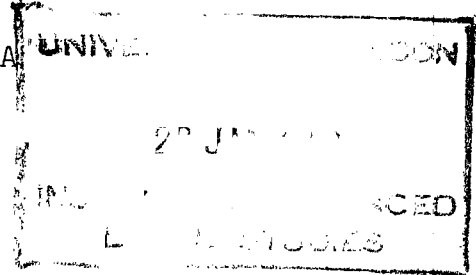


14, 1958

IN THE PRIVY COUNCIL

No. 7 of 1958

ON APPEAL
FROM THE HIGH COURT OF AUSTRALIA



B E T W E E N

LAURI JOSEPH NEWTON, LIONEL NEWTON
FRANCIE UNA CHRISTIAN, HENRY JAMES
LANE, EXECUTORS OF THE ESTATE OF
ROBERT NATHAN, deceased, STELLA
MAUD ADELIN LANE and LEONARD ALFRED
FENTON (Respondents) ... Appellants

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52118

- and -

THE COMMISSIONER OF TAXATION OF THE
COMMONWEALTH OF AUSTRALIA (Appellant)
Respondent
(Consolidated Appeals)

CASE for the APPELLANT

RECORD

1. This is an Appeal (pursuant to special leave granted by Her Majesty in Council on the 31st day of October, 1957) from a majority judgment of the Full High Court of Australia, dated the 31st May, 1957, allowing an Appeal by the Respondent Commissioner of Taxation from a judgment given on 15th August 1956, by Kitto J., sitting in the original jurisdiction of the High Court of Australia. By his judgment, Kitto J. allowed Appeals by the Appellant taxpayers against amended assessments of income tax for the years of income ended 30th June 1950 and 1951. The several matters before the High Court of Australia were consolidated by the order granting special leave to appeal.

III. p.130

p.127

p. 43

pp.1-187

2. By the amended assessments appealed from, the Appellant taxpayers were assessed in a total sum (in addition to amounts of tax already paid by them under the original assessments upon them in respect of the relevant financial years) in excess of £1,853,000, one-third of which was imposed by way of penalty.

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III. p.19
LL. 1-18.

3. It was conceded on behalf of the Respondent Commissioner that the transactions, the subject matter of the amended assessments, would not, apart from Section 260 of the Income Tax and Social Services Contribution Assessment Act, have involved the Appellants in any liability for taxation, but it was contended by him, and held by the majority of the Full Court (Dixon C.J., McTiernan, Williams and Fullagar J.J., Taylor J. dissenting) that Section 260 operated to enable the Commissioner to disregard certain transfers of shares, and to assess the Appellants, the transferors, as if - notwithstanding the transfers of the shares - they had continued to be the holders thereof, and to treat moneys (which were not in fact received by the Appellants) as dividends received by them.

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4. Section 260 is in the following terms:-

"Every contract, agreement, or arrangement made or entered into, orally or in writing, whether before or after the commencement of this Act, shall so far as it has or purports to have the purpose or effect of in any way, directly or indirectly -

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(a) altering the incidence of any income tax;

(b) relieving any person from liability to pay income tax or make any return;

(c) defeating, evading, or avoiding any duty or liability imposed on any person by this Act; or

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(d) preventing the operation of this Act in any respect,

be absolutely void, as against the Commissioner, or in regard to any proceeding under this Act, but without prejudice to such validity as it may have in any other respect or for any other purpose."

III. p.3

5. At all material times the Appellants held between them all the ordinary shares in three Companies, Lane's Motors Proprietary Limited, Neal's Motors Proprietary Limited and Melford Motors Proprietary Limited. In this Case these Companies will be referred to individually as Lane's Neal's

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and Melford respectively, and collectively as the motor companies.

6. At all materials times the motor companies carried on business in Melbourne as distributors and sellers of motor cars, and similar businesses were carried on there by subsidiaries, namely, British Service Proprietary Limited, which was a subsidiary of Lane's; Allcars Proprietary Limited and Overland (Victoria) Proprietary Limited, which were subsidiaries of Neal's; and Devon Motors Proprietary Limited, which was a subsidiary of Overland (Victoria) Proprietary Limited.

III. pp. 3, 4

7. The Appellants belong to two family groups, neither related to each other. In the year 1949 some of the shareholders, because of their individual financial commitments, found it necessary to raise the question of public flotation of one or more of the motor companies. In addition, because of a great expansion in the business of each of the motor companies, it appeared that the companies could no longer depend upon accumulated profits and loans for working capital and that the capital structure of each company should be substantially reformed. To this end in June, 1949, Mr. J. V. Ratcliffe, a consulting accountant of wide experience in financial and taxation problems, was consulted by some of the Appellants. The question of forming the motor companies into public companies was discussed. In September 1949 after Mr. Ratcliffe had examined the accounts of the Companies, he submitted a proposal which would enable the re-organization of the capital structure of the companies, together with calculations which showed the advantages of this proposal over other alternative courses available. These calculations showed in respect of each possible course the liability to tax which would fall upon the companies in respect of undistributed profits under Division 7 of Part III of the said Act. Under that Division a Private Company as therein defined may, broadly speaking, re-organize its shareholding (before the end of the year of income) so as to cease to be a Private Company, or pay a dividend within a limited period after the end of the year of income, or pay undistributed profits tax in respect of the profits not so distributed. Mere capitalization of undistributed profits by the issue of shares to the existing shareholders was impracticable as it would have involved the shareholders, by reason of the operation

pp. 4, 5

pp. 23 - 29

RECORD

III. p.4. of the provisions of the Act as to provisional tax,
 p.24, L.34. in finding 30/- for every £1 share received. Mr.
 Ratcliffe proposed division of the ordinary shares
 in each company into Classes "A" and "B", attach-
 ment of special dividend rights to the "A" shares,
 sale by the Appellants of the shares of that class
 to a purchaser, and the taking up by the Appellants
 of a large number of new preference shares to be
 issued at par in the motor companies, and to be
 paid for out of the proceeds of the sales. The 10
 p.24, L.42. Purchaser put forward by Mr. Ratcliffe was a Private
 p.11, L.5. Company, Pactolus Pty. Ltd., part of whose business
 was to deal in shares, and in which none of the
 Appellants had any interest and with which none of
 the Appellants had any connection whatever and of
 whose affairs none of the Appellants had any know-
 ledge. The Appellants decided to fall in with
 p.31 this proposal. Lengthy negotiations between the
 Appellants and their legal advisers on the one hand,
 and Mr. Ratcliffe acting on behalf of Pactolus Pty.
 Ltd. and its legal adviser on the other, ensued, at 20
 the end of which the Appellants executed in favour
 of Pactolus Pty. Ltd. options to purchase the "A"
 shares as proposed.

8. The following summary in respect of shares in Lane's will sufficiently indicate the detailed steps taken in completion of the transactions:-

- pp. 9 - 13. (a) On the 14th December 1949, special resolutions
 were passed by the shareholders of this Company
 classifying the ordinary shares as "A" ordinary 30
 and "B" ordinary, and attaching special divi-
 dend rights to the "A" ordinary shares. By
 virtue of these special dividend rights no
 dividends could be paid on the "B" ordinary
 shares until not less than £5.15.10 per share
 (of which 2/2d. per share should be tax - paid
 under the said Division 7) had been paid on
 the "A" ordinary shares. When this amount
 had been paid, the "A" ordinary shares carried 40
 only a fixed five per cent. cumulative prefer-
 ential dividend with limited voting rights.
- (b) On the same day, by a further resolution,
 445,000 £1 shares of the unissued capital were
 converted into "B" preference shares.
- (c) On the 15th December 1949 each of the Appel-
 lants gave to Pactolus Pty. Ltd. an option to
 purchase his holding of "A" ordinary shares
 for the sum of £5.16.0d per share.

(d) On the 16th December 1949, the directors of Lane's resolved that 402,679 £1 "B" preference shares should be offered at par to the persons entitled to the dividends from the "A" ordinary shares on or after 19th December 1949.

10 (e) On the 19th December 1949, Pactolus Pty. Ltd. exercised the options and paid to the Appellants sums totalling £458,820.12.0, being the full purchase price of the "A" ordinary shares. Transfers of these shares were thereupon registered.

(f) On the same day Pactolus Pty. Ltd. applied for the "B" preference shares and paid therefor the sum of £402,679.

(g) On the 20th December 1949, the directors of Lane's declared dividends on the "A" ordinary shares as follows :-

(i) £8,569.18.6 (or 2/2d. per share) out of profits tax - paid under Division 7;

20 (ii) £262,232 out of the profits of the year ended 30th June 1949;

(iii) £175,495.8.0 out of profits of the year ending 30th June 1950.

These dividends amounted to £5.12.10 per share, and on the same day the sum of £446,295.6.6 was paid to Pactolus Pty. Ltd. in respect of that dividend.

30 (h) On the same day, the directors of Lane's allotted to Pactolus Pty. Ltd. the "B" preference shares and after such allotment Pactolus Pty. Ltd. sold the "B" preference shares so allotted to the Appellants who paid it a total sum of £402,679 therefor.

(i) All the cheques making the payments above referred to were banked simultaneously at the same bank on 21st December 1949.

40 (j) On 22nd March, 1950, the directors of Lane's declared, out of the profits of the Company for the year ending on 30th June, 1950, a dividend of 3/- per share in respect of the "A" ordinary shares and paid to Pactolus Pty. Ltd.

RECORD

the sum of £11,866.1.0 in respect of that dividend. This further dividend exhausted the special dividend rights attached to the "A" ordinary shares.

III. pp.13-18

9. The other transactions, the subject matter of the Appeals, differed in some detailed respects from those summarized above, but neither Kitto J. nor any member of the Full High Court found any material difference between them

10. In aggregate, Pactolus Pty. Ltd. acquired 161,213 shares and received in dividends a total sum which exceeded by £102,414 the amount which it paid as purchase money for those shares. 10

11. In December 1949, however, Pactolus Pty. Ltd. had paid out in the purchase of the shares acquired by it in that month approximately £19,000 more than the dividends it received in that month in respect of those shares.

12. In March 1950, Pactolus Pty. Ltd. received a further £73,069 by way of dividends in respect of the shares purchased by it in December 1949. 20

13. The Balance of the sum of £102,414, the excess of the aggregate receipts over disbursements mentioned in Paragraph 10, resulted from transactions in November 1950 and June 1951. The said sum of £102,414, which included the said sum of £73,069 received in March 1950, in respect of shares transferred in December 1949 was included in the amended assessments made against the Appellants.

III. p.5,11
p.6

14. At the time of making the original proposal, Mr. Ratcliffe was the principal shareholder in Pactolus Pty. Ltd. but prior to the purchase in December 1949 Pactolus Investments Proprietary Limited became the principal shareholder in Pactolus Pty. Ltd. The shareholders in Pactolus Investments Proprietary Limited were various members of the Ratcliffe family, including Mr. Ratcliffe. 30

p.12, L.26
p.14, L.27
p.16, L.12
p.17, L.34
p.18, L.37

15. Pactolus Pty. Ltd. sold the whole of the shares it acquired, with one exception, (namely, the "C" ordinary shares in Melford's) to Pactolus Investments Pty. Ltd. At the time of sale, these shares carried a fixed five per cent. cumulative preference dividend, and were sold at £1 per share. 40

16. In their respective income tax returns for the years of income ended 30th June 1950 and 30th June 1951 the Appellants did not return as part of their assessable income any of the proceeds of the sales of their shares in the motor companies, nor any of the dividends paid by the motor companies to Pactolus Pty. Ltd. The amended assessments, the subject of this Appeal, increased the assessable incomes of the Appellants by the total amount of the special dividends received by Pactolus Pty. Ltd. from the motor companies. They were described in an alteration sheet which accompanied each notice of amended assessment as the Appellants' proportion of distributions made by the motor companies.
17. None of the preferential dividends paid in respect of the shares sold by the Appellants have at any time been included in an assessment of the income of any of the Appellants.
18. The amended assessments also assessed the Appellants to additional tax under Section 226(2) of the Act in a sum in excess of £600,000 on the footing that the Appellants had omitted from their returns the total amount of the special dividends received by Pactolus Pty. Ltd.
19. Objections were lodged by the Appellants against the amended assessments and disallowed by the Commissioner. Thereupon they were forwarded by the Respondent, at the Appellants' request, to the High Court of Australia to be heard in its original jurisdiction as "Appeals" under Section 187 of the Act.
20. The appeals were heard by Mr. Justice Kitto before whom witnesses, called on behalf of the Appellants, were examined and cross-examined. Mutual admissions of certain facts were made by the parties, but otherwise no evidence was tendered by the Respondent. On the 15th August, 1956, His Honour ordered that the amended assessments be set aside.
- The Respondent appealed to the Full High Court of Australia from the Order of Mr. Justice Kitto and by a majority the Appeal was allowed, and on the 31st day of May 1957 it was ordered that the amended assessments be restored.
- I. p.13.
- p.12.
- pp.15 - 18.
- II. pp. 69 - 454.
pp. 1 - 68.
- III. p.43.
- p.44.
- p.55.

21. The basis upon which the amended assessments were supported by the decision now appealed from was that in the case of each share transaction there was an arrangement having the purpose or effect of defeating, evading or avoiding the liability to which the Appellants would have been subjected if the dividends in fact received by Pactolus Pty. Ltd. had been received by the Appellants, and that this conclusion satisfied the requirements of Section 260 of the Taxing Act, so that the Commissioner was entitled not merely to treat the said transfers of shares as void, but to treat the Appellants as having received the said dividends and also to regard such dividends, not in fact received by the Appellants, as "omitted income" so as to warrant the imposition of the penalties in excess of £600,000 already mentioned. 10

22. This appeal accordingly raises the question whether Section 260 upon its true construction enables the Commissioner to treat as void a transfer of shares conceded to be genuine and operative to divest the transferor of the property in the shares to which it related, and to regard the transferor as having received dividends in fact paid to the transferee if it be established that the transferor and the transferee entered into the sale with the object (inter alia) of thereby precluding the liability for taxation which would or might have accrued to the transferor if he had retained the shares and if dividends had been declared and paid to him in respect thereof. 20 30

23. The Appellants submit that both on principal and on authority, Section 260 cannot be so construed, and, amongst other things, submit :-

(a) that so far as presently relevant Section 260 does no more than deprive of legal effect, to the extent to which it would avoid an actual liability to tax, a transaction within the terms of the section which is set up by a taxpayer in answer to an assessment which is otherwise justified on existing facts. Accordingly, it is of no avail to the Commissioner unless, apart from what may be disregarded because of the Section, and without further assumption, a state of facts exists upon which the assessment can be justified; 40

(b) that so far as presently relevant the Section

only applies where the purpose or effect of the contract agreement or arrangement is to defeat evade or avoid liability to tax which in truth the circumstances have already attracted. It cannot in any event apply where no more can be said than that a liability to tax would or might arise if some event occurred in the future;

10 (c) that in any event Section 260 does not apply where the liability which is said to be avoided is or would be a liability of a Company to pay tax under Division 7 of Part III of the Act;

(d) that the Section does not apply where the transaction sought to be impeached has other purposes or effects than the avoidance of taxation; but in any case, it can only apply to such a transaction or to such a severable part of a transaction as has no other purpose or effect than the avoidance of taxation;

20 (e) that Section 260 is not available to avoid an actual transfer of property. The changed ownership of property resulting from an actual transfer is a fact which cannot be ignored by the Commissioner;

(f) that in any case, Section 260 can only be applied to a contract agreement or arrangement, made orally or in writing, which is effective in law to alter or modify legal rights or relationships.

30 24. Section 260 and its predecessors have not been the subject of frequent judicial decision, and, so far as reported cases show, have only been applied in favour of the Commissioner on four occasions (including the instant case). A Section of this kind was first introduced into Commonwealth Income Tax legislation by the Act of 1915-1916, Section 53 of which was in the following form:-

40 "Every contract, agreement, or arrangement made or entered into, in writing or verbal, whether before or after the commencement of this Act, shall so far as it has or purports to have the purpose or effect of in any way, directly or indirectly -

(a) altering the incidence of any income tax; or

- (b) relieving any person from liability to pay any income tax or make any return; or
- (c) defeating, evading, or avoiding any duty or liability imposed on any person by this Act; or
- (d) preventing the operation of this Act in any respect;

be absolutely void but without prejudice to its validity in any other respect or for any other purpose." 10

This Section and its immediate successor, Section 93 of the Income Tax Assessment Act, 1922-1934, differed from the present Section in the following respects:-

- (i) In place of the words "orally or in writing" now appearing in the Section, Section 53 and Section 93 contained the words "in writing or verbal".
- (ii) The words "as against the Commissioner or in regard to any proceeding under this Act" did not appear in Section 53 or Section 93. 20
- (iii) In place of the words "but without prejudice to such validity as it may have in any other respect or for any other purpose", Section 53 and Section 93 contained the words "but without prejudice to its validity in any other respect or for any other purpose". 30

25. In Deputy Federal Commissioner of Taxation v. Purcell, 29 C.L.R. 464 at p.466, 467, Knox C.J. expressed the view that Section 53 of the Act of 1915-1916 did not apply in a case where the taxpayer actually disposed of income producing property, even though one of his objects in doing so was to lessen the burden of taxation. On appeal to the Full High Court, Gavan Duffy and Starke J.J. (at p.473) agreed with the Chief Justice, and said that if a person actually disposed of income producing property to another so as to reduce the burden of taxation, the Act contemplated that the new owner should pay the tax. 40

26. In Jagues v. Federal Commissioner of Taxation, 34 C.L.R. 323, the taxpayers had entered into an agreement for the reconstruction of a mining company which involved their acceptance of fully paid shares in the new company. They subsequently made a second agreement, replacing the first, by which instead of accepting fully paid shares, they agreed to apply for unpaid shares and to pay calls thereon, the purpose of the new agreement being to obtain the deduction allowed by the Act in respect of calls on mining shares. Rich J. (at p.331) confined his attention to the Appellant's personal contract whereby he became a shareholder liable to pay calls, and held (at p.339) that this contract fell within Section 53. His decision was affirmed on appeal. Knox C.J. (at p.355) considered that as the transactions were not intended to create real rights and obligations, but were entered into for the purpose of obtaining the deduction, Section 53 applied. Isaacs J. (at p.359) pointed out that the word "arrangement" was the third in a descending series, from which he inferred that the Section did not apply to a conveyance or transfer of property, legal or equitable, as such, and said that the Section did not contemplate an instrument actually changing the real ownership. Isaacs J. and Starke J., however, also held that the arrangement there made was avoided by Section 53.

27. In Clarke v. Federal Commissioner of Taxation, 48 C.L.R. 56, the taxpayer had agreed to grant a lease of a hotel for the sum of £20,000. In order to avoid liability to tax on the sum of £20,000 as a premium received in connection with a leasehold, he granted a lease to a company incorporated by him and under his sole control, and arranged for the Company to sell the lease for £20,000, £10,000 of which was paid to the taxpayer by the purchaser of the lease and was, by agreement between the taxpayer and the Company, treated as a loan from the Company. Rich, Dixon and Evatt J.J., held that Section 93 of the Act of 1922 applied to the case and that the sum of £10,000 was income of the taxpayer. In a joint judgment Their Honours said of Section 93:-

"In its application perhaps it can do no more than destroy a contract agreement or arrangement in the absence of which a duty or liability would subsist. Where circumstances are such that a choice is presented to a prospective

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taxpayer between two courses one of which will, and the other will not, expose him to liability of taxation, his deliberate choice of the second course cannot readily be made a ground of the application of the provision. In such a case it cannot be said that, but for the contract agreement or arrangement impeached, a liability under the Act would exist. To invalidate the transaction into which the prospective taxpayer in fact entered is not enough to impose upon him a liability which could only arise out of another transaction into which he might have entered but in fact did not enter."

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28. In Bell v. Federal Commissioner of Taxation, 87 C.L.R. 548, the taxpayer was one of the only seven shareholders, each holding one £1 share, in a company incorporated in the Territory of Papua. A sum of £78,500 was available for distribution by the company. An arrangement was made between all the shareholders, who had decided on a distribution of £77,000 of the available profits of the Company, by which each sold his share for £11,000 to a person selected by the company's solicitor. The purchaser paid for the share with money borrowed from the company's solicitor, who in turn borrowed money from the company. After transfer of the shares the company declared the dividend of £77,000 and the several cheques given for loans, purchase money, and dividends were simultaneously cleared, leaving the taxpayer with £11,000 which the Commissioner claimed was taxable as income. McTiernan J., who heard the appeal in the original jurisdiction of the High Court, held that the purported sale of shares was a pretence, and that the taxpayer was taxable as the real shareholder in the company. On appeal to the Full High Court, it was held that the transfers must be treated as effectual but that by virtue of Section 260 the Commissioner was entitled to treat the taxpayer as having received the sum of £11,000 as a dividend upon shares owned by him.

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29. At pp. 552, 553 of the report, McTiernan J. said that Section 260 applied "only to a contract agreement or arrangement", and quoted Isaacs J. in Jaques' Case to the effect that this "collocation" of words does not include a "conveyance or transfer of property, legal or equitable, as such". He said that "Section 260 could not be applied to a transfer

of shares without careful consideration" of the earlier authorities, "and, perhaps, without overruling the dictum made by Isaacs J., in Jacques' Case".

10 30. In the Full Court (Dixon C.J., Williams, Webb, Fullagar and Kitto J.J.) it was held that Section 260 could be applied so as to invalidate a transfer of shares or other property as being part of a wider course of action constituting an arrangement. For this proposition Jacques' Case and Clarke's Case were cited as authority. It was also held -

- 20 (i) that the words "duty or liability imposed on any person by this Act" in Section 260, refer, not to a liability to pay a particular amount of tax, but "to a liability such as Section 17 of the Act imposed on Bell, to pay tax in respect of his taxable income ascertained by including in his assessable income his proportion of the Papuan Company's profits if and when he should participate in a distribution of them" (p.57⁴);
- 30 (ii) that when the share transfers were treated as void, it could be said that £11,000 of the Company's profits passed "indirectly but by steps which are clearly traceable on the face of the bank's ledgers, into Bell's bank account" and that Bell being ex hypothesi a shareholder at that time, the effect of Section 260 was "to eliminate those features of the case upon which the exclusion of the £11,000 from assessable income depends and by that means to establish the correctness of the assessment appealed against."

31. The Appellants submit that Bell's Case was wrongly decided and, in addition to the reasons given in Paragraph 23 hereof, they submit :-

- 40 (i) that the Full High Court erroneously treated Jacques' Case and Clarke's Case as authority for the view that in certain circumstances Section 260 can be applied to set aside an actual transfer of property. It is submitted that on its true construction Section 260 cannot operate to invalidate a transfer of property, and that

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Purcell's Case and the judgment of Isaacs J. in Jaques' Case support this construction of the Section. In Clarke's Case there was no transfer of property other than the grant and assignment of the lease, and if these had been invalidated the money received by the taxpayer could not have been treated as a premium received in connection with a leasehold estate;

- (ii) that the Full High Court erroneously decided that the "liability" referred to in Section 260 could refer to a liability to pay tax if and when the taxpayer should participate in a future distribution of profits. It is submitted that a taxpayer cannot be held to avoid taxation by so arranging his affairs that the event which would give rise to a liability to taxation never occurs; 10
- (iii) that the Full High Court erroneously decided that the expression "liability imposed on any person by this Act" in Section 260 (c), was a reference to the general liability imposed upon all taxpayers to pay tax upon taxable income; 20
- (iv) that the Full High Court erroneously held that the effect of the application of Section 260 was to convert a payment made to the taxpayer as and for purchase money on a sale of shares into a distribution of profits. It is submitted that the step so taken by the Full High Court was not warranted by Section 260 and was contrary to the principles laid down in previous cases and reaffirmed in Bell's Case itself; 30
- (v) that the result of Bell's Case could only be obtained by deciding that the purported transfers were no more than a pretence and therefore ineffective to alter the ownership of the shares or the beneficial interest in the dividends. 40
32. The Appellants further submit that even if Bell's Case were correctly decided, the decision in that case was wrongly treated as applicable to the instant case, for reasons to be indicated in Paragraph 44 of this Case.

33. In the present case, Mr. Justice Kitto made the following findings of fact:-

- (a) that every step taken was genuinely intended to have full effect; there was nothing in the nature of a sham or pretence; III. p.19, L.7.
- (b) that the Appellants really and effectually divested themselves of all legal and beneficial interest in the ordinary shares sold by them; p.19, L.10.
- 10 (c) that none of the Appellants participated directly in any of the distributions of dividends and that every penny thereof went directly to Pactolus Pty. Ltd.; p.22, L.45.
- (d) that it was not a term of the bargain between the parties that the special dividends, when paid to Pactolus Pty. Ltd., should be applied by it in paying the purchase price of the "A" ordinary shares; p.33, LL.26, 44. p.39, L.19. p.41, L.8.
- 20 (e) that the simultaneous banking of cheques was simply adopted as the obvious businesslike method of dealing with cross payments. p.33, L.46.
34. The decision of His Honour that the amended assessments should be set aside was based on the following opinions expressed by him:-
- (a) that apart from Section 260 the original shareholders could not be said to have derived from the dividends which were declared and paid in the course of the transactions anything that could be treated as assessable income in the assessment of their respective taxes; 30 p.19, L.2
- (b) that Bell's Case established that, although the word "arrangement" does not include a conveyance or transfer of property as such, it does include any kind of concerted action by which persons may arrange their affairs for the stated purpose, or so as to produce the stated effect; and that a conveyance or transfer of property may be void as against the Commissioner as forming part of a course of action which constitutes an arrangement in this sense; 40 p.20, L.24

RECORDS

- III. p.20, L.34 (c) that an arrangement having the purpose or effect of avoiding the general liability to pay tax imposed by Section 17 is within the operation of Section 260, sub-paragraph (c);
- p.20, L.44 (d) that the Section is an annihilating provision only, so that it avails the Commissioner where, and only where, the result of its rendering an arrangement void to the extent which it mentions is to leave standing a state of affairs in which a challenged assessment is justified; 10
- p.36, L.44 (e) that for the Commissioner's contention to succeed it was necessary for him to rely on Section 260 not only to annihilate the legal effect of the sales and transfers of the "A" ordinary shares but to add to the facts of the case a fictional agreement by the original shareholders to the effect that in the event of the transaction being regarded for any purpose as void so far as it invested in Pactolus Pty. Ltd. a right to receive a special dividend, then their own right to receive that dividend should be satisfied by a payment of the amount to Pactolus Pty. Ltd., and that Section 260 could not perform this feat; 20
- p.38, 39 (f) that Bell's Case was distinguishable by reason of the findings of fact in that case, which made it possible to say that the money received by the taxpayer was in truth a distribution of the company's profits to the taxpayer, and that the transactions could be disregarded as having been entered into for no other purpose than to impress upon the dividend the character of capital in the process of passing it from the company to the taxpayer; 30
- p.42, L.31 (g) that while it was true that the Appellants had chosen the course they adopted in preference to other possible courses because Mr. Ratcliffe satisfied them that it was the most advantageous course for themselves and their companies, having regard to the way in which the income tax law would operate, the choice they made and what they actually did was to take the price they were offered for a parcel of shares 40

carrying special rights with respect to distributable profits and not to take the distributable profits, and that it would require more than a merely voiding provision to reverse the choice.

- 10 35. Upon the Appeal to the Full Court of the High Court of Australia, the Chief Justice did not deliver separate reasons but stated that he agreed in all substantial respects with the view expressed by Williams J. and Fullagar J. The other members of the Court delivered separate reasons for judgment, a summary of which follows. III. p.55
36. Mr. Justice McTiernan considered that:-
- (a) the meaning of the word "arrangement" in Section 260 includes settlement of details made in anticipation of some event, also the action taken as fulfilment of a plan; p.56, L.27
- 20 (b) that the word "purpose" in Section 260 means the object aimed at and accomplished, and "effect" means the end attained irrespective of the motive; p.56, L.40
- (c) that a transfer of shares before payment of a dividend is not within Section 260 because neither the dividend nor any part of it is derived by the transferor, but that in the present matters there were schemes involving more than mere sales and transfers of the shares in question; p.58, L.17
- 30 (d) that the Commissioner was entitled to rely upon Section 260 if the proportion of the dividend included in the taxable income of each Respondent was "really and truly his income"; p.58, L.27
- 40 (e) that the forms of sale and transfer of the shares clearly had the effect of relieving each Respondent from liability to which he would have been exposed had he continued to be the shareholder when the companies paid the dividends in question. The schemes were undoubtedly designed to secure that purpose, and their execution attained that end if the sales and transfers could stand against the Commissioner; p.58, L.33

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- III, P.58, L.45 (f) the series of steps taken to carry out each scheme constituted an arrangement;
- p.58, L.48 (g) that it was not necessary to find in any of the schemes a binding stipulation that Pactolus Pty. Ltd. would use the dividends as the fund out of which to pay for the shares transferred to it;
- p.59, L.19 (h) that the circumstances were analogous to those of Bell's Case and called for a similar application of Section 260; 10
- p.59, L.26 (i) that when the transfers of shares were set aside the Respondents could not claim that what they received from Pactolus Pty. Ltd. was the price of their shares, and as such capital;
- p.59, L.30 (j) that this mode of applying the Section left standing the fact that the companies had made these distributions out of their profits;
- p.59, L.46 (k) that Section 260 having operated, the Respondents were liable upon the basis that they received the full amount of the dividends, although in fact they had not received them. 20

37. With respect to His Honour's reasons, the Appellants submit:-

- (i) that insofar as they proceed upon the footing that a transfer of shares may be avoided under Section 260, His Honour evidently acted in obedience to the decision of the Full High Court in Bell's Case, and did not give effect to the doubts expressed by himself in that case; 30
- (ii) that the word "arrangement", as interpreted by His Honour, is used in a double sense, as meaning a contractual arrangement, and also as meaning the action taken to carry out such an arrangement. It is submitted that the word "arrangement" must be interpreted in the light of its collocation with contract and agreement, and that, so interpreted, it cannot include a step taken by one party or another, in performance of the agreement, still less can it include steps taken pursuant to a "commercial understanding" which, not being of a 40

legal character, cannot itself be avoided by Section 260;

- 10 (iii) that the reasoning embodied in sub-paragraphs (d) to (k) of Paragraph 36 above involves a circular argument which may be expressed as stating that Section 260 applied if the dividends attributed by the Respondent Commissioner to each Appellant were "really and truly his income", that if Section 260 applied the dividends could not be regarded as income of Pactolus Pty. Ltd., that if they were not income of Pactolus Pty. Ltd. they must have been income of the Appellants and that accordingly Section 260 applied;
- 20 (iv) that there is an inconsistency between sub-paragraphs (i) and (k) of Paragraph 36, in that sub-paragraph (i) is based on the view that the price of the shares constituted the income, but sub-paragraph (k) is based on the view that the dividends received by Pactolus Pty. Ltd. constituted the income;
- (v) that insofar as the decision was based on Bell's Case it was erroneous, both because Bell's Case itself was wrongly decided, and because the circumstances of the instant case were not analogous to those of Bell's Case;
- 30 (vi) that the reasoning summarised in sub-paragraph (j) was erroneous inasmuch as His Honour's decision did not "leave standing" the distributions made by the Companies, but substituted a distribution to the Appellants for the distributions actually made to Pactolus Pty. Ltd.

38. The Honourable Mr. Justice Williams considered :-

- 40 (a) that a study of the alternative courses open to the Appellants to re-organize the capital structure of their companies was quite irrelevant to the solution of the real issue, and even if it could be relevant did not appear to

III. p.62,
L.33.

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him to lend any aid to that solution, and accordingly it was only necessary to examine the plan that was finally adopted;

- p.67, L.31. (b) that the special dividends declared in favour of Pactolus Pty. Ltd. were assessable income of Pactolus Pty. Ltd.
- p.68, L.24. (c) that the words "purpose" and "effect", although in the alternative, do not appear to have any real difference in meaning, since the purpose of a contract agreement or arrangement must be what it is intended to effect, and that intention must be ascertained from its terms. When the terms have been ascertained, their purpose must be what they effect; 10
- p.69, L.37. (d) that the transactions entered into were arrangements, the purpose of which was directly or indirectly to defeat evade or avoid a liability imposed on the shareholders by the Act;
- p.71 LL.3-29. (e) that the case for the Commissioner could be put equally well by impeaching the whole of the steps taken, commencing with the passing of the special resolutions, and that the result of adopting this course would be the same as upon the view put by the Commissioner, that the steps antecedent to the transfers of shares were not avoided by Section 260; 20
- p.72, L.12. (f) that the arrangement itself was not a precise legal character, but that it consisted of quite clear commercial understandings between the parties as to the concerted action necessary to carry it out; 30
- p.72, L.30. (g) that Bell's Case was primarily a decision on its own particular facts, but that so far as it bore on the present case it appeared strongly to support the Commissioner;
- p.73, LL.4-25. (h) that the statement in Bell's Case that the arrangement in that case represented nothing but a method of impressing upon the monies the character of a capital receipt did not indicate that Section 260 only applied in a case where the doing of what is prescribed by Section 260 was the sole purpose and effect of the arrangement. It is sufficient if the arrangement has in part that purpose or effect, although the 40

arrangement may have other purposes or effects as well;

(i) that he (Mr. Justice Williams) would have been prepared, if necessary, to hold that the sole purpose and effect of the arrangement was to defeat evade or avoid the liability imposed upon the shareholders by the Act; p.73, L.25.

10 (j) that when Section 260 had done its work it was the monies represented by the special dividends that the shareholders must be considered to have received, and that the shareholders must be held to have consented to Pactolus Pty. Ltd. acquiring the cash and shares as part of its remuneration for carrying out the arrangement, and accordingly that any portion of the dividends which Pactolus Pty. Ltd. received must be considered to have been paid to it with the consent of the Appellants. p.74, L.15

20 39. With regard to the matters set out in the foregoing paragraph, the Appellants submit:-

(i) As to sub-paragraph (a), that a study of the alternative courses open to the Appellants was directly relevant to the question whether the purpose or effect of the challenged transactions was to defeat evade or avoid a liability imposed upon the Appellants.

30 The Appellants submit that if there were available to them at least two other courses whereby they might achieve substantially the same result as was here achieved without rendering the companies liable to tax under Divison 7, and without rendering themselves liable to tax upon dividends declared, it could not be said that the acceptance of a third proposal had the purpose or effect of avoiding liability to taxation. It was not contested by the Commissioner that 40 there were open to the Appellants two alternative courses which are dealt with by Kitto. J. in his reasons for judgment and may be summarized as follows :-

(a) The Appellants might have formed a p.25, L.27.

holding company and sold their shares to the holding company prior to 31st December in the relevant year, and might then have declared a dividend in favour of the holding company, subsequently converting the holding company into a public company prior to 30th June of the following year.

- (b) Alternatively the Appellants might have formed a holding company with a capital structure of such a kind that it would not have been a private company within Division 7 of Part III of the Act, and might then have declared a dividend in favour of the holding company. 10

If either of these courses had been adopted, neither Division 7 tax nor ordinary income tax on the dividends would have been payable. 20

p.34, L.15.

In the case of Lane's the former course was in fact subsequently adopted, and the profits of the year ended 30th June, 1950, included in the special dividends, if they had not been distributed as special dividends to Pactolus Pty. Ltd. would have been distributed by way of dividend to the holding company, Lane's Motors (Holdings) Limited, which became a public company prior to 30th June, 1951 and accordingly was not assessable to tax under Division 7. 30

Accordingly, the facts proved in evidence show that in any case no Division 7 tax would have been paid on so much of the dividends received by Pactolus Pty. Ltd. from Lane's as represented profits for the year ended 30th June, 1950 (see Paragraph 8(g) above). 40

The Appellants submit that these circumstances demonstrate that neither the companies nor the shareholders were under any relevant liability to taxation at any material time, and that in no case can it be said that

the purpose or effect of the challenged transactions was to defeat evade or avoid any liability to Division 7 tax or ordinary income tax.

10 (ii) As to sub-paragraph (b) of Paragraph 38, if the special dividends declared in favour of Pactolus Pty. Ltd. were assessable income of that company, it cannot be said that any liability imposed by the Act was defeated. As is indicated by Gavan Duffy and Starke J.J., in Purcell's Case (29 C.L.R. at p.473) the Act con-
 20 templates that upon an actual change in ownership the new owner will be assessable in respect of the income thereafter derived from the property. Whether such assessment results in payment of tax depends upon the circumstances of the new owner, which cannot affect the validity or significance of the transfer of ownership. If the special position of the purchaser were a relevant consideration, a person who sold shares might be taxed on a subsequent dividend if the purchaser was exempt from income tax (e.g. a charity) or had an income less than the minimum amount on which tax is payable, or was liable to pay tax at a lower rate
 30 than the vendor.

40 (iii) As to sub-paragraph (c) of Paragraph 38, the Appellants submit that if there is no difference in meaning between purpose and effect, and if Section 260 applies to cases in which the avoidance of tax liability is not the sole effect, then an agreement which has the effect, not contemplated by the parties, of reducing tax recovery, but which has other real and substantial effects, may be avoided by the Commissioner. This conclusion, the Appellants submit, cannot be sustained.

(iv) As to sub-paragraph (e) of Paragraph 38, if the whole of the steps taken were impeached, the necessary result would be to avoid the declaration of the dividends, so that no distributions of profits would have been made by the companies, and

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Division 7 tax would have been payable by them unless one of the permissible alternatives previously mentioned had been adopted; the impeachment of the whole of the steps taken could not have rendered the Appellants liable on the footing that they had received the whole of the special dividends; nor, upon the facts proved, would the impeachment of all the steps have necessarily rendered Lane's liable to tax upon the amounts distributed to Pactolus Pty. Ltd. (see sub-paragraph (i) of this paragraph). 10

(v) As to sub-paragraph (f) of Paragraph 38, Section 260 can only apply to a "contract agreement or arrangement made or entered into orally or in writing" and it has been held by the Full Bench Court that unless an arrangement has some effect in law it cannot be avoided. It was, it is submitted, an essential step in the reasoning of Williams J. and of Fullagar J. that it was intended by the parties that the dividends should be used by Pactolus Pty. Ltd. to provide the bulk of the purchase money for the shares. But Kitto J. found that this was not a term of the bargain between the parties (see Paragraph 33 above), and there was no evidence which would support the view that there was even a "commercial understanding" to this effect. But in any case a commercial understanding which is not of a precise legal character is not a "contract agreement or arrangement made orally or in writing", having such a legal effect as could be avoided by Section 260. (See Paragraphs 23(f) and 37(ii) above). 20 30

(vi) As to sub-paragraph (g) of Paragraph 38, the Appellants have submitted that Bell's Case is erroneous, and in any event distinguishable. Whereas Williams J. did not think that Bell's Case was decisive of the instant case, Fullagar J. considered it to be indistinguishable, and McTiernan J. considered that it was analogous and called for a similar application of Section 260. 40

p.72, L.31.

p.98, L.13.

p.59, L.19.

(vii) With respect to sub-paragraph (i) of Paragraph 38, it is submitted that if the word "purpose" in Section 260 is synonymous with "effect", it could not properly be said that the transactions here in question had no other purpose or effect than to avoid taxation; further, that even if "purpose" is construed as meaning "motive" or "object" the evidence called and the findings made by Kitto J. showed that the parties had other motives and objects than the avoidance of taxation, which was not in any relevant sense the object sought to be achieved.

p.25, L.31.

(viii) As to sub-paragraph (j) of Paragraph 38, the Appellants submit that this part of the reasons of the learned Judge departs from the principle previously laid down and later affirmed by the Full High Court, that Section 260 has an annihilating effect only. The learned Judge in this passage did not merely treat the "arrangement" as ineffective in law, but drew inferences of fact inconsistent with the actual facts proved, on the footing that Section 260 permitted the Commissioner not only to treat these facts as failing in legal effect, but to treat them as non-existent. Furthermore, whereas in Bell's Case, it was a material part of the reasoning that the moneys held liable to taxation could be traced into the hands of the taxpayer, in the instant case the learned Judge, having inferred (contrary to the findings of Kitto J.) that there was an "arrangement" whereby the moneys received by Pactolus Pty. Ltd. as dividends, should be employed to pay the purchase money due by Pactolus Pty. Ltd., held that this entitled the Commissioner to avoid the share transfers, and that the Appellants were taxable in respect of all moneys received by Pactolus Pty. Ltd. by way of dividend including the sum of £102,414 which could not only not be traced even as currency into their hands, but of which £73,069 was in fact received by Pactolus Pty. Ltd. some months after the sale and transfer of the shares in respect of which the dividends were paid.

p.70, L.9.

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40. The Honourable Mr. Justice Fullagar considered:-

- III. p.78, L.1. (a) that evidence of preliminary negotiations could be relevant to the question of the purpose which those concerned had in view, and could also be relevant if a question were raised (which was not in fact the case) as to the reality of the steps taken, but that the evidence in question could throw no light on the question whether the receipts of cash and shares ought to be regarded for income tax purposes as income receipts or capital receipts, this being a question of law depending on the construction and effect of Section 260; 10
- p.79, L.7. (b) that it was evident that the intention of Division 7 of the Act was to create a true dilemma by saying to a private company "Either you distribute such and such a proportion of your taxable income or you do not distribute it. If you do distribute it your shareholders will pay £x by way of income tax. If you do not the Company will pay £x by way of income tax." 20
- p.87, L.11. (c) that if Section 260 were interpreted very literally it would seem to apply to cases which it was hardly conceivable that the legislature should have had in mind, but that, on the other hand, any limitation which one might seek to imply might appear to deprive the Section of all practical effect; 30
- p.87, L.42. (d) that the primary criterion adopted for defining the transactions which the legislature desires to nullify is the purpose which the particular transaction in question was designed to effect, though the Section adds ex abundanti cautela a reference to "purported effect";
- p.96, L.1. (e) that there were two questions to be determined; first, whether the operations which the Commissioner challenged were actuated by one or more of the purposes mentioned in Section 260, i.e., was there a contract agreement or arrangement which had in view the attainment of one or more of those purposes; and second, what is the effect of the application of Section 260 to the case? 40

- (f) that the relevant purpose existed and that the arrangement was an arrangement struck at by Section 260, since the agreement or arrangement had for its purpose the avoiding of the liability imposed by Section 44, and Division 7 of the Assessment Act; p.97, L.24.
- (g) that the case could not be distinguished in any material respect from Bell's Case; p.98, L.13.
- 10 (h) that Section 260 entitled the Commissioner to look at the end result and to ignore all the steps which were taken in pursuance of the avoided arrangement; p.98, L.43.
- (i) that the Commissioner had assessed the Appellants only on what actually came into their hands, and had assessed them on nothing that they did not actually receive; p.104, L.8.
- 20 (j) that the Commissioner was entitled in assessing the Appellants to base the assessments on the whole of what the shareholders received without making any allowance for the cash and shares which were left in the hands of Pactolus Pty. Ltd.; and that what was received and finally retained by Pactolus Pty. Ltd. was by way of remuneration or reward to Pactolus Pty. Ltd. (which was the same thing as saying to Mr. Ratcliffe) for services rendered in conceiving and assisting in carrying out a plan which would avoid the necessity of paying many thousands of pounds in income tax. p.103, L.20.
to
p.104, L.5.
- 30 41. With respect to the reasons for judgment of His Honour Mr. Justice Fullagar the Appellants submit :-
- 40 (1) As to sub-paragraph (a) of Paragraph 40, that the evidence of preliminary negotiations referred to by His Honour was examined by Mr. Justice Kitto in order to ascertain whether there was any bargain or agreement whereby Pactolus Pty. Ltd. was bound to apply the dividend moneys in payment of purchase money on the shares purchased by it. On the basis on which Kitto J. proceeded, that Bell's Case was correctly decided, it was necessary to ascertain whether there was any arrangement between the Appellants that moneys III. p.23, L.9.
pp. 38, 39.

to be distributed by the companies should find their way into the hands of the Appellants, since the existence of such an arrangement was an essential step in the conclusion reached in Bell's Case. The evidence as to the negotiations was, therefore, on the hypothesis that Bell's Case was rightly decided, relevant to the question whether the receipt of purchase money by the Appellants ought to be regarded as income receipts or capital receipts. 10

(ii) As to sub-paragraph (b) thereof, that His Honour was in error in saying that the intention of Division 7 of the Act was to create a true dilemma. One of the choices offered to the shareholders and directors of a private company was to re-arrange its shareholding in such a way that it did not fall within the definition. This could be done either by disposing of more than 25% of the ordinary shares and obtaining Stock Exchange listing, or by increasing the number of shareholders and altering the voting power so that no group of seven shareholders (together with their relatives) could exercise more than 50% of the voting power. In either case, neither Division 7 tax nor ordinary tax would be paid on profits retained by the Company. The Appellants submit that the course adopted by them was a further alternative not forbidden by the Act, and also submit that even if steps were taken to obviate Division 7 tax it did not follow that the Appellants should be treated as if they had received dividends which they did not receive. 20 30

(iii) As to sub-paragraph (c) of Paragraph 40, the Appellants submit that on a literal construction the Section is not a wide but a narrow one. It does not in terms apply to any relationship which is not contractual in character, and if limited in the way in which the Appellants contend it can still have a practical and significant operation. 40

The Appellants further submit that His

10 Honour, in choosing between a wider and a narrower construction of a doubtful Section of a taxing Act, ought to have preferred the narrower construction, that the construction adopted by him was contrary to earlier authority, and that as construed by him, no limitation of any kind was imposed, and accordingly that the Section would, as His Honour said, apply to cases which it was hardly conceivable that the legislature should have had in mind.

20 (iv) With respect to sub-paragraphs (d), (e) and (f) of Paragraph 40, the Appellants submit that His Honour was in error insofar as he considered that it was sufficient for the application of Section 260 that one of the purposes was to defeat evade or avoid liability to taxation, even though the parties had other purposes as well.

(v) As to sub-paragraph (g), the Appellants submit that the instant case is distinguishable from Bell's Case for the reasons set out in Paragraph 44 hereof.

30 (vi) With respect to sub-paragraph (h) of Paragraph 40, the Appellants submit that the conclusion reached by His Honour did not in fact accord with the principle here embodied, since he did not ignore all the steps which were taken. In the case of the first four transactions, the end result was to leave the bulk of the funds involved in the hands of the Companies and if all the steps taken were ignored, the Companies should be treated as not having distributed these profits by way of dividend.

40 (vii) As to sub-paragraph (i) of Paragraph 40, it is submitted that His Honour was in error as to the agreed facts of the case. As pointed out in Paragraph 10 above, the amounts received by the Appellants as purchase money fell short, by more than £102,000 of the total sum of the dividends received by Pactolus Pty. Ltd., and, as Kitto J. found, the whole of the dividends

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were paid directly to Pactolus Pty. Ltd. (Paragraph 33(c) above). But the Commissioner's amended assessments included as income of the Appellants the whole of the dividends so paid to Pactolus Pty. Ltd.

(viii) As to sub-paragraph (j) of Paragraph 40, the Appellants submit:-

(a) that His Honour based this conclusion on an erroneous view of the facts, for the reasons stated in sub-paragraph (vii) hereof; 10

(b) that His Honour was in error for the reasons stated in sub-paragraph (viii) of Paragraph 39 hereof.

42. The Honourable Mr. Justice Taylor who dissented considered:-

III. p.109,
LL.18, 35.

(a) that in an attempt to give some intelligible meaning to the Section the view has been taken that there may be, on the part of a taxpayer, an avoidance of liability to tax within the meaning of the Section in respect of income before that income has been derived, but that the assignment or transfer of income-producing property of itself, while it has the effect of avoiding tax in this general sense, has never been regarded as offending against the Section; 20

p.111, L.43.

(b) that the authorities showed that an arrangement might present features of a very special character, and consideration of the dealings made constituting the arrangement might reveal that the arrangement had no practical, economic or commercial significance beyond the avoidance of liability to pay income tax, and that in such cases the arrangement, though not a sham in a strict sense, is removed from that category only by the presence of dealings which, although they are effective in law as such, serve no practical purpose other than the avoidance of income tax; 30

p.115, L.24.

(c) that although the operation of Section 260 is not invoked by every arrangement which has the effect of avoiding income tax in the general sense already indicated, it will be invoked where the arrangement has no significance or purpose but the avoidance of tax in that sense; 40

- 10 (d) that the present case was clearly distinguish-
able from earlier cases, including Bell's Case,
since it was not true that the transactions had
no purpose other than the avoidance of the
liability of tax, and had no significance other
than the achievement of this result; since
each Respondent sold and intended to sell
shares which were and still remained of con-
siderable value and as consideration for the
various transfers the purchaser intended to
pay, and each Respondent to receive, the pur-
chase price;
- 20 (e) that even if Section 260 had applied, it
would not entitle the Commissioner to treat
the amounts actually received by the Respon-
dents as income. In the present case the Res-
pondents parted with assets of considerable
value and it was impossible by ignoring one
part of the relevant transaction to character-
ize the actual receipt of the price of the
shares as a receipt of assessable income;
- 30 (f) that to treat the dividends as having been
received by Pactolus Pty. Ltd. and passed to
the Respondents as the shareholders did not
depend merely upon the notional avoidance of
the several transfers but could be reached
only by taking further notional steps, that
is, by attributing to Pactolus Pty. Ltd. an
intention to account to the Respondent for the
dividends received by it, and that although
the notional annihilation of the transfers
might leave the amounts paid by Pactolus Pty.
Ltd. to the Appellants without a character it
could not operate to invest them with a new
character;
- 40 (g) that in concluding that the amounts paid to
the Appellants as purchase money could not be
treated as income in their hands, the conclu-
sion must also be reached that the amounts
received by Pactolus Pty. Ltd. from the Com-
panies could not be treated as having been
received by the Appellants.

p.122.

p.123, LL.29,
41.

p.123, L.47.

p.124, L.40.

43. The Appellants submit that, except insofar
as His Honour applied Bell's Case, by which he was
bound, His Honour was correct in the reasons given
by him for rejecting the contention of the Respon-
dent.

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44. The Appellants further submit that insofar as the majority judgments of the Full High Court applied Bell's Case to the instant case, they failed to observe that that case was distinguishable from the instant case in important respects. In particular, the Appellants submit:-

- (i) that whereas in Bell's Case the "arrangement" there found to exist had, as was expressly stated, no other purpose or effect than to avoid the liability for taxation which would have accrued if a distribution had been made to the original shareholders, a similar finding could not be made upon the facts in the instant case; 10
- (ii) that in Bell's Case the taxpayer and the other original shareholders had agreed between themselves that profits of the Company would be distributed pursuant to a plan which would ensure that each of them would receive an equal proportion of the profits so distributed, and the whole arrangement between them amounted to no more than a manner of distribution to themselves of the profits which they had already decided to distribute to themselves. In the present Case Kitto J. expressly found that no arrangement was made that moneys paid out by the Companies should come into the hands of the Appellants; 20 30
- (iii) that in Bell's Case the decision was expressly founded on the fact that £11,000 of the Company's profits had passed "indirectly but by steps which are clearly traceable on the face of the bank's ledgers, into Bell's bank account". In the present case no such tracing was possible, and, as stated in Paragraph 10 hereof, £102,414, portion of the sum included in the amended assessments as income of the Appellants, represented excess of receipts by Pactolus Pty. Ltd. over its disbursements, and accordingly could not in any sense be regarded as traceable into the hands of the Appellants. 40

45. The Appellants contend that the inferences drawn by Williams and Fullagar J.J. as to the

arrangements made between the parties were inconsistent with evidence tendered by the Appellants and accepted by His Honour Mr. Justice Kitto. This evidence, which is to be found in the evidence of Mr. Ratcliffe, and the Appellants Henry Lane and Lauri Newton, shows that :-

- 10 (i) the proposal made by Mr. Ratcliffe resulted from a discussion initiated with a view to considering the conversion of the companies or some of them into public companies;
- (ii) that alternative proposals for reforming the capital structure of the Companies were considered and rejected;
- (iii) that the Appellants and Pactolus Pty.Ltd. negotiated at arm's length, and under the advice of their own Solicitors, in respect of the sale and purchase of shares;
- 20 (iv) that no question arose at any time of remunerating Mr. Ratcliffe, either directly or through Pactolus Pty. Ltd., for services rendered by him in carrying the transactions into effect;
- 30 (v) that the Appellants at no time arranged that the dividends should be used to meet the obligation of Pactolus Pty. Ltd. to pay purchase money, and that in fact Pactolus Pty. Ltd. provided some £19,000 of its own money to finance the purchase and had previously sought bank accommodation for a much larger sum.

46. The taxing Acts contain the following provisions relevant to imposition of additional tax by way of penalty.

- 40 "161. (1) Every person shall, if required by the Commissioner by notice published in the Gazette, furnish to the Commissioner in the prescribed manner, within the time specified in the notice, or such extended time as the Commissioner may allow, a return signed by him setting forth a full and complete statement of the total income derived by him during the year of income, and of any deductions claimed by him:

Provided that the Commissioner may, in the notice, exempt from liability to furnish returns such classes of persons not liable to pay income tax as he thinks fit, and any persons so exempted need not furnish a return unless he is required by the Commissioner to do so.

161. (2) If the taxpayer is absent from Australia or is unable from physical or mental infirmity to make such return, the return may be signed and delivered by some person duly authorised. 10

226. (2) Any taxpayer who omits from his return any assessable income, or includes in his return as a deduction for expenditure incurred by him an amount in excess of the expenditure actually incurred by him, shall be liable to pay as additional tax an amount equal to double the difference between the tax properly payable by him and the tax that would be payable if it were assessed upon the basis of the return furnished by him, or the amount of One pound whichever is the greater." 20

47. The Commissioner in this case not only treated the whole of the special dividends in fact received by Pactolus and not received by the Appellants as assessable income of the Appellants but also treated the whole of such dividends as omitted income of the Appellants for the purposes of Section 226(2) of the taxing Acts and therefore assessed the Appellants to additional tax by way of penalty in a sum in excess of £600,000, being 50% of the tax levied by way of amended assessment in respect of such dividends. 30

48. Neither before the primary Judge nor before the Full Court of the High Court was any argument addressed on the question of whether or not in the event of the Appellants failing in their principal contentions the Commissioner in any event had power to impose additional tax by way of penalty.

49. Having regard to the reasons upon which the majority of the Full Court has decided against the Appellants, the Appellants desire to offer the following submissions with respect to the imposition of additional tax by way of penalty. 40

50. If the Appellant's argument on the main question is accepted, no question under Section 226 (2) can arise.

51. If, on the other hand, the reasons of the majority of the Full Court of the High Court are accepted, a further question does arise, namely:-

10 Whether, when the Commissioner may ignore a transaction so as to treat as assessable income that which is not otherwise in fact or in law actual income of the taxpayer, and the Commissioner elects so to do, such notional income is "omitted" income for the purposes of Section 226(2).

52. With respect to this question, the Appellants would desire respectfully to submit:-

- 20 (1) That if, as certain passages in the reasons of the majority of the High Court suggest, Section 260 may be susceptible in any given situation of more than one application and, as the Appellants would submit, need not be applied at all by the Commissioner, it cannot be known prior to actual assessment whether the section will be applied nor how it may be applied.
- (2) That if, contrary to the Appellants' submission on the main question, Section 260 can be applied so as to treat as assessable, moneys not in fact received by the taxpayer and which are assessable income of some other taxpayer, such moneys cannot be regarded as "omitted" income under Section 226.
- 30 (3) That, upon the reasons of the majority of the High Court, the Commissioner had no power to access additional tax by way of penalty in respect of the sums which he treated as assessable income by the use of Section 260.

53. The Appellants hereby submit that the Orders of the Full High Court of Australia were erroneous and that the judgment of Kitto J. should be restored and the objections of the Appellants to the amended assessments made by the Respondent should be allowed for the following among other

40

R E A S O N S

1. BECAUSE none of the dividends in fact paid to Pactolus Pty. Ltd. formed part of the assessable income of any of the Appellants.

2. BECAUSE the Commissioner was not entitled to disregard any part of the transaction between the Appellants and Pactolus Pty. Ltd.

3. BECAUSE even if the Commissioner was entitled to and did disregard the whole or some part of the transactions between the Appellants and Pactolus Pty. Ltd. none of the said dividends would be found in the hands of the Appellants as assessable income.

4. BECAUSE the findings of fact made by His Honour Mr. Justice Kitto were correct and there was no warrant for any departure therefrom by members of the Full Court. 10

5. BECAUSE none of the transactions or events found by Mr. Justice Kitto to have taken place, alone or in combination, amounted to a contract, agreement or arrangement within the meaning of Section 260.

6. BECAUSE the transactions did not have, nor did they purport to have either the purpose or effect of doing any of the things specified in Paragraphs (a), (b), (c) or (d) of the Section. 20

7. BECAUSE Section 260 does not prevent a taxpayer from so arranging his affairs by real and effective transactions that his liability to taxation is less than it would have been if he did not so dispose of his property.

8. BECAUSE Section 260 does not more than deprive of legal effect to the extent stated in the Section, a transaction within its terms which is set up by a taxpayer in answer to an assessment which is otherwise justified on existing facts; and is of no avail to the Commissioner unless, apart from what may be disregarded because of the Section, and without further assumption, a state of facts exists upon which the assessment appealed against can be justified. 30

9. BECAUSE insofar as Section 260(c) refers to a liability to pay tax, the liability referred to must be a particular liability to tax which in truth the circumstances have already attracted; and because the Section cannot in any event apply where no more can be said than that a liability to tax would or might arise if some event occurred in the future. 40

10. BECAUSE Section 260 does not apply where the liability said to be avoided is or would be a liability of a Company to pay tax under Division 7 of Part III of the Act.
11. BECAUSE Section 260 does not apply where the transaction sought to be impeached has other purposes or effects than the avoidance of taxation; and in any case, can only apply to such a transaction or to such a severable part of a transaction as has no other purpose or effect than the avoidance of taxation.
12. BECAUSE Section 260 only applies to transactions which are contractual in character, and is not available to avoid an actual transfer of property.
13. BECAUSE the whole of the sums held to be income of the Appellants was assessable income of Pactolus Pty. Ltd.
14. BECAUSE Section 260 can only be applied to a contract agreement or arrangement made orally or in writing, which is effective in law to alter or modify legal rights or relationships, and the arrangement found by the majority of the Full High Court to exist in the present case was, if it existed, a "commercial understanding" having no effect in law.
15. BECAUSE the case of Bell v. Federal Commissioner of Taxation 87 Commonwealth Law Reports 548, was not correctly decided.
16. BECAUSE both Bell's Case and the instant case are contrary to previous authority of the High Court of Australia which has never been over-ruled and has frequently been cited with approval.
17. BECAUSE in any case both the facts and circumstances in Bell's Case and the reasons given for judgment were distinguishable from and inapplicable to the instant case.
18. BECAUSE the majority judgments now appealed from did not correctly apply Section 260, in that they treated the transactions which were found to exist as non-existent, and drew inferences of fact which could only have been drawn if no such transactions had been entered into.

RECORD

19. BECAUSE in every instance the effect of the application of Section 260 to the facts of the instant case could only be to annihilate the declaration of the dividend and the distribution thereof, since those circumstances alone avoided what inevitably otherwise would have been a liability for taxation.

20. BECAUSE, even if, contrary to the Appellants' submission, the Commissioner was entitled to treat the dividends in fact paid to Pactolus Pty. Ltd. as assessable income of the Appellants, such dividends, not in fact received by the Appellants, were not "omitted" income within the meaning of Section 226(2).

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G. E. BARWICK.

R. M. EGLESTON.

J. A. NIMMO.

IN THE PRIVY COUNCIL

No. 7 of 1958

ON APPEAL FROM THE HIGH COURT
OF AUSTRALIA

B E T W E E N

LAURI JOSEPH NEWTON, LIONEL NEWTON
FRANCIE UNA CHRISTIAN, HENRY JAMES
LANE, EXECUTORS OF THE ESTATE OF
ROBERT NATHAN, DECEASED, STELLA
MAUD ADELINE LANE and LEONARD ALFRED
FENTON (Respondent) ... Appellants

- and -

THE COMMISSIONER OF TAXATION OF THE
COMMONWEALTH OF AUSTRALIA (Appellant)
Respondent

(Consolidated Appeals)

CASE for the APPELLANT

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W.C.2.
Solicitors for the Appellants.