HIGH COURT OF AUSTRALIA

Rose

Vs.

Federal Commissioner of Taxation

(Dixon(1), Fullagar(1) and Kitto(1) JJ.)

5 November 1951

CATCHWORDS

Income Tax (Cth.) - Assessable income - Disposal of assets of business - "Dispose" - Assets of business transferred by sole owner to partnership consisting of himself and others - Income Tax Assessment Act 1936-1948 (No. 27 of 1936 - No. 44 of 1948), ss. 36 (1), 59 (1) (2).

HEARING

Perth, 1951, September 10;Melbourne, 1951, November 5. 5:11:1951 CASE STATED.

DECISION

November 5.

The Court delivered the following written judgment: -The taxpayer had for many years before 8th July 1948 carried on business as two sons into partnership on the footing that the capital of the partnership should belong to the three partners in equal shares and that profits should be divided equally. The capital was to consist of the assets of the business which the taxpayer carried on. A partnership deed was executed by which the taxpayer's resolve was carried out. The date upon which the transaction took effect and the assets of the taxpayer's business actually became assets of the partnership was 8th July 1948, although the deed bore the date of 30th June 1948 and according to its terms the partnership was to be deemed to have commenced at an earlier date. In assessing the taxpayer's taxable income derived during the year commencing 1st July 1948 the commissioner treated the transaction as a disposition by the taxpayer of the assets of his business to the partnership. On this footing he applied s. 36 (1) of the Income Tax Assessment Act 1936-1948 to the livestock and s. 59 (2) to such of the assets as had been the subject of allowances for depreciation. Section 36 (1) provides that where the whole or any part of the assets of a business carried on by a taxpayer is disposed of by sale or otherwise howsoever, whether for the purpose of putting an end to the business or any part thereof or not and the assets include any property being (amongst other things) trading stock the value of that property shall be included in his assessable income and any person acquiring it shall be deemed to have purchased it at the amount of that value. By virtue of the definitions of "trading stock" and "live stock" in s. 6, the sheep and horses upon the taxpayer's station were comprised in the trading stock of the business for the purposes of s. 36. The value of the livestock taken into account at the end of the previous year of income pursuant to s. 32 was the cost price and that under s. 29 was the value at which they must be taken into account at the

beginning of the year of income in which the transaction took place. Section 36 (8) (a) (i) provides that for the purposes of the section the value of any livestock shall be the market value on the day of disposal. The market value of the livestock as at 8th July 1948 exceeded the cost by 7,118 pounds. (at p122)

2. The effect of s. 59 (2) is to include in the assessable income of a taxpayer any amount by which the consideration for which the property is disposed of exceeds its depreciated value, when depreciation has been allowed or is allowable under the Income Tax Assessment Acts. By sub-s. (3) (d), where property is disposed of otherwise than by sale, the consideration is to be taken as the value, if any, of the property at the date of disposal. Among the assets becoming partnership property were certain things upon which depreciation had been allowed and their value on 8th July 1948 exceeded their depreciated value by 1,016 pounds. (at p123)

3. In the assessment the two figures of 7,118 pounds and 1,016 pounds were included as part of the taxpayer's assessable income and the question for decision is whether ss. 36 and 59 respectively afford a justification for so including these sums or any part of them. In the case of each provision the question depends upon the expression "disposed of". Does the transmutation of the property in the assets from the sole property of the taxpayer to the co-ownership of him and his two sons as partners in equal shares involve a disposal of the livestock and of the depreciated property for the purposes of ss. 36 (1) and 59 (2) respectively? (at p123)

4. As the objects of the two provisions are not the same it is desirable to deal with the question in relation to each of them separately. The central purpose of s. 36 was to alter the law laid down in such decisions as Commissioner of Taxation for W.A. v. Newman [1921] HCA 37; (1921) 29 CLR 484 ; Hickman v. Federal Commissioner of Taxation [1922] HCA 58; (1922) 31 CLR 232 ; and N.S.W. Land & Agency Co. Ltd. v. Commissioner of Taxation (1926) 26 SR (NSW) 560; 43 WN 168 . It was thought necessary to go beyond sales for a money consideration and to include all alienations inter vivos and to employ value as the test of what should go into the assessable income, even where there was a price. Devolutions upon death were dealt with by s. 37. In employing the words "dispose of" s. 36 doubtless meant to include every alienation of trading stock. "Disposition" and "dispose of" are expressions of the widest import. But the subject of the disposition must be considered as well as the ambit of the expression "dispose of". Section 36 is concerned with the disposal of the whole or part of the assets of a business when trading stock is included in the disposition. Now it seems quite clear that, unless the partnership can for the purposes of s. 36 be considered as a distinct entity to which the assets were transferred, the disposition by the taxpayer consisted in imparting to his two sons equal undivided shares in the assets as co-owners with himself. Further, the admission of the sons into partnership with him may be regarded as an entire transaction of which the alienation to each of them of an equal undivided third share in the assets of the business was only a legal consequence or incident. When s. 36 speaks of disposing of the assets of a business it is speaking of a transfer of the proprietor's ownership of the assets, including the immediate right to their possession, subject of course to any encumbrance, whether existing or newly created. But it is not speaking of the transfer of an undivided fractional interest in the assets. It is not speaking of the vesting in another or others of an undivided share or shares in the business including the assets. Plainly it is directed at the disposal of the entirety of ownership in the assets and not the conversion of single ownership into collective ownership. (at p124)

5. The commissioner's case must therefore depend on making good the proposition that for the purpose of s. 36 a partnership is to be considered a separate entity distinct from the individuals who compose it, so that when the taxpayer vested what was his as an entirety in himself and his two sons

as partners having co-ownership, he is to be considered for the purposes of s. 36 as having "disposed of" the property as an entirety in the assets to a distinct legal entity. A partnership is not a distinct legal entity according to English law. In Scots law a firm is a legal person distinct from the partners of whom it is composed. But in our law it is far otherwise with partnerships. "The members of these do not form a collective whole, distinct from the individuals composing it; nor are they collectively endowed with any capacity of acquiring rights or incurring obligations": Lindley on Partnership, 11th ed. (1950), vol. 1, ch. 1, s. 4. If, therefore, a partnership is to be treated for the purpose of s. 36 as a distinct legal entity, it must be because of an assumption which the Income Tax Assessment Act requires, not because of the general law. But an examination of that Act discloses no ground for construing it as requiring that such an assumption should be made. By s. 6 the word "partnership" is defined to mean an association of persons carrying on business as partners or in the receipt of income jointly but not to include a company. Division 5 of Part III, which deals with partnerships, is based upon the view that the collective income earned by the partnership belongs according to their shares to the partners regardless of its liberation from the funds of the partnership, that is, its actual distribution. There appears to be no foundation for importing into s. 36 a conception of a partnership varying from that adopted by the general law. (at p124)

6. It follows from what has been said that the formation of the partnership was a transaction falling outside s. 36 (1) and that the consequent investing of the three partners with property in the assets of the business belonging to the taxpayer did not involve a disposition of those assets within that section. (at p125)

7. Although the object to which s. 59 is directed is not the same as that of s. 36, the considerations governing the decision of the question whether the transaction is within the words "dispose of" in s. 59 are not very different. The subject of s. 59 is the place which should be given, in the ascertainment of taxable income, to an excess or deficiency in the real value of an asset upon which depreciation has been allowed when the trader or manufacturer disposes of it or it is lost or destroyed. The section goes much further than taking into account the excess or deficiency in the actual proceeds of realization. But nevertheless it is clear enough that it is concerned with the disposal, loss or destruction of the property as an entirety and not with the creation or transfer of an undivided share in the asset. That being so the reasoning which has been pursued above in relation to s. 36 applies equally to s. 59 and leads to the conclusion that it does not cover the transaction by which the taxpayer made his sons equal partners with himself in his business and the assets thereof. (at p125)

8. For these reasons both questions in the case stated should be answered - No. (at p125)

ORDER

Order that questions 1 and 2 in the case stated be answered - No.

The commissioner to pay the appellant's costs of the case stated.

Cause remitted to Kitto J.

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