constituted by an act of a positive nature, such as the giving of negligent advice, then the breach would have occurred at that point of time with the result that the limitation period in contract would have run from that time. That in turn demonstrates why the decision of Oliver J. on the tort issue is of such potential importance in the situation of a professional advisor giving negligent advice to his client who later suffers consequent loss.

BOUCHE v SPROULE[1] *IN AUSTRALIA*

W.A. Lee*

For as long as the Australian taxation system does not particularly penalise the creation of life interests it is to be expected that testators, and even sometimes settlors *inter vivos*, will create life interests and that trustees for life tenants and remaindermen will be faced with the numerous problems associated with the maintenance of the capital and income accounts.

Moreover with the increased activity of trustee investment in the stock market, and the volatility of that market, capital and income issues are bound to arise for trustees who are holding stocks and shares in their trust portfolio. This article examines the duties of the trustees who hold stocks and shares upon any trust which requires the separation of the capital and income accounts and recounts some of the Australian authorities demonstrating the law in fact situations untested elsewhere.

Where stocks or shares are settled upon trust they are normally to be regarded as part of the capital assets of the trust, although the company itself is not concerned with the fact. As Baggallay J. said in *Re Bouch*[2]: "The company are not supposed to know anything about tenant for life or remainderman. They only know the registered holder."

Where the company pays a dividend to the trustee as such registered holder that dividend is normally to be regarded as a distribution of income, payable to the tenant for life. As Roper J. said in *Blakewell* v. *Holme*[3]:

> "Normally any dividend paid by a company whether it be from business profits or capital profits is income in the hands of a trustee shareholder to which life tenants are entitled."

And Vaisey J. said in *Re Kleinwort's Settlement Trusts*[4]:

> "These accretions to the normal income of the trust fund are sometimes metaphorically described as 'windfalls'; and when they have left the parent tree, I can see no principle for notionally replacing them on the boughs from which they have fallen."

* B.A. (Manc.), L.L.B. (Lond.), Reader in Law, University of Queensland.

1. (1887) 12 App. Cas. 385.
2. (1885) 29 Ch.D. 635 at p. 650.
3. (1934) 44 S.R. (N.S.W.) 150 at p. 154.
4. [1951] Ch. 860 at p. 863.

The form in which the dividend is received makes no difference: it may, for instance, consist of shares in another company in which the company has invested past profits or with which it has come to some agreement,[5] or upon nationalisation,[6] or a distribution, in lieu of arrears of dividend of the company's own shares surrendered for the purpose by another shareholder.[7]

Likewise if a company carries profits into a reserve account for some time and eventually distributes these reserves, the distribution will be income in the hands of a trustee shareholder.[8] Moreover:[9]

> "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 authorised reduction in capital. Any other payment made by it 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.
>
> 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."

So that apart from any apportionment to be made at the commencement or termination of the trust, or upon a change of income beneficiary, apportionments with which this article is not concerned, such dividends are not normally apportioned at all.

On the other hand, where a company is lawfully *reducing* its capital or being wound up, and dividends are paid to trustee shareholders by way of such reduction or winding up, then such dividends are capital in the hands of the trustees. The trustees are simply recovering the trust's investment in the company.[10] Conversely, calls on shares are payable out of capital and if the life tenant pays calls on shares he will normally be entitled to reimbursement out of capital.[11] It appears that a distribution of profits as capital should not be regarded as a reduction of capital for this purpose, and that those cases[12] where such distributions were made and were held to be capital as between life tenant and remainderman should be regarded as overruled.[13]

But these principles may become confused where a company decides to capitalise profits by using profits either wholly or partly in the financing of share issues. What often happens, where a company

5. *Re Thomas* [1916] 2 Ch. 331.
6. *Re Sechiari* [1950] 1 All E.R. 417; *Re Kleinwort's Settlement Trusts* [1951] Ch. 860.
7. *Re McIver's Settlement* [1936] Ch. 198.
8. *Re Connolly* (1903) 3 S.R. (N.S.W.) 57; *Drew* v. *Vickery* (1919) 19 S.R. (N.S.W.) 245.
9. Per Lord Russell of Killowen in *Hill* v. *Permanent Trustee Co. of N.S.W.* [1930] A.C. 720, at p. 731.
10. *Re Armitage* [1893] 3 Ch. 337; *Re Hassell* [1916] V.L.R. 594; *Re Barritt's Trusts* [1962] S.A.S.R. 293; *Hill* v. *Permanent Trustee Co. of N.S.W.* [1930] A.C. 720, at p. 729.
11. *Todd* v. *Moorhouse* (1874) L.R. 19 Eq. 69; *Smith* v. *Barton* (1896) 17 N.S.W.R.Eq. 180; *Day* v. *Day* (1903) 4 S.R. (N.S.W.)21.
12. eg. *Knowles* v. *Ballarat Trustees, Executors and Agency Co. Ltd.* (1916) 22 C.L.R. 212; *Fisher* v. *Fisher* (1917) 23 C.L.R. 337; *Perpetual Trustee Co. Ltd.* v. *Champion* (1921) 21 S.R. (N.S.W.)501.
13. By *Hill* v. *Permanent Trustee Co. of N.S.W.* [1930] A.C. 720.

wishes to capitalise profits, is that it declares a dividend of the profits and at the same time invites the shareholder to purchase new stock which the company is issuing. If the trustee is given a free economic choice in the matter, so that he may accept the dividend, then the dividends must be regarded as income of the trust in accordance with the principles just outlined. Even if he decides to use the dividends to purchase the new shares, the new shares will be regarded as belonging to the life tenant;[14] and if a proportion of the cost of the new shares is furnished out of dividends that proportion will be regarded as income of the trust and the tenant for life will be entitled to a charge on the shares allotted for the amount of that proportion.[15]

But this may not happen in practice because in many cases the offer which the company makes to its shareholders is particularly advantageous to them, so advantageous that they are under a "practical compulsion" to accept it. It is an offer which cannot be refused: and a trustee shareholder, faced with so advantageous an offer, is under an even greater compulsion to accept it because he is dealing with trust funds which he has a duty to preserve. Sometimes the shareholder-trustee is given no choice in the matter anyway.[16] Under the rule known as the rule *Bouch* v. *Sproule*[17] bonus issues of shares accepted in such circumstances are regarded as capital and accrue to the capital of the trust. In *Hawkins* v. *Hawkins*[18] a company issued a cash bonus and at the same time offered in allotment of shares upon such advantageous terms that it amounted practically to a compulsion on the shareholders to use the dividend to pay for the allotment. Referring to the question of practical compulsion Harvey J. said:[19]

> "The compulsion upon the shareholder need not be legal or contractual, but may, in the words of Issacs J in *Mitchell* v. *Hart* [(1914) 19 C.L.R 33 at 41.] arise from the ordinary promptings of human nature. 'Such compulsion arises', he says, 'where the bonus or dividend is so offered that the ordinary instincts of human self interest of a reasonably prudent man will naturally and instantly direct the money back into the coffers of the company in exchange for the new shares contemporaneously offered, notwithstanding that these are legally refusable by the shareholders.' That appears to be the test which in the light of these authorities the Court has to apply to the facts of the present case. In our opinion the company, under the terms in which it made the offer of shares in this case, did apply that practical compulsion to its shareholders seeing that the refusal of the shares would on the facts mean a considerable net loss to the shareholders."

There are several Australian cases in which practical compulsions have been found so that bonus share issued have been added to the

14. *Re Despard* (1901) 17 T.L.R. 478; *Re Kennon* [1924] V.L.R. 478.
15. *Mitchell* v. *Hart* (1914) 19 C.L.R.33; *Re Jones* [1917] St.R.Qd.74; *Re Sichlau* [1927] V.L.R. 355; cf. *Re Malam* [1894] 3 Ch. 578.
16. *Re Wilkinson* [1954] V.L.R.486.
17. (1887) 12 App.Cas. 385.
18. (1920)20 S.R. (N.S.W.) 550.
19. Ibid., at p. 557.

corpus of the trust.[20] And in *Re Wilkinson,* Gavan Duffy J. said[21]:

> "Where a company has authority to increase its capital and issues bonus shares out of accumulated income without giving shareholders any election to take their share in the form of a cash payment, the bonus shares are, in the absence of a contrary intention expressed in the will, to be treated as capital."

It is possible to express doubts as to the propriety of the rule just enunciated. In favour of the rule it may be said that where bonus shares are so allocated the price of the company's shares will fall because the value of all the shares, old and new, will still reflect only their total asset backing, which has not changed. So that bonus shares which are issued without payment to trustees should always be regarded as capital.[22] To give the tenant for life the bonus shares would be to deplete the value of the old shares in the capital account. Further, where a company capitalises its profits it effectively ensures that these profits can no longer be divisible among its shareholders as profits. On the other hand, against the rule, it may be said that if a company decided to distribute and not capitalise the tenant for life would undoubtedly take the distribution, but the value of the shares would fall, their asset backing having been reduced. Further, when it is observed that it lies within the power of the company to decide whether to impose a practical compulsion upon its shareholders or to offer them a free choice it seems, paradoxically, to lie within the power of the company to decide whether the tenant for life or the remainderman shall take company profits. But in *Bouche* v. *Sproule* itself Lord Herschell quoted[23] the judgment of Fry LJ in the Court below:

> "When a testator or settlor directs or permits the subject of his disposition to remain as shares or stock in a company which had the power either of distributing its profits as dividends or of converting them into capital, and the company validly exercises this power, such exercise of its power is binding on all persons interested under the testator or settlor in the shares, and consequently what is paid by the company to the shareholder as capital, or appropriated as an increase of the capital stock in the concern, enures to the benefit of all who are interested in the capital."

The justification, therefore, for in effect enabling the company to decide whether profits shall become capital or income of the trust is that the settlor authorised those shares to remain as part of the trust estate. In any case it is not that the company decides whether the profits shall go to the capital or income of the trust estate: all the company decides is whether profits shall be distributed or capitalised, and it does that without regard to any question of whether some of its shareholders happen to hold the shares upon trusts with which it is not concerned.

Nevertheless it is understandable that the rule in *Bouch* v. *Sproule*

20. *Will of Woolcott* [1905] V.L.R.599; *Perpetual Trustee* v. *Cohen* (1916) 16 S.R. (N.S.W.) 242; *Douglas* v. *Lawler* (1916)16 S.R. (N.S.W.)253.
21. [1954] V.L.R. 486 at p. 489.
22. *Re Hart* [1954] V.L.R. 239.
23. (1887) 12 App. Cas. 385 at p. 397.

has been subject to certain assaults, and the particular assault, which has been made more effectively in Australia than in England, is where the trustee shareholder has, by reason of shares vested in him, decisive powers of voting in the company board room when the issue of distribution or capitalisation of profits arises. Then, in exercising those powers, the trustee shareholder is under a fiduciary obligation to safeguard the rights of the successive beneficiaries under his trust. In observing this obligation Australian cases demonstrate whilst acknowledging the integrity of his discretion as trustee that sometimes it is proper for him to support the company in its proposal to capitalise and sometimes it is his duty to oppose the company's proposal: it may well depend on the history of the source of the profits which it is sought to capitalise. In *Re Zimpel*[24] for instance the court insisted, when a trustee sought advice as to whether he should vote in favour of or against capitalisation of profits, that he should vote against capitalisation because it is his duty to maintain the status quo as between beneficiaries and that status quo would be disrupted by the proposed capitalisation. But in *Re Campbell*[25] trustees had power as directors and shareholders of a company to deal with accumulated profits in various ways, all of which would affect their destination as capital or income of the trust fund. Helsham J. reiterated the rule that the trustee must exercise his voting power so far as possible to maintain a strict impartiality between tenant for life and remainderman, and then considered the circumstances in which the profits in the case before had been accumulated, saying that they had been accumulated for the most part before the trust had been created. He then said:[26]

> "For these reasons I believe the trustees would be justified in regarding the sum as something that ought to be treated as an asset of the estate at the time of death, and in using their position as shareholders to ensure that the right steps are taken to see that it becomes such. The decisions must be that of the trustees, having regard to the trust instrument and all the circumstances; but they would be justified in adopting this view upon the material that has been placed before me."

In the New Zealand case of *Re Bell*[27] the court recognised explicitly that the trustee's duty to his beneficiaries does not negative any element of discretion in the way in which he may decide to vote in the company debate. The trustee shareholders asked the court how they should vote on a question of whether profits should be capitalised. The court advised them to exercise a bona fide discretion in deciding that question and they voted in favour of capitalisation. The court sustained their decision.

Even more interesting is *Hill* v. *Permanent Trustee Co. Ltd.*[28] where the court actually readjusted the rights of life tenant and remainderman where it felt that the trustees had made a mistake

24. [1963] W.A.R. 171.
25. [1973] 2 N.S.W.L.R. 146.
26. Ibid., at p. 157.
27. [1940] N.Z.L.R.15.
28. (1933) 33 S.R. (N.S.W.)527, a sequel to *Hill* v. *Permanent Trustee Co. of N.S.W.* [1930] A.C.720.

respecting their duties and powers as shareholders in this situation. What happened was that the trustee shareholders, who were company directors by reason of their holdings, assented under a mistaken view of the law to a procedure for the alteration of the articles of the company the effect of which was, in the result, to permit funds which were of a capital nature to be distributed as income, so that the tenant for life became entitled instead of the remainderman. The court held that if the trustees had understood the position they would have realised that they should have opposed the alteration in the articles and the distribution would not have been made to the life tenant. Harvey C.J. in Equity said:[29]

> "In my opinion the Court is not bound to hold that because the trustees acted in the exercise of their voting power in a way in which a prudent man might have acted, the respective rights of the tenant for life and remainderman are irrevocably determined. It may not always be easy to ascertain what has prompted a trustee in the exercise of a discretionary power, such as the power of voting at a company meeting; but in my opinion where the motives which have prompted the vote are clearly ascertained, and the reasons for the vote are ascertained to have been based on a mistake of law, the Court ought, if the fund is still in the hands of the trustees, to rectify the mistake of the trustees."

The court consequently adjusted the position in favour of the remainderman.

The rule in *Bouche* v. *Sproule*[30] may be varied by a contrary intention appearing in the trust instrument. In *Re Longley*[31] for instance a testratrix gave upon trust for a life tenant and remainder 'the annual income' from a company in which she was a shareholder. The company paid annual dividends partly from profits but partly from funds which had been built up of accumulated profits. It was held that the part funded from the accumulated profits was capital and did not come within the description of annual income as used by the testatrix. However the court may be reluctant to give a literal construction to expressions of contrary intention where that construction would violate the general policy of the law to protect the interests of all beneficiaries. In *Re Sears*[32] a testator bequeathed to a tenant for life 'all dividends, bonuses benefits and rights accruing' from certain ordinary shares which he owned. The company issued bonus shares to existing shareholders on the basis of two ordinary shares of 5/- each for each ordinary share held. The question was whether this issue should go to the tenant for life under the wording used by the testator. The court rejected that contention, Virtue J saying[33]

> "Viewing this question of construction broadly I would lean strongly against ascribing to the words used by the testator a meaning which would confer on the tenant for life capital benefits at the expense of the inheritance. After all, the creation of successive interests in property is

29. (1933)33 S.R. (N.S.W.)527 at p. 539.
30. (1887)12 App. Cas. 285.
31. [1906]V.L.R. 541.
32. (1951)53 W.A.L.R.57; and see *Re Seppelt's Trusts* [1972]S.A.S.R.100.
33. (1951) 53 W.A.L.R. 61.

> normally done with the object of preserving the property intact for the ultimate beneficiary. And I find it difficult to accept a construction which would in the present case reduce the value of the corpus of these trusts to less than one-third of their value at the time of the testator's death a little over six months ago or to believe that such was the testator's intention."

This judgment is in accordance with earlier decisions.[34]

Of comparative interest, in attempting to achieve an overview of the rules just discussed, is the provision of section 5 of the American Uniform Principal and Income Act, which is that all dividends payable in the shares of the corporation shall be deemed principal, and other dividends, including ordinary and extraodrinary dividends and dividends payable in shares or other securities or obligations of corporations other than the declaring corporation, shall be deemed income. Where the trustee has the option of receiving a dividend in cash or in stock of the declaring corporation, it is income regardless of the choice made by the trustee. It is submitted that in the final analysis Australian case law is moving pragmatically in this direction, although it has the capacity to deal with other possibilities.

Lastly it is perhaps proper to point out that the principles just discussed, for the purposes of determining whether company dividends are distributions or capitalisations in relation to the rights inter se of successive beneficiaries under a trust, having nothing whatever to do with the definition of capital and income for the purposes of fiscal legislation. The definition of capital and income in fiscal legislation is exclusively a matter of the interpretation of the given legislation.[35]

34. See per Griffith C.J. (quoting Lord Eldon) in *Mitchell* v. *Hart* (1914)19 C.L.R.33 at p. 40 and *Re Speir* [1924] 1 Ch.359.
35. See *Commissioner of Income Tax (Queensland)* v. *Brisbane Gas Co.* (1907)5 C.L.R.96 per Griffith C.J. at pp. 104-5.

Exploiting the Rejected Corporate Opportunity

P.A. Butler*

In the case of *Queensland Mines Ltd.* v. *Hudson*[1] the Privy Council was concerned with the resolution of the problem of whether or not a director should be made liable to account for profits accruing from the exploitation of a business opportunity or advantage specifically renounced by his company. The problem, which was left unanswered in *Regal (Hastings) Ltd.* v. *Gulliver*[2] was decided upon in the director's favour by the Supreme Court of Canada in *Peso Silver Mines Ltd* v. *Cropper*.[3] But that decision was much criticised by some

* LL.B. *(Qld)*, LL.M. *(Lond.)*, Barrister-at-Law, Lecturer in Law, University of Queensland.

1. (1978) 52 A.L.J.R. 399.
2. [1967] 2 A.C. 134n.
3. (1966) 58 D.L.R. (2d) 1.