

[HIGH COURT OF AUSTRALIA.]

THE FEDERAL COMMISSIONER OF TAXATION APPELLANT ;

AND

THE FOSTER BREWING COMPANY LIMITED RESPONDENT.

Income Tax—Assessment—Company—Income—Deduction—Dividends—Payment out of income for year—Income Tax Assessment Act 1915 (No. 34 of 1915), sec. 16. H. C. OF A. 1917.

MELBOURNE,
March 14, 15.

Barton, Isaacs,
Gavan Duffy
and Rich JJ.

A company, whose assets consisted principally of shares in another company, paid a dividend for each of the half-years ending 31st January 1915 and 31st July 1915. A few days before each dividend was paid the company had no money in hand. It had in its books an account called a reserve fund of the nominal amount of £15,000 which represented undivided profits that had been invested in income-producing property. Immediately before the payment of each of the two dividends the company received by way of income from its assets a sum rather larger than the amount of the dividend. Each sum when received was paid to the credit of the company's banking account, which was then overdrawn, but by such payment became in credit to an amount exceeding the amount of the dividend, and each dividend was immediately paid by cheques drawn upon that banking account. In its return of income for the year ending 30th June 1915 for the purposes of the *Income Tax Assessment Act 1915* the company claimed to deduct the amount of the two dividends from its total income for that year, but the Commissioner apportioned the dividends between the amount appearing in the profit and loss account for the half-year ending 31st January 1915 as having been brought forward from the previous half-year and the net profit for the year, and allowed a deduction of only the proportionate amount of the dividend so attributed to the net profit for the year.

Held, on the evidence, that the dividends sought to be apportioned were wholly income distributed to the members within the meaning of sec. 16 of the *Income Tax Assessment Act 1915* and that their entire amount was deductible from the net profit of the period.

Decision of Griffith C.J. : *Foster Brewing Co. Ltd. v. Federal Commissioner of Taxation*, 22 C.L.R., 288, affirmed.

H. C. OF A. APPEAL from *Griffith C.J.*

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This was an appeal by the Federal Commissioner of Taxation from the decision of *Griffith C.J.*: *Foster Brewing Co. Ltd. v. Federal Commissioner of Taxation* (1)—where the facts appear.

Starke and *Morley*, for the appellant. The word “income” in sec. 16 of the *Income Tax Assessment Act* means income for the year of taxation, and for the purpose of ascertaining the taxable income of a company for a particular year the amount which may be deducted is so much of the income for that year as has been paid to shareholders. If, therefore, the dividend to shareholders has been paid out of a fund consisting partly of accumulated profits and partly of income for the year, it must, for the purpose of ascertaining how much may be deducted, be apportioned between the accumulated profits and the income for the year. See *Heslop v. Paraguay Central Railway Co.* (2). In order to determine whether a dividend has been paid out of the income for the year or out of the fund made up of that income and the accumulated profits, what the Company has in fact done is the determining factor. The Company paid the dividends in question here out of its profits generally, and it has in its balance sheet and its books of account debited the dividends to the general balance of the profit and loss account. The question of how the credit in the bank out of which the dividend was paid was created is of no importance.

[*RICH J.* referred to *Foster v. New Trinidad Lake Asphalt Co. Ltd.* (3).]

Mann, for the respondents. The object of sec. 16 is to avoid double taxation, and also to ensure that the whole of a company's income for the particular year shall be taxed either in the hands of the shareholders or in those of the company itself. The view put for the Commissioner would have the effect of bringing about double taxation, as was pointed out by *Griffith C.J.* *Primâ facie* a dividend is paid out of the profits for the particular year in respect of which it is paid. The facts here support that *primâ facie* position. A profit and loss account is not intended to show out of what funds dividends have been paid, but is intended to show the result of the

(1) 22 C.L.R., 288.

(2) 54 Sol. J., 234.

(3) (1901) 1 Ch., 208.

financial transactions for the particular period so that shareholders can see whether there has been a profit or a loss.

Morley, in reply.

BARTON J. It appears that this company carried forward each half-year, in its profit and loss account, an amount which was made up of two specified sums, namely, first, an accumulated fund, and, secondly, the profit of the previous half-year. As against the amount so made up there appeared in the profit and loss account of each succeeding half-year, on the credit side, a sum of £2,880 to meet the dividend and bonus which were paid. The net profit for the half-year in review was disclosed in the last previous account, to which it was debited. The two accounts must, of course, be read together.

It is argued that these accounts show that the sum appearing as dividend and bonus was paid out of a mixed or general fund, and cannot be referred to the profits of the particular half-year only. As I understand the term, a dividend, according to the general acceptance, is the same thing as is indicated in sec. 16 of the Act, that is, income distributed to the members or shareholders of the company, to be deducted from its total income. That sum, when it is less than the profit seen to have been made for the period under review, is, according to public understanding, referable to that profit. So also when the sum is equal to the profit. But if it appears that the sum paid is larger than the profit, it is the general understanding that resort has been had to the other existing funds of the company to make up the excess. I think that the profit and loss accounts of companies are in general made up in accordance with this understanding. And there is nothing in the Act which is inconsistent with, or apparently designed to do away with or to run counter to, this general understanding, in accordance with which the Statute should therefore be read.

If I am right so far, then, as the sum declared as dividend is in each case less than the net profit made in the half-year under review, it comes within the words of the Act. It is declared from the net profit of the half-year, and is deductible, not by way of apportionment in the manner assumed by the Commissioner, that is, in part

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from the net profit and in part from the anterior accumulations, but only from the total income of the half-year. If I am right there, the conclusion of the learned Chief Justice is abundantly right and his decision cannot be disturbed. The case appears to me to lie within a small compass. Unless a departure from the common understanding is seen, we need not be troubled with minor differences in the manner in which this or that accountant may choose to keep a profit and loss account. Especially is this so when we consider that the accounts made up after the passage of the Act merely followed the method in which they were made up before its passage, without any relation to prospective liability to taxation. Where it is apparent, as it is here, that there is a profit for the taxable period exceeding the amount of the dividend, I think that in all common sense there is an end of the matter. Men of business do not do the thing which, inferentially, the Commissioner has attributed to this company.

I think the appeal should be dismissed.

ISAACS J. I also think that the appeal should be dismissed. The matter turns upon the construction and application of sec. 16 (1) of the *Income Tax Assessment Act* 1915. As I view it, the taxpayer, the amount of whose total income is undoubted, has to show what is claimed as a deduction. In this case the taxpayer has to show that the sum of £5,760 was distributed out of income *primâ facie* taxable. He launches his proof by showing that every penny of that £5,760 was paid to the shareholders by cheques on the banking account of the Company, which then stood in credit, and that every penny of that credit was composed of moneys paid in and being income received in that period and admitted to be for that period. If that stood as the only evidence, it could not be doubted that the taxpayer had proved his case. That proof is affirmative proof, and as it stands, unaccompanied by any other evidence, excludes the notion that the sum of £5,760 was paid out of any other moneys than the income referred to. Other evidence might, however, show that the money was utilized only as a temporary expedient and that its place was really filled up by other

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The Commissioner, for this purpose, introduced other evidence, namely, profit and loss accounts and a journal. The journal is colourless. The profit and loss accounts, on their face, represent in each half-year a sum carried forward from the previous half-year and being on the face of the profit and loss accounts an undivided sum of profits. From that undivided sum of profits is taken in each case the amount paid in each half-year by way of dividend, namely, £2,880. In the two half-years the sum of £5,760 was paid. That evidence, if it stood alone, might not unreasonably have led to the conclusion that the sums so paid were paid out of an indiscriminate sum of "profit fund," as I call it by way of convenience. But it is not conclusive of that; I mean it is not inconsistent with these sums paid for dividends being referable to some particular part of the "profit fund" I have mentioned. But when as against that inconclusive evidence there is placed the very definite *prima facie* evidence of the payment out of the banking account I have mentioned, it appears to me that upon the whole the proper conclusion to be drawn as a matter of fact applicable to this particular case is that the sums were paid out of the income for the taxable period.

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On these grounds I think the appeal should be dismissed.

GAVAN DUFFY J. In my opinion the proper inference to be drawn from the facts proved and admitted is that the two dividends in question were paid out of the profits of the two half-years. That being so, it follows that the decision of the learned Chief Justice was perfectly correct.

RICH J. What my brother *Gavan Duffy* has said expresses my opinion.

Appeal dismissed with costs.

Solicitor for the appellant, *Gordon H. Castle*, Crown Solicitor for the Commonwealth.

Solicitors for the respondents, *Pavey, Wilson & Cohen*.

B. L.