

is any ground for an appeal to the mercy of the Government, that course is still open. The only order we can make is to dismiss the appeal with costs.

Appeal dismissed with costs.

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Solicitor for the appellant, *F. Kelly*, Adelaide (for *R. I. D. Mallam*, Darwin), by *McCay & Thwaites*.

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

B. L.

[HIGH COURT OF AUSTRALIA.]

MEARES APPELLANT ;

AND

THE ACTING FEDERAL COMMISSIONER OF }
TAXATION } RESPONDENT.

ON APPEAL FROM BARTON J.

Income Tax—Assessment—Dividends from company—Payment out of accumulated profits—Amount carried forward to credit of profit and loss account—Income Tax Assessment Act 1915-1916 (No. 34 of 1915—No. 39 of 1916), sec. 14 (b).

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The term “profit and loss account” in the last proviso to sec. 14 (b) of the *Income Tax Assessment Act 1915-1916* means an account showing the transactions of a company during a given period in which are entered on one side amounts received, and on the other the expenditure incurred during the same period in producing those receipts. The difference shows the profit or loss for that period. It is not a necessary part of the account that it should show how the profit, if any, has been or is intended to be disposed of.

MELBOURNE,
March 14,
21.
Griffith C.J.,
Gavan Duffy,
Powers and
Rich JJ.

An amount is “carried forward by a company to the credit of the profit and loss account,” within the meaning of that proviso, when a balance of profit of any period is grouped with the receipts proper of the next succeeding

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period in making up the amount available to defray the expenditure for the later period, so as to show the intention of the company to treat the amount so transferred as forming part of the transactions of the later period.

The account kept by a company under the name of the "profit and loss account" did not show in respect of a particular year any sum brought forward from the preceding year or carried forward to the succeeding year but showed a sum of profit or loss confined to the current year and, as a balance, transferred to another account called an "appropriation account." It was the latter account that showed the amount of accumulated profits brought forward from the preceding year, the amount paid as dividend, and the amount carried forward to the succeeding year. For the year ending 30th June 1915 the dividend was larger than the amount of profit transferred from the so-called profit and loss account.

Held, that the amount appearing in the "appropriation account" for that year as accumulated profits brought forward from the preceding year was not an amount "carried forward to the credit of the profit and loss account" within the meaning of the last proviso to sec. 14 (b), and therefore under the first proviso was not to be included as part of the income of the company for that year.

Decision of *Barton J.* : *Meares v. Acting Federal Commissioner of Taxation*, 23 C.L.R., 358, reversed.

APPEAL from *Barton J.*

This was an appeal by Richard Henry Meares from the decision in *Meares v. Acting Federal Commissioner of Taxation*, reported 23 C.L.R., 358, where the facts are sufficiently set out.

Schutt (with him *Eager*), for the appellant. The "profit and loss account" referred to in the last proviso to sec. 14 (b) of the *Income Tax Assessment Act 1915-1916* is an account kept under that name by the particular company. The Legislature must be taken to have known what is the usual practice of companies with regard to a profit and loss account. They did not intend to strike at sums which are not in fact included in the profit and loss account and which are in no sense sums which are usually carried forward in the profit and loss account. The amount in question was not carried forward in any account which can properly be called a profit and loss account. If the view taken by *Barton J.* is correct, it destroys the whole effect of the first proviso to sec. 14 (b).

[Counsel referred to *Partington v. Attorney-General* (1); *Dawson's Accountants' Compendium*, 4th ed., p. 497.]

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Starke (with him *Mann*), for the respondent. The term "profit and loss account" is not a legal term or one to which the Court can give a meaning without the assistance of expert evidence. It is a term of art in business. On the evidence the appropriation account is part of the profit and loss account of this company. The amount in question is a fluctuating balance of profits, and is within the last proviso to sec. 14 (b) no matter in what account it appears. The only way to escape that proviso is to put the sum in question into a reserve fund for a particular purpose. [Counsel referred to *Encyclopædia of Accounting*, vol. v., pp. 366-368.]

Schutt, in reply.

Cur. adv. vult.

The judgment of the COURT, which was read by GRIFFITH C.J., was as follows:—

March 21.

Among the categories of income liable to taxation under the *Income Tax Assessment Acts* 1915 (sec. 14) are dividends paid to any member or shareholder of a company which derives income from a source in Australia, subject to the proviso that "where a company distributes to its members or shareholders any undistributed income accumulated prior to the first day of July one thousand nine hundred and fourteen the sum so received by the member or shareholder shall not be included as part of his income."

A further proviso, upon which this appeal depends, was added, by amendment, in the same year as follows: "Provided also that amounts carried forward by a company to the credit of the profit and loss account shall not be deemed to be accumulated income."

The amount upon which the Commissioner has assessed the income tax now in question was a portion of undistributed income of a company, earned before 1st July 1914, but not applied in payment of dividends until after that day.

(1) L.R. 4 H.L., 100, at p. 122.

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In order that dividends paid out of it may be liable to taxation it must be established that it was "carried forward by the Company to the credit of the profit and loss account." What, then, do these words mean? The sum in question was not entered in any account called by that name in the Company's books as a sum brought forward from a previous account, but we do not think that that fact is conclusive of the matter.

In our opinion the phrases "carried forward" and "profit and loss account" have a well recognized meaning. The account called the "profit and loss account," whether of a company, a partnership or an individual, is an account showing the transactions of the business adventure during a given period, usually a year or half-year, in which are entered on one side amounts received, and on the other the expenditure incurred during the same period in producing those receipts. The difference shows the profit or loss for that period. It is of the essence of the account that it is for a stated period.

It is not a necessary part of the account that it should show how the profit, if any, has been or is intended to be disposed of, or how the loss, if any, has been or is intended to be made up. It is not unusual, however, to include such information.

Sometimes, as was the practice of this company and of the firm whose business they took over, the whole of the profit shown is transferred to an account called an "appropriation account," in which is recorded the manner of its disposition. Very often a partial disposition by way of distribution in dividends or transfer to what is called a "reserve fund" or some other special fund is shown, and if these dispositions do not exhaust the whole amount a balance will remain.

We can now see plainly the meaning of the words "carry forward." In the first place they import an act of volition on the part of the company.

It is, as our daily experience shows, not uncommon to transfer such a balance to the profit and loss account for the next succeeding period, and to group it with the receipts proper of that period in making up the amount available to defray the expenditure for the period. When this is done by a company, the company shows its

intention to treat the amount so transferred as forming part of the transactions of the later period. This, then, is what is meant, and all that is meant, by carrying forward by the company to the credit of the profit and loss account. Its doing so may well be thought inconsistent with an intention to treat the amount so dealt with as an accumulated fund, and the Act says that it shall not be so regarded. When the company itself so includes a sum in its current receipts, it is to be regarded as so included for all purposes of taxation, without any disentanglement of accounts which the company has thought fit to combine.

The contention of the Commissioner involves the consequence that, whenever a company distributes to its members any income earned but not distributed before 1st July 1914, the account which shows that distribution becomes *ipso facto* part of the profit and loss account, and that the entry in it of the amount to be distributed is therefore *ipso facto* a carrying forward of that amount to "the profit and loss account." Such a construction of the later proviso would be to make it, not a qualification, but a flat negation, of the principal enactment to which it is a proviso. This was clearly not the intention of Parliament.

We think, therefore, that the sum in question is not within the second proviso. The appeal must be allowed, and the respondent must pay the costs both here and before *Barton J.*

Appeal allowed and assessment reduced accordingly. Respondent to pay costs of appeals to this Court and to Barton J.

Solicitors for the appellant, *Meares & Duigan.*

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

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