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Study on Taxation Example

Introduction This case considers the issue of the ordinary income and whether or not a gift of shares to an accountant Lewis Hays by the owner of the company Richardson's Meat Industries Ltd. is assessable as ordinary income for the accountant's personal services to the private company and the owner. He worked for company for many years and the company upon transition from private to public company the owner gave the accountant a substantial amount of shares. However, when reached by the Federal Commissioner of Taxation the accountant was of the stance that the shares are not been awarded to him in return to his past services but as a gift therefore are not subject to taxation as ordinary income. **The Case:** In the year 1951, the Taxation Board of Review taxed 12,000 shares of Richardson's Meat Industries owned by George William Richardson. These shares of 5s each were given to Lewis Hayes as a gift by his ex-employer and boss George Richardson.

The Commissioner decided to tax the shares at a total face value of 3,000 pound as a part of taxpayer's assessable income. Similarly, the majority of board keeping the same view in mind were of the opinion that the commissioner's decision was rightly made and the shares must be taxed since Richardson received constant advice from Hayes and for that Hayes was never paid. Lastly, Richardson's statement, "...were given in recognition

of services rendered in the past by the recipients and as an inducement or incentive to continue good service in the future” stamped the matter. The commissioner was of the view that the shares issued to Hayes should be constituted as assessable income since the payment of money or a transfer of property although given in form of a gift, as there was no obligatory reason to present it, may in certain cases be income in the hands of the recipient. He was concluding his hypothesis on the basis of English cases that of Squatting Investment Co Ltd and Squatting Investment Co Ltd. Lewis and Christine Hayes both decided to appeal to the High Court on this matter and the court decided to hear the matter for appeal stating that the board of review’s decision of marking the shares as assessable income based on statutory definition of value of allowances ect. was in fact a matter of law under sections No. 27 of 1936, No. 48 of 1950 and ss. 6, 26 (e) and 196 (I) of Income Tax and Social Services Contribution Assessment Act 1936-1951. Section 196 (I) of the act gave Hayes the right of appeal to the High Court from any decision of a board of review, which involves a question of law. **The Judgement:** Judge Fullagar gave a detail judgement on the matter that covered all the aspects of the case starting from 1939 when Hayes was residing in Melbourne. Hayes was an accountant by profession and Richardson was carrying on business in Hobart in meat and small goods under the name of “Richardson’s Choice Provisions”. Richardson’s was expanding, and was searching for a qualified accountant with special experience in costing. Hayed on Richardson’s invitation relocated to Hobart and entered into his employment.

Although his designation was not decided he performed duties as both supervising accountant and general financial adviser. Later on in 1944 Richardson transformed his business into Richardson’s Choice Provision Pty Ltd. Richardson held two fifths of the shares in the company established with a paid up capital of 17,000 pounds.

Hayes had about 3000 shares of 1 pound in the company, and also held the positions of the director in the company and its secretary but retained the right of private practise. Hayes stated that Richardson lent him 500 pounds for payments on his shares. However, Hayes only had his private practice. Following the course of events in 1947 Richardson decided to retain control of his deteriorating business and he wanted to hold all shares or none at all. He bought all shares but 500 held by his son including those of Hayes at 22s 6d or 23s 0d a rate lower than what Hayes wanted yet he sold his share anyway by August 1947. At this point every shareholder agreed that

Richardson must regain complete control and Hayes considered himself under a moral obligation to facilitate the change for the greater good.

However, Richardson told him that he would not lose anything and he would make it up to him someday. In the years to follow the business flourished and expanded until 1950 when it was decided to be transformed into a public company in 1950. The company was incorporated on 22nd May 1950 under the name Richardson's Meat Industries Ltd. However, the liquidation of the proprietary company did not happen and continued to exist as an operating organization, though the shares passed on to the new public company. At this point Richardson acquired 212,000 shares of 5s. 0d. each in the public company and these were given to him against his share in the proprietary company and other property acquired from him. Upon acquiring these shares Richardson stated that he felt he had "done particularly well" – that he had "achieved an ambition and made a success of things". Thus primarily in a spirit of generosity, prompted by these not unnatural reflections, that he decided to make certain voluntary dispositions. He made large monetary gifts to certain public institutions, as to which no question arises. He also, by letter dated 27th June 1950 directed the secretary of the public company to issue 52,000 of the 212,000 shares, to which he was entitled, to the following persons – 4000 to D. C. Richardson, 4000 to G. H. Richardson, 12,000 to Henri Albert Christie, 12,000 to Lewis Hayes, and 20,000 to Christie and Hayes "on behalf of the staff of" the proprietary company. Fullagar stated in his judgement that "It is true that the decision was a decision on a question of fact in the sense that there was an ultimate factum probandum: the taxpayer had to prove that what he received was not income, and the board determined that he had failed in his proof. But that determination involved a consideration of what constitutes income, and that is a question of law. The board had also to consider the construction of s. 26 (e) of the Act. The decision turned on the view taken by the board on those matters, and that decision is right or wrong according as the board's view on those matters was right or wrong." He at this point referred to the case of Lord Parket of Waddington in *Farmer v Cotton's Trustee* (1915) and stated that several taxation cases create serious difficulty in relation to the distinction, which often has to be drawn, between "questions of fact" and "questions of law". He was of the view that the factum probandum (the ultimate fact in issue) that is ultimately dependant on the facta probantia (the facts adduced to prove or disprove the ultimate fact) where the factum probandum involves a term used in a statute, the question whether the

accepted *facta probantia* establish that *factum probandum* will generally – so far as I can see, always – be a question of law. He further stated that, in his opinion, the decision of the board involves a question of law, and the appeal lies. He also scrutinized the facts which led the majority of the board to the conclusion that what the appellant received was income. He accepted all relevant facts as they were presented including Hayes employment by Richardson as a supervising accountant and general adviser in the business and receiving a salary. He pointed that 1942 he ceased to be a full-time employee of Richardson, and since that year he has been in private practice as a public accountant. He also accepted that Hayes has been remunerated for his services as director and secretary in Richardson's companies from 1944 – 1947 and then till 1950 as secretary. And yet was not paid for services of a trifling nature, such as the preparation of land tax returns and giving advice to Richardson. He also accepted that one gathers that the advice was generally accepted, and the result seldom, if ever, regretted and Richardson felt that he had "made a success of things", he was disposed to give a real measure of credit for that success to advice and assistance received over the years from his business associate and personal friend. However, Fullagar rejected that Richard's statement signed in December 1952 at the time of interview in the Commissioner's office in Hobart contained only part of the truth and not the complete truth about why the 41385 shares were given out. Richardson had stated that these were in recognition of the services in past and to continue good service in the future. He also objected on the matter that Hayes statement regarding his understanding that all the shares given by Richardson in June 1950 were subject to tax in the hands of the recipients and he did not intend to claim exemption.

Fullagar stated the matter though of small importance should have been objected and disallowed but the board ignored it at that point. Neither advice received by Hayes, nor his own view of the legal position, nor his intention at that time to contest or not to contest his assessment, could have any possible bearing on the question before the board. Therefore, the receipt of the shares in question here was not, in my opinion, a receipt of income by Hayes. What was done, as I think, amounted to a simple gift of property and nothing more. To conclude the matter Fullagar stated that Richardson was motivated by both services render and gratification for the continued advice he received from Hayes as well as keeping up his promise that he would make it up to him some day.

Further he stated that, a voluntary payment of money or transfer of property by A to B is prima facie not income in B's hands. If nothing more appears than that A gave to B some money or a motor car or some shares, what B receives is capital and not income. But further facts may appear which show that, although the payment or transfer was a "gift" in the sense that it was made without legal obligation, it was nevertheless so related to an employment of B by A, or to services rendered by B to A, or to a business carried on by B, that it is, in substance and in reality, not a mere gift but the product of an income-earning activity on the part of B, and therefore to be regarded as income from B's personal exertion. A very simple case is the case where A employs B at a salary of 1000 pounds per annum, and at the end of a profitable year "gives" him a "bonus" of 100 pounds. Obviously the bonus is income. It is paid without obligation, but it is clearly in truth part of what B has earned during the year." Whereas, the commissioner contended that the receipt was an income receipt because it fell within the general conception of income, or alternatively that it fell within the terms of s. 26 (e) of the Act. Section 26 provides that "the assessable income of any person shall include . . . (e) the value to the taxpayer of all allowances, gratuities, compensations, benefits, bonuses and premiums allowed, given or granted to him in respect of, or for or in relation directly or indirectly to, any employment of or services rendered by him, whether so allowed, given or granted in money, goods, land, meals, sustenance, the use of premises or quarters or otherwise". I doubt very much whether s. 26 (e) has the effect of bringing into charge any receipt which would not be brought into charge in any case either by virtue of the general conception of what constitutes income or by virtue of the definition of "income from personal exertion" in s. 6. The words "directly or indirectly" are doubtless intended to cast the net very wide, but it is clear that there must be a real relation between the receipt and an "employment" or "services". If the receipt in the present case does not fall within the general conception of "income", it is not, in my opinion, caught by s. 26 (e). **The Verdict:** Fullagar added that, if as a result of his friend's advice A buy shares of a company Z and make great profits then a gift of 1000 pounds to his friend is by no means income earned by his friend B. If the receipt of the shares were a receipt of income, the amount to be added to assessable income would seem to be not the amount of their face value but the amount of their market value. It may be, of course, that face value and market value were identical. Thus Fullagar ordered that the assessment must be reduced by 3000 pounds which was the value of the shares.