Privy Council Appeal No. 77 *of* 1929.

Robert Alan Hill and others - - - - - *Appellants*

v.

The Permanent Trustee Company of New South Wales, Limited, and others - - - - - - - *Respondents*

FROM

THE SUPREME COURT OF NEW SOUTH WALES.

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 29TH JULY, 1930.

Present at the Hearing:

LORD BLANESBURGH.
LORD TOMLIN.
LORD RUSSELL OF KILLOWEN.

[*Delivered by* LORD RUSSELL OF KILLOWEN.]

The Permanent Trustee Company of New South Wales, Limited (hereinafter referred to as the Trustee Company) is the trustee of the will of Richard Hill, deceased, and in that capacity holds as part of the investments, representing the trust estate, 40,800 shares in a company called the Buttabone Pastoral Co., Ltd. (hereinafter called the Buttabone Company). The Trustee Company is also the trustee of the trust fund comprised in a trust declared by indenture dated the 9th January, 1914, and in that capacity holds 17,600 shares in the Buttabone Company.

In November, 1927, the Trustee Company received from the Buttabone Company a sum of £19,380 in respect of the 40,800 shares, and a sum of £8,360 in respect of the 17,600 shares, and the questions raised for decision on the present appeal are whether the sum of £19,380 is to be treated as *corpus* or income under the trusts of the said will, and whether the sum of £8,360 is to be treated as *corpus* or income under the trusts of the said indenture.

The relevant facts must first be stated. The testator (who died in August, 1895) was at his death the owner of a grazing property known as "Buttabone Station"; after his death additional lands were purchased which were paid for partly out of income of his estate and partly by moneys borrowed on the security of the lands purchased. For some years the testator's lands and the lands so purchased were worked together as one business. It is not a matter of surprise that complications and litigation ensued. The litigation was compromised in 1909, with the Court's sanction so as to bind infant beneficiaries. Under the compromise all the lands both original and additional were sold to the Buttabone Company, fully paid shares of £1 each in that company to the number of 85,000 being received by the then trustees of the said will as representing the capital of the estate employed in the said business. Other fully paid shares were issued to those individuals whose income had been used for capital purposes, in satisfaction of their claims and interest.

Subsequently, viz., in 1914, the said declaration of trust was executed in exercise of powers contained in the said will for the purpose of settling upon certain trusts one of the shares of the testator's estate. Some of the said 85,000 shares were appropriated to those trusts.

Some of the settled shares held under the will have become distributable and have been distributed upon the deaths of tenants for life leaving issue, with the result that at the present time the Trustee Company holds the said 40,800 shares and the said 17,600 shares in the capacities beforementioned.

The Buttabone Company carried on business from the date of its incorporation, its business including wool-growing, the breeding and fattening of sheep and cattle, and the buying and selling of live stock.

In the year 1924 the Board of Directors determined that the time was opportune for disposing of the Buttabone Company's lands and stock to the best advantage of the shareholders, and between the 9th December, 1924, and the 22nd April, 1925, substantially the whole of the Buttabone Company's lands, live stock and other assets were sold, but as to some of the lands the terms of sale allowed six years for the payment of the total purchase money.

Save in so far as the proceeds of sale have been distributed as hereafter appears, those proceeds have been invested and the income of the investments, and the interest paid by purchasers during the six years, have been distributed as dividend among the shareholders.

No resolution has ever been passed for the winding up of the Buttabone Company, but on the 12th April, 1926, a resolution for voluntary liquidation proposed by a shareholder at a general meeting was defeated.

The original Articles of Association of the Buttabone Company relating to dividends were in the following form :—

"ARTICLE 122.—No dividend shall be payable except out of the profits arising from the business of the Company and no dividend shall carry interest.

"ARTICLE 124.—The directors may from time to time pay to the members (on account of the next forthcoming dividend) such interim dividends as in their judgment the position of the Company justifies. Subject as aforesaid the dividends shall be declared by the Company at its Ordinary General Meetings.

By special resolution passed at an Extraordinary General Meeting held on the 12th April, 1926, and confirmed at another Extraordinary General Meeting held on the 28th April, 1926, articles 122 and 124 were altered and now run thus :—

"ARTICLE 122.—No dividend shall be payable except out of the profits of the Company, and no dividend shall carry interest.

"ARTICLE 124.—The directors may from time to time pay to the members such interim dividends as in their judgment the position of the Company justifies."

On the 28th April, 1926, the Board passed a resolution in the following terms :—

"Out of the sum of £103,342 14*s.* 3*d.*, which arose wholly and exclusively from the sale of the land and improvements of the Company which were not acquired for the purpose of re-sale at a profit, there be paid to the shareholders an interim dividend at the rate of 11*s.* 8¾*d.* per share, and that such dividend be payable at the Company's office on and after noon on the 6th day of May, 1926."

A circular letter, dated the 3rd May, 1926, was sent to the shareholders, the terms of which ran thus :—

"I have been instructed by the directors to advise that at a meeting held on the 28th ultimo the Board decided to pay to the shareholders out of moneys arising wholly and exclusively from the sale of the Company's land and improvements, a dividend at the rate of 11*s.* 8¾*d.* per share, which is payable at the registered office of the Company at noon or after on Thursday the 6th instant.

"And I have further to advise that the directors decided to pay this dividend for the purpose of making a distribution of capital assets in advance of the winding up of the Company, as the Company has ceased to carry on its business.

"The directors have consulted a leading equity counsel who advises that this dividend is not subject to either State or Federal Income Tax."

No question arises for decision on this appeal in regard to this payment of 11*s.* 8¾*d.* per share.

On the 11th November, 1927, the Board passed a resolution in the following terms :—"That out of the profits of the Company a cash dividend of 9*s.* 6*d.* in respect of each fully paid share in the Company be declared and to be payable as soon as funds are available."

A circular letter dated the 28th November, 1927, was sent to the shareholders, the terms of which run thus :—

"I have been instructed by the directors to advise that at a meeting held on the 11th instant it was decided to pay out of the profits of the Company a cash dividend of 9*s.* 6*d.* in respect of each fully paid share in the Company. In accordance with this decision I enclose cheque for ,

being the amount to which you are entitled, and I will be obliged if you will sign and return to me in due course the attached form of acknowledgment.

"I have also been instructed to state that the dividend is being paid out of the profits arising from the sale of breeding stock, being assets of the company not required for purposes of resale at a profit, and that it is free of Income Tax."

The Trustee Company having received the cash dividend of 9*s.* 6*d.* per share (amounting to £19,380 in respect of the settled shares and £8,360 in respect of the shares subject to the declaration of trust) issued an originating summons for the determination of the questions: (1) Whether upon the true construction of the said will and in the events which had happened the said sum of £19,380 should be treated as income or capital of the settled shares, and (2) whether upon the true construction of the said declaration of trust and in the events which had happened the said sum of £8,360 should be treated as income or *corpus* of the funds the subject of the said declaration of trust.

No distinction was drawn in the argument before their Lordships between these two sums, or between the phraseology of the trusts declared by the two instruments. The case was discussed by reference only to the wording of the will, and was argued upon the footing that according as the said sum of £19,380 was to be treated as *corpus* or income under the will so the said sum of £8,360 was to be treated as *corpus* or income under the declaration of trust. The two sums stand or fall together, and may be considered as if they were both subject to the trusts of the will. It is accordingly only necessary to refer, and that briefly, to the terms of the will. The first gift of income to the testator's sons and daughters is under the description of the balance or residue of "the net income to be derived from my said estate." This gift would appear to be confined to the period during which his daughter, Laura, resides in a certain cottage. There then follows a trust for sale and conversion of the whole estate and a trust of the proceeds in the following terms:—

"Upon trust to invest the same upon such security and generally in such manner as my trustees shall think fit with power to alter and vary any such investment or investments for another or others and to pay the net income or profits to be derived from such investment or investments in equal shares between my said ten sons and daughter during their respective lives, but so that each of them shall have the personal enjoyment thereof and not have the power to mortgage encumber or deprive himself or herself thereof by way of anticipation the share of my said daughter to be for her sole and separate use and free from the debts control or engagements of any husband and from and immediately after the death of each of my said sons and daughter upon trust as to one-eleventh part or share of the capital of my said trust estate for the child if only one or the children if more than one of the son or daughter so dying in equal shares and proportions as tenants in common and I declare that in the event of the death of any or either of my said sons or daughters without leaving lawful issue him or her surviving then and in such case the share of such son or daughter so dying shall be held upon trust in equal shares for the survivor or survivors of my said sons and daughter in the same manner as the original share devised to him her or them by this my will."

The case was also argued upon the footing that the payment of 9*s*. 6*d*. per share was the payment of a dividend by the directors in due and proper exercise of the powers conferred upon them by Article 124. Further, it is common ground, and rightly so, that the shares of the Buttabone Company rank as authorised investments of the trust funds, both under the will and the declaration of trust.

These being the relevant facts of the case the point for decision is capable of statement thus : Is the sum of £19,380 " net income or profits to be derived from such investment or investments," or is it " capital of my said trust estate " ?

The question which thus arises is one which may frequently occur when investments, representing a settled trust fund, include shares in a limited company which are not restricted to a fixed rate of dividend. So long as such a company is a going concern and is not restricted as to the profits out of which it may pay dividends, it may distribute as dividends to its shareholders the excess of its revenue receipts over expenses properly chargeable to revenue account. The balance to the credit of profit and loss account may in many cases be divided as dividend even if the Company's capital account is in debit ; and such a distribution by way of dividend would, *prima facie*, be " income or profits " of the trust share, and belong to the tenant for life ; it would not be " capital of my trust estate." On the other hand, if the company instead of distributing the same balance as dividends, resolved upon liquidation, the shareholder would be repaid his share capital and in addition the share of surplus assets in the liquidation attributable to his shares. The moneys received by the shareholder in the liquidation may be swollen by reason of the fact that the company has in its possession undivided profits, but no part thereof would belong to a tenant for life as income ; it would all be *corpus* of the trust estate.

From this it would appear that moneys paid in respect of shares in a limited company may be income or *corpus* of a settled share according to the procedure adopted, *i.e.*, according as the moneys are paid by way of dividend before liquidation or are paid by way of surplus assets in a winding up. Each process might appear to involve some injustice, the former to the remainderman, the latter to the tenant for life.

In truth the only method by which the rights of the respective *cestuis que* trust can be safeguarded and made incapable of being varied or affected by the conduct of the company, is by the insertion of special provisions in the trust instrument clearly defining the respective rights of income and *corpus* in regard to moneys received by the trustee from limited companies, in respect of shares therein held by him as part of the trust estate.

The learned Judge in the present case decided that the two sums in question should be treated as *corpus* and not as income. The grounds of his decision appear to have been that the answer to the question depended upon what was the intention of the

Company in making the distribution, and that upon the whole of the evidence he came to the conclusion that the distribution was in fact, and was intended by the Company to be, a distribution of capital assets in anticipation of liquidation. He further held that in order to convert profits into *corpus* as between tenant for life and remainderman, no conversion by the company of the profits into share capital was necessary, but that profits distributed might be *corpus* as between tenant for life and remainderman, even though no part of the fund was retained by the company in a capitalized form. As regards this part of his decision he realized that such a view was in conflict with the judgment of Eve, J. in *Bates, Mountain* v. *Bates* [1928], Ch. 682, but he felt himself bound to consider the law as settled otherwise by reason of two decisions of the High Court of Australia, viz., *Knowles* v. *Ballarat Trustees* (22 C.L.R. 212), and *Fisher* v. *Fisher* (23 C.L.R., 337).

It will be necessary for their Lordships to consider these three authorities, and to decide which of them, in their view, is based on a correct interpretation of the law.

Before doing so it would seem advisable to draw attention to certain salient points relevant to the matter in debate.

(1) A limited company when it parts with moneys available for distribution among its shareholders, is not concerned with the fate of those moneys in the hands of any shareholder. The company does not know and does not care whether a shareholder is a trustee of his shares or not. It is of no concern to a company which is parting with moneys to a shareholder whether that shareholder (if he be a trustee) will hold them as trustee for A absolutely or as trustee for A for life only.

(2) A limited company not in liquidation can make no payment by way of return of capital to its shareholders except as a step in an authorized reduction of capital. Any other payment made by it by means of which it parts with moneys to its shareholders must and can only be made by way of dividing profits. Whether the payment is called " dividend " or " bonus," or any other name, it still must remain a payment on division of profits.

(3) Moneys so paid to a shareholder will (if he be a trustee) *prima facie*, belong to the person beneficially entitled to the income of the trust estate. If such moneys or any part thereof are to be treated as part of the *corpus* of the trust estate there must be some provision in the trust deed which brings about this result. No statement by the company or its officers that moneys which are being paid away to shareholders out of profits are capital, or are to be treated as capital, can have any effect upon the rights of the beneficiaries under a trust instrument which comprises shares in the company.

(4) Other considerations arise when a limited company with power to increase its capital and possessing a fund of undivided profits, so deals with it that no part of it leaves the possession of the company, but the whole is applied in paying up new shares

which are issued and allotted proportionately to the shareholders, who would have been entitled to receive the fund had it been, in fact, divided and paid away as dividend.

(5) The result of such a dealing is obviously wholly different from the result of paying away the profits to the shareholders. In the latter case the amount of cash distributed disappears on both sides of the company's balance sheet. It is lost to the company. The fund of undistributed profits which has been divided ceases to figure among the company's liabilities; the cash necessary to provide the dividend is raised and paid away, the company's assets being reduced by that amount. In the former case the assets of the company remain undiminished, but on the liabilities' side of the balance sheet (although the total remains unchanged) the item representing undivided profits disappears, its place being taken by a corresponding increase of liability in respect of issued share capital. In other words, moneys which had been capable of division by the company as profits among its shareholders have ceased for all time to be so divisible, and can never be paid to the shareholders except upon a reduction of capital or in a winding up. The fully paid shares representing them and received by the Trustees are therefore received by them as *corpus* and not as income.

Their Lordships now turn to the decisions which bound the learned Judge and formed the basis of his judgment. Inasmuch as much consideration was given by the High Court of Australia and before their Lordships' Board to the decision of the House of Lords in *Bouch* v. *Sproule* (12 A.C. 385), it is advisable to consider what was the decision in that case and what was the basis upon which it rested. It is not, in their Lordships' view, an authority for the proposition that the company's statement of intention determines as between tenant for life and remainderman whether a sum paid away by the company to a shareholder who is a trustee is income or *corpus* of his trust estate. In *Bouch* v. *Sproule*, no moneys, in fact, left the company's possession at all. It is not an authority which touches a case in which a company parts with moneys to its shareholders. The essence of the case was that the company, not by its statements, but by its acts, showed that what the shareholders got from the company was not a share of profits divided by the company, but an interest in moneys which had been converted from divisible profits into moneys capitalized and rendered for ever incapable of being divided as profits. In those circumstances it was held that shares which were issued to a trustee shareholder, and which represented the moneys so capitalized, were as between his *cestuis que* trust *corpus* and not income, because the company had decided that the profits in question should be permanently added to the company's capital. Lord Watson stated the point concisely when he said:—

> "In a case like the present where the company has power to determine whether profits reserved and temporarily devoted to capital purposes

> shall be distributed as dividend or permanently added to its capital, the interest of the life tenant depends in my opinion upon the decision of the company."

There is no decision in the Courts of this country which justifies the view that a person beneficially entitled in remainder to shares in a limited company, is entitled to any interest in profits lawfully distributed during the lifetime of the tenant for life by a company not in liquidation, and such a view is, their Lordships think, contrary to principle. The nearest approach to such a decision is to be found in the cases which are referred to in *Bouch* v. *Sproule*, and are commonly known as the Bank cases, of which one, viz., *Irving* v. *Houston* (4 Paton. Sc., App. 521), is a decision of the House of Lords. They, however, are cases *sui generis*, not susceptible of easy explanation. As Lord Herschell said in *Bouch* v. *Sproule* (at p. 397), *Irving* v. *Houston* is

> " an authority governing only a case similar in its facts, that is to say, a case where the company has no power to increase its capital, but has accumulated profits, and used them in fact for capital purposes, and afterwards distributes these profits among the proprietors."

In the case of *Knowles* v. *Ballarat Trustees* (*supra*), the facts were that the directors of a limited company which was not in liquidation by resolution resolved upon the payment to the members of (1) a dividend of 6*d*. per share ; (2) a bonus of 6*d*. per share ; and (3) " distribution of assets 10*s*. per share." The holders of some shares in the company (who held them under a will upon trust for a tenant for life) having received these sums, applied to the Court to have it determined whether the 10*s*. per share was income or capital. The will contained no special provisions relevant to the question. The 10*s*. per share was paid out of accumulated profits. The High Court (Isaacs J. dissenting) held that the moneys were capital of the trust estate, because though they were payments of cash made out of accumulated profits the company intended the moneys to be a distribution of capital as distinguished from dividends.

A careful consideration of the judgments delivered by the majority of the High Court Judges satisfies their Lordships that the decision is based upon the view that a company when dividing among its shareholders a sum of accumulated profit, is entitled to dictate and determine whether the moneys so received by the shareholder shall, in his hands, be deemed *corpus* or income. Their Lordships know of no earlier authority justifying this view. It is a matter with which the company has not the remotest concern. If payment to the shareholders is made out of profits it is income of the shares, and no statement of the company or its directors can change it from income into *corpus*. Their Lordships agree with, and are content to refer to, the dissenting judgment of Isaacs J. as a correct exposition of the law.

Before parting with the *Knowles* case their Lordships desire

to say a word in reference to *re Armitage* ([1893], 3 Ch. 337), upon which reliance was placed by Griffiths C.J. and Barton J. The legal position in that case was quite plain. The old company had sold its assets (including accumulated profits) to the new company, for a price which produced surplus assets in the winding up of the old company to the amount of £9 5*s*. 6*d*. for each share of the old company upon which only £8 per share had, in fact, been paid up. Upon no theory could it be said that any part of the £9 5*s*. 6*d*. was payable to the tenant for life. The moneys paid were all surplus assets distributed in a winding up and took the place in the trust estate of the shares themselves. The difference between the £9 5*s*. 6*d*. and the £8 was a profit to the trust estate, just as if the shares had been sold and had realized £9 5*s*. 6*d*. per share; but no part of the £9 5*s*. 6*d*. was income of the tenant for life.

The other decision of the High Court, *Fisher* v. *Fisher* (*supra*), requires no additional discussion. The majority of the judges followed their previous decisions in the *Knowles* case. Isaacs J. again dissented.

These were the two authorities which in the present case Long Innes J. felt constrained to follow, in preference to adopting the reasoning of Eve J. in the later case of *re Bates*, *Mountain* v. *Bates* (*supra*).

There the directors of a limited company had made payments to shareholders out of distributable profit, but had stated:— "It must be clearly understood that this is neither a dividend nor a bonus, but is a capital distribution." Eve J. held that the payments were income receivable by a tenant for life. This appears to their Lordships to be an authority directly applicable to the present case, and their Lordships find themselves in complete agreement with the learned Judge, both as regards his decision and the reasoning upon which it is based. Their Lordships desire to adopt the language used by Eve J., and to say in regard to the fund out of which the sums of £19,380 and £8,360 were paid by the Buttabone Company to the Trustee Company:—

> "Unless and until the fund was in fact capitalized, it retained its characteristics of a distributable property . . . and no change in the character of the fund was brought about by the company's expressed intention to distribute it as capital. It remained an uncapitalized surplus available for distribution either as dividend or bonus on the shares or as a special division of an ascertained profit . . . and in the hands of those who received it it retained the same characteristics."

For these reasons their Lordships are of opinion that the two sums here in question should be treated as income and not as *corpus*. They are "net income or profits derived from such investment or investments"; they are not "capital of my said trust estate."

Their Lordships desire to add that they see no reason for assuming that in making this distribution the directors had

in mind any question of rights as between tenants for life and remaindermen beneficially interested in shares held by trustee shareholders. It may be that they had, but the wording of the circular letter of the 28th November, 1927, appears to their Lordships to indicate that the principal questions present to the minds of the directors were: (1) the relief of their shareholders from liability to pay income tax on the profits distributed, and (2) section 4 (*g*) of the Income Tax Assessment Act, 1924.

Counsel for the respondents addressed to their Lordships a new and alternative argument. It was this. It was said that the distribution of 9*s*. 6*d*. per share out of profits arising from the sale of breeding stock could not have been made if the old Article 122 of the company's had remained unaltered; that no alteration could have been made if the Trustee Company had voted against it; that in not voting against the alteration the Trustee Company has committed a breach of duty; that a breach of duty by a trustee cannot operate to alter the beneficial rights and interests of his *cestuis que* trust; and that as a matter of administration the Court would direct the Trustee Company to deal with the moneys so as to prevent the remaindermen from being prejudiced by being deprived of a fund of which they could not have been deprived if the Articles of Association had not been altered.

This would appear an unusual contention to be raised and determined upon an originating summons issued by a trustee; but it must fail in these proceedings because the basic allegation has not been proved, viz., that the distribution could not have been made under the old Article 122. This is a question upon which (depending as it does upon the consideration of materials not before them), their Lordships express no conclusion.

Their Lordships are accordingly of opinion, upon the materials before them, that the two sums mentioned in the originating summons should be treated as income, and that the decree of the 12th November, 1928, should be varied by substituting the word "income" for the word "capital" in the first declaration therein contained and by substituting the word "income" for the word "*corpus*" in the second declaration therein contained, and they will humbly advise His Majesty accordingly.

Their Lordships, however, feel that an opportunity should be given to any beneficiaries who may desire so to do, to assert in hostile litigation (and at their own risk as to costs and otherwise) a claim to have all or any part of the funds retained as capital upon the ground (as indicated above) that the dividend in question could not have been paid if Article 122 of the Company's Articles of Association had not been altered.

Their Lordships accordingly think that a direction should be given to the Trustee Company not to pay over the moneys

to the tenants for life before the 31st October, 1930. If in the meantime any action is commenced as above mentioned the trustees can apply in that action for directions as to how they should deal with the said moneys pending the decision thereof.

The costs of all parties of this appeal will be taxed as between solicitor and client and paid rateably out of the two sums in question in these proceedings.

In the Privy Council.

ROBERT ALAN HILL AND OTHERS

v.

THE PERMANENT TRUSTEE COMPANY OF NEW SOUTH WALES, LIMITED, AND OTHERS.

DELIVERED BY LORD RUSSELL OF KILLOWEN.

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