Perpetual Trustee Co. Ltd v FCT re Murdoch (1942)
Perpetual Trustee Co Ltd v Federal Commissioner of Taxation [1942] HCA 4; (1942) 65 CLR 572 (17 March 1942)
HIGH COURT OF AUSTRALIA
Perpetual Trustee Company (Limited) Appellant; and The Federal Commissioner of Taxation Respondent.
17 March 1942
Williams J.
Weston K.C. (with him Kitto), for the appellant.
Pitt K.C. (with him Collier), for the respondent.
Williams J. delivered the following judgment:—
Mar. 17
Williams J
This is an appeal by Perpetual Trustee Co. (Ltd.), the executor of the will of the testator, Sir James Murdoch, who died on 30th January 1939, against the assessment of his estate by the respondent for the purpose of Federal estate duty.
The respondent valued the dutiable estate at the date of death first at the figure of £296,388 and subsequently at £419,755, whereas the appellant contends that the value should have been £240,074.
The respondent included in the dutiable estate the sum of £14,445, being the proceeds of a policy of insurance effected by the testator on his life with the branch office at Sydney of the National Mutual Life Association of Australasia Ltd. on 16th June 1915. The policy moneys were payable to the testator's wife in the event, which happened, of her surviving him. The proceeds were made trust moneys by sec. 8 of the Life, Fire and Marine Insurance Act 1902-1938 N.S.W.. There is no provision in the Estate Duty Assessment Act 1914-1928 making them part of the notional estate of the testator. Mr. Pitt, whilst not abandoning the point, did not seriously contend that they were rightly included, and in my opinion this amount should be excluded from the dutiable estate.
On 26th August 1938, and, therefore, within twelve months before his death, the testator gave his three daughters Mrs. Gant, Mrs. Johnston and Mrs. Rouse three sums of £4,348, £4,347 and £4,348 respectively, totalling £13,043, to which his wife Lady Murdoch added three further sums of £2,999, £2,998 and £2,999 respectively, totalling £8,996, the combined gifts aggregating £22,039. The three daughters used the gifts to pay in full for 22,039 shares in the company, Murdoch's Investments Pty. Ltd., for which they applied on 26th August 1938 and which were allotted to them on 2nd September 1938. The respondent included the gifts made by the testator in his dutiable estate at their cash value; but in view of the decision of this Court in Trustees Executors and Agency Co. Ltd. v. Federal Commissioner of Taxation[1] Mr. Pitt conceded, as he was bound to do, that the value for duty would be determined by ascertaining the value of the shares into which the moneys can be traced on 30th January 1939.
It appears that the testator had been engaged for many years in the business of a retail shopkeeper at the corner of Park Street and Pitt Street, Sydney. In 1928 he caused to be incorporated two companies, namely, Murdoch's Ltd., which has since continued to carry on this retail business, and Murdoch's Investments Ltd.
The articles of association of the investment company, in addition to giving a right to the directors to decline to register any transfer of shares except transfers to certain relatives

without assigning any reason therefor, restrict the rights of members to transfer shares, apart from transfers to such relatives, in the first instance except to members of the company at a fair price fixed in accordance with the articles, and only allow transfers to strangers if no member is willing to acquire the shares at this price. The fair price is fixed by the company in general meeting once in each financial year for the ensuing year; and, if not so fixed in any year, the fair price for such year is the same fair price as was in fact last fixed by the company, and, failing such fixing by the company, the fair price is deemed to have been fixed at 20s. In the event of any party being dissatisfied with the fair price, it is determined by the auditor of the company for the time being as sole arbitrator and his decision is made final. On 30th January 1939, as no fair price had ever been fixed by the company, it stood at 20s. per share. Each share carries one vote, and a director can be removed by an ordinary or extraordinary resolution.

At first the investment company owned the store in which the retail business is carried on and leased it to the retail company, but in 1934 the investment company sold the property to the retail company for the sum of £390,000, the purchase money being satisfied by the purchaser paying the seller £50,000 in cash and giving it a mortgage back for £340,000. The mortgage provided for interest at the rate of 5½ per cent per annum reducible to 4½ per cent per annum on prompt payment, for the reduction of the principal sum by equal instalments of £5,000 each on the thirtieth days of September in the years 1937 to 1944 both inclusive, and for payment of the balance then owing on 30th September 1944, subject to the terms of clause 19. By clause 19 the mortgagor was given the option to extend the time for payment of the balance of principal for another five years, the interest to be at the rate then being charged by the appellant upon trust funds lent on first mortgage of property in the City of Sydney and sums of £5,000 to be repayable on 30th September in each year during the extended period. Clause 20 provided that the Moratorium Act 1932 N.S.W. should not apply to the mortgage, which contained personal covenants to pay the principal and interest, duly certified in accordance with the Act.

During the years ending 30th June 1936, 1937 and 1938 respectively the retail company showed sufficient profits, after payment of the outgoings including the instalments of principal and interest due under the mortgage and making provision for taxation, to leave in round figures balances of £23,000, £20,000 and £26,000, which were more than sufficient to pay in full the annual dividends on the 9 per cent preference shares, totalling £16,300. On 30th June 1938 the balance to credit of profit and loss account was £9,300. According to the balance-sheet of the retail company of 30th June 1938 there remained tangible assets, excluding the mortgaged property, costing £325,000, to satisfy its unsecured creditors, whose debts, including provision for taxation, totalled £18,400.

On 30th January 1939 the principal of the mortgage debt was £330,000; and the value of the mortgaged property, assessed by Messrs. Thompson and Crammond on behalf of the appellant and not contradicted by the respondent, was £327,000; so that, as far as could be judged from the circumstances then existing, the prospects were that the mortgagor would be able to continue to discharge its obligations under the mortgage as they became due, and, in the event of default, the mortgagee would be able to recover the debt in full, either out of the mortgaged property, or, if there was a deficiency, by enforcing the personal covenant.

On 30th January 1939 the share-holding in the investment company, apart from the signatories to the memorandum of association, was as follows: Sir James Murdoch 360,000, Lady Murdoch 20,000, Mrs. Gant 16,347, Mrs. Johnston 16,346, and Mrs. Rouse 16,346. The total shares issued were therefore 429,046, all of which were fully paid except the seven signatory shares. Its main asset, apart from the mortgage, was rent-producing real estate, worth about £95,000, let at good rentals producing over 7 per cent per annum net profit.

Messrs. Thompson and Crammond's valuation of the mortgaged property was made on the basis of a 7 per cent capitalization of the probable net rentals; and, apart from the lifts, did not take into account the value of the fixtures and the fittings, which, with certain other property, appeared in the balance-sheet of Murdoch's Ltd. for the year ending 30th June 1938 at the cost figure less depreciation of £45,931. They valued the mortgage debt at £213,350. As the most probable purchaser would be a company desirous of using the building for its present purpose of an emporium, it would seem that some value should be given to this item. The figure was also arrived at without attributing any value to the personal covenant. Moreover, the prosperous condition of the mortgagor's business and the value of its unsecured assets made it practically certain that it would at least pay the interest and the annual instalments of principal, and that the pinch, if any, would occur when the balance of principal became due in 1949. But keeping in mind the value of the mortgaged property compared to the amount of the debt; that without extensive alterations it would only be valuable for an emporium and therefore would be difficult to sell; that the mortgage had still five years to run with a right to extend the term for a further five years, so that if no default occurred the main balance of the principal would not be recoverable for ten years (whereas the most favoured term in 1939 was for three years); that it was not an independent loan on mortgage but a means for securing the balance of purchase money on a sale; that the rate of interest was low compared to the current rate 5½ per cent for such an advance; that the value of the personal covenant must be considered in the light of the evidence that a purchaser of the debt would only have regard to the value of the mortgaged property; that unless there was default most of the principal would not be recoverable for ten years and the assets securing the personal covenant were such that they could seriously depreciate in value if the mortgagor suffered adverse trading conditions; that some of the assets were of problematical value (as, for instance, shares in subsidiary companies), and trade creditors competing for unsecured assets might increase; it is necessary, in my opinion, to discount appreciably the value of the mortgage debt. Since Mr. Thompson valued the mortgaged property in 1934 at £324,000, and he and Mr. Crammond value it, with certain alterations, in 1939 at £327,000, it would appear to be unlikely that it would decrease seriously in value by 1949. If, therefore, a purchaser of the mortgage debt was prepared to pay £270,000, the interest returned would be at the rate of 5½ per cent per annum, and he could expect to be repaid £50,000 by ten instalments of principal, so that in 1949 he would have as security a property valued at approximately £327,000 to secure a debt of £220,000; or, in other words, the debt would then be approximately two-thirds of the value of the property; while, if the mortgagor did not exercise its option to extend the term of the mortgage and only repaid the five instalments due in the years 1939 to 1943, the principal would still be reduced to £245,000 or approximately 75 per cent of its value, which, Mr. Crammond said, would be the maximum percentage a speculator relying solely on the value of the mortgaged property would be prepared to pay.

Assuming £270,000 to be the value of the mortgage debt, and accepting the values placed on the real estate by Messrs. Thompson and Crammond and not contradicted by the respondent, the assets of the investment company, if realized on 30th January 1939, might have been expected to produce the following amounts:—Blaski Building £45,000, Warrington £22,000, Tiverton £10,000, 10 Tusculum Street £8,000, the mortgage £270,000, debtors—advances to C. W. Maughan £170, dep. Murdoch's £3,000, current account Sir James Murdoch deceased £3,957, Commonwealth bonds £9,000, cash at bank £2,715, accrued interest £1,237, total £375,079, less liabilities £3,511 and 1½ per cent expenses of liquidation £5,650 equal £9,161: balance £365,918. This gives a capital value of slightly over 17s. per share.

The appellant urged that the shares must be valued as they existed on 30th January 1939 with the restrictions upon transfer imposed by the articles, whereas the respondent contended that the valuer must take into account the potentiality that the 360,000 shares which the testator owned were more than sufficient to carry a special resolution, and so would enable the executor or the purchaser to alter the articles and remove the restrictions or place the company in voluntary liquidation if it became desirable to realize the assets. The Estate Duty Assessment Act does not, like the statutes in question in such cases as Attorney-General v. Jameson[2], Salvesen's Trustees v. Inland Revenue Commissioners[3], Inland Revenue Commissioners v. Crossman (Ethel Maclean)[4], provide any criterion by which the shares are to be valued, so that it is open to the valuer to take into account every material circumstance existing at the death in order to determine the true value. Since a shareholder is not a trustee of his vote, it is evident that a parcel of shares sufficient to carry a special resolution may have a higher value than parcels which are insufficient for that purpose. Indeed, a shareholder who has the power to appoint or remove the board of directors, to alter the articles, or to place the company in liquidation, possesses an interest which, apart from extraneous circumstances such as companies being treated unfairly in the matter of taxation, is substantially equivalent to absolute ownership. As this was an attribute of the parcel of shares owned by the testator before and after his death it follows that they should be valued on the basis that the executor or a purchaser would have this control over the company. Mr. Weston asked me to find as a fact on the evidence that there was no-one willing to purchase a parcel large enough to give this measure of control, but, to my mind, a finding on this point one way or the other is irrelevant. It is true that in Macarthur Onslow v. The Commissioner for Stamps[5] and in Blackwood's Executors v. Commissioner for Stamps[6] the Full Court of New South Wales, applying Jameson's Case[7] by analogy to the Stamp Duties Act 1898, which did not contain any specific provision that the value should be ascertained on the basis of a sale in the open market, arrived at a value based upon an inquiry similar to that undertaken by the Court in assessing the compensation payable upon a compulsory purchase, where the question is what is the price at which a reasonably willing purchaser would buy the land if it was being put to its best use at the date of resumption, this being the true value of the land to the owner. Such an inquiry postulates a hypothetical purchaser, so that, even where there is only one such purchaser, it must be assumed that the vendor would only be willing to part with the land for its real value and that the purchaser would be willing to pay this amount (Vyricherla Narayana Gajapatiraju

v. The Revenue Divisional Officer, Vizagapatam[8]). When shares in a company are being bought and sold on the Stock Exchange, and there are no abnormalities affecting the market, the price at which the shares are changing hands in the ordinary course of business is usually their true value; but, as Denniston J. said in In re Alfred Louisson[9]: "In every case what is wanted is the actual value (the market price is simply a convenient way of getting at such value), making, of course, due allowance for anything incident to the nature and character of joint-stock shares in comparison with ordinary partnership assets": See also Commissioner of Stamp Duties v. Haynes[10]; Myer v. The Commissioner of Taxes[11].

On the present appeal there are two parcels of shares to be valued, those owned by the testator and those allotted to the three daughters on 2nd September 1938. It could be urged that the latter parcel should be valued at a lower amount than the former because they did not carry the voting control already mentioned. But by his will the testator bequeathed his residuary estate, which included the shares, to his daughters equally, directing that their interests should be settled on themselves for life with the remainder to their issue, so that, since the executor would be certain to consult the daughters in exercising its voting rights, the will might provide a sound reason for not allotting different values to the two parcels. But in any event I cannot see why, in all the circumstances of the present case, the restrictions on transfer should have had any depressing effect on the value of the daughters' shares so long as that value was not fixed in excess of the fair value of one pound per share. The expenses of management were trifling, sec. 103 (2) (e) (a) of the Income Tax Assessment Act 1936 (Federal) in effect required the distribution of the whole of the net profits by way of dividend, and small shareholders would be safeguarded against unfairness or injustice by the Companies Act 1936 N.S.W., sec. 208 (2), which authorizes the Court to wind up a company if satisfied that the directors have acted in their own interests rather than in the interests of members as a whole.

The main items to be taken into account in valuing shares are the earning powers of the company and the safety of the capital assets in which the shareholders' money is invested.

Transferability of the shares is also important, but, in certain classes of companies, not registered on the Stock Exchange, restrictions would not necessarily depreciate the value of the shares so long as they were not such as to destroy such a right of transfer as was reasonable in the circumstances. Where it is intended that more than twenty persons shall undertake business with a view to the acquisition of gain they must incorporate themselves into a company, but, where the number is less than twenty, the main advantage of incorporation, as opposed to partnership, is that the liability of the shareholders is limited. Where a person has assets which he desires to invest on mortgage or in rent-producing properties he usually acts solely or as a member of a partnership, and it is unusual to find companies formed for such a purpose, because such investments are not likely to involve the investor in any serious liability. Where, therefore, the assets of the company comprise such investments, particularly the former, its shares would not be attractive except to a small number of investors, but this limited class would surely be satisfied to accept a yield on their shares appropriate to the assets in which the company's capital was invested. So, where a company's assets consisted solely of investments in mortgages secured on good rent-producing properties with ample margins, and those mortgages were in January 1939 producing 5 per cent per annum, the then ruling rate of interest on loans by trustees, it would be difficult to attribute any but a value approaching par to the shares; and, as 7 per cent per annum was at that time considered a fair return on funds invested in rent-producing real estate in good localities, one would expect the shares of a company owning such real estate also to have such a value. And it must be remembered that the relevant taxation Acts at that time contained equitable provisions to prevent double taxation, the taxation paid by companies being allowed as a rebate to the shareholders, so that where their rates exceeded that of the company the company had in effect prepaid a part of their tax for their benefit.

The appellant sought to justify a value of nine shillings to eleven shillings per share by comparing the position of the investment company, especially with respect to earning power, capital security, and transferability of the shares, with other companies, alleged to be comparable, registered on the Stock Exchange. I agree with the respondent's contention that none of these companies are in fact comparable. In so far as they throw any light on the problem, they appear to me to support the valuation of seventeen shillings per share. The main assets of most of them were subject to substantial mortgages, and in many cases there were several classes of shares. No serious disadvantage need be attributed to either of these factors where the net tangible assets provide adequate security for the capital and there is no internecine dispute existing between the different classes; and in the case of the preference shares the dividend was generally covered many times by the profits of normal years; but a company which has no debt and only one class of shares would appear to have a slight advantage over a company which is heavily indebted or has several classes of shares, and in the case of preference shares the fact that on a winding up they are usually only entitled to a return of their nominal capital must have some slight effect on the excess of their market value over par which would tend slightly to increase the dividend yield. Moreover, preference shares are generally only entitled to a fixed cumulative dividend and do not participate in any surplus profits after paying a dividend on the ordinary shares or in the issue of bonus shares.

The assets of two of the companies, Brook House Ltd. and Hampton Court Ltd., were rent-producing real estate. The yield from the former was £6 13s. 4d. per cent and the latter £6 5s. 9d. per cent, so that the yield from the rent-producing property of the investment company was quite comparable with that of these two companies. The average yield from a number of preference shares in companies which Mr. Spier considered to be comparable was £6 1s. 8d. per cent, the average number of times the dividend was covered by the profits being 4.66 and the average net tangible assets per one pound preference share £4 8s. 5d. It is to be noted incidentally that the average yield from four of the most favoured of these companies, Anthony Hordern & Sons Ltd., David Jones Ltd., Farmer & Co. Ltd. and Hordern Bros. Ltd., is only 5 per cent; but, assuming an investor could buy sound preference shares which could be relied upon to produce a yield of 6 per cent in normal years, this could not affect the yield an investor would expect who preferred to invest in a company owning the assets possessed by the investment company for, as Mr. Quinan said: "Freehold property is naturally a better asset than plant and machinery, or, we will say, stock." Moreover, taking the profits of the investment company for the year ending 30th June 1938, as adjusted by Mr. Nelson, at £17,949, the yield to an investor who purchased shares at seventeen shillings would be almost 5 per cent, or practically the same as the yield from the preference shares of the four companies already mentioned and above the yield from those of Farmer & Co. Ltd. and David Jones Ltd.

Sharebrokers would no doubt advise their clients that it would be better to invest their money in the preference shares of companies registered on the Stock Exchange producing a well-covered dividend yield of 6 per cent instead of in the investment company yielding 4½ per cent; but it is difficult to follow the contention that the shares in the investment company would not be as attractive if purchased at the price of fifteen shillings, which would give the same yield, unless it is based on an over-emphasis of the slimming effect of the restrictions on transfer and of non-registration on the Stock Exchange, incidents which appear to tend to restrict the number of purchasers rather than to depress the value of the shares; so that, even looking mainly to the yield, I am unable to follow the estimates ranging from nine shillings to eleven shillings, submitted on behalf of the appellant. At nine shillings, the capital cost of the mortgage debt to the purchaser would only be £91,000, while for each one shilling above nine shillings this cost would increase by £21,451, figures which show decisively such estimates do not give sufficient weight to the importance of capital value.

The conclusion is that the value of both parcels of shares on 30th January 1939 was seventeen shillings per share. At this price the shareholder in the investment company would have obtained an interest in assets producing a satisfactory yield having regard to their character and affording ample security for his capital.

The appeal should therefore be allowed and the matter remitted to the respondent to reassess the appellant on the basis that the sum of £14,445 should be excluded from the dutiable estate, that the gifts to the daughters should be valued for the purposes of duty at 17/20ths of £13,043 and the testator's 360,000 shares in the investment company at seventeen shillings each.

As to costs, the appellant has succeeded on the points of law relating to the insurance policy and the basis of valuing the gifts to the daughters. On the facts, it alleged the testator's shares in the investment company should be valued at eleven shillings. The respondent's valuation of twenty shillings has been substantially reduced, but only by a third of the amount at issue between the parties. On the whole I think I should order the respondent to pay half of the appellant's taxed costs.

Appeal allowed. Remit the matter to the respondent to reassess the appellant on the basis that the sum of £14,445 being the proceeds of the policy of life insurance effected by Sir James Murdoch deceased with the National Mutual Life Association Ltd. on 16th June 1915 in trust for his wife if she survived him is to be excluded from the dutiable estate of the deceased and that the gifts totalling £13,043 made to his three daughters on or about 26th August 1938 are to be valued at £11,086 and the 360,000 shares of one pound each held by the deceased in Murdochs Investments Ltd. at £306,000. Respondent to pay one-half of appellant's taxed costs.