

Held, by Knox C.J., Higgins and Rich JJ. (Gavan Duffy and Starke JJ. dissenting), that the expenditure of the purchase-money was an expenditure of capital, and even if it could be treated as an outgoing of the business it was in the nature of an outgoing of capital, any deduction in respect of which is forbidden by sec. 23 (1) (a) of the *Income Tax Assessment Act 1922-1924*.

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APPEAL from the Deputy Federal Commissioner of Taxation for Western Australia.

A partnership of which the appellant, Joseph Douglas Webster, was a member and which carried on the business of pastoralists, purchased on 1st April 1923 the pastoral property known as "Myroodah," with all stock, &c., thereon, which included sheep in full wool. Subsequently the sheep were shorn and the wool obtained therefrom was sold. The Deputy Federal Commissioner of Taxation having included the proceeds of the sale of the wool in the partnership assessment for the year 1st April 1923 to 30th March 1924 under the *Income Tax Assessment Act 1922-1924*, and having disallowed the appellant's objection thereto, the notice of objection was treated as an appeal to the High Court. The appeal came on for hearing before the Chief Justice, who directed the matter to be argued before the Full Court.

Other material facts are stated in the judgments hereunder.

Downing K.C., with him *Connor*, for the appellant. The wool on the backs of the sheep purchased was a severable commodity. The sale of such wool is a conversion of capital; and the proceeds of sale are not income but capital.

[HIGGINS J. referred to *Clark v. May* (1).]

Under sec. 17 of the *Income Tax Assessment Act 1922-1924* the vendor is liable to pay tax on the value of the wool on the sheep's backs at the time of sale; the purchaser should not be also liable.

Walker, for the respondent. Wool on sheep's backs cannot be considered as distinct from the sheep at the time of sale. It does not become distinct from the sheep until shearing. It is capital whilst it is on sheep's backs and income when it is shorn. A purchaser gets the money expended on acquiring such wool when he sells the sheep or when they die. Wool on sheep's backs is not a marketable commodity (*City of London Contract Corporation v. Styles* (2); *In*

(1) (1852) 16 Beav. 273.

(2) (1887) 2 Tax Cas. 239.

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There is no evidence as to what price the purchaser would have paid for the sheep off shears.

Downing K.C., in reply.

Cur. adv. vult.

The following written judgments were delivered :—

KNOX C.J. AND RICH J. On 15th January 1923 the appellant acquired an option of purchase exercisable on or before 31st March 1923 over the pastoral property known as "Myroodah" on a walk-in-walk-out basis with all stock, &c., thereon. The price fixed was a lump sum of £18,000. The appellant duly exercised the option of purchase, and on 30th April 1923 the transaction was completed by the execution of transfers and payment of the balance of purchase-money. For the purpose of assessing stamp duty the sum of £12,375 was at the time of completion agreed as the value of the sheep included in the sale, but no valuation was made of the wool on the sheep's backs as distinct from the value of the sheep as animals. On or before 1st April the appellant went into possession of the station, and from that date he and his partner carried on there the business of graziers or pastoralists. In the ordinary course of such business the sheep on the station were shorn, and the wool obtained from the 33,000 sheep acquired with the station was sold for £10,977. During the year in question (1st April 1923 to 31st March 1924), being the year of income for the purposes of this case, some sheep died, some were sold, some rams were bought, and there was some natural increase, and it may be assumed that the necessary adjustments have been made and allowed by the Commissioner in accordance with the provisions of the *Income Tax Assessment Act* 1922-1924, and no question now arises in respect of these matters. Substantially, the case may be and has been treated for the purpose of the present appeal as if the sheep purchased with the station in March 1923 remained on the station until 31st March 1924. The only question now calling for decision is whether, in ascertaining the income of the partnership for the year beginning 1st April 1923

(1) (1910) 1 Ch. 389, at p. 401.

(2) (1896) 2 Ch. 241, at p. 248.

and ending on 31st March 1924, a deduction should be made from the gross income of the partnership (including the proceeds of sale of wool referred to above) of the value on 1st April 1923 of the wool on the backs of the sheep purchased with the station.

In our opinion the deduction claimed is not authorized by the Act. It is not disputed that the partnership carried on during the year in question the business of pastoralists or graziers, or that the shearing of sheep and sale of the resulting wool is in the ordinary course of carrying on such a business.

By the *Income Tax Assessment Act* "assessable income" is defined as meaning "the gross income which is not exempt from taxation," and this definition clearly covers the gross proceeds of sale of the wool in question. By sec. 23 of the Act it is provided that in calculating the taxable income of a taxpayer the total assessable income derived by the taxpayer from all sources in Australia shall be taken as a basis, and from it deductions shall be made in respect of the matters specified in that section. The proceeds of sale of the wool being assessable income, and properly included as such in the calculation of taxable income, it is for the appellant to show that the deduction of £8,009 which he now claims to make from the assessable income of the partnership is authorized by the provisions of that section. This sum of £8,009 represents the estimated value as at 1st April 1923 of the wool on the backs of the sheep purchased with the station. It was not a sum agreed upon between the appellant and the vendor as the price of such wool, but was paid as an undefined portion of the sum of £18,000, the purchase-money on the station on a walk-in-walk-out basis. The expenditure of £18,000 in purchase-money was for the purpose of acquiring the assets and stock-in-trade of the business in the carrying on of which the assessable income was derived. It was clearly an expenditure of capital, and, even if it could be treated as an outgoing of the business, it was in the nature of an outgoing of capital, any deduction in respect of which is forbidden by sec. 23 (1) (a) of the Act. Assuming, as the fact appears to be, that of that £18,000 the sum of £12,375 was paid for the purchase of the sheep from which the wool in question was obtained, the expenditure of that sum also was clearly an expenditure or outgoing in the nature of capital. It was paid in

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order to acquire capital assets of the business purchased and carried on by the partnership. So far as the assets purchased consisted of live-stock which were dealt with by sale or ceased to exist, provision is made by secs. 16 and 17 of the Act for the method in which the resulting profit or loss is to be treated, but we can find in the Act no justification for treating any part of the purchase-money paid to acquire a business and the assets used in carrying it on otherwise than as an expenditure of capital. It was, however, suggested that the amount which the appellant claims to deduct might be treated as a sum laid out in the purchase of a commodity which was afterwards sold by the partnership, and that on this footing it should be deducted from the gross proceeds of sale of the wool, in the same way as a deduction is allowed of the price paid by a trader for goods purchased and afterwards sold by him. But the agreement in this case was not for the purchase of the wool on the sheep's backs, but for the purchase of the sheep, and what was sold by the partnership was not the sheep purchased but the wool the produce of those sheep. And it should not be overlooked that the wool which was on the sheep's backs on 1st April 1923 was in the natural course of events replaced by the growth of wool during the ensuing twelve months, so that on 1st April 1924 such of the sheep purchased as remained on the station were again in the wool and substantially in the same condition in that respect and probably of about the same value as on 1st April 1923. The question whether the purchaser of wool on the sheep's back, as distinct from the sheep, is entitled to deduct from the proceeds of sale of the wool the price paid by him for it does not arise in this case.

For these reasons we are of the opinion that the appeal should be dismissed.

HIGGINS J. I concur with the Chief Justice and *Rich J.* in their reasoning and in their conclusion. All the proceeds of the wool shorn and sold in the year in which the income was derived—1st April 1923 to 1st April 1924—were obviously “proceeds of the business” of pastoralist “carried on by the taxpayer,” and therefore have to be included in his income from personal exertion, under sec. 4. They form part of the gross income not “exempt” from

taxation, and therefore part of his "assessable income" (sec. 4); and, after the deductions allowed by sec. 23, they form part of his "taxable income." But there is no deduction allowed for outgoings of capital under sec. 23; and the whole price of £18,000 for the station and stock as they stood, including the wool on the backs of the sheep, was an outgoing of capital, whether the balance of purchase-money was paid before or after 1st April 1923. In the profit and loss account for the year, no part of £18,000 could be included as expenditure as against receipts.

I cannot help thinking that any difference of opinion in this case is chiefly due to failure to grasp the specific provisions of our Australian Act as distinguished from the English Acts. To determine the "profits" of the business is not—I say it with all respect—"the first step" to be taken. Under the definition in sec. 4 of "income from personal exertion," the first step is to ascertain the "proceeds"—the gross proceeds—of the business carried on by the taxpayer. These proceeds (including all the moneys realized from the sale of trading stock or wool) become the "assessable income"; from the assessable income have to be deducted (*inter alia*) "all losses and outgoings (*not being in the nature of losses and outgoings of capital*)" (sec. 23 (1) (a)). What remains after the deductions is the "taxable income" (sec. 4; sec. 23). This "taxable income" much resembles "profits," in the case of a business; but "profits" is hardly the suitable word for all income from personal exertion—e.g., "salary, wages, . . . pensions." In short, our tax is on "taxable income"; and the payment of £18,000 for the station, stock, &c., on a "walk-in-walk-out" basis is clearly an outgoing of capital.

GAVAN DUFFY AND STARKE JJ. In the year 1923 a partnership of which the appellant was a member purchased for the sum of £18,000 cash the Myroodah station situated on the Fitzroy River, West Kimberley, consisting of pastoral leases on a walk-in-walk-out basis, as on and from 31st March 1923, with all stock thereon. There were on the station some 33,000 sheep in the wool; and the parties to the contract of purchase about April 1923 allocated the purchase-moneys for the purpose of stamp duties and otherwise,

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as we were informed, in the following manner :—(a) 33,000 sheep (more or less) in the wool at 7s. 6d. per head, £12,375 ; (b) cattle, horses, mules and donkeys, £500 ; (c) stores, plant and other effects, £500 ; (d) leases and improvements, £4,625 : £18,000. The propriety and accuracy of this allocation has not been questioned. In August 1924 the partners made a return of their income from all sources in Western Australia for the year ending on 31st March 1924, which was apparently the date adopted for the annual balance of the partnership accounts (see *Income Tax Assessment Act* 1922-1925, sec. 32). This appeal turns upon the ascertainment of the income derived from the Myroodah station for the accounting period, and more particularly it concerns a sum of £8,009 receipts from wool which the Commissioner has added to the income returned by the partnership.

Now, in ascertaining the taxable income derived by the partners from Myroodah station, it is necessary as a first step to determine the profit that accrued to them in the accounting period in carrying on the business of pastoralists on the station. The profit of a business is the surplus that remains after providing for the cost of commodities used and expenses incurred in carrying on the business (*Usher's Wiltshire Brewery Ltd. v. Bruce* (1)). Thus in an ordinary trading concern the profit would be ascertained by debiting stock at the commencement of the period to which the account relates, and crediting the sales and the closing stock. Sheep and wool differ in kind from ordinary commodities, but profit or loss made or incurred in trading or carrying on business with them must be ascertained on the same basic principles. Consequently, in determining the profit from carrying on the business of Myroodah station for the accounting period, the partners would be justified in debiting their trading account with the cost allocated to the sheep in wool and crediting it with sales of sheep and wool and the value of sheep in hand at the close of the period. Profit or loss for the accounting period cannot possibly be ascertained unless the value of the wool which forms part of the price paid for the trading commodity—sheep in wool—is taken into account and debited against sales. Some adjustments would, no doubt, be required in

account in this case owing to the fact that the wool was a growing commodity, and was severed for the purposes of sale ; but that is a matter of detail.

The partners in their accounts and in their return ascertained, or endeavoured to ascertain, the profit on sheep and wool separately. In the first place they ascertained the cost of the wool (£6,301), and deducting that sum from the total sum allocated to the purchase of sheep in wool (£12,375), they ascertained the cost of the sheep without wool (£6,074). The Commissioner has not challenged the steps by which the partners ascertained the cost of the wool, and it is therefore unnecessary to say whether the profit on sheep and wool was rightly separated in the partnership return, or whether the method pursued in ascertaining the cost of the wool was right or wrong. What the partners did was to take the total proceeds of the wool from the sheep purchased (£10,977), and deduct the appreciation in value of wool between shearing and sale and the value of the wool grown on the sheep's back between the date of purchase and date of shearing. At the time of purchase there were forty-nine and one-half weeks' growth of wool on sheep's backs, and at the time of shearing fifty-nine weeks' growth of wool. The value of wool grown on sheep's backs between date of purchase and date of shearing was thus ascertained by a proportion sum.

The items so deducted from the total proceeds of the wool (£2,968) were treated as income, and the balance (£8,009) was taken to be the value of the wool on the backs of the sheep at the date of purchase ; and from this sum of £8,009 were deducted shearing and other expenses, bringing the net value of wool on sheep's backs at the time of purchase to £6,301, and therefore, according to the partners the cost of the wool purchased by them under the walk-in-walk-out contract. It was the above-mentioned sum of £8,009 by which the Commissioner increased the wool receipts of the partnership. The result necessarily is that the Commissioner refuses to allow any deduction for the cost of the wool purchased by the partnership ; and that, for reasons above stated, is clearly wrong. It is wrong on any test applied in ordinary business, and equally wrong as applied to a pastoralist's business. It was contended, however, that the *Income*

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Tax Assessment Acts 1922-1925 justified the action of the Commissioner. The Commissioner relied upon secs. 16 (a) and 17 of the Acts, and the Statutory Regulations made under those Acts. The former section requires that all live-stock (with certain exceptions) not disposed of at the beginning and end of the accounting period shall be taken into account at values as prescribed. The Regulations, Statutory Rules 1923, No. 12, cl. 50, prescribe that the value shall be calculated on the basis of the cost price of the stock. The cost price must be the subject of calculation in some cases, and the method adopted by the partners of calculating the cost price of the stock has not been challenged in this case by the Commissioner and must be taken to be in accordance with the Acts and Regulations.

The latter section requires that the proceeds derived from the sale of the trading stock or part of the trading stock, as defined by the Act, of any business shall be assessable income, that is, the gross income which is not exempt from taxation (sec. 4) ; but in calculating taxable income for the purposes of the Act the profits of a business can only be determined after providing the commodities in which it is dealing. There is nothing in the Act which deprives the partners of an allowance for the cost price of the wool used by them in their business.

The appeal ought, therefore, to be allowed.

Appeal dismissed with costs.

Solicitors for the appellant, *Stone, James & Co.*

Solicitor for the respondent, *J. C. Walker.*

P. V. F.