[HIGH COURT OF AUSTRALIA.]

HOOPER & HARRISON LIMITED (IN LIQUIDATION) . . . . . } APPELLANT;

AND

THE FEDERAL COMMISSIONER OF TAXATION . . . . . } RESPONDENT.

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SYDNEY, *July* 23-25; *Nov.* 29.

Knox C.J., Isaacs, Higgins, Gavan Duffy and Rich JJ.

War-time Profits Tax—Assessment—Deductions from profits—"Income tax paid in respect of the profits"—Payment after accounting period—Income tax on profits paid to shareholders—Dividends paid after accounting period—Capital of business—Meaning of "trading profits invested in the business"—War-time Profits Tax Assessment Act 1917-1918 (*No.* 33 *of* 1917—*No.* 40 *of* 1918), *secs.* 15 (4), (5), 17 (1).*

Held, by *Knox* C.J., *Higgins* and *Gavan Duffy* JJ., that under sec. 15 (4) (*b*) of the *War-time Profits Tax Assessment Act* 1917-1918 a deduction is allowed of income tax paid in respect of the profits of the accounting period notwithstanding that it is paid after the accounting period has expired.

* Sec. 15 of the *War-time Profits Tax Assessment Act* 1917-1918, after providing that the profits of a business shall be taken to be the actual profits arising in the accounting period from sources in Australia and that certain deductions shall not, and certain others shall, be allowed, provides that "(4) Deductions shall not be allowed on account of the liability to pay, or the payment of, war-time profits tax . . . : Provided that a deduction shall be allowed from the profits of an accounting period of . . . (*b*) Commonwealth and State income taxes paid in respect of the profits, less any refunds of Commonwealth and State income taxes received in the accounting period," &c. "(5) For the purposes of this section 'income tax paid in respect of the profits' shall be . . . (*c*) in the case of a company, the amount of the tax (if any) paid by the company, together with the aggregate of the amounts of tax that would have been payable by each shareholder if the share of the profits credited or paid to him had been the only income derived by him from sources within Australia:" &c. Sec. 17 (1) provides that "The amount of the capital of a business shall be taken to be the amount of its capital paid up by the owner in money or in kind, together with all accumulated trading profits invested in the business, with the addition or subtraction of balances brought forward from previous years to the credit or debit respectively of profit and loss account."

Held, also, by *Knox* C.J., *Higgins* and *Gavan Duffy* JJ. (*Isaacs* and *Rich* JJ. dissenting), that, in the case of a company, for the purpose of estimating under sub-sec. 5 (*c*) the aggregate of the amounts of tax that would have been payable to each shareholder if the share of the profits credited or paid to him had been the only income derived by him from sources in Australia, a dividend declared after the accounting period had expired out of the profits of the accounting period should be taken into account.

Held, also, by *Isaacs*, *Higgins* and *Rich* JJ. (*Knox* C.J. and *Gavan Duffy* J. dissenting), that, for the purpose of estimating the aggregate referred to in sub-sec. 5 (*c*) where two or more dividends have been paid out of the profits of the accounting period, the income tax which would have been payable by each shareholder should be calculated on the sum of the dividends paid to him and not on each dividend separately.

Per Isaacs and *Rich* JJ. :—The only questions raised by the case being (a) whether a dividend declared after the accounting period had expired out of the profits of the accounting period should be taken into computation, and (b), if it should, whether it should be aggregated with a dividend declared during the accounting period, these questions should be answered: (a) the later dividend being a transaction outside the accounting period is not computable in respect of that period; and (b) if it were so computable, it should be aggregated.

Held, further, by the whole Court, that, in order that "accumulated trading profits" may be "invested in the business" within the meaning of sec. 17 (1), there must be shown an intention permanently to use those profits for the purposes of the business, and the facts that the profits have been ascertained and that they are being used in the business do not constitute an investment of them in the business.

CASE STATED.

On the hearing of an appeal to the High Court by Hooper & Harrison Ltd. (in Liquidation) from an assessment for war-time profits tax in respect of the year ending 30th June 1919, *Rich* J. stated a case for the Full Court which, as amended at the hearing, was substantially as follows :—

1. The appellant Company is a limited company duly incorporated in the State of New South Wales and for some years prior to its liquidation, hereinafter mentioned, carried on the business of merchants and warehousemen in the States of New South Wales, Victoria, Queensland and other States of the Commonwealth, and had its head office in Sydney in the State of New South Wales.

2. On 2nd June 1920 the appellant Company went into voluntary liquidation, and Harold Wilson Anderson was appointed liquidator thereof.

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3. This is an appeal from assessment of war-time profits tax for the financial year commencing on 1st July 1918 and ending on 30th June 1919, and based on the war-time profits derived from sources within Australia during the year ending on the said 30th June 1919.

4. A return of the profits of the appellant Company liable to be taxed in respect of the said financial year was duly made by the appellant Company, and the respondent made assessments in respect thereof.

5. The appellant Company paid the amount claimed in such assessments, and by notices of objection duly objected thereto.

6. The appellant Company in the ordinary course of its business balanced its books of account and prepared a balance-sheet and profit and loss account of its business as on 31st December and 30th June in each and every year. In addition thereto, accounts and balance-sheets of the business of the appellant Company were for the purposes of the Commonwealth Income Tax Assessment Acts made up for yearly periods ending on 30th June in each year; and such accounts and balance-sheets were furnished to the respondent along with the appellant Company's returns under such Acts, and were accepted by him.

7. On 26th October 1918 the appellant Company paid a dividend of £9,267 3s. 1d. to its shareholders. Such dividend was paid out of the profits for the six months ended on 30th June 1918, and the balance of such profits was on 19th November 1918 transferred to general reserve.

8. On 12th April 1919 the appellant Company paid a dividend of £9,281 5s. to its shareholders. Such dividend was paid out of the profits for the six months ended 31st December 1918, and the balance of such profits was on the said 12th April 1919 transferred to general reserve.

9. On 11th October 1919 the appellant Company paid a dividend of £9,307 10s. 6d. to its shareholders. Such dividend was paid out of the profits for the six months ended 30th June 1919, and the balance of such profits was on 10th November 1919 transferred to general reserve.

10. For the purpose of calculating the amount of war-time profits liable to taxation under the *War-time Profits Tax Assessment Act*

1917-1918 in respect of the said financial year, the respondent allowed as a deduction under sec. 15, sub-secs. 4 (*b*) and 5 (*c*), the aggregate calculated as set out in par. 11 hereof of the amounts of Commonwealth income tax that in the events which have happened would have been payable by each and every shareholder if the share of the said profits credited or paid to him had been the only income derived by him from sources within Australia.

11. In order to ascertain the aggregate amounts of Commonwealth income tax that would have been payable as aforesaid by each shareholder, the respondent ascertained the amount that each shareholder received of the dividend that was paid on the said 12th April 1919, and calculated the Commonwealth income tax that each shareholder would have had to pay if the said dividend paid to him on the said 12th April 1919 had been the only income derived by him from sources within Australia, calculating the said tax at the rate in force for income so derived during the year ended 30th June 1919; and also ascertained the amount that each shareholder received of the dividend that was paid on the said 11th October 1919, and calculated the Commonwealth income tax that each shareholder would have had to pay if the said dividend paid to him on the said 11th October 1919 had been the only income derived by him from sources within Australia, calculating the said tax at the rate in force for income so derived during the year ended 30th June 1920: and added the said amounts so found together and allowed the total so obtained as the amount to be deducted.

12. The appellant Company claims that the amount to be deducted should be calculated in the manner set out in par. 13 hereof:

13. The respondent should ascertain the amount that each shareholder received of the said dividends paid on 12th April 1919 and on 11th October 1919 respectively, and after adding these two amounts together should calculate the Commonwealth income tax that each shareholder would have been liable to pay if the said total of the two dividends received by him had been the only income derived by him from sources within Australia, calculating the said tax at the rate in force for incomes so derived during the year ended 30th June 1919; and the aggregate of the said amounts so found

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in respect of each and every shareholder should be the amount to be deducted.

14. The balance-sheet and profit and loss account of the appellant Company for the six months terminating on 31st December 1918 showed a balance to the credit of profit and loss account amounting to the sum of £42,074 19s. 10d., being the net profits derived by the appellant Company from sources within Australia during the six months ended 31st December 1918. No part of this sum was withdrawn from the business of the appellant Company, but the same remained and was used in the said business until 12th April 1919, when, by resolution of a general meeting of the appellant Company duly passed on the said 12th April 1919, the sum of £32,793 14s. 10d., being the said sum of £42,074 19s. 10d. less the said dividend of £9,281 5s., was transferred to general reserve.

15. The respondent, in computing the capital employed in the business of the appellant Company as aforesaid, excluded the whole of the said sum of £42,074 19s. 10d. for the period extending from 1st January 1919 to 12th April 1919, but included the said sum of £42,074 19s. 10d. less the said dividend of £9,281 5s. paid on the said 12th April 1919 for the period between the said 12th April 1919 and 30th June 1919.

16. The appellant Company claims that in computing under the *War-time Profits Tax Assessment Act* 1917-1918 the amount of capital employed in its business the whole of the said sum of £42,074 19s. 10d. should be treated as part of the capital so employed during the period between 1st January 1919 and 12th April 1919, and that such amount should be taken into account for such period in ascertaining the amount of capital employed in the said business during the accounting period.

The questions for the determination of the High Court were as follows :—

1 (a) Are both the dividends, April 1919 and October 1919, or is either and which of them, to be taken into calculation in computing the amount of income tax deductible by the Company under sec. 15, sub-secs. 4 and 5 (*c*), of the Act ?

(b) If both are to be so taken, are they to be aggregated before calculating the amount of tax which would be payable by each shareholder ?

(c) If aggregation is proper, what is the rate of income tax in respect of the aggregated amount ?

2 (a) Is the appellant Company entitled, in computing the amount of capital of the business for the said financial year, to include the said sum of £42,074 19s. 10d. as capital of the business for the period between 1st January 1919 and 12th April 1919 ; or

(b) If it is not so entitled, then whether any, and if so what, proportion of such sum should be included as such capital for such period ?

Leverrier K.C. (with him *Harper*), for the appellant.

Innes K.C. (with him *E. M. Mitchell*), for the respondent.

Cur. adv. vult.

The following written judgments were delivered :—

KNOX C.J. AND GAVAN DUFFY J. In the financial year 1918-1919 —extending from 1st July 1918 to 30th June 1919—the appellant, in accordance with its usual practice, balanced its books on 31st December 1918 and on 30th June 1919. Out of the profits ascertained to have been made during the first half-year, the appellant on 12th April 1919 distributed to its shareholders by way of dividends the sum of £9,281 5s., and out of the profits ascertained to have been made during the second half-year the appellant on 11th October 1919 distributed to its shareholders by way of dividends the sum of £9,307 10s. 6d. In assessing the appellant to war-time profits tax, the respondent treated each dividend separately—that is to say, he ascertained the amount that each shareholder received of the April dividend, and calculated the amount that such shareholder would have had to pay in respect of Commonwealth income tax if such dividend had been the only income derived by him from sources in Australia during the financial year in which it was received ;

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he dealt with the October dividend in the same way, and allowed as a deduction an amount equal to the sum of the amounts of tax so ascertained. The appellant contends that the respondent should have added together the amounts received by each shareholder in April and October respectively, and should then have calculated the amount which that shareholder would have had to pay in respect of Commonwealth income tax for the financial year 1918-1919, if the total amount so received by him in respect of both dividends had been the only income derived by him from sources within Australia during that year, and that the respondent should have allowed as a deduction the aggregate of the amounts as so ascertained. The parties assumed that both the April and October dividends should be included in the calculation; the only question raised by them on this point being whether the method of calculation adopted by the respondent or that put forward by the appellant was the correct method of ascertaining the amount of deduction to be allowed. But during argument it was suggested from the Bench that the October dividend ought not to be brought into the calculation, and the first question for decision is whether both dividends are to be taken into account in arriving at the deduction to be allowed. This question turns on the meaning of sub-secs. 4 and 5 of sec. 15 of the *War-time Profits Tax Assessment Act* 1917-1918, which are in the following words :—(4) " Deductions shall not be allowed on account of the liability to pay, or the payment of, war-time profits tax, but a deduction shall be allowed for any sum which has been paid in respect of the profits on account of any war-time profits tax or similar tax imposed in any country outside the Commonwealth: Provided that a deduction shall be allowed from the profits of an accounting period of (*a*) Commonwealth and State land taxes paid in that accounting period, less any refunds of those taxes received in that accounting period; and (*b*) Commonwealth and State income taxes paid in respect of the profits, less any refunds of Commonwealth and State income taxes received in the accounting period; and (*c*) all rates and other taxes paid in Australia in the accounting period. (5) For the purposes of this section ' income tax paid in respect of the profits ' shall be (*a*) in the case of an individual the

amount of tax that would have been payable if the profits had been the only income derived by him from sources within Australia; (*b*) in the case of a partnership the aggregate of the amounts of tax that would have been payable by each partner if the share of the profits coming to him had been the only income derived by him from sources within Australia; and (*c*) in the case of a company, the amount of the tax (if any) paid by the company, together with the aggregate of the amounts of tax that would have been payable by each shareholder if the share of the profits credited or paid to him had been the only income derived by him from sources within Australia: Provided that in calculating the income tax under this sub-section no deduction shall be made from the profits on account of the war-time profits tax payable in respect of those profits."

It will be noticed that while the deduction prescribed by sub-sec. 4 in respect of land taxes, and of rates and taxes other than land or income taxes, are expressed to be of "taxes paid in that accounting period" and of rates and taxes "paid in the accounting period," that in respect of income taxes is expressed to be of "taxes paid in respect of the profits," and having regard to the opening words of the proviso the phrase "the profits," in our opinion, must be taken to mean the profits made in the relevant accounting period. The question to be answered, in the case of taxes other than income tax, is "Were the taxes in respect of which deduction is claimed paid in the accounting period?" and, in the case of income tax, "Were the taxes in respect of which deduction is claimed income taxes paid in respect of the profits made in the accounting period within the meaning of the definition contained in sub-sec. 5?" The distinction appears to be natural in view of the fact that income tax cannot be paid until after the close of the period in which the income arose. If sub-sec. 4 stood alone, without the interpretation provided by sub-sec. 5, we think it would be clear that the deduction would be of any Commonwealth or State income tax actually paid by the taxpayer, whether during or after the accounting period, in respect of the profits made during that period, subject to the provision as to refunds received by him during that period. To what extent, then, did sub-sec. 5 affect the right to this deduction in the case of a business owned by a company? Under the provisions of the Commonwealth

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income tax laws in force when this Act was passed, a company was liable to pay tax only upon (a) so much of its assessable income as had not been distributed to its shareholders, (b) so much of its assessable income as had been distributed to shareholders who were absentees, and (c) interest paid to absentees in respect of debentures or money lodged at interest with the company. On so much of the assessable income as had been distributed to shareholders or paid by way of interest to persons who were not absentees, the individual recipients were chargeable with income tax. But in the case of an individual carrying on a business the whole of the profits of the business were included in his assessable income.

The war-time profits tax was imposed on the war-time profits of a business whether carried on by an individual or by a company. It follows that, if sub-sec. 4 had stood alone without the definitions contained in sub-sec. 5, the deduction allowable in the case of a business carried on by an individual might, and probably would, have been different from that allowable in the case of a business carried on by a company though the war-time profits of the business were the same. Probably a desire to approximate these divergent positions was the reason for the insertion of sub-sec. 5; but, whatever may have been the object of the Legislature in enacting these provisions, it is our duty to construe the words as they stand. Sub-sec. 4 (*b*) as expanded by sub-sec. 5 (*c*) would run as follows: "Provided that in the case of a company a deduction shall be allowed from the profits of an accounting period of the amount of income tax (if any) paid by the company together with the aggregate of the amounts of income tax that would have been payable by each shareholder if the share of the profits credited or paid to him had been the only income derived by him from sources in Australia." Having regard to the provisions of the income tax laws referred to above, we think these words are free from ambiguity.

We have pointed out that the expression "the profits" in sub-sec. 4 (*b*) must, in our opinion, be taken to mean the profits of the business during the relevant accounting period. We can find no justification for attributing a different meaning to the expression "the profits" in sub-sec. 5 (*c*). On this footing sub-sec. 5 (*c*) specifies as factors in the calculation to be made (1) the amount of

the income tax paid by the company in respect of the profits of the accounting period—a tax necessarily paid after the expiration of that period, and (2) the amounts of income tax that would have been payable by each shareholder if the share of the profits made during that accounting period which was in fact credited or paid to him had been the only income derived by him from sources within Australia. No day is named in sub-sec. 5 as that before which income tax must have been paid by the company or the share of profits must have been paid or credited to the shareholder; but, as the sub-section provides for a calculation to be made for the purpose of ascertaining the amount of war-time profits tax which is to be assessed, the natural inference is that the relevant facts are to be regarded as at the time when the assessment is made. We can find nothing in the Act which requires that the facts shall be ascertained as at any other date.

In this case the share of the profits of the accounting period 1st July 1918 to 30th June 1919 credited or paid to each shareholder in fact included the dividend paid in October 1919 as well as that paid in April 1919. Apparently the assessment was made after October 1919, and, in our opinion, the words of the enactment require that both dividends should be included in the calculation. It was suggested during argument that the administration of the Act would be rendered difficult, if not impossible, unless such a limitation were introduced. We think a sufficient answer to this suggestion is furnished by the fact that the Act has been and is being administered on the assumption that the share of the profits of an accounting period, whenever credited or paid to a shareholder, is to be taken into account in ascertaining the amount of the deduction to be allowed under this provision.

The next question is whether the method adopted by the respondent for ascertaining the amount of the deduction is correct. We think it is. The deduction is of "the aggregate of the amounts of tax that would have been payable by each shareholder" on a certain hypothesis. This phrase on its grammatical construction imports that each shareholder might have been liable to pay more than one amount of tax in respect of the share of the profits credited or paid to him, and the sum to be deducted is to be found by adding together

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all amounts of tax that would have been payable by each shareholder if the share of the profits credited or paid to him had been the only income derived by him from sources within Australia. The only departure from ascertained facts is the hypothesis that the shareholder derived no income from sources within Australia except the share of the profits credited or paid to him; and we think the calculations to be made in this case are (1) what tax would have been payable by the shareholder if the share of the profits paid to him in April 1919 had been his only income from sources within Australia during the financial year, and (2) what tax would have been payable by him if the share of the profits paid to him in October 1919 had been his only income from sources within Australia during that financial year. The sub-section contains nothing to justify the adoption of any average rate of tax or the application of a rate other than the appropriate rate for the financial year in which the share of profits was actually credited or paid.

There remains a question arising on the construction of sec. 17 (1) of the statute. The balance-sheet and profit and loss account of the appellant Company for the six months terminating on 31st December 1918 showed a balance to the credit of profit and loss account amounting to the sum of £42,074 19s. 10d., being the net profit derived by the appellant Company from sources within Australia during the six months ending on 31st December 1918. We are not told when this balance was ascertained or the balance-sheet prepared. No part of this sum was withdrawn from the business of the appellant Company, but the sum remained and was used in the business until the 12th day of April 1919, when, by resolution of a general meeting of the appellant Company, the sum of £32,793 14s. 10d., being the said sum of £42,074 19s. 10d. less the dividend of £9,281 5s., was transferred to general reserve. The appellant contended that the sum of £42,074 19s. 10d. was part of the capital of the business within the meaning of sec. 17 (1) from 1st January 1919. The respondent treated the sum of £32,793 14s. 10d. as being part of the capital of the business from 12th April 1919, the date of the transfer to general reserve, and disallowed the rest of the appellant's claim.

Sec. 17. (1) is as follows: "17. (1) The amount of the capital

of a business shall be taken to be the amount of its capital paid up by the owner in money or in kind, together with all accumulated trading profits invested in the business, with the addition or subtraction of balances brought forward from previous years to the credit or debit respectively of profit and loss account." For the appellant it was argued that inasmuch as the sum of £42,074 19s. 10d. had been earned in the half-year terminating on 31st December 1918 and continued to be used in the business after that date, it constituted accumulated trading profits invested in the business. In our opinion, profits not withdrawn from the business pending a resolution of a general meeting of a limited liability company are not necessarily invested in the business within the meaning of the sub-section. To constitute such an investment we think it must at least be shown that there was an intention permanently to use the profits for the purpose of the business. How such an intention should be evidenced in the case of a limited liability company, we need not pause to discuss as it is not pretended that any such intention existed before 12th April 1919 with respect to any part of the sum of £42,074 19s. 10d. It must be remembered that sec. 17 (1) applies, not only to the business of an incorporated company, but also to that of a single individual or firm. In every case the capital of the business is to consist of what is put into it by the owner out of his or its own resources or out of the profits made by the business. The composite mass thus formed may be increased or decreased by a credit or debit to the profit and loss account at the end of any accounting year. The latter provision would be not only unnecessary, but inconsistent with the rest of the sub-section, if the amount of capital represented by accumulated profits invested in the business were held to vary with the amount of profit gained or loss sustained, not only before the owner had determined how and how far such profit or loss was to affect the pre-existing capital, but even before the amount of such profit or loss had been ascertained.

In our opinion the appellant's contention cannot be maintained.

ISAACS AND RICH JJ. Two distinct questions arise under the *War-time Profits Tax Assessment Act*. The first has reference to the computation of profits; the second to the computation of capital. We deal with each separately.

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1. *Computation of Profits.*—The " accounting period " in this case is, by force of sec. 7 (4), the period of twelve months from 1st July 1918 to 30th June 1919, because that was the period for which the accounts of the business were made up for the purposes of the *Income Tax Assessment Act* 1915-1916. On 26th October 1918 the Company paid a dividend of £9,267 3s. 1d. out of the profits for the six months ending 30th June 1918. This dividend may be disregarded, as neither side relies upon it, and it is quite irrelevant because relating to profits of the previous period. On 12th April 1919 a dividend was paid of £9,281 5s. out of the profits made in the first half of the accounting period. On 11th October 1919 a dividend was paid of £9,307 10s. 6d. out of the profits made in the second half of the accounting period. These are material.

The Commissioner made certain allowances by way of deduction under sec. 15 (5) (*c*) of the Act and the Company claims more. The Commissioner treated both the dividends of April and October 1919 as cognizable factors in computing the Company's taxable profits for the accounting period ending in June 1919, but he segregated them for the purpose of ascertaining the amounts of income tax which, under par. (*c*) above, would have been payable by the shareholders. The Company claims that not only should the October dividend be included in the computation of the period ending in the previous June, but also that the two dividends of April and October should be first united and treated as one dividend, and then, as a higher amount of tax would be hypothetically payable, the deduction in favour of the Company would be so much the greater. One can imagine the attitude of the same persons if the Commissioner had applied that process to the actual taxation of the shareholders in respect of the same dividends. But on the assumption that the October dividend must by law enter into the calculation at all on the ground that par. 4 of sec. 15, and par. 5 (which is its interpretation), extend to the date of assessment, it seems to us the Company's view was clearly right. And it is quite manifest that taking the date of assessment as the terminal date is the only possible ground for including the October dividend. If we are to assume that *every* crediting or payment of the profits which were derived by the Company during the accounting period, is to enter into the

computation, whether such crediting or payment took place during or after the accounting period, provided only it took place before the day of assessment, it must follow that the two dividends are to be aggregated. Sub-sec. 4 must be read as interpreted by sub-sec. 5 (*c*), and sub-sec. 5 (*c*) is distinct as to "the share of the profits credited or paid to him." It is treated for the purposes of that paragraph, and therefore of sub-sec. 4, as *one share*—one indivisible share—as the income and the only income which during the appropriate period is derived by the shareholder. There is no separation of the income brought within the sub-section; that stands together, whatever it may be, and so must be aggregated. For instance, if two or more dividends were wholly within the financial year, they would be aggregated. Consequently, if the date of assessment and not 30th June ends the period contemplated by sec. 15 (5) (*c*), aggregation must take place within the period so defined. By aggregation we mean that where the same person receives the two dividends he pays on the sum of the two. As to the proper rate on this basis, we find it difficult to say. The date of assessment theory leads us to what might have been an impasse. But in this case the yearly rates remain the same, and so there is no practical difficulty. If the system is right, the rate must be the same. We are unable to say more as to the rate on the assumption made—an assumption which, as will be presently explained, we are personally wholly unable to accept. If, however, we are wrong as to that, we see no escape from aggregation whatever the consequences may be. The central point of the whole controversy, and the key to the problem it gives rise to, is that it is not the person, the taxpayer, that is the subject of the tax: it is the *business*, and the business in respect of *each separate year*. That business is required to show its taxable profits for each accounting period, and for no other period, except, of course, the corresponding pre-war period in order to arrive at the war-time profits. That is the dominant feature of the legislation as established by this Court (*McKellar* v. *Federal Commissioner of Taxation* (1)) and by the House of Lords under the English Act (*Wankie Colliery Co.* v. *Commissioners of Inland Revenue* (2)). Once that feature is firmly grasped, it becomes almost axiomatic, in the absence of express direction to the contrary,

(1) (1922) 30 C.L.R., 198.

(2) (1922) 2 A.C., 51.

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that *the transactions affecting the calculation of the taxable profits for that period are transactions within that period* and therefore, if the period closes with the company in possession of profits which it has not yet determined to distribute, but has so far determined to retain in the business, it would be contrary to the whole scheme and to common sense to allow subsequent alterations of its position in relation to those profits months or years afterwards to be relevant transactions for the purpose of determining the business situation for the given accounting period. But is the assumption that the October 1919 dividend is a factor for the previous year's tax correct? We recognize that the Commissioner has certainly acted very generously towards the Company, and has given the Company the benefit of a possible doubt or of a practical adjustment. If it were permissible to us to rest upon what he has done in this case, we should not trouble further. But there is a judicial responsibility on the Court to declare the law as it is, and not as parties assume it to be, and particularly when other persons and the Public Treasury are concerned in the settlement of the law. And in our opinion the *October* 1919 *dividend, being itself a transaction entirely outside the accounting period* and a transaction that might never have occurred at all, or to the extent that eventually happened, and one that when it did happen altered the position of the Company in relation to its profits for the accounting period, is not proper to enter into the computation of the taxable profits of the accounting period. In our opinion, as we have said, the taxable profits of a given accounting period are by the Act intended to be determined by the operations of that period alone. Gains and losses, incomings and outgoings, not referable to that period are not material to determine or to alter the result of that specific period's trading. We cannot agree with the appellant's argument that the law makes a difference in the liability of a taxpayer merely because the Commissioner happens to assess him a week or a month or a year earlier or later. Assessments are preceded by returns and are generally based on them, and the Act no more regards the date of the Commissioner's assessment as the standard of liability than it does the date of the taxpayer's return. The inalterable relevant dates are the termini of the financial period, namely, the first and last days of the financial year. It would be

monstrously unjust that of two taxpayers in hypothetically similar positions, because A happens—perhaps by reason of his alphabetical precedence—to be assessed three months earlier than the other of them, A should have a different liability—either more or less—merely because of the accident of their relative dates of assessment. Every assessment, whenever made, relates to the actual circumstances of the period it deals with and excludes all other periods, except where by express words or necessary implication the contrary is indicated. Sec. 15 is headed "computation of profits," and it is extremely important to keep in mind that that is the subject of the section. What the whole section is directed to is the ascertainment of a sum which represents the net amount of profits of the taxpayer for the accounting period; that is, in this case, between 1st July 1918 and 30th June 1919. The section starts by directing that, subject to the Act, "the profits shall be taken to be the actual profits arising in the accounting period from sources within Australia." Deductions are dealt with, partly by negative and partly by affirmative provisions.

Much argument was rested on the absence, in some portions of the section, of the words "in the accounting period." Now, the initial direction just quoted must, except where the contrary appears, govern the whole scope of the computation. If the object sought is "the actual profits arising in the accounting period," that naturally excludes extraneous events unless something very clear and specific introduces them. That consideration applies certainly and unquestionably to a great portion of the section, For instance, in sub-sec. 3 the losses in par. (*a*) are not expressly limited to the accounting period, but could anyone doubt they are in fact so limited? For instance, would losses by fire, robbery or embezzlement that occurred after the financial year be deductible if the assessment happened to be delayed a month, and not otherwise? So in par. (*b*) as to alterations to plant machinery and premises. In par. (*c*) the words "in the accounting period" occur, but because of the words "written off." In par. (*d*) the payments and gifts referred to are, in our opinion, limited to those within the accounting period, and do not include either payments or gifts made before or after that period. And so with contributions in par. (*e*). If a contribution of £1,000 were made

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to the Repatriation Fund in August 1919 by each of two companies, would the allowance depend on whether the Commissioner's office happened to get out the assessment sooner or later? If so, one company would be entitled, and the other not entitled, to deduct the contribution. That seems to us so unfair and fantastic a taxing law that we are unable to attribute such an intention to the Legislature. And yet the appellant's argument that the date of assessment governs the matter imperatively requires it. Then comes sub-sec. 4. It enacts that Australian war-time profits tax is not a proper deduction, but says "a deduction shall be allowed for any sum which has been paid in respect of the profits on account of any war-time profits tax or similar tax imposed in any country outside the Commonwealth." That is to say, a tax imposed on the profits of that period by the law of another country—say, England—should be treated as an outgoing for that period because the liability arose in respect of the transactions of that period, and should be deducted accordingly. Then comes a proviso that a deduction shall be allowed from the profits of an accounting period of (*a*) Commonwealth and State land taxes paid in that accounting period, less any refunds of those taxes received in the accounting period. This we regard as a very strong adherence to the business principle of limiting the relevant factors of computation to the appropriate period. The same may be said of par. (*c*)—all rates and other taxes paid in Australia in the accounting period. As to par. (*b*), which is the provision directly under consideration, the words are: "*Commonwealth* and State *income taxes paid in respect of the profits*, less any refunds of Commonwealth and State income taxes received in the accounting period." Before referring to par. (*c*) of sub-sec. 5, it is desirable to consider what, apart from sub-sec. 5, would be the meaning and effect of the expression "Commonwealth and State income taxes paid in respect of the profits." Of course they mean, to begin with, income taxes imposed by the laws of the Commonwealth and the States. That is to say, the income taxes "paid" are paid strictly in accordance with the requirements of those laws—and those laws alone, for the *War-time Profits Tax Assessment Act* makes no provision whatever for them, any more than for the "land taxes" or "rates and other taxes" in pars. (*a*) and (*c*) of sub-sec. 4.

So it is necessary to look, for instance, at the Commonwealth *Income Tax Assessment Act* in order to see what income taxes would be paid "in respect of the profits," and by whom. By sec. 14 of that Act an individual shareholder's taxable income includes (*inter alia*) "profits *credited or paid*" to him by a company. By sec. 16 a company's taxable income does not include what during the financial year is *distributed* to shareholders, but it does include—and this is an all-important matter—all distributable profits for that year which are *not distributed* to shareholders. What we have said is indicative of three things under the Income Tax Acts, namely, (1) that "profits" *not distributed* are taxable as against the company itself; (2) that "profits" when credited or paid to a shareholder are *eo nomine* taxable as against him, and the company is not taxable in respect of such of its "profits" as are distributed; and (3) that, since the Income Tax Acts look to the whole income of a taxpayer, the shareholder's liability to tax in respect of profits as part of his income and additional income may increase the amount of his tax. All those three circumstances would operate if par. (*b*) of sub-sec. 4 were left unqualified. That would result in an inquiry as to what portion of the "profits" had been distributed during the accounting period by being either "credited or paid," and what portion had been left undistributed. As to the undistributed portion during that period, the actual amounts of income tax paid by the company in respect of them would be ascertained—and that would be deducted as a matter of course whatever happened to the undistributed portion afterwards. As to the distributed portion for that period the aggregate of the amounts of tax paid by shareholders would be ascertained and, because that, even if not paid, would be a liability attaching to the profits and existing synchronously with the ending of the accounting period, it would be a liability created by the events that occurred within the period. The two sets of amounts—the company's amount and the shareholders' amounts, would be definite and final, and would cover the whole of the profits, but would not overlap. But the third of the circumstances mentioned, namely, taxation of a shareholder on the basis of his combined income, would be inconsistent with the scheme and purpose of the *War-time Profits Tax Assessment Act*, which taxes not the

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combined income of a taxpayer, but the profits of a "business" as a separate entity irrespective of its ownership. This distinction had to be provided for, and is provided for in sub-sec. 5, which has this for its sole purpose. It so enacts in par. (*a*) for an individual, in par. (*b*) for a partnership, and in par. (*c*) for a company.

We entirely dissent from the notion that this provides for a fictional income tax. The tax contemplated is very real; it is a tax that has been actually paid; it is the very tax that has been paid for the period under consideration; the deduction of the tax provided for can never be more than the tax that had been actually paid for that period, but it may be less, because it is to *be the income tax actually imposed but limited rigidly to the purposes of the business in question for the same period.* The matter seems to us to be as plain as anything could possibly be, and as far removed from a fiction on the one hand, and an additional tax on the other, as simple English words can secure. That is all that par. (*c*) does. It is quite a mistake, therefore, to imagine, as argued for the appellant, that its effect is to permit the Company to be taxed on profits undistributed at the end of the accounting period (which might be the whole of them) and then, on distribution later, allow the shareholders' taxes year by year in respect of the same profits, or the same and other profits indistinguishably mingled, to be added to the deduction so as to reduce the taxable profits of the earlier period. That would be an unreasonable and unfair course and generally an impracticable course, and it would require some very clear words to justify a Court in adopting it. Sub-sec. 5 of sec. 15 says that for the purposes of this section (that is, for the purpose of deducting income tax) "income tax payable in respect of the profits" shall be—in the case of a company—(1) *the amount of the tax (if any) paid by the company together* with (2) the aggregate of what we may call *the shareholders' tax* amounts for distributed profits. But there is no trace of any desire of the Legislature to allow two deductions in respect of tax on the same identical profits. And yet that is precisely what the appellant contends for, and what is necessarily allowed, if the Court allows the October dividend to enter into the calculation. This may be clearly demonstrated. The profits of the Company for the financial period in question consisted of

£9,281 5s. distributed in April 1919, and £9,307 10s. 6d. and other moneys all left undistributed until after 30th June 1919. On the expiration of 30th June 1919, therefore, under the *Income Tax Assessment Act*, the Company was liable for, and must have since paid, income tax on all its profits for the year except the £9,281 5s. distributed in April; that is, it *paid tax as on undistributed profits on* (*inter alia*) the £9,307 10s. 6d. *subsequently distributed in October* 1919. Consequently sec. 15 (5) (*c*) in its first direction requires that the amount so paid by the Company itself on the £9,307 10s. 6d. shall be deducted for the purposes of war-time profits tax for 1918-1919. That requirement is distinct and inexorable, unless we strike out from sub-sec. 5 (*c*) the words "the amount of the tax (if any) paid by the company," which is not permissible either overtly or tacitly. Now, after the financial year closed, namely, in October 1919, that sum of £9,307 10s. 6d. was distributed, and consequently for the later year 1919-1920 the individual shareholders recipients of the dividend were liable to pay income tax. But if the Company is allowed for the *preceding* year 1918-1919 also to deduct the shareholders' tax in respect of the October dividend, that is, the £9,307 10s. 6d., it necessarily follows that two deductions are allowed to the Company for tax (Company's and shareholders') in respect of the *identical sum of money*. We see, as we have said, no trace of legislative warrant for that double deduction—only to be attained by going entirely outside the year's transactions, and confusing the operations of distinct financial periods.

The result of this examination is that there is no ground for holding that by reason of the pure accident of the date of assessment necessarily varying by reason of administrative business or for any other reason the Legislature contemplated any dealing with the profits by distribution, mingled or not mingled, at some period or periods — perhaps months, perhaps years — after the close of the accounting period, so as to affect the computation of the profits solely attributable to that period.

Consequently, the strict and true construction of the Act would exclude the inclusion of the dividend of October 1919 as a factor in computing the Company's taxable profits for the period of twelve months ending 30th June 1919, and makes the assumption above

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stated untenable. If anything be necessary to confirm this, it is found in the very practical fact that Parliament, when passing the war-time profits legislation, did so at the end of 1917, and, by sec. 18 (2) of the assessment Act, the first assessment of taxation under that Act was to be in respect of the financial year beginning 1st July 1915, that is, a year ending at least fifteen months prior to the passing of the war-time profits legislation. And sec. 41 of *Income Tax Assessment Act* makes income tax "due and payable thirty days after the service by post of a notice of assessment." The Commissioner may permit instalments, but obviously they would terminate before the next financial year began. Assessments subsequent to the first were to be made for each succeeding financial year; and that practice has, of course, been followed. It is obvious, therefore, that Parliament contemplated that Commonwealth and State income taxes proper would have been *already paid in respect of each accounting period* as created under the later legislation long before that later legislation came into existence or operation. The word "paid" in the relevant passage is consequently referable, not to a period after the commencement of the *War-time Profits Tax Assessment Act*, but to the liability created by the Commonwealth and State Income Tax Acts for the appropriate accounting periods.

2. *Computation of Capital.*—The material facts as to this are that the balance-sheet and profit and loss account for the six months ending 31st December 1918 showed a balance to the credit of profit and loss account of £42,074 19s. 10d., being that half-year's net profits from Australian sources. No part of this sum was withdrawn from the business but the whole of it remained and was used in the business until 12th April 1919. On that day a general meeting of the Company resolved that the sum of £32,793 14s. 10d., being the balance of the half-year's profits less £9,281 5s., the April dividend above mentioned, should be transferred to general reserve. The Company claims to be allowed, as capital employed in the business, the full sum of £42,074 19s. 10d. from 1st January 1919 to 12th April 1919 and thereafter the sum of £32,793 14s. 10d. The Commissioner allows £32,793 14s. 10d. from 12th April, and nothing prior to that date. The argument addressed to us on behalf of the Company was twofold:— First, it was said, in effect, that, as it is established there were in

fact profits for the previous half-year of £42,074 19s. 10d. and as these were actually used in the business, they must, within the meaning of sec. 17 (1), be taken to be capital, because they were necessarily by the end of December 1918 " accumulated " and were in fact used, and therefore " invested," in the business. Next, it was said that the resolution of 12th April was a recognition that the whole £42,074 19s. 10d. had been accumulated and used as capital from 31st December previous, and the declaration of dividend £9,281 5s. was a mere diminution *pro tanto* of that sum. It was urged also that the mere tacit leaving of the profits in use in the business from 1st January 1919, and even before, was equivalent to conversion into capital. The Commissioner's contentions negatived these, and asserted the necessity of some exercise of volition to convert the profits into capital in order to satisfy the terms of sec. 17 (1), " accumulated trading profits invested in the business."

In *McKellar* v. *Federal Commissioner of Taxation* (1) it was observed as to sec. 17 (1) that the capital spoken of is the capital of the particular *business*. The statutory words are " the capital *of a business* " and " the amount of *its* capital." It is essential to have this fact constantly in view. Then, after referring to the capital of the business actually " paid up " by the owner in money or in kind, it was said :—" Then to this are to be added all accumulated trading profits made at any time and invested in the business, that is, treated as capital, and this adjusted by the addition or subtraction of balances brought forward from previous years to the credit or debit of profit and loss account. This, with the exception of the capital provided for in sub-secs. 2 and 3, is generally speaking the capital to be computed, which represents the money value of the business as the machine by which the profits for the given period have been made." That generalization seems to us, on the more direct consideration of the particular section now necessary, to be correct ; but a closer analysis is called for.

Sec. 17 (1) is a legislative statement couched in business terms and addressed to the plain understanding of business men. It enacts that, for the ascertainment of the " amount of the capital " of a business for any given accounting period, three factors (subject

(1) (1922) 30 C.L.R., at p. 207.

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to express modifications in other sub-sections) shall determine the amount, namely, (a) capital actually paid up; (b) accumulated trading profits invested in the business; (c) profit and loss balances brought forward from previous years. In order to place the respective contentions on their proper footing, it is necessary to understand how these several factors are understood independently of this legislation. The first factor—actual capital—needs no elucidation beyond that already stated in *McKellar's Case* (1). The second factor, in view of the arguments we have had addressed to us, requires some explanation. First, we think it desirable to state why we think that the case of *Meares* v. *Acting Federal Commissioner of Taxation* (2) has no bearing on this case. That case, it is true, dealt with a section (sec. 14) of the *Income Tax Assessment Act* which referred to a profit and loss account and accumulation and the carrying forward an amount. But the case was not concerned with the meaning of "accumulation" except so far as the proviso declared income should *not* be deemed to be accumulated. And the Court held that the words "carried forward" in the proviso imported an affirmative act of volition, which was inconsistent with an intention to treat the fund as an accumulated fund. But here we have to consider what, apart altogether from such a negative proviso, is understood by the expression "accumulated profits" in the business world, and, further, what is the meaning of the added condition "invested in the business." The section is directed to all businesses, whether owned by individuals, firms or companies. Nothing turns on what is known as the *de jure* capital, or share capital, of limited companies. The capital in question is *de facto* capital entirely, but, though *de facto* capital, it must be ascertained as the section declares and may consist of, and does in truth include, what ordinarily would not be taken in strict accountancy to be "capital." Nevertheless, the Legislature has determined that in fairness for the purposes of the Act all that it has included is a productive part of the profit-making machine, the product of which is taxed. The expression "accumulated profits" is familiar in judicial decisions and well known in the mercantile world for over 150 years. But for present purposes it will be sufficient to refer to very few cases, namely,

(1) (1922) 30 C.L.R., 198. (2) (1918) 24 C.L.R., 369.

Hollis v. *Allan* (1), decided by *Kindersley* V.C. in 1866, and *Bouch* v. *Sproule* (2) in 1887. Later cases exemplify and support this, the most important of which is *Commissioners of Inland Revenue* v. *Blott* (3). In *Hollis* v. *Allan* the Vice-Chancellor drew a distinction between "current profits" and other profits. That is to say, he drew a distinction between, on the one hand, "current profits" of a given year, *in which he included a surplus balance of profits of a previous year not appropriated to any fund*, and, on the other, profits in a fund accumulated in previous years for any purpose. And, in our view, the true import of the term "accumulated profits" is that they are profits which the company has appropriated to some reserve account, whether that account be of a capital nature or not. "Accumulation" in that connection does not mean the mere existence of profits, even over a lengthened period, however they are employed; but it connotes the affirmative gathering of these profits, or such as may be selected, into a measured or measurable heap and allocated to a named reserve fund, whatever its nature may be. But even when profits are "accumulated" they are not necessarily capital. Whether they become so or not depends upon whether they are effectually converted into capital. What amounts to an effectual conversion of profits into capital depends on the proper view to be taken of the doctrine of *Bouch* v. *Sproule*. But as in this case we are not concerned with the difference between capital *de jure* and capital *de facto*, we are free to refer to the authorities mentioned for the purposes of this case. In *Bouch* v. *Sproule* (4) the House of Lords reversed the decision of the Court of Appeal. But much of the reasoning of the Court of Appeal was approved. Pages 658 and 659 of 29 Ch. D. may be referred to as indicating the opinion of that Court that accumulated profits are not necessarily regarded as capital, even when appropriated to a fund, unless the nature of the fund itself indicates an intention to capitalize. But, as Lord *Herschell* points out (5), the intention of a company to capitalize *de facto* its accumulated profits may (in certain cases) be shown where it "has *accumulated profits and used them, in fact, for capital purposes.*" We omit the remainder of the sentence because it is irrelevant here.

(1) (1866) 14 W.R., 980.
(2) (1885) 29 Ch. D., 635; (1887) 12 App. Cas., 385.
(3) (1921) 2 A.C., 171.
(4) (1887) 12 App. Cas., 385.
(5) (1887) 12 App. Cas., at p. 397.

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Lord *Herschell* also observes (1) that the foundation of the judgment in *Irving* v. *Houstoun* (2) was that the accumulated profits had become part of the floating capital of the concern. His Lordship adds these very important words :—" But they had become so, not by reason of any declaration of the company that they should be so, but only in the sense that, *having accumulated*, they were, *de facto*, *used as part of its capital*. In this sense, however, all *accumulated profits which are in use for the purposes of the business* of any company, may equally be said to form part of its floating capital." That is shortly expressed by the statutory words " invested in the business." In *Blott's Case* (3) Lord *Sumner* observes, " apart from the Companies Acts, profits may be capitalized in more ways than one." One observation may here be made. It is, of course, competent to a trader to introduce fresh capital into his business at any moment. And the Legislature thought it necessary to specially declare by sec. 12 (2) that the deduction specified in sub-sec. 1 with reference to increased capital employed in a business should be proportionate to the part of the accounting period during which the additional capital has been employed. This indicates that increase of capital during the accounting period is to be taken into account. The third factor above mentioned, namely, profit and loss balances brought forward from previous years, fulfils two functions. One function is that of adjustment by reason of the identity of the business reaching back, and involving possibly consideration of capital introduced in earlier years and either increased or diminished in the course of trading. As to this it is unnecessary to say more. The other function is both to prevent the injustice of taxing as profits in a given year a sum brought forward that had already been taxed as such in the previous year, and to give credit to the taxpayer for the actual use of that sum for its productive aid in making the profits of the current year. This is done by including the balance brought forward from previous years as capital for the purposes of the Act. Such a balance, as has been seen by reference to *Hollis* v. *Allan* (4), is in ordinary circumstances not capital. But for this purpose the Legislature treats it as capital. It is not " accumulated profits."

(1) (1887) 12 App. Cas., at p. 393.
(2) (1803) 4 Paton Sc. App., 521.
(3) (1921) 2 A.C., at p. 207.
(4) (1866) 14 W.R., 980.

That is at once seen if we recollect that the net balance to the credit of the profit and loss account when brought down may be dealt with variously. Say, for instance, the net balance is £100,000, of which £40,000 is appropriated to capital reserve and £50,000 to reserves not of a capital nature, leaving £10,000 unappropriated and simply carried forward. Then of the £100,000 there is £90,000 worth of "accumulated profits" and £10,000 of profits unaccumulated and simply "carried forward." They, when "brought forward," that is, when considered not as part of the transactions of the former year but as part of the transactions of the accounting year, are to be taken as "capital" for the purposes of sec. 17. The words "from previous years," of course, must be adhered to. Obvious reasons exist for their insertion, but there is no need to discuss reasons when the words are imperious. It is sufficient to say that there is no connection between the limitation of previous years in relation to profit and loss balances and the accumulation of profits representing the second factor.

We apply these considerations to the facts. It was contended before us that, inasmuch as it was now clearly established by the balance-sheet approved on 12th April 1919 that there had in fact been profits during the half-year ending 31st December 1918, these profits, since they actually existed and were not taken out of the business and were not inconsistently dealt with before 31st December, but were left to assist in making the profits for the succeeding half-year, must be treated as capital. This, we are utterly unable to accept both because it assumes business impossibilities, and because it is contrary to the high judicial authorities referred to, and to the general tenor of all the judgments in *Blott's Case* (1). Laying aside that contention, the question is: Were the profits of the first half of the financial year 1918-1919, namely, £42,074 19s. 10d., accumulated? The facts show they were. They were accumulated on 12th April 1919, and not before. That was the day when the Company resolved how those profits should be treated, and it determined to divide them into two distinct portions, namely, £9,281 5s., which it decided to distribute and part with altogether, and £32,793 14s. 10d., the balance which it resolved to keep but to transfer to

(1) (1921) 2 A.C., 171.

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general reserve. As from that date, and not before, the profits became "accumulated profits." As to the sum of £9,281 5s., that never answered, and never can answer, the description "accumulated profits." It belongs to the shareholders individually. The appellant's contention to be entitled to compute the whole sum of £42,074 19s. 10d. as capital between 1st January 1919 and 12th April 1919, is clearly unsupportable. His allowance of £33,793 14s. 10d. as from 12th April, is fully as much as could possibly be allowed.

We would, on the basis of our own opinion, answer the questions as follows:—1 (a) The dividend of 19th April only is to be taken into calculation in computing the amount of income tax deductible by the Company under sec. 15, sub-secs. 4 (*b*) and 5 (*c*) of the Act. In that case it would be unnecessary to answer questions 1 (b) and 1 (c). As to questions 2 (a) and 2 (b), we answer in the negative. But, having regard to the fact that the majority of the Court hold that the date of assessment controls the operation of sec. 15 (5) (*c*), we are bound to accept that decision for the purpose of enabling the Court to give a consistent ruling determining the rights of the parties. On that basis, and on that only, we answer the questions as follows:—1 (b) we answer in the affirmative for the reasons we have hereinbefore stated in detail. Then as to 1 (c), for the reasons hereinbefore expressed we answer: the rate common to the two financial years 1918-1919 and 1919-1920. We answer 2 (a) and 2 (b) in the negative.

HIGGINS J. I concur with the Chief Justice and *Gavan Duffy* J. in their view that *both* the dividends in question—the dividend paid on 12th April 1919 and the dividend paid on 11th October 1919—are to be brought into the computation of "the share of the profits credited or paid" to the shareholders for the purpose of the fictional income tax to be deducted under sec. 15 (5) (*c*) of the *War-time Profits Tax Assessment Act* 1917-1918. But, in my opinion, the fictional income tax must be calculated for each shareholder on the sum of these two dividends paid to him—not on each dividend separately.

I cannot see that we are justified in treating the words "if the

share of the profits credited or paid to him " as if they were " if the share of the profits credited or paid to him *in the accounting period.*" The draughtsman of the Act has scrupulously inserted the words " in the accounting period " wherever he meant them to be, and omitted them wherever he did not mean them to be. For instance, under sec. 15 (4) (*a*), no land taxes are to be deducted from the profits of the accounting period unless they are paid " in that accounting period " ; and under sec. 15 (4) (*c*), no rates, &c., are to be deducted unless they are paid " in the accounting period." But, under sec. 15 (4) (*b*), the words " in the accounting period " are markedly omitted from the provision for deduction of income taxes. The reason for the difference in language is obviously that income taxes—unlike land taxes and rates—cannot be paid or even assessed till after the accounting period. The only limitation on the income taxes to be deducted is that they must be " paid *in respect of the profits* "—that is to say, the profits of the accounting period (in this case 1918-1919). The profits made in the accounting period are, as it were, pursued timelessly, but divided into two parts—(1) the part distributed to shareholders and (2) the part not distributed to shareholders. The reason for this division is, of course, that under the system adopted in the Federal Income Tax Acts, the shareholders pay income tax on the dividends distributed (sec. 14 (*b*)), and the company pays income tax on the balance (sec. 16 (1)): *Income Tax Assessment Act* 1915-1918.

I confess that for some time I was strongly of opinion that both the Commissioner and the taxpayer Company were wrong in treating the income tax that would be payable on these dividends, or either of them, as being a proper deduction from the profits of the business. We are dealing with the profits made from the business in the accounting period 1st July 1918 to 30th June 1919 ; and, as the income tax in respect of these profits would not be payable till after 30th June 1919, it seems to be absurd to treat payments to be made (or fictionally made) after that date as being deductions applicable to the year 1918-1919. But, on further examination of the Act, I find that the words support no other intention. We must take the words of the Act literally, and give effect to them, unless we find that in

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their literal meaning they would lead to such an absurd result that they cannot possibly be accepted in their literal meaning.

There is no doubt that anomalous results may be pointed out from this interpretation, as well as from any other interpretation, of sec. 15. For instance, the assessment for war-time profits tax has to be made for each financial year (sec. 18 (2)); and so has the assessment for income tax (*Income Tax Assessment Act* 1915-1918 (sec. 10)); and if the Commissioner were so guileful as to assess for war-time profits tax before he assess for income tax, it would seem that he could prevent the company from getting its deduction of income tax actually paid by the company—that is to say, in the original assessment for war-time profits. But if, after the original assessment, the company pay its income tax for the accounting period, there is provision in the Act for alteration of the assessment even though war-time profits tax has been paid (sec. 23 of *War-Time Profits Tax Assessment Act*; and see sec. 15 (6)). We may think that the machinery for carrying out the principles laid down in sec. 15 (4) and (5) is liable to abuse; but it is for Parliament to improve the machinery, not for us to wrench the Act from its true meaning in order to meet the possibility of abuse. I think I should point out, in considering the effect of sec. 15, that the deductions referred to in sub-secs. 2 and 3 are of a nature quite distinct from that of the proviso to sub-sec. 4, and of sub-sec. 5. The former are deductions from receipts of the business—deductions made in the process of *ascertaining* the profits arising in an accounting period; the latter is a deduction to be made *after* the profits of the business have been ascertained—a deduction "from the profits" (cf. sec. 18, "the *net* profits"). It is, moreover, a mistake to suppose that this interpretation of sec. 15 (4) and (5) involves two deductions instead of one in respect of the same part of the same profits. Suppose that the company make £10,000 profits in the year 1918-1919, and distribute in that year £3,000 of those profits, carrying £7,000 to reserve; and suppose that it distribute the £7,000 in a subsequent year. According to my view, if war-time profits tax has been computed for the year 1918-1919, and even if it has been paid, the scheme of the Act is that there should be an alteration in the assessment of the company. This might involve the reducing of the income tax

of the company and the increasing of the income tax fictionally payable by the several shareholders; but there would not be any double deduction of income tax on the same part of the same profits. The precise difficulty has been met, so far as regards income tax as distinguished from war-time profits tax, by sec. 16 (2A) of the *Income Tax Assessment Act*; there is there a distinct provision for a rebate. There is no such provision contained in the *War-time Profits Tax Assessment Act*; but under sec. 23 there are means provided whereby the Commissioner may alter his assessment as often as new circumstances arise. Other conundrums may be suggested; but it is not for this Court to frame a proper scheme: it is for Parliament.

But in my opinion—and here I am compelled to differ from the Chief Justice and *Gavan Duffy* J.—the fictional income tax has to be calculated for each shareholder on the sum of these two dividends paid to him—not on each dividend separately. As the tax is progressive, the point affects the rate at which each shareholder's tax is to be calculated. Suppose shareholder X receive in April 1919 a dividend of £200, and in October 1919 a dividend of £200. The Commissioner claims that the fictional income tax for X should be calculated on the April £200, as if X had no income from other sources; then on the October £200, as if &c.; then that the two amounts of income tax should be added together, and the total deducted from the profits of the business. The Company claims that the two sums of £200 should be added together, the fictional income tax calculated on the total £400, and that fictional income tax deducted from the profits. In my opinion, the Company is right. The fictional income tax is to be calculated as "if the share of the profits credited or paid" to the shareholder "had been the only income derived by him"—not as if *each dividend* credited or paid had been &c. Up to the present, the two dividends paid constitute "the share of the profits credited or paid" to the shareholder X. As I read sec. 15 (5) (*c*), the deductions in the case of a company from the profits of the relevant year are (1) the amount of income tax actually paid by the company; (2) the aggregate of the amounts of tax-that-would-have-been-payable-by-each-shareholder if the share of the profits, &c. The tax paid by the company is single; the taxes fictionally paid by the separate shareholders have to be

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aggregated. We are to find the tax that would be payable by shareholder A, then the tax that would be payable by shareholder B, then the tax that would be payable by shareholder C, &c.—in each case on the basis of the shareholder having no outside income, and at the rate appropriate to the shareholder's share of the profits for the relevant year received by him; and then deduct the total of the fictional income taxes from the profits.

Question 1 (c), as to the rate at which the income tax is to be assessed, is not to be answered, as I understand; and, of course, I make no formal answer to it. There is no indication of any variation for the relevant years; and though the rates may vary, in progressive taxation, according to the total amount of the dividends paid to the shareholders respectively, we are not informed what dividends were paid to each shareholder. But, although the question is not to be answered, it is not to be assumed that the answer to this question must react unfavourably on the principle on which I should answer questions 1 (a) and 1 (b). In sec. 15 (5) (*c*) the words "that would have been payable" must refer to some time; and the only time relevant in the context is the time that the company paid its income tax. I think, therefore, that the rate to be applied to the respective shareholders is the rate appropriate to the year in which the Company paid, or ought to have paid, its income tax in respect of the profits undistributed.

Question 2 is as to the effect of sec. 17—"Capital": "The amount of the capital of a business shall be taken to be the amount of its capital paid up by the owner in money or in kind, together with all accumulated trading profits invested in the business, with the addition or subtraction of balances brought forward from previous years to the credit or debit respectively of profit and loss account."

It appears from the case (par. 14) that the net profits made by the Company for the six months ending with 31st December 1918 were £42,074 19s. 10d., and this fact appeared in the balance-sheet as on that date. This sum remained in the business and was used therein until the general meeting of the Company on 12th April 1919; and then the Company by resolution declared and paid a dividend to the amount of £9,281 5s., and transferred the balance £32,793 17s. 10d. "to general reserve." The Commissioner has

refused to treat the sum of £42,074 19s. 10d. as capital of the Company as from 31st December 1918, but has treated the £32,793 17s. 10d. as capital of the Company as from 12th April 1919 to 30th June 1919. The Company insists that the whole sum of £42,074 19s. 10d. should be treated as capital of the Company as from 31st December 1918.

Of course, the greater the capital, the less would be the percentage shown by the profits, and the less would be the tax. But the question is, should those profits as from 31st December 1918 be treated as additional capital—capital added to the capital paid up by the shareholders. Sec. 17 (1) applies to other taxpayers as well as to companies; and this explains the generality of the language used—"all accumulated trading profits invested in the business." But the word is "invested"—not "used"—in the business. The mere fact that profits are carried to "general reserve," as here, does not prevent the Company from using them for dividends afterwards. They still remain undrawn profits. We have not been supplied in this case with the memorandum and articles of this Company; but we may assume that they contain nothing which turns all reserves into capital, or prevents the directors from distributing the reserves as dividends (see *In re Bridgewater Navigation Co.* (1)). To use the words of *Romer* L.J. in *In re Hoare & Co. Ltd.* (2), the Company "might have used it" (the reserve) "in equalizing dividends, or, if they had chosen, they might have applied it in making good lost capital, or have applied it to any purpose they thought fit within the objects of the Company. Now what does such a fund as that represent? To my mind it in no wise represents the capital account properly so called." The usual methods of "capitalizing profits" in the case of a company are described in *Palmer's Company Law*, 10th ed., p. 221. It is done sometimes by declaring a bonus and making a call payable at the same date. "But more commonly what is desired is to issue paid-up bonus shares to the members and at the same time to carry from reserve to capital account a corresponding amount. . . . To do what is desired, it is therefore necessary to declare a bonus or dividend payable out of reserve . . . so that each member may have an individual right, and

(1) (1891) 2 Ch., 317, at pp. 327-328.

(2) (1904) 2 Ch., 208, at p. 214.

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this can then be satisfied by the issue of paid-up shares." The point is that the mere use of the reserve profits in the business is not enough; there must be a definitive appropriation of the reserve to capital, so that it is no longer available for dividends or for purposes other than the purposes of capital.

In my opinion, therefore, so far, no part of the sum of £42,074 19s. 10d.—the net profits derived from July to December 1918, and appearing to the credit of profit and loss in the balance-sheet of 31st December—can be treated as "accumulated trading profits invested in the business" either as from 31st December 1918, or as from 12th April 1919. Neither the use in the business, nor the carrying of the balance to general reserve after deduction of the dividend, is enough. There must be a definitive *investment* in the business.

But sec. 17 goes on to say, as to profit and loss balances—"with the addition or subtraction of balances brought forward from previous years to the credit or debit respectively of profit and loss account." "From previous years"—"previous" is a relative term—previous to what? Obviously, I think, previous to the accounting period under consideration (see secs. 12, 16 (1), (6), (9), &c.). But here the balance was not carried forward from the years previous to the accounting period 1918-1919; it was carried forward during the accounting period. I have not omitted to consider the effect of sec. 12 on this point:—"(1) Where during the accounting period increased capital has been employed in a business, a deduction shall be made from the profits of the accounting period of the greater of the following sums" (stated) ". . . (2) The deduction specified in the last preceding sub-section shall be proportionate to the part of the accounting period during which the additional capital has been employed." Then there is a converse provision for the case of decrease of capital during the accounting period. But sec. 12 does not take the words "from previous years" out of sec. 17; the indulgence given by sec. 17 in respect of balances to credit of profit and loss brought forward is confined to balances brought forward "from previous years"; and ample effect can be given to sec. 12 by treating it as applicable (e.g.) to new paid-up shares issued during the accounting period.

In my opinion, the proper answer to question 1 (a) as newly framed is that *both* these dividends should be taken into the calculation; to question 1 (b) is Yes. The proper answer to question 2 (a) is, in my opinion, No; and to question 2 (b) is No proportion.

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Questions answered:—(1) (a) *Both*. (1) (b) *Yes*. (1) (c) *Not answered*. (2) (a) *No*. (2) (b) *No*.

Solicitors for the appellant, *Braund & Watt*.

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

B. L.

[HIGH COURT OF AUSTRALIA.]

THE NATIONAL TRUSTEES, EXECUTORS AND AGENCY COMPANY OF AUSTRALASIA LIMITED . . . . . } APPELLANT;

AND

THE FEDERAL COMMISSIONER OF TAXATION . . . . . } RESPONDENT.

Land Tax —Assessment—Owner—Joint owners—Deduction of £5000*—Trustees—Will of testator who died before 1st July* 1910*—Trust to pay income to children—Discretion to trustee to withhold part of income — Land Tax Assessment Act* 1910-1916 (*No.* 22 *of* 1910—*No.* 33 *of* 1916), *secs.* 3, 11, 38 (7).

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MELBOURNE, *Oct.* 12, 15.

SYDNEY, *Dec.* 13.

Knox C.J., Isaacs, Higgins, Rich and Starke JJ.

By his will a testator, who died before 1st July 1910, after certain specific gifts gave the residue of his estate real and personal to his trustee upon trust to sell and convert with full power to postpone, and to manage and let the real estate during postponement; and any rents were to be treated as income under the trust for investment. He directed that the net residue should be invested and, subject to an annuity to his widow and to the proviso next hereinafter mentioned, that the income should be paid to such of five of his children as