25,250 share capital was issued.

Minoil Services, of which Mr. Grasso was the sole proprietor, was appointed consulting geologist to the company. It was given instructions to prepare an exploration programme for the area which would cost no more than $20,000. Mr. Shierlaw and Mr. Robertson placed considerable reliance in Mr. Grasso's knowledge of the area and the recommendations which he made as to its possibilities and for its exploration.

In July, Minoil Services began to study the material available in the Department of Mines relating to the geology of the area. The area included the sites of two old mines, the Lady Lehmann and the Ivy Queen, which had been worked for copper ore at about the beginning of the century when rich pockets of ore were exhausted and mining operations were discontinued. Minoil Services formulated an exploration programme which involved the percussion drilling of holes in positions which it indicated for the purpose of locating the extent of the mineralization. By an agreement dated 29th October 1968 the taxpayer engaged

Mr. P. P. Harbutt, a drilling contractor, to carry out the drilling programme. Mr. Harbutt drilled eighteen holes, a total of 2,084 feet. The programme cost the taxpayer $15,734. As it happened, it was the last exploration work which the taxpayer was to undertake.

On 9th December 1968 Mr. Grasso circulated to shareholders Progress Report No. 1 in which he recorded the completion of the drilling and stated that assay results were awaited. In the same month the taxpayer received Geological Report No. 1 prepared by Mr. W. G. Shackleton, a geologist employed by Mr. Grasso. The report recorded the percussion drilling programme which had taken place and recommended a modest diamond drilling programme costing $12,900, to be undertaken at the Lady Lehmann and the Ivy Queen mines in order to further define the ore bodies known to exist in those places.

There was some apparent inconsistency between the evidence of Mr. Robertson and Mr. Shierlaw as to the consideration given by the taxpayer to the report. Mr. Shierlaw said that the recommendations for drilling contained in the report were considered and it was thought that as an initial step one hole costing $4,000 might be drilled at the Ivy Queen mine. Mr. Robertson, however, said that the report was overtaken by negotiations with other tenement holders to which I shall refer shortly. Mr. Shierlaw spoke, I think, of what he had in mind after considering the report. And I accept Mr. Robertson's evidence as establishing that the directors did not make a decision on the recommendations made by Mr. Shackleton because at the end of 1968 discussions commenced between the taxpayer and Billy Springs Pty. Limited, a company which held more than

one mining tenement in the North Flinders Range in the close vicinity of S.M.L. 206, with a view to reducing exploration costs and ultimately to the formation of a company which would acquire the tenements of each company.

Again there is some difference between the accounts given in evidence by Mr. Robertson and Mr. Shierlaw concerning the commencement of the discussions in December 1968. Mr. Robertson says that on the initiative of Mr. Thomas a discussion took place in Mr. Shierlaw's office between himself and Mr. Thomas concerning the possibility of reducing exploration costs to be incurred by both companies by combining resources or adopting a common programme. This discussion was followed by a meeting in January at North Adelaide.

On the other hand, Mr. Shierlaw says that he had a meeting in his office with Mr. Thomas in December in which Mr. Thomas proposed that Billy Springs Pty. Ltd. should be converted into a public company and that it should make an offer of shares to the public. He sought Mr. Shierlaw's advice and assistance and requested him to underwrite the issue. Mr. Shierlaw declined on the ground that the prospects of the company were not demonstrated to be sufficiently promising to justify a public issue. Mr. Shierlaw says that Mr. Robertson was not present and that he cannot recall introducing Mr. Robertson to Mr. Thomas. There is, I think, no essential inconsistency between the two accounts. I accept that two distinct conversations occurred when Mr. Thomas visited Mr. Shierlaw's office and that they took place on the initiative of Mr. Thomas.

In January 1969 a meeting was held at North Adelaide. It was convened by Mr. Thomas of Billy Springs Pty. Ltd. It was

attended by representatives of all companies and syndicates exploring in the area. The taxpayer was represented by Mr. Shierlaw. The meeting considered the proposal that a central company should be formed to acquire tenements already held, to explore them and to raise capital on the footing that it would be more economic to carry out a common exploration programme in the area. With this end in view, an independent firm of consulting geologists, Burrill and Associates, were appointed to inspect and evaluate the tenements held by parties who wished to join in. The consulting geologists were provided by each party with available reports and material relating to its area.

In late February or March 1969 Mr. Jones of Burrill and Associates inspected the area accompanied by a representative of each company or syndicate. Mr. Jones made a verbal report several days after his inspection and delivered a written report two weeks later. He reported that the areas inspected were well worthy of a major exploration programme.

The verbal report was received at a further meeting of the representatives of the companies and syndicates held in March 1969. The meeting was again convened by Mr. Thomas. Mr. Shierlaw represented the taxpayer at the meeting. It was decided that a company would be incorporated under the name of North Flinders Mines N.L., that it would raise $2,500,000 by means of an issue of shares to the public, that it would acquire the tenements of members of the group, that the value to be placed on the consideration for the acquisition of the tenements would be $500,000, one-fifth of the capital to be raised and that it should be provided as to $100,000 in cash and as to

the balance in fully paid shares in the company to be formed. The value of $500,000 placed on the assets to be acquired was not supported by a valuation; it seems to have been fixed arbitrarily on the basis that one-fifth of the amount raised by the company would be a reasonable value.

Mr. Jones was asked to express his opinion as to the comparative worth of the individual tenements. He did so by allotting to each company or syndicate units according to his estimate of the worth of its tenement, twenty units in all being allotted. The members of the group accepted Mr. Jones' estimate. Billy Springs Pty. Ltd. and the Castle Mines Syndicate were each allotted six units; the taxpayer was allotted three units. The taxpayer accordingly became entitled to have a value of $75,000 placed on its lease of which $15,000 would be paid in cash.

These arrangements were recorded in an agreement dated 20th March 1969 between the taxpayer, Billy Springs Pty. Ltd., the members of the Castle Mines Syndicate, Max Lademan, Poseidon N.L. and N. C. Shierlaw and Associates, by which Mr. Shierlaw's firm agreed to underwrite an issue of shares to the public by the company to be formed. The agreement also recorded the terms on which the tenements were to be acquired by the company. In the case of the taxpayer the consideration was expressed to be $75,000, of which $15,000 was payable in cash, the balance to be satisfied by the issue of fully paid 50c shares at par.

On 15th April 1969 North Flinders Mines N.L. was incorporated. Mr. Shierlaw was appointed Chairman of Directors and Mr. Grasso was also appointed a director. Steps were then

taken to implement the provisions of the agreement made on 20th March 1969.

In the meantime the assay results of the drilling carried out by Mr. Harbutt on S.M.L. 206 had been obtained. Mr. Grasso sent to the taxpayer's shareholders Progress Report No. 2 dated 21st April 1969. It stated that some encouraging copper values had been obtained, but that intersections so far had not yielded mineralization of economic grade. He went on to state:

> "The drilling, however, has proved that the area is mineralized and recommendations have been made for continued exploration. An aggressive exploratory programme involving considerable expenditure will be necessary to do justice to the area; but as this would be beyond the financial resources of Admin Exploration Pty. Ltd., it was decided to negotiate the Tenement with a larger company.
>
> A proposition very favourable to Admin Exploration Pty. Ltd. is presently being negotiated with North Flinders Mines N.L. (a company recently incorporated) and it is hoped that part of the consideration to Admin Exploration Pty. Ltd. will be made in cash."

The proposal for satisfaction of part of the consideration for acquisition of the tenements by an issue of fully paid shares encountered difficulties. It was the policy of the Mines Department to refuse consent to the transfer of special mining leases in circumstances where the consideration proposed to be paid exceeded the amount of expenditure on the tenement. The Department regarded fully paid shares in North Flinders Mines N.L. as having a value equal to par. Accordingly, the value of the proposed consideration exceeded the amount which had been expended on S.M.L. 206.

This obstacle was overcome by substituting the

grant of options to subscribe for shares as the consideration to be provided in lieu of fully paid shares. It was decided to issue 2,000,000 options to the vendors in lieu of 800,000 shares, the taxpayer again receiving three-twentieths of the total, that is, 300,000 options in lieu of 120,000 shares. This solution to the problem was adopted after consideration had been given to the inclusion in the transfer from the taxpayer to North Flinders Mines N.L. of two mineral claims to which part of the excess consideration could be attributed, a proposal that was not carried out. The two mineral claims had been pegged by the taxpayer over the Lady Lehmann and Ivy Queen mines, that is, within the boundaries of the special mining lease.

By an agreement dated 15th May 1969 between North Flinders Mines N.L. and the intending vendors to that company they agreed to sell and the company agreed to purchase their mining tenements, including S.M.L. 206 for which the consideration was expressed to be $15,000 cash and 300,000 options to take up fully paid 50c shares in North Flinders Mines N.L. at par. The agreement was made conditional upon the consent of the Minister for Mines to the transfer of all the mining tenements dealt with by the agreement or to notification of the approval of new special mining leases for two years covering the areas of the existing tenements. Clause 7 provided that the options were exercisable by the vendors within five years from the date of the agreement and in multiples of 10,000.

The taxpayer surrendered S.M.L. 206 on 2nd May 1969 and on 16th May 1969 it was given notice of acceptance by the Minister for Mines of the surrender. North Flinders Mines N.L.

secured new special mining leases in lieu of the existing tenements and the agreement was completed.

However, a difficulty was seen to exist by Billy Springs Pty. Ltd. which was minded to sell or transfer its options and to do so in parcels smaller than 10,000. It had earlier refused to execute the agreement of 15th May 1969 on the ground that the provisions of the option clause relating to exercise and transferability did not give effect to what the parties had agreed upon, but did so on Mr. Shierlaw giving an undertaking on behalf of North Flinders Mines N.L. that it would be rectified subsequently.

Likewise, the directors of the taxpayer intended to have one-half approximately of the options in North Flinders Mines N.L. to which it was entitled given to its shareholders. By a notice dated 12th June 1969 from the taxpayer they were informed that one-half of the options to which it was entitled would be issued to them. However, the provisions of cl. 7 provided an obstacle to these proposals and the agreement was varied so as to permit the options granted to be exercised by persons other than the original vendors. An amending agreement dated 15th October 1969 varied the principal agreement by providing that the options should be transferable before their exercise and that they were exercisable by the holder for the time being. Provision was made for the issue of certificates for 100 options or multiples of 100 options.

On 27th May 1969 North Flinders Mines N.L. paid to the taxpayer the sum of $15,000 under the agreement to purchase S.M.L. 206. On 12th June 1969 the taxpayer paid the sum of $22,000 to Australian Gold and Uranium N.L., $15,000

representing the subscription for 30,000 fully paid 50c shares in that company and the balance representing a loan of $7,000 to it. Australian Gold and Uranium Pty. Ltd. had been incorporated at the same time as the taxpayer by Messrs. Shierlaw, Grasso and Robertson and the two companies had common shareholders.

The balance sheet of the taxpayer as at 30th June 1969 included as fixed assets:

Exploration and Development Account	$15,751.97
300,000 options in North Flinders Mines N.L.	.....

The amount of $15,751.97 was the expenditure incurred on S.M.L. 206. It is accepted that at 30th June 1969 the lease had ceased to be an asset owned by the company. Mr. Shierlaw says that the expenditure incurred should not have been included as an asset of the taxpayer and that the amount should have been attributed to the options.

On 15th February 1971 the mineral claim pegged by the taxpayer over the Ivy Queen mine was transferred by the taxpayer to North Flinders Mines N.L. There was no agreement for the transfer and the evidence does not indicate why it took place. The mineral claim was subsequent in time to the taxpayer's special mining lease which by virtue of the Mining Act was paramount to the mineral claim. But North Flinders Mines N.L. elected to require a surrender of the lease and the grant of a new lease which, being subsequent in time, was subject to the mineral claim. It was, I assume, to avoid this difficulty that the taxpayer transferred the claim.

Mr. Shierlaw and Mr. Grasso became directors of North Flinders Mines N.L., Mr. Shierlaw being appointed Chairman

of Directors. Mr. Shierlaw was also a director of Poseidon N.L. which was a vendor to North Flinders Mines N.L. In June 1969 the North Flinders company filed a prospectus and made its offer of shares to the public.

On 1st October 1969 Poseidon N.L. announced that it had discovered copper nickel sulphides in Western Australia. Two days later North Flinders Mines N.L. subscribed for, and was allotted, 100,000 fully paid 50c shares in Poseidon N.L. The shares in Poseidon N.L. rose dramatically in value in consequence of the announcement of the discovery. So also did the shares in North Flinders Mines N.L. which had been listed on the Stock Exchange meanwhile.

The rise in the market price of North Flinders Mines N.L. shares was due to its holding of Poseidon N.L. shares. The North Flinders company's shares were well above $7 in the latter half of December 1969 and at their peak reached $17 or $18 in Australia and $20 in London.

In January 1970 the taxpayer made a sale of 55,000 options to take up shares in North Flinders Mines N.L. for $313,267. This was the only sale of its options which has been made. It occurred as the result of an approach by a London broking associate of N. C. Shierlaw and Associates who had sold on behalf of a client 55,000 fully paid shares in North Flinders Mines N.L. when he held certificates for 55,000 contributing shares only. There was a significant disparity between the price of the fully paid shares and the contributing shares. The purchase and exercise of options was the best answer to the difficulties of the London broker and his client. There was no market in options at the time.

The price of $5.50 per option was negotiated, the market price of the fully paid shares then being $7.50 and the contributing shares paid to 20c being $4.50. It is not disputed that the sale yielded a profit to the taxpayer of $298,267.

On 27th February 1970 Mr. Grasso circulated to shareholders of the taxpayer a document entitled "Summary of Activities" which recorded the events which had occurred, and mentioned that 1,000 shares in Samin N.L. had been allotted to the taxpayer at par. It contained the statement:

> ". . . both the Lady Lehmann and Ivy Queen prospects were found to contain sub-economic copper sulphide mineralization. At this stage funds were being depleted and although other prospects were known in the Special Mining Lease area, it was decided to negotiate with North Flinders Mines N.L."

It went on to say:

> "Consideration is presently being given to a suitable tax-free method (if possible) of distributing some or all of the company's assets to the respective shareholders."

However, as a result of advice which it received, the company went into voluntary liquidation pursuant to a special resolution of its members passed on 14th May 1970. Mr. J. I. N. Winter, Chartered Accountant, was appointed liquidator and a distribution of $300,000 was made to its shareholders on 6th May 1970.

The respondent based his case on both the first and second parts of s. 26(a). In this case it is accepted that the first part of s. 26(a) is not satisfied if the taxpayer shows that the acquisition of the property was not actuated by the sole or dominant purpose of profit-making by sale (see Evans v. The Deputy Federal Commissioner of Taxation for South Australia

(1936), 55 C.L.R. 80 at p. 99, per Rich, Dixon and Evatt JJ.). That profit-making by sale was not the sole or dominant purpose for acquisition in a given case may be demonstrated by showing that the dominant purpose actuating the acquisition was another and inconsistent purpose, as for example, retention as an investment. So also the taxpayer may show that, although profit-making by sale was a purpose, or a consideration, which actuated the acquisition, it was not the dominant purpose, either because another and inconsistent purpose actuated the acquisition in an equal degree or because before and at the time of acquisition the taxpayer held no firm view as to what he would do with the property and the prospect of its sale at a profit was recognized as no more than a possibility to be later considered in common with other possibilities which at or before the time of acquisition appeared no less remote.

But any discussion of the application of the provision must take account of the burden of proof thrown upon the taxpayer by s. 190(b). It is for him to show that the assessment is excessive by satisfying the Court that his purpose in acquiring the property was not to make a profit by selling it. As Windeyer J. pointed out in Buckland v. The Commissioner of Taxation (1960), 34 A.L.J.R. 60 at p. 62, the taxpayer may fail to displace the first part of s. 26(a) if the evidence, although disclosing that the taxpayer before acquisition was undecided as to the use to which he would put the property, enables the Court to draw the inference that it was nevertheless bought for the dominant purpose of making a profit by sale.

In applying the first part of s. 26(a) the Court is usually concerned with the sale of property, initially bought

for a pecuniary consideration. In these cases, in general, the purpose for which the property is bought is associated with the use to which the property is intended to be put. But it does not follow that a purpose of acquisition, dissociated from the use to which the property might be put, is irrelevant to the inquiry which the Court is required to make by the first part of s. 26(a). A profit made on sale may escape that provision because the dominant purpose of the taxpayer in acquiring the property was dissociated from the use to which it was intended to be put (see Federal Commissioner of Taxation v. McClelland (1969), 118 C.L.R. 353 at p. 376, per Kitto J.).

Here the transaction was one by which the taxpayer disposed of its principal asset and, by way of consideration for that disposition, acquired the options. The purpose of the taxpayer in acquiring the options is therefore necessarily related to its purpose in entering into the agreement.

The question is whether the evidence of Messrs. Robertson and Shierlaw, the two witnesses called for the taxpayer, satisfies me on the probabilities that the options were not acquired for the purpose of a sale at a profit. They said that the taxpayer's purpose in acquiring S.M.L. 206 was to search for and develop mineral deposits which could be exploited. By inference, if not by explicit statement, they indicated that only after exploration had taken place would a decision be taken as to future action in connection with the lease. There is no evidence that either witness or Mr. Grasso had a past history of developing mining leases for profitable sale. The other company which they had incorporated, Australian Gold and Uranium N.L., acquired S.M.L. 207 and sold it to Sundowner Minerals but

when and in what circumstances the evidence does not reveal.

Neither the short term of S.M.L. 206, nor the limited amount which they were required to spend, and did spend, on that lease, establishes that the taxpayer took up the lease to sell it at a profit. It was prudent to take a short term lease and avoid an obligation to expend a large amount. No doubt the lease could be renewed, if the results of exploration warranted that course. Moreover, as Mr. Robertson said, further capital could be raised if exploration continued into the second year.

Mr. Robertson and Mr. Shierlaw said that the initiative in bringing together the other mining and exploration companies and syndicates in the area and in proposing the transfer of existing tenements to a new company was taken by Billy Springs Pty. Ltd., not by the taxpayer. Mr. Robertson and Mr. Shierlaw were impressive witnesses. Their evidence was not shown to be incorrect in any particular. There is no evidence to the contrary of what they said on this aspect of the case, apart from a reference in a report prepared by Mr. Jones to the group having been convened by Mr. Shierlaw. Mr. Shierlaw became Chairman of the North Flinders company on its incorporation and no doubt played a significant part in the discussions which led up to that event, but I see no reason why I should not accept the evidence that the initiative was taken in the early stages of discussions by Billy Springs Pty. Ltd.

The respondent pointed to the circumstance that the taxpayer did not carry out any part of the exploration programme advised by Mr. Shackleton. Once discussions commenced with Mr. Thomas of Billy Springs Pty. Ltd. in December

1968 with respect to the possibility of reducing costs by the adoption of a common programme, it would have been impractical for the taxpayer to have continued the exploration of its area in isolation.

In these circumstances I accept the evidence of Messrs. Robertson and Shierlaw concerning the purpose of the acquisition of S.M.L. 206. The purpose was that of exploration and development of mineral deposits with a view to deciding what course should be followed after a suitable programme had been undertaken. The intended exploration came to an end when the discussions commenced at the end of 1968. It is in this setting that the transaction between the taxpayer and North Flinders Mines N.L. is to be approached.

With respect to that transaction the evidence given by the two witnesses for the taxpayer must be scrutinized with care. Mr. Robertson said that the initial proposal to transfer S.M.L. 206 to North Flinders Mines N.L. for cash and shares was favourable to the taxpayer because all shareholders had "the common objective of developing the mineral potential" of the area and because "the company was able to retain an interest in the area". Mr. Shierlaw said that the transaction gave the taxpayer and others the opportunity of increasing "the size of their operation with mutual benefits as well as diversification" and that the options would enable the shareholders of the taxpayer "to share in any benefit that would happen to the group . . . bearing in mind the option had no value unless there was a general rise in the price of North Flinders shares".

The respondent advanced several reasons why this evidence should be rejected. First, there was the absence

of detailed minutes kept by the taxpayer recording the transactions. In other circumstances the absence of such minutes would excite suspicion of the account given by Messrs. Robertson and Shierlaw. But the events were recorded in some detail in the contemporaneous minutes of North Flinders Mines N.L.

Secondly, there is a statement contained in a letter of 19th November 1970 from Messrs. Peat, Marwick, Mitchell & Co., accountants for the liquidator, to the Deputy Commissioner of Taxation:

> "The vendor group comprising five separate vendors, sought in the first place to receive their entire consideration in cash."

It is in conflict with the oral evidence of Messrs. Robertson and Shierlaw. It seems also to be inconsistent with the history of the transaction as it is recorded in the minutes of North Flinders Mines N.L. where it appears that the first proposal was that the vendors should receive cash and shares. That view accords with the oral evidence and with the statement made by Mr. Grasso in Progress Report No. 2 dated 21st April 1969, six days after the incorporation of the North Flinders company, that the taxpayer hoped "that part of the consideration will be in cash". The letter of 19th November 1969, which was no doubt written on the instructions of the liquidator, made no reference to the proposed consideration of cash and shares. It seems therefore that the reference to an entire consideration in cash was an erroneous description of the proposal for cash and shares.

Thirdly, there was the manner in which the consideration for S.M.L. 206 was arrived at. There was no real attempt to value the worth of the lease transferred to North Flinders Mines N.L. Under the original proposal the considerati

was cash and fully paid shares. No doubt the value of the lease was difficult to ascertain, but on the evidence there seems no justification for the conclusion that it was worth $75,000, rather than $15,000 which was the sum expended on exploration, if indeed it was worth that. At no stage was it shown that S.M.L. 206 contained deposits of mineral which could be economically exploited.

Accepting this criticism of the manner in which the consideration was arrived at, I do not consider that it provides a substantial reason for rejecting the testimony of the two witnesses. Indeed, in my view the short history of events confirms the evidence which they gave concerning the reasons why the taxpayer entered into the transaction and regarded it as favourable.

The taxpayer had one asset, S.M.L. 206, which had not been shown to contain mineral deposits capable of commercial exploitation. It was said to be worthy of further exploration, but that would require further capital. For that it could look only to its shareholders. The formation of a larger company to acquire existing tenements in the area for a consideration of cash and shares offered the prospect of greater financial resources and the prospect of systematic exploration of a wider area, including S.M.L. 206, the taxpayer retaining its interest in that exploration by virtue of its proposed shareholding in the new company. Had the transaction taken the form initially proposed, the taxpayer receiving shares in lieu of options, I should have concluded that on the probabilities the taxpayer's principal reason for entering into the transaction was to place itself on a sounder footing by exchanging a lease which it was

not in a satisfactory position to explore, except at a higher cost than it could conveniently provide, for an interest by way of shareholding in a company which was better able financially to explore a wider area. The prospect of selling the shares thus acquired, or selling them at a profit, was in my opinion in the circumstances a subservient consideration.

Although the options which the taxpayer received gave it no more than a right to take up shares in the new company within five years, and the taxpayer did not, and was not obliged to, acquire shares in North Flinders Mines N.L., the alteration in the nature of the consideration was brought about, not by the taxpayer, but by the Mines Department by reason of its objection in the circumstances to the issue of fully paid shares. Accordingly, the taxpayer entered into the agreement of 15th May 1969 for the same reasons that it had proposed to participate in the transaction in its earlier form. In the light of the oral evidence and the circumstances established by other evidence I am satisfied that the options were not acquired by the taxpayer for the purpose of profit-making by sale.

There is no reference to "purpose" in the second part of s. 26(a), but it is firmly established that it has no application to what is the mere realization of a capital asset (McClelland v. Federal Commissioner of Taxation (1970), 120 C.L.R. 487). In my opinion the sale of the options was no more than the realization of a capital asset and the profit thereby made did not fall within the second part of s. 26(a).

It follows from what I have already said that in my opinion neither the proceeds of, nor the profit made on, the sale of the options formed part of the taxpayer's assessable

income under s. 25 or s. 26 of the Act. It is therefore unnecessary for me to consider the other grounds relied upon by the taxpayer.

In other circumstances I should have been disposed to consider the ground based upon s. 23(p), but there is the difficulty that in this case the special mining lease has not been tendered in evidence. There is the admission that the taxpayer acquired an interest "in the nature of a special mining lease", but the respondent's counsel in his closing address disputed that the interest conferred a "right to mine" within the meaning of s. 23(p), although that had not seemed to be a matter in issue on the correspondence passing between the taxpayer's accountants and the respondent. Moreover, in the course of the hearing a concession was made by the respondent's counsel which appeared to have put the point beyond contention. In the light of these circumstances I propose to rest my conclusion on the grounds already considered.

In the result the appeal is allowed with costs. I set aside the assessment and direct the respondent to re-assess the tax payable by the taxpayer without including in the assessable income any part of the proceeds of the sale by the taxpayer of 55,000 options to subscribe for shares in North Flinders Mines N.L. I order that the respondent pay the taxpayer's costs.