[HIGH COURT OF AUSTRALIA.]

THOMAS PROUT WEBB (COMMISSIONER OF TAXES FOR VICTORIA) . . . . APPELLANT;

AND

THE AUSTRALIAN DEPOSIT AND MORTGAGE BANK, LIMITED . . . RESPONDENTS.

ON APPEAL FROM THE SUPREME COURT OF VICTORIA.

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MELBOURNE, *September* 5, 6, 7, 8, 16.

Griffith C.J., O'Connor, Isaacs and Higgins JJ.

Income Tax—Profits of company—Assets taken over for realization—Valuation of assets—Decrease in value—Reduction of capital—Surplus above valuation on realization—Articles of association—Income Tax Act 1903 (*Vict.*) (*No.* 1819), *sec.* 9—*Companies Act* 1896 (*Vict.*) (*No.* 1482), *secs.* 48, 88.

Sec. 9 of the *Income Tax Act* 1903 has not the effect of rendering taxable as income profits of a company which would not be income in the ordinary sense of that term.

The fact of the reduction of the capital of a company, pursuant to sec. 88 of the *Companies Act* 1896, is not by itself decisive of the question of what are the profits of the company for the purposes of the Income Tax Acts.

By *Griffith* C.J. and *O'Connor* and *Higgins* JJ.—The articles of association of a company must be taken into consideration in ascertaining the profits of a company within the meaning of sec. 9 of the *Income Tax Act* 1903.

By *Isaacs* J.—Internal regulations as to the disposal of income cannot be so taken into consideration.

The A. company was formed for the purpose of carrying on the business of banking and also to take over, for a certain price paid in cash, shares and deposit receipts, and realize the assets of another company consisting of debts owing to it and real estate held as security therefor. The amount of the price paid was the total amount of the debts so owing. The capital of the A. company was in 1905 reduced pursuant to the *Companies Act* 1896 by a sum

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representing the difference between the price paid for the assets and their estimated value in 1904. Subsequently to the reduction of the capital certain of the assets were realized, some of them for sums less than the values placed on them in 1904, others for greater sums, but all for sums less than the amounts of the debts for which they were securities, with the result that in each of the years 1905, 1906, and 1907 the total amount obtained by realization was greater than the total valuation in 1904 of the properties realized. By certain of the original articles of association provision was made for keeping an account of the realization of these assets, for charging against the sum realized the price paid for the assets, and for placing to the credit of the reserve fund any sum realized beyond that price. On the reduction of capital these articles were replaced by an article providing that all surpluses over the paid-up capital so reduced which might arise on realization should be carried to the credit of the reserve fund. Another of the original articles provided that the reserve fund might be encroached upon for the purpose of equalizing dividends.

Held, that such surpluses of realization in 1905, 1906, and 1907 were not "profits" within the meaning of sec. 9 of the *Income Tax Act* 1903 and were not chargeable with income tax.

Decision of the Supreme Court of Victoria: *In re the Income Tax Acts (No. 1)*, (1910) V.L.R., 240; 31 A.L.T., 205, affirmed.

APPEAL from the Supreme Court of Victoria.

The Australian Deposit and Mortgage Bank Ltd., having been required by Thomas Prout Webb, Commissioner of Taxes for Victoria, to pay further sums for income tax in respect of the years 1906, 1907 and 1908, duly objected, and their objections were heard by a Judge of the County Court, who stated a case for the opinion of the Supreme Court by which he asked whether certain amounts were profits of the company during the years 1905, 1906 and 1907 respectively within the meaning of the *Income Tax Act* 1903 so as to render the company liable to income tax in respect thereof.

The Supreme Court having decided that the amounts in question were not profits and that the company was not liable to pay income tax in respect of them: *In re the Income Tax Acts* (1); the Commissioner of Taxes now appealed to the High Court.

The material facts are stated in the judgments hereunder.

Irvine K.C. and *Pigott*, for the appellant. The word "profits"

(1) (1910) V.L.R., 240; 31 A.L.T., 205.

in sec. 9 of the *Income Tax Act* 1903 means with respect to any year the increase for the year of the surplus of the value of the assets over the liabilities, or else it means such an enhancement of the value of the assets as would, apart from any internal regulations of the company or determination of the directors, be distributable as dividends. The actual use to which such increase or enhancement is put does not affect its character as "profits." Either of those definitions of "profits" affords the only general principle upon which the Commissioner can act, and applying it the sums in question were "profits." An increase of the value of assets without any realization may ordinarily be distributed as dividends: *Buckley on Companies*, 4th ed., pp. 652, 658; *Stringer's Case*; *In re Mercantile Trading Co.* (1); *Lubbock* v. *British Bank of South America* (2).

[ISAACS J. referred to *Salisbury* v. *Metropolitan Railway Co.* (3).]

For the purpose of ascertaining profits a valuation must be put on the assets. This means of ascertaining the profits of a company was recognized and authorized by the *Companies Act* 1896, secs. 24, 48, 49, and First Schedule, and the *Companies Act* 1900, secs. 12, 16, 17 and the Schedule. The word "profits" had a perfectly definite meaning under these Acts, and that is the meaning the legislature meant it to have in the *Income Tax Act* 1903. [They also referred to *Robinson* v. *Ashton* (4); *Binney* v. *Ince Hall Coal and Cannel Co.* (5); *Foster* v. *New Trinidad Lake Asphalt Co.* (6); *In re Income Tax Acts* (7); *California Copper Syndicate* v. *Harris* (8); *Commissioner of Income Tax (Queensland)* v. *Brisbane Gas Co.* (9); *In re Income Tax Acts* (10)].

[HIGGINS J. referred to *Rishton* v. *Grissell* (11)].

The result of a reduction of capital under sec. 88 of the *Companies Act* 1896 is to remove the company from the position in which nothing could be distributed until the original capital was replaced, and put in the position in which any surplus of

(1) L.R. 4 Ch., 475.
(2) (1892) 2 Ch., 198.
(3) 22 L.T. N.S., 839.
(4) 44 L.J. Ch., 542.
(5) 35 L.J. Ch., 363.
(6) (1901) 1 Ch., 208.
(7) (1907) V.L.R., 54; 28 A.L.T., 100.
(8) 5 Tax Cas., 159.
(9) 5 C.L.R., 96.
(10) (1907) V.L.R., 185; 28 A.L.T., 168.
(11) L.R. 5 Eq., 326.

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assets over liabilities, including the amount of the reduced capital, might be distributed as dividends. It consequently gives a new basis for estimating the profits.

[ISAACS J. referred to *Poole* v. *National Bank of China Ltd.* (1); *In re Nixon's Navigation Co.* (2); *In re Lees Brook Spinning Co.* (3); *Lawless* v. *Sullivan* (4)].

Davis, for the respondents. No general rule can be laid down as to what are to be considered the profits of a company: *Bond* v. *Barrow Hæmatite Steel Co.* (5). The word "profits" in sec. 9 of the *Income Tax Act* 1903 means the profits which a company may at any time lawfully under its constitution distribute as such. The memorandum of association and the articles must be looked at for the purpose of deciding what are such profits, for they are an integral part of the constitution of the company. These surpluses of realization are not "profits of the business" of the company, and, therefore, under sec. 48 of the *Companies Act* 1896, they could not be distributed as dividends. The reduction of capital make no difference whatever as to whether these sums are profits. The reduction of capital is in no way a reduction of assets and in no way operates to turn capital assets into profits. It is a mere piece of bookkeeping. [He also referred to *Smith* v. *Anderson* (6)].

Cur. adv. vult.

Sept. 16.

The following judgments were read:—

GRIFFITH C.J. The question for determination in this case is the liability of the respondents to pay income tax in respect of certain moneys received by them in the years 1905, 1906 and 1907. The relevant facts, when disentangled from the irrelevant, lie in a very small compass. But before stating them I will consider the law to be applied to the facts.

Under the *Income Tax Act* 1895 (No. 1374), the basis of assessment of the income of the taxpayer for any year was his

(1) (1907) A.C., 229, at p. 238.
(2) (1897) 1 Ch., 872.
(3) (1906) 2 Ch., 394.
(4) 6 App. Cas., 373.
(5) (1902) 1 Ch., 353, at p. 364.
(6) 15 Ch. D., 247.

actual income for the year preceding the year of assessment, subject to subsequent adjustment if the actual income for the year proved to be more or less than that assessed on the basis of the previous year's income. Under that Act companies were not liable to income tax, which was, however, payable by the members in respect of dividends actually received by them. By the *Income Tax Act* 1903 (No. 1819) companies were put on the same footing as individuals—this is the effect of sec. 5. Sec. 9 provides that "So far as regards any company liable to pay tax the income thereof chargeable with tax shall . . . . be the profits earned in or derived in or from Victoria by such company during the year immediately preceding the year of assessment." It is contended by the appellant that this section in effect prescribes a rule for determining what is income in the case of a company which is or may be different from that applicable to the case of individuals, and that under this rule anything that can be called profits in the widest sense of that term is to be regarded as income. In my opinion the section has no such effect. I think that the words "income" and "profits" are used in their ordinary colloquial sense, and that nothing can be regarded as income which would not be so regarded in the case of an individual. As applied to the case of a company I think that the term "income" necessarily connotes that the company has earned profits: See *Lawless* v. *Sullivan* (1). But it does not follow that all the profits of a company are taxable income. Whether they are or not must depend upon circumstances, one of the most material of which is the object for which the company is formed. For instance, if a company is formed for the purpose of trafficking in shares, profits made by buying and selling shares would be income, but if the company is formed for acquiring and working land it does not follow that upon a sale of the whole or any part of the land at an enhanced price the amount of the enhancement would be income, although it would, no doubt, in the wider sense of the term, be "profit." The object of the section was in my judgment quite different. It effected two purposes. First, it made the income for the preceding year the absolute, instead of the provisional, basis of assessment in the

(1) 6 App. Cas., 373.

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case of companies, and, secondly, it limited the taxable income to the amount earned in or derived in or from Victoria and not elsewhere. With this I think its operation ended. The question for determination in each case is, therefore, what was the income of the company? The income cannot be greater, but may be less, than the profits.

Various sections of the Income Tax Acts were referred to in argument, all of which tend to support this construction, which is, in my opinion, the natural meaning of the words, and I do not think it necessary to deal with them in detail.

I pass now to the facts. The respondent company, which was registered in May 1892 with a nominal capital of £1,200,000, was in reality a reconstitution of a former company of the same name then in voluntary liquidation. The memorandum of association described the objects of the company in general terms suitable to a banking company. Article 2 of the articles of association stated that the company was formed principally for the purpose of purchasing from the liquidator of the old company all or part of its property and assets and for carrying on its business, and authorized the directors to purchase such property and assets accordingly for such price "both money and shares" in the new company, and upon such terms and conditions as the directors should think fit, with directions as to the allotment of any shares forming part of the price. Article 6 provided that a separate account should be kept of the property and assets of the old company and of the purchase money and shares paid for them so as to show the result of the realization of such property and assets. On one side of the account were to be charged the purchase money paid in cash and the amounts of all preference shares, debentures, and deposit receipts issued in exchange for the indebtedness of the old company, which payments and amounts were to carry interest at 5 per centum per annum with half-yearly rests. On the other side of the account were to be placed all moneys received by the company in respect of the property and assets of the old company and a sum of £66,000, representing the Bank premises in Melbourne, which amounts were to carry like interest with like rests, and this account was to be continued until all the property and assets purchased, other

than the Bank premises, had been realized in money. Article 7 provided that when the account should show that the amount realized for the property and assets was sufficient to provide for all the amounts charged against it, and in addition to provide for all the ordinary shares of the company, paid up to £5 and £1 respectively, issued to the shareholders of the old company, the surplus and all future receipts should be placed to the credit of the reserve fund.

As soon as the company was formed it purchased the property and assets of the old company, and took over its liabilities. The consideration agreed to be given to the old company was £1,556,000, which was satisfied partly by the allotment of fully paid preference shares, partly by the allotment of ordinary shares, some paid up to £5 and some to £1, partly by cash, and partly by debentures and deposit receipts to the amount of £713,000. Apart, therefore, from its ordinary banking business, the company was, in effect, as to the assets taken over from the old company, what is sometimes called an assets realization company. As to these assets its business was to realize them, and it is obvious, having regard to articles 6 and 7, that until they were realized there could not be any profit arising from that part of the business of the company. In fact, they have not yet been realized, but the claim for income tax is in respect of a portion of the realization.

In 1904 a valuation was made of the unrealized portion of the assets of the old company remaining in the respondent company's hands, from which it appeared that, as against debts due to the old company and taken over by the new company amounting (without the 5 per cent. interest provided for by article 6) to £1,013,000, the new company held securities valued at only £330,000, showing an apparent depreciation of £673,000. It was throughout assumed that the value of the debts was not greater than the value of the securities. The prospect of making a profit on this part of the company's business was evidently hopeless.

The company thereupon presented a petition to the Supreme Court of Victoria for reduction of capital, and by order of 13th April 1905 it was ordered that the capital of the company should

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be reduced to £216,000. The shares then actually issued and not forfeited were of a nominal reduced value of £198,946 6s., all of which was fully paid.

The appellant's case is founded upon this reduction and its consequences. It is contended that, whereas without a reduction of capital no profit could ever have been earned, and consequently no dividends could have been paid, until the loss had been recovered, the effect of the reduction was to substitute a new basis for estimating profits, and consequently a new justification for paying dividends. It is suggested that the test for determining whether profits have been earned in any year is afforded by the answer to the question "How much better off is the company at the end of this year than it was at the end of last year as the result of the year's transactions?" and that for the purpose of answering this question the estimated value of the assets at the end of any year as shown in its balance sheet is the absolute and necessary starting point of the calculation. And it is contended that the valuation of 1904, which was shown in the balance sheet for that year, constituted this starting point.

In my opinion this is not the true view of the consequence of a reduction of capital.

In *Poole* v. *National Bank of China Ltd.* (1) Lord *Macnaghten* said:—"Until confirmed by the Court the proposed reduction is not to take effect though all the creditors have been satisfied. When it is confirmed the memorandum is to be altered in the prescribed manner and the company, as it were, makes a new departure. With these safeguards, which certainly are not inconsiderable, the Act apparently leaves the company to determine the extent, the mode, and the incidence of the reduction, and the application or disposition of any capital moneys which the proposed reduction may set free."

After the reduction the company proceeded with the realization of the assets of the old company, and in the years 1905, 1906 and 1907 they sold portions of the assets, some few of which realized sums larger than the values placed upon them by the valuation of 1904, but in nearly all instances much less than the amounts of the debts for which they were security.

(1) (1907) A.C., 229, at p. 238.

The appellant contends that the amount representing the excess of the sums realized in these few cases over the values put upon the particular securities disposed of ought to be regarded as profits of the years in which the realizations took place.

Before dealing with this contention it will be convenient to refer to some additional facts and to incidental arguments founded upon them.

Contemporaneously with the reduction of capital, articles 6 and 7 were cancelled, and a new article (105) was adopted, providing that "all surpluses over and above the paid up capital of the company" (as reduced) which might arise "on the realization of the assets of the company" should be carried to the credit of the reserve fund. It is suggested that in this article the term "assets of the company" means the assets taken over from the old company. I do not think that this is the natural construction of the words, but I will assume that it is.

The effect of the new article so construed is that the assets of the old company were still to be regarded as property with respect to which the only business of the new company was to realize it and apply the proceeds in satisfaction of the debit standing against it, which was to be taken to be reduced to the amount of the reduced capital. In this view no profit could arise from the realizations until an amount equal to the total amount of the reduced capital had been realized. It is, indeed, suggested that the term "all surpluses" means the respective surpluses, if any, realized in respect of each separate portion of the assets over and above the value placed on it in the valuation of 1904. But I cannot find any reference in the article to that valuation, or anything to suggest that the assets were to be regarded as individualized, so that there might be a surplus on any particular item as distinguished from a surplus on the whole. The words are "all surpluses over and above the paid up capital of the company," not "over and above the present estimated values of the individual securities held by the company." The subjects of comparison are the reduced capital on the one hand and the assets on the other, and there is no reference to any valuation as a basis of comparison. A further argument is founded upon articles 104 and 108. Article 104 provided that the directors might from time to time carry to

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the credit of a reserve fund such portions of the amount at the credit of profit and loss at any half-yearly balance (after providing for certain specified dividends) as they might think fit having regard to the financial position of the company. Article 108 provided that the directors might from time to time encroach on the reserve fund for the purpose of meeting contingencies or equalizing dividends. It is argued that the effect of new article 105, providing that all surpluses are to be placed to the credit of the reserve fund, is to make them liable under article 108 to be applied to the payment of dividends, and that they therefore become profits. I do not think that this is the fair construction of articles 104, 105, and 108 taken together, or that any such consequence would follow if it was. Even if the reserve fund were regarded as a single indivisible fund, it would not, in my opinion, follow that money placed to the credit of it would necessarily become profits distributable as dividends. If money which could not lawfully (*i.e.*, not without disobedience to the Companies Acts) be distributed were placed to the credit of the fund that money would still be not distributable. Whether any part of the fund represents actual and distributable profits must be ascertained *aliunde*.

In my judgment the fact of the reduction of capital is of itself quite irrelevant to the question whether the sums in respect of which income tax is claimed were profits or not. There may be cases in which the circumstances attendant upon a reduction of capital are such as to show a new basis for estimating the future profits of the company for all purposes, but I think that in the present case new article 105 excludes any such result.

With regard to the argument that the estimated value of the assets of a company as shown in the balance sheet of one year is the necessary starting point for calculating the profits of the succeeding year, I cannot find any foundation for it either in law or reason. It is, no doubt, true that in many cases it is proper before determining the profits of a year's transactions to take into consideration any known depreciation in the value of the assets of the company and consequent diminution of its capital assets: *Stringer's Case* (1). But it by no means follows that an

(1) L.R. 4 Ch., 475.

estimated appreciation of the value of the assets should be regarded as part of the year's profits (though perhaps it may be so regarded in some cases), or that if isolated portions of the assets realize more than was anticipated the excess necessarily represents profit, although, again, it may be so in some cases. The substance of the matter in the present case is that the original debts, so far as they exceeded the estimated values of the securities, were regarded as bad debts, or valueless assets, so that the alleged profits consist of bad debts unexpectedly recovered. I am disposed to think that if in the returns of the income of a trader a bad debt, proved to be such to the satisfaction of the Commissioner, is (under sec. 9 (2) (*d*) of Act No. 1374) brought into account in reduction of what would otherwise be the taxable profit for the year, the taxpayer ought, on receipt of the debt in a subsequent year, to bring it into account as part of that year's profits. In such a case there might be a *quasi* estoppel as between him and the Crown. But if, as in the present case, the debt is, under the regulations of the company, part of the capital assets with respect to which the only business of the company is to realize them, I do not think that any such consequence follows. Nor do I think that the estimate of the value of assets in the balance sheet of one year is *proprio vigore* anything more than a provisional estimate open to be corrected if afterwards discovered to be erroneous. If the rule were otherwise, the amount of the profits of a company in any year, which is a question of fact, would be concluded by the sanguine or pessimistic opinion of its officers of the preceding year. A correction of the estimate in a subsequent year may also be provisional, although, if in the interval any assets have been disposed of for a larger sum than was anticipated, there is *pro tanto* an ascertained fact to serve as a basis for correction, but as to unrealized assets the estimate is still provisional.

In my judgment, therefore, the amounts in respect of which income tax is claimed in the present case were not profits at all, properly so called, but were merely an unexpected accretion to the provisionally estimated value of the capital assets of the company, and retained the character of capital as distinguished

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from income. *A fortiori* they were not annual income of the year within the meaning of the Income Tax Acts.

For these reasons, which are perhaps not quite the same as those of the Supreme Court, I think that the appeal fails.

O'CONNOR J. The determination of the matters in controversy in this appeal depends upon the answer to two questions. First, what is the meaning of the word "profits" as used in sec. 9 of the *Income Tax Act* 1903? Secondly, were the several sums upon which the Commissioner seeks to charge the tax "profits" within the meaning of that section as properly interpreted. "Profits" is a word capable in itself of a very wide or of a very limited meaning and of many shades of meaning between the two. The meaning which it must be taken to have in the document to be interpreted, whether a Statute or other document, depends upon the subject matter, the object aimed at and the context in which the word stands. In the present case the word to be interpreted stands in the section of an Income Tax Act which subjects the incomes of companies to taxation. In ascertaining the taxable amount of the company's income the machinery of the Act is made applicable. The only difference in assessing the incomes of companies and of individuals is that in the case of companies the tax is directed to be imposed on the profits earned in or derived in or from Victoria during the preceding year. I have no doubt that the word "profits" so used in the section must mean such profits as would constitute income having regard to the business of the company and its constitution. There is no indication in the Act that it was the intention of the legislature to do more than tax what might fairly be considered the income of companies. I agree that, having regard to the nature of the company's business and its constitution, the sums in question cannot be regarded as profits in the sense that I have explained. I have read the judgment of my learned brother the Chief Justice, and concur in his reasoning and in his conclusions. I therefore am of opinion that the appeal must be dismissed.

ISAACS J. I am also in favour of dismissing the appeal, except as hereafter mentioned.

By the conjoint operation of sec. 9 of Act No. 1819 and sec. 2 of Act No. 1985, the respondent company was liable to an income tax of seven pence in the pound upon its yearly profits.

During the respective fiscal years in question moneys were received which may be classified as—(*a*) part repayments of long standing debts, obtained by the sale of securities; (*b*) full repayments of long standing debts, obtained in the same way; (*c*) surpluses over debts, obtained from sale of properties which had been foreclosed for long standing debts.

It is claimed by the appellant that all those receipts were taxable income, as profits earned or derived during the fiscal year.

Apart from the reduction of capital the matter would be clear. Classes (*a*) and (*b*) could not then have been regarded as profits. I do not found this objection on the loss of capital, because I do not think the *Income Tax Act* is affected by such a loss. Parliament, in granting a tax on profits for the year, has not indicated that the financial position of a company—any more than that of an individual—is to have any influence in the matter, once the amount of actual profits on the year's working is ascertained. What is to be done with those profits—whether they may be divided among shareholders, or paid to creditors, or used to recoup lost capital—is immaterial for this purpose. If only they are made, that is enough; they are taxable for State necessities. See *per* Lord *McLaren* in *Edinburgh Southern Cemetery Co.* v. *Kinmont* (1), and *per Farwell* L.J. and *Kennedy* L.J. in *Stevens* v. *Hudson's Bay Co.* (2).

The chief argument for the appellant, however, was that one effect of the reduction of capital is that it must for ever after be taken by a Court that all receipts beyond the honestly estimated value of assets representing the reduced amount of capital are profits; and that the Schedule to Act No. 1699, providing for a profit and loss balance, indicates a parliamentary intention to that effect. For some purposes, no doubt, the reduced capital is conclusive. Generally speaking, the company, so long as it does not contravene sec. 48 of Act No. 1482, and any other statutory enactment for the time being applicable, may, subject to its own internal regulations, divide its receipts standing to the credit of

(1) 2 Tax Cas., 516, at p. 532. (2) 101 L.T., 96, at pp. 97 and 99.

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profit and loss. That is, theoretically and legally it may do so. Whether it should do so from a fair and proper business standpoint is quite another question, and depends on the circumstances as they present themselves to honest business men. I do not think the position can be more strongly stated for the appellant than in the words of *Vaughan Williams* L.J. in *In re Hoare & Co. Ltd. and Reduced* (1). The learned Lord Justice said:—"However much capital you have lost at any given date, if your profit and loss account shows a profit balance, then to the extent of that profit balance you are entitled to distribute that money as dividend notwithstanding the fact that you have lost capital which you have not replaced." And again he says (2):—"What has been done is exactly the same as if the balance of profit and loss, that is to say, the profit balance, had existed in sovereigns."

But that is the ordinary case, where the balance sheet shows the profit balance after taking into account all the capital—that is the share capital—actually paid into the coffers of the company.

Is the situation the same after capital has been reduced? Mr. *Irvine* has argued it is. He says, in effect, that from the moment the nominal capital is lawfully fixed at the lower amount, the maximum amount, which the law for all purposes recognizes as the capital of the company, whatever may have been the capital before, is immaterial now; and henceforth it is to be deemed that the profit and loss balance at the foot of the statutory balance sheet is not capital—and not being capital must be profit. The passage I quoted during the argument from Lord *Macnaghten's* judgment in *Poole* v. *National Bank of China Ltd.* (3) is opposed to that view. The money set free is not there stated to be profits, but is still designated by its actual description, namely, capital moneys which the proposed reduction may set free. That was a quotation from his own judgment in *British and American Trustee and Finance Corporation* v. *Couper* (4).

In *Couper's Case* (5) the learned Lord was, as it seems to me, most explicit with regard to the effect of such a reduction, and beyond this reference to his judgment there, I shall quote only

(1) (1904) 2 Ch., 208, at p. 216.
(2) (1904) 2 Ch., 208, at p. 217.
(3) (1907) A.C., 229, at p. 238.
(4) (1894) A.C., 399.
(5) (1894) A.C., 399, at p. 414.

two lines of it "But if capital money is set free by reduction of capital, no one ever suggested that it could not be returned to the shareholders." Those few words contain two expressions inconsistent with the appellant's argument, they are "capital" and "returned," neither expression is applicable to profits. Besides, the Income Tax Acts deal with facts and not fictions. While, on the one hand, they disregard the general question of solvency or insolvency of any taxpayer, and look only at the actual business result of the year's operations, so on the other hand, they do not, as I conceive, attach a liability to him for fictional income, or anything but what a business man looking squarely at his balance sheet would regard as income. We are not without authoritative guidance as to what income for a given year means. The case of *Lawless* v. *Sullivan* (1) appears to me to place this matter in a very clear light. A New Brunswick Act taxed certain companies on the amount of income received by its agents, and each agent was bound to set forth the whole amount of income received during the fiscal year preceding the assessment. The Privy Council said (2):—"It must always be borne in mind that the tax is imposed on the income received during the fiscal year, and what therefore has to be ascertained for the purpose of assessment is the income for an entire year. There can be no doubt that, in the natural and ordinary meaning of language, the income of a bank or trade for any given year would be understood to be the gain, if any, resulting from the balance of the profits and losses of the business in that year. That alone is the income which a commercial business produces, and the proprietor can receive from it." In this case as in that there is nothing to alter that natural meaning of the word "income."

We then have to ascertain on broad business principles whether the moneys received from the sale of the securities, as they have been indiscriminately called, are properly included among the profits for the year. This takes us to the origination of the bank. Its memorandum shows it to be substantially a banking and financial company, and it has never done any other business. Its original purchase in 1892 included a number of choses in action consisting of debts owing by customers of the old company, and

(1) 6 App. Cas., 373.

(2) 6 App. Cas., 373, at p. 378.

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as it took over the debts, it took, not by force of any purchase of land, but as appendant to the debts, the securities for their repayment. Act No. 1356 placed the new company in complete possession of the assets of the old company. Thus the present bank, taking the accounts as the foundation of its business existence, stepped into the position of the old bank with respect to the debtors, and thenceforth the debts were owed to the new bank in the ordinary course of its banking business, and the several accounts were kept, and interest ran on, and securities were held, as between the new bank and its transferred customers, just as they had been between the old bank and those persons, that is, as separate and distinct accounts. In order to pay for the assets, there has been altogether £899,235 capital paid up directly or indirectly. On the facts as stated, that is not yet repaid or represented by equivalent assets, and so, without attempting to replace any fixed assets lost or depreciated, the debts of the old bank's customers consequently must be taken as representing part of that capital in fact sunk or employed in the business. The result is that during the fiscal year in question the moneys obtained from sale of the securities, so far as they consist of principal moneys, are not profit in any sense, they are *pro tanto* the realization or reduction into possession at actual cost of the property purchased, without any business addition. It is to that extent just as if the bank had not carried on any business whatever, but merely realized previously existing property. The position is very much like that in *Secretary of State in Council of India* v. *Scoble* (1) where the Secretary of State for India purchased a railway, and the purchase money was represented by an annuity, each half-yearly payment representing partly an instalment of purchase money and partly interest on the unpaid portion. The House of Lords held that income tax was not payable on the portion of the annuity representing capital because capital was not taxed as income. Lord *Halsbury* L.C. said in terms very apposite to the present case (2): "You start upon the inquiry into this matter with the fact of an antecedent debt which has got to be paid; and if these sums, which it cannot be denied are partly in liquidation of that debt which is due, are to

(1) (1903) A.C., 299.

(2) (1903) A.C., 299, at p. 303.

be taxed as if they were income in each year, the result is that you are taxing part of the capital." See also *per* Lord *Shand*. In the case of *Stevens* v. *Hudson Bay Co.* (1) *Farwell* L.J. applied the same principle to receipts for the sale of land, but not in the course or as part of the company's business.

I therefore conclude that, with the exceptions to be now mentioned, the sums claimed to be included are not taxable.

The exceptions are: for 1905, £45 excess on Linton's account; for 1906, £98 surplus on Boyle's account; and for 1907, £734, being the sum of the last five items for that year. They stand in the same position as the interest on the *Scoble* annuities, and these, as Lord *Shand* said, were profits. They have come into the bank not as original assets, but as the result of its trading operations, and after allowing for all the expenditure properly debited to revenue, a profit balance for the year has resulted, to which the amounts referred to ought to be added. I do not think any internal regulations as to the disposal of income can affect the operation of the Act upon them. They would permit any person to withdraw himself from liability. And that, I think, would be the effect if the original articles 6 and 7 of the company are to relieve it from income tax on the year's operations.

To that extent should the appeal, in my opinion, succeed—but it is only right to say that the mere allowance of these minor amounts was not the real contest either here or in the Supreme Court, though it may be very important in the future, both to the appellant and the respondents.

HIGGINS J. The question is, are the so-called "surpluses" of 1905, 1906, and 1907 to be treated as "profits" of the bank within the meaning of sec. 9 of the *Income Tax Act* 1903 (No. 1819).

Under that section the income of the company chargeable with income tax is to be "the *profits* earned in or derived in or from Victoria by such company," &c.

These "surpluses" represent the excess of the *actual* receipts in respect of certain debts over the *estimated* receipts—estimated in January 1905.

(1) 101 L.T., 96.

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The bank was incorporated in 1892, and purchased all the property and assets of a former bank (of the same name) in liquidation, at the price of £1,556,971. The property and assets purchased consisted mainly of advances made to customers, mostly secured on real estate, and amounting in the books of the old bank to £1,513,362. At the end of 1904 the advances, as appearing in the books, amounted to £1,013,100 7s. 7d.

If things had gone on as usual during 1905, there would have been the same amount of money received in respect of these debts as was in fact received, and the Commissioner of Taxes could not have claimed that any of the moneys received were "profits." The sums received were in fact less than the debts owing. But, according to a valuation made by the company on 26th January 1905, the value of the debts (or rather of the realty which had been taken as security for the debts) was only £329,813; that is to say, £683,287 7s. 7d. less than the advances.

This valuation resulted in resolutions for the reduction of the capital of the company. The resolutions are dated 2nd and 20th days of March 1905, and were confirmed by the Supreme Court on 13th April 1905. The capital of the company was reduced from £1,200,000 to £216,000 (divided into shares of reduced amounts) and the reduction was affected by cancelling paid up capital "which has been lost or is unrepresented by available assets."

A "surplus" was quick to appear after this drastic reduction of the capital. The first "surplus" appeared in the balance sheet for the half-year ending 30th June 1905. The amount was £793 18s. 9d.; and it appears thus: "To reserve fund (surplus on sales of securities fully realized) £793 18s. 9d." This amount was carried forward to the balance sheet for 31st December 1905; and it there is included in a sum of £2,134 1s. 1d. under the head of "Reserve fund (surplus on sales of securities fully realized)." This sum of £2,134 1s. 1d. is the first of the sums alleged to be profits; and in respect thereof the Commissioner of Taxes claims income tax for 1906 on the ground that it is "profits" earned or derived by the company in 1905.

At first sight it seems curious that a mere diminution of the loss expected in respect of certain debts should be regarded as

profits. A owes £100 to the company; the company estimates that it will recover £50; it actually recovers £60: can one call the £10 "profits" earned or derived by the company?

The Commissioner, however, points out that the capital has been reduced; that the liability of the company "to capital" is therefore less; and he urges that the word "profits" means the excess of the value of the net assets over liability to capital. It is not disputed that the other assets would amply meet the liability to capital. It does not follow, however, that because the difference between assets and liabilities is in some cases to be treated as profits, it is to be so treated in all cases. As *Farwell* J. said in *Bond* v. *Barrow Hæmatite Steel Co.* (1): "there is no hard and fast rule by which the Court can determine what is capital and what is profit." We must consider, *inter alia*, the mode and manner in which a business is carried on (*per* Lord *Halsbury* L.C. in *Dovey* v. *Cory* (2)). The truth is, that the meaning of "profits" is not rigid and absolute; it is flexible and relative—relative to each company; and in ascertaining the meaning of the word in any context, we must consider the whole context. The Commissioner also relies on an alteration of the articles which was passed on the same days as the resolutions for reduction of capital (2nd and 20th March 1905):—"105. All surpluses over and above the paid-up capital of the company, as now reduced, which may arise on the realization of the assets of the company shall be carried to the credit of the reserve fund." The reserve fund referred to is that mentioned in articles 104 and 108. It comes originally from profits (article 104); and it can be used for the purpose of meeting contingencies or equalizing dividends (article 108). It is a fair dilemma: if these surpluses are not profits, why should they be put into a fund which is available for dividends? If they are profits, why not pay income tax?

But the dilemma does not embarrass this Court. On this appeal, we have nothing to do with the validity or propriety of the articles. The Commissioner has to satisfy us that these surpluses are profits within the meaning of sec. 9 of the Act No. 1819. To find what are the profits of any given company, it is necessary to consider the nature and objects of the company. In the case

(1) (1902) 1 Ch., 353, at p. 364. (2) (1901) A.C., 477, at p. 486.

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of a mere investing company, the profits are usually the excess of the interest and dividends received over the current expenditure; in the case of a speculative or jobbing company, the turnover and the appreciation and the depreciation of values have to be taken into account. As is said in *Buckley on Companies*, 9th ed., p. 652, "The profits *of the business*" [*i.e.*, if the profits arising from the business of the company are meant] "are the credit balance of a profit and loss account properly prepared, having regard to the definition of the business in the memorandum of association. They are the excess of revenue receipts over expenses properly chargeable to revenue account." Now, according to article 2, this company was formed principally for the purpose of purchasing from the liquidator of the old bank the whole or portion of its property and assets; and accordingly an agreement was made on 24th June 1892 whereby the liquidator sold to this company all the property of the old company in consideration of cash and shares (preference and ordinary). These debts were the chief part of the property so purchased. Under articles 6 and 7 the directors had to keep a separate account of the property purchased from the liquidator, and of the purchase money, &c., given therefor. On one side of the account was to appear the purchase money with interest at 5 per cent. and half-yearly rests; on the other side, the moneys received in respect of the property, with interest at 5 per cent. and half-yearly rests; and this account was to continue until the property (except the bank premises) should be realized in money. But as soon as the account showed that the amount realized was sufficient to satisfy the amounts charged against it, and to provide for the amount of the ordinary shares issued to the shareholders in the old bank, then the surplus and all future receipts in respect of such account were to be placed to the credit of the reserve fund.

So far as these articles 2, 6 and 7 are concerned, it is clear that these debts were not bought to sell again, and were not what is called "circulating capital." (*Bond* v. *Barrow Hæmatite Steel Co.* (1). The bank simply had purchased debts, and was to collect them or realize the securities; and the transactions in respect of these debts were to be kept distinct from the other transactions

(1) (1902) 1 Ch., 353, at pp. 365-368.

of the bank. None of the money recovered, whether for principal or interest, was to be available for the shareholders until the full purchase money with interest should be repaid, and enough obtained to provide for the ordinary shares issued to shareholders in the old bank; and even then any surplus had to go into the reserve fund.

But these articles were cancelled by resolutions of 13th February and 2nd March 1905; and I have already stated the new article 105.

Again, by articles 114-115 the directors were to lay before the company, at each half-yearly meeting, a statement of the income and expenditure for the half-year, showing the gross income and the gross expenditure; and every item of expenditure fairly chargeable against the half-year's income was to be brought into account so that a just balance of profit and loss might be laid before the meeting. After paying the prescribed dividends to shareholders, the directors had power to carry any of the balance of the amount at the credit of the profit and loss at any half-yearly balance to the credit of a reserve fund (article 104). The intention, therefore, when the bank began, was to look to the income account, and to that alone, for profits (as in *Verner* v. *General and Commercial Investment Trust* (1), and distinguish *Stringer's Case* (2)).

Looking, now, at the memorandum of association to find the objects of the company, they are, in substance—(1) to receive money on loan or deposit or debentures; (2) to lend money on any description of property; (3) to issue bank bills of any kind and bank notes, and to buy and sell, exchange or otherwise deal in all kinds of negotiable securities, gold and other precious metals, and every other kind of property real or personal, and to grant letters of credit; (4) to transact any other banking or agency or financial business of any description; (5) to give any guarantee or security for the performance of business of the company; (6) incidental matters. But it was provided by article 10 that the company should not, unless authorized by a special resolution, exercise any of the powers except (1); (2) with limitations; (3) so far only as "to purchase or take up the shares of any building

(1) (1894) 2 Ch., 239. (2) L.R. 4 Ch., 475.

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society or banking company the public stocks and debentures of the Australian colonies and the debentures of any city town borough or joint stock company"; and (6) incidental matters. There has been no such special resolution passed; and the bank has carried on the business as restricted by article 10, and such business as is involved in the purchase of the property of the old bank, under article 2. The only profits made have been profits earned in business of the kind allowed by articles 2 and 10; and in this business there can be no profits by appreciation of values of assets, or by excess of the amount of debts actually recovered over the amount expected to be recovered. Can there be any doubt that if, on these articles, the manager were to be paid by a percentage of profits, he would not be entitled to reckon any of the surpluses realized, or any appreciation of assets, as profits, for the purpose of calculating his percentage? See *Rishton* v. *Grissell* (1); *Frames* v. *Bultfontein Mining Co.* (2). In short, the business of the company has been in fact such that its profits could have been derived only from the excess of current income over current expenditure, and not from the appreciation of assets.

It is urged, however, that in determining what are profits, it is not right to take into consideration the articles of the company, which may be changed from time to time at the will of the shareholders. I do not accede to this argument, so far, at least, as article 10 is concerned. In the first place, the memorandum also can be changed, with the approval of the Court. In the second place, the company may have taken power in its memorandum to carry on certain forms of business which it does not choose, for the time being, to entrust to its directors. The actual profits have to be found; for that purpose the actual nature of the business done has to be found, and this latter the article assists us to find. If, indeed, the articles were to say that certain sums are not profits which must be profits in view of the nature of the business done, no doubt the Commissioner of Taxes and the Court would not be prevented by the words of the articles from establishing the truth. It is not a question of nomenclature.

(1) L.R. 5 Eq., 326.

(2) (1891) 1 Ch., 140.

But even if we look only to the memorandum of association, and to the actual facts apart from the articles, I should reach the same conclusion—that these "surpluses" are not "profits" of this company within the Act 1819. I assume, for the purposes of this special case, that the debts, &c., purchased from the old bank were bought in valid pursuance of the power in the memorandum to "buy . . . . every other kind of property real or personal." Yet there certainly has been no selling or exchanging or dealing in the debts, and therefore no profits of turnover.

If the word "profits" in sec. 9 means—as it probably means—the money which could be distributed among the shareholders in dividends, the same result follows. For, according to sec. 48 (1) of the *Companies Act* 1896, "No dividend shall be payable to the shareholders of any company except out of the *profits arising from the business of such company.*" Article 106 is to the same effect; but it is not necessary to rely on the articles. The same Act, No. 1819, which imposed this tax on profits, relieved the shareholders of tax on dividends. It would seem as if the legislature determined to tax dividends at their source, by taxing the fund from which dividends could be paid; and that fund, as I have shown from the passage in *Buckley on Companies* already cited, is the difference between revenue and expenses, in the case of a company that cannot pay dividends except out of profits arising from its business. In support of this view as to the meaning of "profits" in sec. 9, I may point to the section which next follows (sec. 10) allowing the company to deduct, in the case of dividends on preference shares, a rateable proportion of the tax from each dividend. Moreover, the next section (sec. 11) prescribes, in the case of life assurance companies, that the income taxable shall be 30 per cent. of the premiums received for the year. This leaves no room for taxation on appreciation of values, in the case of such companies. It has to be borne in mind, also, that the taxable objective is *income*—the amount of money coming in within a specified time; and that it is not our duty to strain the words of a taxing Act so as to suit the purposes of the Crown.

I am of opinion that this appeal should be dismissed.

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Appeal dismissed with costs.

Solicitor, for the appellant, *Guinness*, Crown Solicitor for Victoria.

Solicitors, for the respondents, *Davies & Campbell.*

B. L.

[HIGH COURT OF AUSTRALIA.]

JAMES WALTER RAE . . . . . APPELLANT;

AND

CHARLES SIMMONS . . . . . RESPONDENT.

ON APPEAL FROM THE SUPREME COURT OF NEW SOUTH WALES.

H. C. OF A. 1910.

SYDNEY, *Aug.* 24.

Griffith C.J., Barton, Isaacs and Higgins JJ.

Pastures Protection Act 1902 (*N.S.W.*) (*No.* 111 *of* 1902), *secs.* 49-52—*Local Government Act* 1906 (*N S. W.*) (*No.* 56 *of* 1906), *sec.* 75—*Destruction of rabbits on roads — Powers of Pastures Protection Board — Interference with roads under control of shire councils.*

Under sec. 49 of the *Pastures Protection Act* 1902 it is the duty of the occupier of land to destroy rabbits upon any roads bounding his land, in accordance with the requirements of the Pastures Protection Board.

Sec. 75 of the *Local Government Act* 1906 provides that a council shall have the control and management of all public roads in its area, and that no person shall use any road, or permit a road to be used, so as so affect the exercise of the rights and powers of the council.

Proceedings were taken against the appellant for failing to destroy rabbits on a road bounding his land. The means which the appellant was required by the board to adopt included the destruction of briar and blackberry bushes, which necessitated a breaking of the surface of the road. The Supreme Court held that sec. 49 of the *Pastures Protection Act* did not conflict with sec. 75