HIGH COURT OF AUSTRALIA

Cornell

Vs.

Deputy Federal Commissioner of Taxation (South Australia)

(Knox C.J., Isaacs, Higgins, Gavan Duffy, Rich and Starke JJ.)

25 October 1920

Knox C.J.,

Isaacs, Higgins, Gavan Duffy, Rich and Starke JJ.

The appellant is a shareholder in Cornell Ltd., a company formed under the law of South Australia. The articles of the Company contain the usual provision relating to the distribution by way of dividend of the profits of the Company. Art. 124 provides that no amount shall be paid by way of dividend in excess of that recommended by the directors. In the year 1917-1918 the Company made a profit of £12,663, but no portion of this amount was distributed among the shareholders. The Deputy Federal Commissioner of Taxation, being of opinion that a fair proportion of the profits had not been distributed, availed himself of the power given him by sec. 16 (2) of the *Income Tax Assessment Act 1915-1918*, and the whole sum of £12,663 has been treated by him as if it had been distributed among the shareholders in proportion to their interests in the paid-up capital of the Company. The result is that the appellant has been assessed for income tax as if he had received £4,534 from the Company by way of dividend during the year in question, and his appeal is against this assessment.

The main contention on behalf of the appellant was that sec. 16 (2) of the *Income Tax Assessment Act* was beyond the power of the Commonwealth Parliament. In support of this contention Mr. *Glynn* urged a number of grounds, of which all but two are in our opinion covered in principle by the decisions of this Court in *Osborne v. The Commonwealth*[1]; *Attorney-General for Queensland v. Attorney-General for the Commonwealth*[2]; *Morgan v. Deputy Federal Commissioner of Land Tax (N.S.W.)*[3], and *National Trustees, Executors and Agency Co. of Australasia v. Federal Commissioner of Taxation*[4].

The subject of taxation under sec. 16 (2) of the *Income Tax Assessment Act 1915-1918* is income in the same sense as land is the subject of taxation under sec. 39 of the *Land Tax Assessment Act 1910-1916*. And the proposition that the Legislature "must take things as it finds them, according to State law, and tax or not tax them accordingly" was made in *Morgan's Case*[5] and directly met by the decision in that case and also in the *National Trustees Co. Case*[6]. As was said by *Isaacs* J. in *Morgan's Case*[7], "the Commonwealth Parliament ... cannot be limited by any artificial creations or restrictions which the varying policies of State Legislatures may devise." The fundamental fact, in the present case, is that the shareholders of the Company are the "real and only masters" of the undistributed income in the possession of the Company.

The case of *Waterhouse v. Deputy Federal Commissioner of Land Tax (S.A.)*[8] was relied upon, but

it is sufficient for present purposes to say that the Court there held that the appellant had no interest in the land according to law or the real substance of the case. We have already indicated the very real interest that the appellant in the present case had in the undistributed income of the Company. This is sufficient to distinguish the present case from *Waterhouse's Case*, and to render any further observations upon it unnecessary.

Returning now to *Morgan's Case*[9], the enactment under consideration was sec. 39 of the *Land Tax Assessment Act*, which provided in effect that the shareholders in a company owning land should be deemed to be joint owners of the land belonging to the company and that each shareholder should be liable for land tax in respect of a portion of the value of such land corresponding to his share in the capital of the company. The shareholder had under the law of the State no legal or equitable estate in the land belonging to the company, but it was held that he had a sufficient interest in the land to justify the provision by which he was "deemed to be the owner" of a portion of such land. The section now under consideration is indistinguishable in substance from that dealt with in *Morgan's Case*[10], the only difference being that in *Morgan's Case* the Act dealt with *land* of the company, while in this case the subject matter is *income* of the company. In this case, as in that, the shareholder is not entitled either at law or in equity to obtain for himself, except in accordance with the law of the State and the regulations of the company, any portion of the subject matter dealt with, but in this case, as in that, the Commonwealth Act in no way affects or purports to affect the rights or liabilities of the company and the shareholders *inter se* under State law. In both cases the whole body of shareholders had power, by taking a proper course of action (*e.g.*, by bringing into operation art. 155), to insist on the property in question being actually distributed among them, and it was this circumstance which in *Morgan's Case* was held to give rise to the right of the Commonwealth Parliament to impose taxation on the shareholders in respect of the property of the company.

Mr. *Glynn* challenged the constitutionality of this Act on two other grounds, with which we now proceed to deal. The first of these as stated by Mr. *Glynn* was: "it violates the Constitution by vesting judicial power in respect of tax or penalty in an executive or administrative officer"[11]. It is a sufficient answer to this contention to point out that the Commissioner of Taxation, in exercising the power conferred on him by sec. 16 (2), is not in any relevant sense acting judicially—that is, he is not exercising judicial power. His power is merely to determine as an administrative officer whether in his opinion the company has distributed by way of dividend a fair proportion of its profits. The remaining ground is: "its operation depends on an impossible condition; i.e., under sec. 16 (2) read with sec. 16 (1)—(1) if it distributes anything during a particular year the amount distributed is deducted in arriving at the taxable income and therefore cannot be a distribution of taxable income; (2) taxable income cannot be calculated until the end of the year has arrived and therefore cannot be distributed during the year." In our opinion there is no foundation for this contention, and if it were well founded it would go not to the constitutionality of the provision but to the possibility of applying it.

It follows that question 1 of the special case should be answered: No.

Question 2 of the special case is as follows: "Whether (if the Commissioner is of opinion that a company has not distributed to its shareholders a reasonable proportion of its taxable income) the whole of the taxable income of the company or only a reasonable proportion thereof is to be deemed to have been distributed." On this question it is unnecessary to say more than that in our opinion it is clear on the words of the sub-section construed literally that, when the Commissioner is of opinion that less than a fair proportion of the profits have been distributed, the whole amount of profit which

would otherwise have been taxable income of the company is to be deemed to have been distributed to the shareholders. This question should therefore be answered: The whole of the taxable income of the company.

With regard to question 3 it appears from the facts stated in the special case that the Commissioner might have treated the sum of £15,007 instead of the sum of £12,663 as having been distributed among the shareholders, and consequently that he has assessed the appellant for a smaller sum in this respect than was permissible. We do not think the fact that an assessment is for too small an amount is any reason for setting aside the assessment at the instance of the person assessed. This question should therefore be answered: Yes.

Costs of special case costs in the appeal from assessment.

Questions answered: (1) No; (2) The whole of the taxable income; (3) Yes. Costs of special case to be costs in the appeal.

Solicitors for the appellant, Gillott, Moir & Ahern, for Baker, Glynn, Parsons & Co., Adelaide.

Solicitor for the respondent, Gordon H. Castle, Crown Solicitor for the Commonwealth.

[1] [1911] HCA 19; 12 C.L.R., 321.

[2] [1915] HCA 39; 20 C.L.R., 148; 22 C.L.R., 322.

[3] [1912] HCA 88; 15 C.L.R., 661.

[4] [1916] HCA 62; 22 C.L.R., 367.

[5] [1912] HCA 88; 15 C.L.R., 661.

[6] [1916] HCA 62; 22 C.L.R., 367.

[7] 15 C.L.R., at p. 669.

[8] [1914] HCA 16; 17 C.L.R., 665.

[9] [1912] HCA 88; 15 C.L.R., 661.

[10] [1912] HCA 88; 15 C.L.R., 661.

[11] See 8 C.L.R., at p. 355.

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