[HIGH COURT OF AUSTRALIA.]

STODART . . . . . . . . . . APPELLANT;

AND

THE DEPUTY FEDERAL COMMISSIONER OF TAXATION . . . . . . RESPONDENT.

H. C. OF A. 1928.

PERTH, *Sept.* 11.

MELBOURNE, *Oct.* 15.

Knox C.J., Isaacs, Higgins and Powers JJ.

*Income Tax* (*Cth.*) — *Assessment* — *Company* — *Dividends paid out of profits accumulated prior to* 1*st July* 1914—" *Carried forward in its profit and loss account* "—*Income Tax Assessment Act* 1922-1927 (*No.* 37 *of* 1922—*No.* 32 *of* 1927), *sec.* 16 (*b*) (*i.*), (*ii.*).*

A company in its periodical profit and loss accounts as published showed only the actual amount of profit in respect of the then immediately past accounting period, and did not bring forward therein any profit earned or accumulated in any previous year. In its ledger, however, there was an account headed " Profit and Loss," each period of which commenced with the credit balance brought down from the last preceding period and ended with the balance to be carried down to the succeeding period. The dividend declared in the past had been declared partly out of the year's profit disclosed in the published statements and partly out of " reserves," which " reserves " were in fact the balance of profit accumulated prior to the period in question. On 5th February

* The *Income Tax Assessment Act* 1922-1927, in sec. 16, provides (*inter alia*) that " The assessable income of any person shall include . . . (*b*) in the case of a member, shareholder, depositor or debenture-holder of a company which derives income from a source in Australia . . . (i.) dividends, bonuses or profits . . . credited, paid or distributed to the member or shareholder from any profit derived from any source by the company " ; and (in the second proviso to clause (i.)) " Provided . . . that where a company distributes to its members or shareholders any undistributed income accumulated prior to the first day of July one thousand nine hundred and fourteen the sum so received by the member or shareholder shall not be included as part of his income. For the purpose of this proviso amounts carried forward by a company in its profit and loss account, appropriation account, revenue and expenses account or any other account similar to any of the foregoing accounts shall not be deemed to be accumulated income."

1927 the directors resolved "that a dividend of 1s. 6d. per share be declared . . . . and that the amount thereof . . . be paid . . . out of . . . the reserved or undistributed profits accumulated prior to the 1st July 1914."

*Held*, that the amount brought forward was income accumulated prior to 1st July 1928.

*Held*, also, by *Knox* C.J. and *Higgins* J. (*Isaacs* and *Powers* JJ. dissenting), that the sum brought forward out of which the dividend of 1s. 6d. per share was paid was not carried forward in the company's profit and loss account, and therefore came within the meaning of the second proviso of sec. 16 (*b*) of the *Income Tax Assessment Act* 1922-1927.

APPEAL against the assessment by the Deputy Federal Commissioner of Taxation (W.A.) of the appellant to income tax, which came on for hearing before *Knox* C.J., who (after taking evidence) referred the appeal to the Full Court.

The balance-sheet of Nicholson's (1911) Ltd. (a company carrying on business in Western Australia), which was adopted at a general meeting of shareholders for the year ending 14th May 1914, showed the profit and loss account as made up, the final item being £7,218 0s. 2d. The sum was included in a sum in the balance-sheet of £24,083 5s. 1d. standing on the liabilities side of the account and shown as made up of £16,865 4s. 11d. balance of profit up to 30th April 1913, and £7,218 0s. 2d. balance of the profit for the year ending 30th April 1914. On 5th February 1927 the directors declared a dividend of 1s. 6d. per share to be paid out of the income which had been accumulated prior to 1st July 1914, and in that form. On the balance-sheet for the year ending 30th April 1915, and adopted by the general meeting of shareholders on 25th June 1925, a dividend was declared from the profits disclosed in the profit and loss account for the year ending 30th April 1915. Subsequent balance-sheets were similarly treated. The sum of £24,083 5s. 1d. above mentioned was included on the liabilities side as "profit and loss 1914," but it was not brought into the profit and loss account submitted to the meeting, which consisted of entries exclusively relating to the transaction of the various years. From the dividend of 1s. 6d. per share referred to above, the appellant, who was a shareholder in the Company, received the sum of £863; and he claimed that this sum was excluded from his assessable income

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by force of the second proviso of sec. 16 (*b*) of the *Income Tax Assessment Act* 1922-1925, on the ground that the amount was paid out of undistributed income of the Company accumulated prior to 1st July 1914. The respondent contended that the sum of £721 the proportion of the sum of £863 was paid out of the sum of £24,083 5s. 1d. The respondent further contended that the sum of £24,083 5s. 1d. was not income accumulated prior to 1st July 1914, and that even if it were the sum was carried forward by the Company in its profit and loss account within the meaning of the second proviso of sec. 16 (*b*) and was therefore not to be deemed to be accumulated income.

Further material facts sufficiently appear in the judgments hereunder.

*Downing* K.C. (with him *A. C. Downing*), for the appellant. The fund out of which the dividend received by the appellant was paid was income accumulated prior to 1st July 1914, and therefore the dividend was rightly excluded from his return of income under the second proviso of sec. 16 (*b*) (i.) of the *Income Tax Assessment Act* 1922-1927. The profit was never carried forward by the Company in its profit and loss account. The accounts referred to in the last portion of the proviso have a defined and recognized meaning in accountancy. (See *Spicer and Pegler* on *Practical Auditing*, 1919 ed., p. 401.) The meaning of "undistributed income accumulated" has already been decided by this Court in *Forrest* v. *Federal Commissioner of Taxation* (1). The fund from which the dividend was derived comes within that decision. The only point, therefore, is as to whether that income was carried forward by the Company in its "profit and loss account." The profit and loss account referred to in the sub-section means the one which was certified to by the Company's auditors and presented to and adopted at the annual meeting of the shareholders. The fund is shown in the Company's balance-sheet for the period ending 30th April 1914. The profit and loss account for the following period—1st May 1914 to 30th April 1915—clearly shows that this profit formed no part of the transactions of that period, and in 1916 it was carried to a special

(1) (1921) 29 C.L.R. 441.

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reserve account. The decision in *Meares* v. *Acting Federal Commissioner of Taxation* (1) governs this case. The Commissioner claims to tax the amount because the Company's ledger contains an account which is headed "Profit and Loss" and a record of the profit made during each accounting period. For simplicity and for the purpose of enabling a balance to be readily ascertained, the accounts were carried forward from year to year. The ledger account, however, is not the Company's profit and loss account. It is merely an account where the transactions are "laid up" or recorded in a form easily accessible for future reference. The accountant, instead of having a separate ledger account for each year, put all the transactions into one account. The Company's profit and loss account has always been treated in this Court as the one presented to the shareholders. (See *Foster Brewing Co.* v. *Federal Commissioner of Taxation* (2); *Commercial Banking Co. of Sydney and Bank of New South Wales* v. *Federal Commissioner of Taxation* (3).) The Commissioner relies on a pure technicality which would defeat the clear intention of the proviso.

*Sir Walter James* K.C. and *J. L. Walker*, for the respondent. The appellant contended that the undistributed income accumulated prior to 1st July 1914 had not been carried forward in the profit and loss account of the Company, because it was not carried forward in the profit and loss account presented to the shareholders and adopted by them; the respondent contended that the undistributed income in question had not been accumulated prior to 1st July 1914, and if it had been so accumulated it had been carried forward by the Company in its profit and loss account because it was so carried forward in an account or entry headed "Profit and Loss" in the ledger of the Company.

[The appellant and the Court agreeing that the accumulated income in question had been carried forward in the said ledger account or entry, the Chief Justice intimated that the real question at issue was whether the said ledger account or entry, or the profit and loss account presented to and adopted by the shareholders, was

(1) (1918) 24 C.L.R. 369.
(2) (1916) 22 C.L.R. 288.
(3) (1917) 23 C.L.R. 102.

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the profit and loss account of the Company as mentioned in the second proviso to sec. 16 (*b*) of the *Income Tax Assessment Act* 1922-1927.]

The ledger account or entry was the profit and loss account of the Company for the purposes of the said proviso, because the accounts of the Company must under the provisions of the *Companies Act* 1893 (W.A.) be kept in books of account; that ledger is a book of account, and contained an account or entry headed "Profit and Loss" which contained a record of the Company's profit and loss in which the accumulated income in question had been carried forward after 1st July 1914; and a journal in which copies had been made of the annual profit and loss accounts of the Company presented to the shareholders, in which accounts the accumulated income in question had not been so carried forward, was not a book of account at all either for the purposes of the *Companies Act* 1893 or for the purpose of accountancy. [*Hooper & Harrison Ltd.* (*in Liquidation*) v. *Federal Commissioner of Taxation* (1) referred to as to income not accumulated.]

*Downing* K.C., in reply.

*Cur. adv. vult.*

Oct. 15.

The following written judgments were delivered:—

KNOX C.J. At the annual general meeting of shareholders in Nicholson's (1911) Ltd. (hereinafter referred to as "the Company") held on 7th May 1914, it was resolved that the balance-sheet submitted by the directors for the year ending 30th April 1914 be adopted. The balance-sheet was, in accordance with the usual practice, accompanied by a profit and loss account showing in some detail how the profit for the year 1914 was made up and appropriated, the final item of the appropriation account being "Profit and loss £7,218 0s. 2d." This sum was taken into the balance-sheet as part of an item £24,083 5s. 1d. standing on the liabilities side of the account and shown therein as made up of £16,865 4s. 11d. balance of profit to 30th April 1913 and £7,218 0s. 2d. balance of profit of the year ending 30th April 1914. The balance-

(1) (1923) 33 C.L.R. 458, at p. 479.

sheet for the following year ending 30th April 1915, accompanied as usual by a profit and loss account, was submitted to and adopted by the annual general meeting of shareholders held on 25th June 1915. At that meeting a resolution in the words following was carried: "Resolved that a dividend of 10 per cent be declared from the profits disclosed in profit and loss account for year ending 30th April 1915, payable on 30th April 1916 or prior thereto at the discretion of the directors." In the balance-sheet so adopted the sum of £24,083 5s. 1d. mentioned above was included on the liabilities side as "profit and loss 1914," but it was not brought into the profit and loss account submitted to the meeting, which consisted exclusively of entries relating to the transactions of the year ending 30th April 1915.

In the balance-sheet for the period of fourteen months ending 30th June 1916 the same sum of £24,083 5s. 1d. was entered on the liabilities side under the heading "Reserves" and the sub-heading "Reserve fund," the total reserves amounting to £28,843 5s. 1d., but no entry relating to that sum was contained in the profit and loss account submitted with the balance-sheet to the annual general meeting held on 12th July 1916 at which the balance-sheet was adopted and a resolution carried in the words following:—"Resolved that the profit of £6,404 4s. 7d. as disclosed by the profit and loss account be distributed among the shareholders in proportion to the number of shares held by each. Resolved that a dividend of £195 15s. 5d. be declared and paid from Reserves."

By 30th June 1926 the amount formerly standing at the credit of Reserves had been reduced by payments thereout from time to time to £17,000 11s. 4d. At a meeting of the directors of the Company held on 5th February 1927 it was resolved "that a dividend of 1s. 6d. per share be declared on the 76,000 ordinary shares of the Company and that the amount thereof totalling £5,700 be paid to the shareholders at the discretion of the directors out of the sum of £17,000 11s. 4d., being the amount of the reserved or undistributed profits accumulated prior to the 1st day of July 1914."

In due course and before 30th June 1927 the dividend so authorized was paid to the shareholders, the amount received by the appellant in respect thereof being £863. The appellant claims that this sum

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is excluded from his assessable income by force of the second proviso to sec. 16 (*b*) of the *Income Tax Assessment Act* 1922-1925 on the ground that the amount was paid out of undistributed income of the Company accumulated prior to 1st July 1914. The respondent disputes this contention as to £721 the proportion of the sum £863 taken by him to have been paid out of the sum of £24,083 5s. 1d. mentioned above. As to the balance of £142 the respondent treats this as paid out of the sum of £4,760 entered in the balance-sheet of 30th April 1914 under the headings "Reserve for discounts and rebates" and "Reserve for bad and doubtful debts," and excludes it from the assessable income of the appellant.

The respondent contends that the sum of £24,083 5s. 1d. above mentioned was not income accumulated prior to 1st July 1914, and that, even if it was, that sum was carried forward by the Company in its profit and loss account and was therefore not to be deemed to be accumulated income. The first of these contentions seems to me quite untenable. The sum £24,083 5s. 1d. represented trading profits earned by the Company in two preceding years and not distributed or otherwise dealt with, and, in my opinion, is properly described as accumulated income of the Company. It was in existence before 1st July 1914 and is therefore income accumulated prior to that date. (See *Meares* v. *Acting Federal Commissioner of Taxation* (1) and *Forrest* v. *Federal Commissioner of Taxation* (2).)

The facts relied on in support of the second contention are as follows:—The ledger of the Company contains an account headed "Profit and Loss" and on 30th April 1914 this sum of £24,083 5s. 1d. was entered therein as the balance standing to the credit of the account. The entries in this account for the year ending 30th April 1915 are in the words and figures following:—

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1915, April 30. | | | | 1914, May 1. | | | | |
| To sundries .. | £12,384 | 14 | 3 | By balance .. .. | £24,083 | 5 | 1 |
| ,, balance .. .. | 28,115 | 1 | 1 | 1915, April 30. | | | |
| | | | | By sundries .. | 16,416 | 10 | 3 |
| | £40,499 | 15 | 4 | | £40,499 | 15 | 4 |

This account proceeds from year to year, the credit balance at the end of each year being brought down into the account for the following year. The respondent contends that these entries show

(1) (1918) 24 C.L.R. 369.
(2) (1921) 29 C.L.R. 441.

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that the sum of £24,083 5s. 1d. was carried forward into the profit and loss account of the Company within the meaning of the second proviso to sec. 16 (*b*) of the Act and is therefore not to be deemed to be accumulated income.

The questions turn on the meaning to be given to the words "carried forward by a company in its profit and loss account" in the second proviso to sec. 16 (*b*) of the Act, and the concrete question in this case is whether the profit and loss account submitted to shareholders or the account in the ledger headed "Profit and Loss" is the account which answers the description of "its profit and loss account." It is, as appears by the evidence, the universal practice to present to the shareholders of a company periodically at regular intervals a balance-sheet showing the position of the company at a given date accompanied by a profit and loss account showing the result of the operations of the company during the accounting period immediately preceding and up to that date. This practice has always been well known, and it may be assumed that it was not ignored by Parliament when enacting the provision now under consideration. The result of this account must, of course, be shown in the accompanying balance-sheet which is, and is generally required by law to be, certified by the auditors as a correct statement of the affairs of the company, an authentication which necessarily covers the profit and loss account. It is true that the profit and loss account so presented or, indeed, any profit and loss account must, as was said by *Griffith* C.J. in *Meares' Case* (1), be for a stated period and it would seem to follow that profit made during a preceding period could find no place in such an account, but the learned Chief Justice proceeded in his judgment in that case to show what was meant by a company carrying forward in the profit and loss account. In the present case it is clear that in the profit and loss account presented to shareholders there was no carrying forward of the sum of £24,083 5s. 1d., for neither that sum nor any part of it appears in any profit and loss account so presented after that for the year ending 30th April 1914. The *Income Tax Assessment Act* is an Act dealing with business affairs and is addressed to business people. If a business man asked for the profit and loss account of a company

(1) (1918) 24 C.L.R. 369.

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he would necessarily mean the account for some definite period, and he would I think expect to be furnished with the profit and loss account for that period which was presented by the company to its shareholders, and with nothing else. In my opinion this is the meaning which should be attributed to the words "its profit and loss account" in the enactment now under consideration. The account in the Company's ledger headed "Profit and Loss" does not appear to me to be a "profit and loss account" within the ordinary meaning of those words. It is in reality a record or statement, or, as my brother *Higgins* suggested, a history, of the results of the profit and loss accounts of the Company over a series of years showing and intended to show only the amount in the hands of the Company at any given date as a result of its operations extending over a number of successive periods. For convenience of book-keeping it is kept as a continuous account so as to show at a glance the total amount standing at any given balancing date to the credit of profit and loss, but it is not different in principle from a record made by entering in the ledger as separate and independent items the amount of profit or loss for each accounting period. If the entries were so made it would be necessary to calculate from the separate items the total amount standing at any time to the credit of profit and loss, but this calculation is dispensed with by keeping the account in the form in which it appears in the ledger.

In my opinion the profit and loss account of the Company presented each year to shareholders is the account described in the second proviso to sec. 16 (*b*) as "its profit and loss account," and it follows that the appeal should be allowed.

ISAACS J. On 5th February 1927 a limited company called Nicholson's (1911) Ltd. declared a dividend of 1s. 6d. per share on 76,000 shares, amounting to £5,700, to be paid out of £17,000 11s. 4d. undistributed profits which had in fact been accumulated before 1st July 1914. The Commissioner has assessed the appellant for income tax in respect of his share of the dividend, and the appellant objects on the ground that the income taxed is excepted by the second proviso to par. (i.) of sec. 16 (*b*) of the *Income Tax Assessment Act* 1922-1927. Whether it is so excepted is the issue in this appeal.

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On the authority of *Forrest's Case* (1), by which I am bound and which is an a fortiori case (see *Rydge* on the *Commonwealth Income Tax Acts* 1922-1923, at p. 97), it must be taken that prior to and on 1st July 1914 the Company had accumulated profits amounting to £24,083 5s. 1d., and that on 5th February 1927 a portion of those profits, namely, £17,000 11s. 4d., remained "undistributed." The issue narrows itself down to the one question: "Are those profits, £17,000 11s. 4d., in the circumstances here appearing to be "deemed" as on 5th February 1927 to be still "accumulated"? The proviso referred to declares: "For the purposes of this proviso amounts carried forward by a company in its profit and loss account, appropriation account, revenue and expenses account, or any other account similar to any of the foregoing accounts shall not be deemed to be accumulated income."

The Commissioner says that in a profit and loss account of the Company standing in its ledgers the whole sum of £24,083 5s. 1d. had certainly in 1915, and even in 1916, been carried forward to the credit of that account, and therefore those profits are not for the purposes of sec. 16 (*b*) to be deemed "accumulated." The appellant denies that the account referred to answers the description of any of the accounts mentioned in the passage quoted from the proviso, and he says further that in the only account which does answer that description, namely, a profit and loss account for the trading year ending 30th April 1915, laid before a general meeting of shareholders on 25th June 1915, no mention is made of the sum of £24,083 5s. 1d. or any part thereof. Of course, no one would deny that the statement of the profit and loss of the Company for the trading year ending 30th April 1915 may not improperly in one sense be called an account of profit and loss for that period, though it is more properly called a "statement" of profit and loss for that period exclusively. But that is not the question we have to determine. What will decide the liability or non-liability of the appellant, and of his fellow-shareholders, and probably of many other taxpayers in similar circumstances throughout Australia, is whether a ledger account such as that relied on by the Commissioner can, and whether the particular ledger account in the circumstances

(1) (1921) 29 C.L.R. 441.

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of this case does, come within the quoted terms of the proviso. If this account can and does answer the statutory description, then no one possessing eyesight can hesitate to admit the profits were in fact "carried forward" in that account.

Now, whether we approach this matter from the standpoint of law or of recognized accountancy practice, or of simple acknowledged fact in the particular case, the Commissioner's view appears to be right. It will help to clarify the position if it be examined in the order indicated.

(1) *Law.*—We have to interpret the quoted passage. The general scheme of par. (i.) of sec. 16 (*b*) is plain enough. There are three steps discernible : first, accepting the settled distinction between the income of the company itself and that of its individual members, the paragraph declares that a dividend received by the member after the tax operates is his assessable income, no matter when the Company received the income distributed—(that is quite ordinary); next, as a concession, dividends out of company's profits accumulated by it before the tax operated at all (that is, before 1st July 1914) are exempted from the primary liability; but, thirdly, that concession arises only provided the company has in its accounts kept the prior accumulation clear of the operations of later years, by not intermingling in certain indicated accounts the prior profits with the profit or loss results of later years, thereby destroying their completely separate identity as pure profits, and probably rendering later taxation examination more difficult and probably evasive. The last step is by no means an arbitrary condition. It was, in its original form, inserted as a desirable and fair provision by an amending Act (No. 47 of 1915). It is really based on the practical conduct and management of company funds, as distinguished from their technical legal character. A net profit made by an individual is, as a rule, passed on to his capital account. In the case of a company that cannot be done, because there "capital" has a technical character. But as a matter of business the net profit of a given period, though divisible among shareholders in dividends, may be thought to be better employed in future operations of the company. In that case the company expressly or tacitly determines not to distribute the profits in dividends, at all events for the present,

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but to carry them over and use them in the nature of capital—though not legally its capital—and, unless lost or otherwise appropriated, always open to distribution. But if the company does not at once distribute them, and proceeds so to use them, the books must show the carrying over and their practical incorporation, at all events for the time, with the working capital of the company. In that case the Legislature has followed the example of the company by disregarding technicalities and looking only to the actual business operation. It has treated the profits so carried forward in the books, and utilized in fact as capital, as having for the time lost their exclusive character as pure profits intended for distribution only, and consequently their exclusive identity with the pre-taxing period. So regarding them, the Legislature has thought it fair for taxing purposes, which deal with business realities, to attach them to the later period, and when they, or what is left of them, ultimately lose their temporary character of working capital and are at last treated as pure profit for dividend purposes, that is the period looked to, and the dividends are fixed accordingly. The nature of the whole operation is, of course, familiar in company accountancy, and an excellent pre-tax reference to it is found is Mr. *Morley's* book the *Australian Manual of Accountancy and Commercial Law* (South Australian edition) published in 1910, particularly at pp. 176-177, 235-236. This is practically repeated in the edition of 1923, at pp. 229-230.

That is really the key to the present problem. It may be that the retention of the provision for the concession is at this date anomalous. Profits that were accumulated before 1st July 1914 and are not yet distributed can scarcely in any true sense after fourteen years retain their original character. Unless, therefore, the easy method of escape asserted by the appellant be really part of the intention of Parliament, the matter seems to me to be worth reconsideration.

It is evident that any such condition as the appellant seeks to attach, namely, the presentation to and adoption by a meeting of an account in which the carrying forward is formally stated, is foreign to the substance of the matter and would permit, as in this case, the very thing to be done and to be shown by the regular

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books of the company, and yet leave the dividends immune, simply because the directors, in their personal interests, chose to omit the formal reference.

Any such condition must in any case be found in the natural meaning of the words used, and, if on examination the words reasonably construed include that condition, no doubt it must be given effect to. But the difficulty is to find such a meaning in the words. Great reliance is placed on behalf of the appellant on the word "its." That word simply means "the company's"—being the pronoun for the noun immediately preceding. To interpolate, as the appellant virtually does, after the words "its profit and loss account" the further words "presented to and adopted by the company at its general meeting of shareholders," is obviously legislation unwarrantable in any case, and particularly so in taxation Acts, to the actual terms of which by highest authority we are directed to stick. The latest formulation of the law on this point is taken from the judgment of Lord *Atkinson* in *Ormond Investment Co.* v. *Betts* (1). It is as follows: "It is well established that one is bound, in construing Revenue Acts, to give a fair and reasonable construction to their language without leaning to one side or the other, that no tax can be imposed on a subject by an Act of Parliament without words in it clearly showing an intention to lay the burden upon him, that *the words of the statute must be adhered to, and that so-called equitable constructions of them are not permissible.*" Any profit and loss account, if kept as companies ordinarily keep such an account, that is under the direction and supervision and the power of correction ordinarily exercised and not prohibited by the articles, answers the description in the statute. (See generally *Buckley on Companies*, 10th ed., at pp. 630 *et seqq.*) Applying this test, it will be seen, and particularly bearing in mind the law of Western Australia (sec. 42 of the *Companies Act* 1893) requiring directors to keep accounts, and recognized accountancy practice, and the facts of this particular case, the ledger account relied on by the Commissioner must be regarded as the Company's account, kept by its volition, and in view of the facts falling completely within the passage above quoted from the section of the Act.

(1) (1928) A.C. 143, at p. 162.

Certainly the word " its " is not in itself capacious enough to hold the extensive implication required to sustain the appellant's contention. The marsupial pouch essential to carry that implication for a " profit and loss account " must necessarily belong to the passage as a whole, and therefore carry also the " appropriation account " and the " revenue and expenses account," and, furthermore, every possible account that is " similar to any of the foregoing accounts." What possible justification exists for so enormous an implication ? It is urged that Parliament *must* have so intended. But why *must* it ? A little examination of the words it has used ought to dispel that notion and prove the contrary.

In the first place, the extract quoted, by its drag-net reference to " similar " accounts, indicates a very broad inclusion in relation to accounts and to companies, an inclusion to protect the Treasury and not to defeat it, an inclusion, moreover, not limited by any technicalities or conditions, but referable to actual facts. It is important to remember what *Lindley* L.J. said in *Lee* v. *Neuchatel Asphalte Co.* (1) : " As regards the mode of keeping accounts, there is no law prescribing how they shall be kept." What Parliament was insisting on in all events as a fact destroying immunity was the carrying forward by a company in some one of a recognized class of accounts kept by its agents duly authorized to keep its accounts, the prior accumulated profits.

Then we have to remember that " company " in sec. 16 (*b*) extends to every " company " which has " members," " shareholders," " depositors " or " debenture-holders," and distributes " dividends," " bonuses " or " profits." By sec. 4, " unless the contrary intention appears," the word " company " includes all bodies or associations corporate or unincorporate, but does not include partnerships. There is clearly no contrary intention here—rather is that intention strengthened. It is manifest, therefore, and confirmed by the express exclusion of reversionary bonuses on policies of insurance, that " company " in the quoted passage includes, not only companies limited and having Table A, but also such limited companies as have excluded or modified Table A and whether they are limited by shares or guarantee. Further, all sorts of associations,

(1) (1889) 41 Ch. D. 1, at p. 25.

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corporate or unincorporate, are included so long as they possess the attributes mentioned of members, &c., and distribute dividends, &c. Consequently among others are banks, however incorporated, whether by charter or special Act or otherwise, assurance and insurance companies, however incorporated, co-operative societies and even unincorporated bodies not being partnerships.

Parliament has thus cast its net far too widely and closely to allow of escape by the artifice resorted to in the present case and presently to be made clear. We must, therefore, put aside any notion that the words quoted are limited by any consideration of Table A of the Second Schedule to the *Companies Act* or anything corresponding to it. That would confine the meaning of the words "its" and "company" in a manner that would be disastrous to the revenue and would act most inequitably as between companies that were working under Table A, or its equivalent, and those that were not. And even as to companies under the ordinary *Companies Act*, the meaning suggested would attribute to Parliament either an unexampled simplicity or an unexpected recklessness with respect to the revenue. Everyone knows, and presumably including Parliament, that whether any company accounts are to be presented to shareholders is an internal matter, controllable entirely by the company itself. The suggestion leaves to the company—that is, eventually to the interested shareholders—the option of being liable to or being free from taxation, although profits are carried forward and so intermingled in accountancy with future trading years as to lose their identity of character and date. As to other companies within the ambit of the sub-section, the futility of the proviso is even more distinct.

It follows that, besides being legislation of the least defensible character, the implication claimed by the taxpayer would make the quoted passage wholly ineffective. On the other hand, adhering to the words of the statute, the accounts of a company kept in its books in the ordinary manner under the supervision and control of the directors and including "its profit and loss account" and any similar account fall naturally within the words of the Legislature. To call them the mere records of an unnamed accountant is to misunderstand the position and to defeat the very object of the accountancy. An accountant is a mere necessary instrument of

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those who are the directing minds of the corporation. To perceive the full absurdity of the contention, we have only to imagine a litigation with a company in which an individual opponent relying on entries in the company's books is met with the same objection—that they are not the company's accounts, but mere records. Between that case and this there is no real distinction.

(2) *Accountancy Practice.*—The central contention of the appellant is vital to his case. It is that Parliament in using the words "its profit and loss account" meant *only* a statement of profit and loss actually laid before a general meeting of shareholders as is ordinarily contemplated either by Table A of the *Companies Act* or some corresponding provision in the articles, and therefore no profit and loss account merely kept in the ordinary way in the company's books, however full and accurate, comes within the statutory provision with which we are concerned.

To justify that contention an extract from Messrs. *Spicer and Pegler's* work on *Practical Auditing* (1919) was relied on. Before considering that extract it is well to recall the fact that Table A and the usual corresponding provisions in articles do not require a profit and loss "account." They require a "statement," really an income and expenditure statement, for the one specific trading period then under consideration, "so that a just balance of profit and loss may be laid before the meeting," that is, as arts. 81 and 82 of the Western Australian Table A show for "the year." For the moment let us assume, notwithstanding the contrary already shown, that every "company" is one which is bound to conform to that requirement. It is clear that to comply with that requirement the carrying into the statement a balance of profit from a previous period would be contrary to or at least foreign to the statement required. The very object of the limitation of the statement to the one period is to keep its results distinct beyond question from those of another period. (See per Lord *Macnaghten* in *Railway Co.* v. *Attorney-General of Jamaica* (1).) It is therefore certain that when Parliament used the phrase "carried forward" in relation to the accounts it mentioned, it did not perpetrate so palpable a blunder as to suppose the profits of a prior period could ever properly be carried

(1) (1893) A.C. 127, at p. 136.

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into, and so as possibly to confuse, the strictly periodic statement referred to in Table A. Obviously it meant to refer to a profit and loss account in which, if the company, or those entrusted with the discretion of keeping its accounts, thought right in its interests to "carry forward" the profits of one year to the credit of the next, such an entry would be normal and proper. Consistently with recognized accountancy practice, the accumulated profits of £24,083 5s. 1d. could not possibly have been "carried forward" into the 1915 trading period "statement." The accounts referred to in sec. 16 (*b*) must be accounts of a more general nature, found in the ordinary course of accountancy in the company's books of account.

The distinction, which is vital, between the statement of a company's profit and loss for a specific period and its ordinary profit and loss account properly so called, is shown very plainly by two writers of acknowledged authority on the subject. As to the limited statement (say) for a given trading year, it is stated in Mr. *Carter's Advanced Accounts* (Australian ed.), at p. 457: "The balance of the last year's profit must *not* be shown in the *profit and loss account*—a very common mistake of students." (The italics are Mr. *Carter's*.) We are asked to commit and endorse—and what is perhaps worse, we are asked to say that Parliament foolishly insisted on—the error so pointedly warned against. Mr. *Carter* adds: "If we mix up last year's profit with this year's, we shall not be able to find the correct profit for the year at all." Mr. *Carter* repeats these observations in his latest English edition of 1923, at p. 401. (See also Mr. *Barton's* work, *Australasian Advanced Accountancy* (1918), at p. 17.)

On the other hand, the real and true "profit and loss account" of a company not specifically limited to a given period, is its "account" of its general progress as to "profit and loss," and is what is known as its "nominal account" (see *Carter*, p. 3, and *Barton*, p. 14) in the company's principal book, the ledger. That continued—and, if balances are carried forward, continuous—account is the only "profit and loss account" of the company to which, for the reasons already stated, the words of the section "carried forward by the company *in* its profit and loss account" can properly and reasonably be applied. The balance-sheet is really not an "account" at all. It is a statement which should, as Messrs. *Spicer and Pegler* (1925) truly say (p. 393), be "a document setting out the true position of the business in such a manner as may be easily understood by men of business intelligence." It is a statement of assets and liabilities (see *Carter*, p. 42, and *Barton*, p. 18). But, as is pointed out, both by *Carter* and *Spicer and Pegler*, it is not confined to assets and liabilities, because the credit balance of the profit and loss account is not properly speaking a liability, nor is the debit balance of that account an asset. But the balance-sheet necessarily contains in the case of a company, a reference to its undivided profits, on the liabilities side. Mr. *Carter*, at p. 457 of his Australasian edition, observed: "The shareholder frequently does not receive a copy of the profit and loss account, but only of the balance-sheet." We do well to remember this and the next portion of the passage when considering what was actually done in 1915 at the general meeting, and we ought to emphasize the words "a *copy* of the profit and loss account." The passage continues:—"On the balance-sheet, therefore, it is usual to show the balance of profit brought forward from the previous year, the net profit of the current year, and any deductions already made. The shareholder has then to attend the general meeting and vote how the balance shall be distributed." The extract quoted by Mr. *Downing* from *Spicer and Pegler* (the passage is repeated in their 1925 edition at p. 390) does not detract from what has been said. The passage, it will be observed, uses the expression "profit and loss account" in two senses, and this, apparently, has led to some misapprehension. But even so, the central consideration is left untouched. The passage uses the term "profit and loss account" in the sense of a composite account consisting of (1) the trading or manufacturing account, whereby a gross profit (let us assume) is shown, (2) the profit and loss account proper, which accepts the result of a gross profit and arrives at a net profit, and (3) the appropriation account, which disposes of the net profit. But throughout the whole passage, with one exception, even the combined account is limited to "the given period." But, say the authors, and this is the exception, "the last section of the profit and loss account should show the balance of profit or loss

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carried forward," &c. That is to say, the *appropriation account* should show this, *not the profit and loss account proper*, which is the second section, and the only one corresponding to the statement of income and expenditure for the year, referred to in Table A. Mr. *Morley*, in his work already referred to, also points out the distinction between (1) the trading or manufacturing account, (2) the profit and loss account proper, and (3) the appropriation account. Parliament clearly shows, by distinguishing between the profit and loss account and the appropriation account, that it does not use the first expression in the combined sense employed by *Spicer and Pegler*. It is manifest that if the composite account, as described by *Spicer and Pegler* and put forward by the appellant, be what is required by Parliament in sec. 16 (*b*), then the passage from that section as quoted herein can never have practical operation. No company, for instance, is ever likely to publish its trading or manufacturing account, which would disclose to the world its inner business operations, and Table A requires nothing whatever requiring appropriation accounts to be laid before the meeting. It is clear that *Spicer and Pegler* have united in one common expression the whole procedure from the purchase of stock to the appropriation of net profits, and unfortunately, may it be said, employ the same expression for the whole as for one integral part to which the name specially belongs.

Now, somewhat anticipating the narration of actual events in Nicholson Ltd.'s book-keeping, the extract lastly quoted from *Carter* represents just what took place in 1915. There was no copy of the profit and loss account as appearing in the books for the given period presented to the shareholders. They were provided with the "statement" limited to the relevant year, as required by the articles, and this showed a net profit for the period of £3,677 12s. 8d. But the balance-sheet also furnished to them showed the following in the liabilities :—Profit and loss 1914, £24,083 5s. 1d. ; ditto 1915, £3,677 12s. 8d. : £27,760 17s. 9d. That is to say, the profits as aggregated to 1914 were shown to be further aggregated with the 1915 profits. The shareholders, no doubt, specially limited their dividends to the 1915 profits, but that did not matter. The proviso does not depend on distribution of former income, but on whether it was "carried forward." No shareholder could help seeing from the form in which the total was presented that the two sums were massed together—quite unnecessarily if the former was not "carried forward." The union of the two balances in the balance-sheet would not satisfy the words of the proviso, but inspection of what is called the "profit and loss account" of the Company, standing in the place where such an account is always found, would have clearly borne out the indication given of aggregation. If, therefore, it be possible in law to regard such an account as appears on pp. 37-39 of the ledger as the Company's profit and loss account, it only remains to see whether the Company in fact so treated it, and carried forward in that account the profits of £24,083 5s. 1d.

(3) *The Facts.*—The precise nature of the account must now be stated. In the ledger index under the letter "P" is a reference to "Profit and loss, 37." Turning to folio 37 of the ledger, an account is opened under the heading "Profit and Loss." Some reliance was placed for the appellant that the word "account" is not added to "Profit and loss." But neither is such a word added to (say) "John Jones" in the ledger. It is well understood that the ledger contains "accounts," and the word "account" would be superfluous. The "profit and loss" account runs continuously through folios 37, 38 and 39. It begins with the trading year ending 30th April 1912, and takes in the trading years ending respectively 30th April 1913, 1914 and 1915. Then, with a significance that will later become apparent, there is a trading period 1st May 1915 to 30th June 1916, and thereafter the trading years end on 30th June in regular succession to 1928. This account is posted from the journal, as is natural, and at folio 4 of that book, to which posting figures take us, for the years to 1915 we find no fewer than six references to "Profit and Loss Account" in full or abbreviated form, as "P. & L. A/c," and a reference to "37," which, of course, means folio 37 of the ledger. There can, therefore, be no doubt whatever that the Company up to the end of its trading year ending 30th April 1915, treated as, and expressly called the ledger account referred to, its profit and loss account. Subsequent to 30th April 1915, entries in the journal refer to the ledger account as "Profit and loss 37,"

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which, notwithstanding the omissions of the word "account" or its abbreviation "a/c" means the same thing.

As to the contents of the ledger account. For the year 1912 there is one credit posted item from p. 42 of the journal, "Sundries £28,429 4s. 8d."; and there are five debit items of sundries posted from folio 4 of the journal, where further references are given. After subtracting the debit items from the gross credit item, there is shown a balance of £8,860 15s. 4d., representing the net profits for the trading year 1912. That sum of £8,860 15s. 4d. is carried forward to the credit of the next trading year in the same account and on the same folio, under date 1st May, and a process similar to the first of debits and credit is repeated, leaving a composite balance of profit for the two years of £16,865 4s. This in turn is carried forward to 1914 and the process repeated, all on the same folio, resulting in an aggregate balance at the end of April 1914 of £24,083 5s. 1d.

During the next trading period, but not until September 1915, the *Income Tax Act* was passed. On 15th November 1915 an amending Act introduced, as from 1st July 1914, a proviso corresponding to the proviso now falling to be interpreted and applied. In the meantime, still on folio 37 in the same "profit and loss" account, the following entries were made, which constitute the crucial facts of this case:—

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1915. | | | | | | | | |
| Apr. 30. | | | | May 1. | | | | |
| To sundries (42) | £12,384 | 14 | 3 | By balance .. | £24,083 | 5 | 1 |
| Balance .. | 28,115 | 1 | 1 | 1915. | | | |
| | | | | Apr. 30. | | | |
| | | | | By sundries .. | 16,416 | 10 | 3 |
| | £40,499 | 15 | 4 | | £40,499 | 15 | 4 |
| May 1. | | | | May 1. | | | |
| To sundries (4) .. | 354 | 3 | 4 | By balance .. | £28,115 | 1 | 1 |
| | £27,760 | 17 | 9 | | | | |

At folio 42 of the journal the sum of £353 3s. 4d. is found as an adjustment as per journal folio 557, which folio is not in evidence, but is immaterial. Obviously, then, by that account for the trading year 1915, ending 30th April, there was on 1st May 1914 carried forward *to the credit* of the profit and loss account for the next period the whole sum of £24,083 5s. 1d. and deliberately and finally so, as far as that trading year was concerned, precisely as was done in prior years. Until

November 1915, when by the Act No. 47 of that year a new proviso came into force, and retrospectively, there was no reason for altering the practice of carrying forward profits to the credit of the next year so as to incorporate and identify them with the later operations of the Company, instead of leaving them segregated and belonging exclusively to ante-tax period. But the new proviso was : "Provided also that amounts carried forward by a company to the credit of the profit and loss account shall not be deemed to be accumulated income." We then see a change in the method of dealing with the account on p. 37 of the ledger. It stands thus :—

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1916. | | | | May 1. | | | | |
| May 1. | | | | Balance .. | .. £27,760 | 17 | 9 | |
| Sundries (52) .. | £3,300 | 0 | 0 | | | | | |
| June 30. | | | | 1916. | | | | |
| Sundries (53) .. | 6,600 | 0 | 0 | June 30. | | | | |
| ,, .. | 24,083 | 5 | 1 | Sundries .. | .. 20,211 | 19 | 3 | |
| ,, (54) .. | 13,807 | 14 | 8 | | | | | |
| Balance .. | 181 | 17 | 3 | | | | | |
| | £47,972 | 17 | 0 | | £47,972 | 17 | 0 | |

There is more than one remarkable fact in common with this account. The first credit item, 1st May—that is 1915, and, of course, before the proviso—represents, as already mentioned, the aggregated profits to date. The first debit entry, £3,300, represents amount of dividend authorized at the meeting of 25th June 1915, and payable on or before 30th April 1916—a date which up to that time represented the end of the trading year. But the next debit entry, though under date 30th June 1916, represents a sum composed of dividends not resolved upon until the meeting of 12th July 1916—nearly a fortnight after the date entered. The debit of £24,083 5s. 1d. is remarkable for two reasons. Without a shadow of doubt it was the direct outcome of the proviso of 1915 already quoted. It was certainly not made because the Company, or its representatives, thought it good book-keeping to keep segregated the profits of separate years. Had that been the motive, not £24,083 5s. 1d. but £27,760 17s. 9d. would have been the entry. As it is, the sum of £3,677 12s. 8d., the profits for 1915, still stands carried forward to the credit of the profit and loss account for 1916. That is the first remarkable feature of this debit entry. The next is that *unless the Company*—that is, those who represented it for the purpose—*really believed that the account on folio* 37 *of the ledger was* "*its profit and loss account,*"

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*the debit entry would be senseless.* What would make it proper to take out of credit £24,083 5s. 1d. and leave in £3,677 17s. 9d.? Why should either be taken out as a mere record? And if a record, then, as to £24,083 5s. 1d., of what fact or resolution or transaction? The only referable transaction so far as the evidence takes us is the transfer as on 30th June 1916 of that sum to an account called "Reserve" (exhibit M). There we find as the first corresponding entries :—

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1916. | | | | 1916. | | | | |
| June 30. | | | | June 30. | | | | |
| To balance .. | £28,843 | 5 | 1 | By profit and loss | £24,083 | 5 | 1 |
| | | | | ,, rebates on T.P. a/cs .. | 4,500 | 0 | 0 |
| | | | | ,, reserve B/D .. | 260 | 0 | 0 |
| | £28,843 | 5 | 1 | | £28,843 | 5 | 1 |

We find, however, apart from that reserve, that in the succeeding years the balance of prior periods are as usual carried forward to the credit of the account. Clearly, the Company made that debit entry of £24,083 5s. 1d. in order to remove, as far as it could, the accumulated profits up to 1st July 1914 from what it then knew well was "its profit and loss account," and put it in the so-called "reserve" account with no alteration of business fact, but a mere change of name. There has been no explanation given by any witness then in the employ of the Company or in any way connected with the actual entry. The appellant, a director then and now, did not give any evidence, nor did anyone connected with the Company, except its present secretary, who was asked in cross-examination: "You transferred £24,083 5s. 1d. from profit and loss account?" He said: "From an account showing the accumulations, that £24,000 odd was transferred to a separate page headed 'Reserve, 30/4/1914.'" "What was the reason for transferring?" "I was not the secretary at the time, but I assume the reason was to group together—" His Honor :— "You cannot assume. You cannot say the reason then." He says further he was not then in an executive position. No executive officer at the time, no director, no auditor was called to give any explanation. So we must draw the only reasonable conclusion which has been stated. It is unnecessary to express any decided opinion whether the "reserve" account to which the sum of £24,083 5s. 1d.

was transferred is not in truth an account similar to an "appropriation" account within the meaning of the statute. It might with equal truth be headed "Appropriation," and it left the sum transferred at the disposal of the Company for the identical purposes and in the identical way that existed prior to the transfer. A "reserve" simply, that is, without allocation to some specifically named object, means that the sum "reserved" is for the time withheld from distribution and is used in the business. See *Morley* (p. 73 of 1910 ed. and pp. 229-230 of 1923 ed.); *Carter* (p. 624); *Barton* (p. 98), who refers to such a reserve as "additional trading funds," and *Spicer and Pegler* (1923 ed., p. 146), the last named writers showing it may be "additional working capital." This brings the position back to what it was before transfer, and it must not be supposed that if necessary the "reserve" account would not fall—*qua* the sum of £24,083 5s. 1d.—within the drag-net words of the statutory passage quoted.

As a simple matter of ultimate *fact*, however, appearing from all the evidentiary circumstances, the account standing at folios 37, 38 and 39 was and is the Company's profit and loss account, was so termed by the Company in its journal, and was for purposes of the 1915 proviso treated by the Company as such, and the profits prior to July 1914 were therein carried forward.

The appeal should be dismissed with costs.

Higgins J. The appellant is a shareholder in Nicholson's (1911) Ltd. The scheme of the Federal income tax, so far as relevant, is that a shareholder of a company which derives income from Australia has to pay the tax on any dividends paid to him by the company as from 1st July 1914; but there is a proviso (sec. 16 (*b*) (i.) ) that where the company distributes to its shareholders any undistributed income accumulated prior to that date the sum so received by the shareholder shall not be included as part of his income taxable. In other words, the tax is not on the income derived by the company before that date, if not distributed but accumulated. But the proviso is qualified in this way, that "amounts *carried forward* by a company *in its profit and loss account* . . . shall *not* be deemed to be *accumulated* income." So that if the dividend is declared out of the

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profits shown by the company's profit and loss account, and those profits include amounts merely carried forward by the company from previous periods in its profit and loss account, the shareholder is not allowed to treat those amounts as if they were income "accumulated" before 1st July 1914. The proviso is in favour of the company; the qualification of the proviso is in favour of the Commissioner; and the Commissioner has to show that the amounts which he claims to be assessable so far as paid to the shareholder had been "*carried forward by a company in its profit and loss account.*"

Now, in this case the assessment to which the taxpayer objects was made in respect of income for the financial year 1927-1928 based on income derived during 1926-1927. The Commissioner treats a dividend of £863 which was paid to the taxpayer in 1927 in pursuance of a resolution of the directors dated 5th February 1927 as assessable income of the shareholder and taxable. But it turns out that the dividend was paid out of a sum of £17,000 11s. 4d., the balance of accumulated profits of the Company accumulated before 1st July 1914. Not one penny of this dividend is payable out of profits made after 1st July 1914, or out of profits merely "carried forward" in the Company's profit and loss account. The words of the resolution appearing in the minutes are: "Resolved that a dividend of 1s. 6d. be declared on the 76,000 ordinary shares of the Company, and that the amount thereof totalling £5,700 be paid to the shareholders at the discretion of the directors out of the sum of £17,000 11s. 4d. *being the amount of the reserved or undistributed profits accumulated prior to the first day of July* 1914." A line was drawn by the Company at 1st July 1914. Up to that date the balance of the profits for the year ending 30th April 1912 (£8,860 15s. 4d.) was carried forward in the profit and loss account to the year 1913 and added to the balance of the profits for the year ending 30th April 1913 (£8,804 9s. 7d.), making £16,865 4s. 11d. in all; and this total was added to the balance of profits for the year ending 30th April 1914 (£7,218 0s. 2d.), making £24,083 5s. 1d. in all. This total is the sum from which the sum of £17,000 11s. 4d., and therefore the sum of £863, were derived (as shown by exhibit M). But this total of £24,083 5s. 1d. (30th April 1914) is *not* carried forward in the profit and loss account for the year ending 30th April 1915; and the dividends for 1915 and 1916 are declared (with a slight exception for 1916) out of the profits for 1915 and out of the profits for 1916 respectively. In short, this dividend of 5th February 1927, payable out of the £17,000 11s. 4d., is due solely to profits made during the period before 1st July 1914, and undistributed and accumulated before that date; whereas the sum of £17,000 11s. 4d. (or rather the £24,083 5s. 1d. of which it is the residue) was not carried forward in the Company's profit and loss account as a balance to be added to the profits of any of the subsequent years. In other words, the proviso in sec. 16 (*b*) (i.) applies to this dividend, and the qualification of the proviso does not apply.



Except as to a dictum of *Griffith* C.J. in *Meares' Case* (1), the cases which have been cited seem to confuse the position rather than to illuminate it. There *Griffith* C.J. says:—"It is, as our daily experience shows, not uncommon to transfer such a balance to the profit and loss account for the next succeeding period, and to group it with the receipts proper of that period in making up the amount available to defray the expenditure for the period. When this is done by a company, the company shows its intention to treat the amount so transferred as forming part of the transactions of the later period. This, then, is what is meant, and all that is meant, by carrying forward by the company to the credit of the profit and loss account." This makes the issue of the debate reasonably clear when the facts are clearly grasped. The only entry that seems to justify any argument seems to be that in exhibit N—which is a brief summary or history of "profit and loss" during the existence of the Company; but it does not show that the £17,000 11s. 4d. out of which the dividend was paid was "*carried forward by the Company in its profit and loss account.*" Even in exhibit N, it will be seen on a cursory glance that the mode of carrying forward profits from year to year on the liabilities side up to 1st July 1914 ceased from that date forward. But, in my opinion, exhibit N is not the profit and loss account of the Company—"its" profit and loss account—that is referred to in sec. 16; and the balance to profit and loss to 30th April 1914 was *not* carried forward to the profit and loss account

(1) (1918) 24 C.L.R., at p. 372.

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for the year 30th April 1914 to 30th April 1915, so as to make one total amount available for dividends, or otherwise. The entries in the ledger which are represented by exhibit N were obviously made by one hand in or after June 1923; they were not made by way of "*carrying forward*" any sum in the profit and loss account of the Company—that is to say, in the profit and loss account or statement of income and expenditure for a period which has to be put before the shareholders (Table A, Second Schedule to *Companies Act* 1893, arts. 81-82).

To satisfy the qualification of the proviso to sec. 16 of the Assessment Act, it is not sufficient for the Commissioner to show that in some account, or in some summary or history of accounts contained in the books, there is a continuous chain of figures showing the history of the Company as to profit and loss (as well as the history of the Company as to capital): he has to show that in that account which is the Company's distinctive profit and loss account—"its" profit and loss account (or appropriation account or similar account)—the amount of previous profits has been carried forward; and that distinctive account can here only be the account laid before the shareholders periodically in pursuance of the articles:—"Once at least in every six months the directors shall lay before the *Company, in general meeting,* a statement of the income and expenditure for the period succeeding that embraced by the then last statement, made up to a date not more than three months before such meeting. . . . Every item of expenditure fairly chargeable against the year's income shall be brought into account, so that a just *balance of profit and loss may be laid before the meeting*" (Table A, arts. 81 and 82). Nor, to satisfy the qualification of the proviso, is it sufficient that the balance-sheets show the various balances for the various years. A balance-sheet, if true, must show the static position of the various funds or sums which are represented by the company's assets. To satisfy the words of the qualification the Commissioner has to show that balances of profit earned before the 1st July 1914 have been carried forward (not in balance-sheets, but in "its" (the Company's) "profit and loss account"); and he has not shown it. Parliament has selected this simple fact of accountancy as the criterion, and we have no right to substitute any other, however reasonable. It may seem, indeed, to many, at first sight, that in keeping so closely to the strict meaning of the precise words used, "amounts *carried forward* by a company *in its profit and loss account*," &c., we give too much weight to the express words, and not sufficient weight to what may be called probabilities of a business-like scheme. But this is a revenue Act; and it is well established that "no tax can be imposed on a subject by an Act of Parliament without *words* in it clearly showing an intention to lay the burden upon him, that the *words* of the statute must be adhered to, and that so-called equitable constructions of them are not permissible" (per Lord *Atkinson* in *Ormond Investment Co.* v. *Betts* (1)).

The effect of the words "at the discretion of the directors" contained in the resolution of 5th February 1927 has not been discussed. Nor has it been argued that sec. 18 of the *Judiciary Act*, which allows a case to be argued before the Full High Court, does not apply to an appeal to a Justice of the High Court under sec. 51A of the *Income Tax Act* 1922-1927. In the absence of argument, I shall assume these matters in favour of the Commissioner; but I desire to reserve my opinion should argument be raised hereafter.

In my opinion, the objections of the taxpayer to the assessment are valid; and the appeal from the Commissioner should be allowed, with costs both before the primary Judge and before this Court.

Powers J. The facts and the material sections of the Act to be considered in this case have been fully set out in the reasons for the judgments just delivered, and I do not think it necessary to repeat them.

The decision of the Court in this appeal depends on the answers to the two following questions: (1) Were the amounts in question undistributed income (or profits) accumulated prior to the 1st July 1914 within the meaning of sec. 16; (2) if so, was the "accumulated income" carried forward in the profit and loss account referred to in the proviso to sec. 16 (*b*) (i.)?

As to the first question the following facts are admitted:—(1) That the profit for the year ending 30th April 1912 was £8,860 15s. 4d.

(1) (1928) A.C., at p. 162.

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This was shown in the annual statement submitted to the shareholders of profit and loss for the year mentioned (headed Profit and Loss Account), and in the balance-sheet submitted to the shareholders. It also appears in an account in the Company's ledger headed Profit and Loss. (2) That the undistributed profit for the year ending 30th April 1913 was £8,004 9s. 7d. This was also shown in the annual statement referred to and the balance-sheet up to April 1913 and in the ledger in the account headed Profit and Loss. (3) That the undistributed profit for the year ending 30th April 1914 was £7,218. This was also shown in the annual statement referred to and in the balance-sheet and in the ledger. These were the undistributed profits prior to 1st July 1914, and amounted in all to £24,083 5s. 1d.

The question is whether these undistributed profits were "accumulated amounts" within the meaning of sec. 16. The answer to that question should be in the affirmative, for it is beyond question (1) that in the balance-sheet submitted to the members in 1913 the amounts are shown as accumulated profits distributed—1912, £8,860 15s. 4d.; 1913, £8,004 9s. 7d.: £16,865 4s. 11d. (2) The amount above mentioned is also shown in the ledger account in the Company's books (headed as Profit and Loss) as £16,865 4s. 11d. balance of profit and loss at 30th April 1913. (3) In the balance-sheet submitted to the members in 1914 the amounts are shown as accumulated profits not distributed—1913 (as above), £16,865 4s. 11d.; 1914, £7,218 0s. 2d.: £24,083 5s. 1d. The amount £24,083 5s. 1d. was also shown in the ledger account referred to, headed Profit and Loss Account, as the balance of profits undistributed to 30th April 1914. It is therefore clear that the undistributed profits were "accumulated undistributed profits"; and it was decided by this Court in *Meares* v. *Acting Federal Commissioner of Taxation* (1) and *Forrest* v. *Federal Commissioner of Taxation* (2) that undistributed profits so accumulated were "accumulated income" within the meaning of sec. 16.

The next question is whether the profits referred to were carried forward in the profit and loss account referred to in the proviso to sec. 16. That they were not carried forward in the annual statement

(1) (1918) 24 C.L.R. 369. (2) (1921) 29 C.L.R. 441.

of profit and loss, headed Profit and Loss Account, submitted to the members, is clear; but it is just as clear, in my opinion, that they were carried forward in the balance-sheets submitted to the members each year, and in the only profit and loss account in the books of the Company, namely, in the proper book in which to keep such an account—that is, in the ledger after the Act operated. Referring to the profit and loss account in the ledger, p. 38, it will be seen that the undistributed profits for the year ending 30th April 1912 amounted to £8,860 15s. 4d. That amount was carried forward on 1st May 1912 and added to the 1912-1913 receipts, and the ledger balance of undistributed profits on 30th April 1913 appears as £16,865 4s. 11d. That £16,865 4s. 11d. was carried forward on 1st May 1913 and added to the 1913-1914 receipts, and the ledger balance of undistributed profits on 30th April 1914 appears as £24,083 5s. 1d. This £24,083 5s. 1d. is the total of undistributed profits prior to 30th April 1914. That £24,083 5s. 1d. was carried forward in the ledger on 1st May 1914 and added to the receipts for the year 1913-1914, and the ledger balance of undistributed profits on 1st May 1915 was shown as £27,760 17s. 9d. The £27,760 17s. 9d. is the real undistributed profits for the year ending 30th April 1915—£3,677 12s. 8d. plus the £24,083 5s. 1d. The same £27,760 17s. 9d. was carried forward in the balance-sheet. Not only was the £24,083 5s. 1d. carried forward in the ledger in 1915 as part of the £27,760 17s. 9d., but the account in the ledger shows that the £27,760 17s. 9d. was also carried forward in the ledger on 1st May 1915, and added to the receipts for the year 1916 (up to 30th June). On 30th June 1916, *and not until then*, the £24,083 5s. 1d. was debited in the profit and loss account in the ledger, and placed, as is shown in another account, into a reserve account. If it had not been carried forward in the profit and loss account until 30th June 1916, why debit the profit and loss account with it on 30th June 1916.

In the balance-sheet for 1916, under the heading of Liabilities, there appears the following entry: Reserves (30th April 1914), rebate on T.P. A/cs £4,500; B/D debts £260; reserve fund £24,083 5s. 1d. That looks as if the £24,083 5s. 1d. had been placed in a reserve fund in 1914, but the copy of the reserve account itself

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in the books of the Company (exhibit M) shows that the £24,083 5s. 1d. was not placed in reserve until 30th June 1916, which corresponds with the entry in the profit and loss account in the ledger. It is so clear that the £24,083 5s. 1d. was carried forward in the profit and loss account in the ledger as undistributed accumulated profits up to 30th June 1916 that I agree with the Chief Justice where he said in his reasons for judgment: "The concrete question in this case is whether the profit and loss account submitted to the shareholders or the account in the ledger headed 'Profit and Loss' is the account which answers the description of 'its profit and loss account'" in sec. 16.

Parliament referred in the *Companies Act* to the annual "statement of profit and loss" as a statement of profit and loss, not an account of profit and loss. In sec. 16 in the Act in question Parliament referred to the accumulated income carried forward in the "profit and loss account." (2) It must be assumed that Parliament must have been aware that the "annual profit and loss statement or account" submitted to shareholders (referred to as a statement) only deals or ought to deal with the actual profit and loss for the one year preceding the meeting, and that it would have been an error in the statement referred to to have included in any of the annual statements referred to any reference to accumulated profits of previous years. The Company did not do so in the statements submitted in 1912, 1913, 1914 or in 1915, but only referred to those undistributed accumulated profits in each of the annual balance-sheets submitted to the shareholders and in the ledger account. (3) It is not reasonable to assume that Parliament meant to allow companies to avoid payment of the tax imposed by the Act simply by neglecting to insert in, or by wilfully omitting from, the annual statement of profit and loss references to undistributed accumulated profits of past years; if in fact in the balance-sheets, and in the profit and loss account of the Company in the ledger, the accumulated undistributed profits were shown as carried forward each year. The so-called profit and loss account referred to in the *Companies Act* as a statement of profit and loss is only an annual statement of the one year's profit and loss, and is not an account or copy of any account in the books of the Company. It only contains particulars collected from accounts in the books and shows the totals of all receipts and outgoings during one year, including losses. The totals are all collected from the different accounts in the books of the Company and set out in the statement referred to. It would be irregular, to say the least, for the Company to have inserted in the statement any reference to previous undistributed profits, and it was not, in my opinion, the profit and loss account referred to in the proviso to sec. 16. The profit and loss account in the ledger is the only one entered in the books of the Company as an account of profit and loss, and is the usual account necessarily kept by all firms and companies to show not only profits for one year but for each and every year of the firm's or company's business. Exhibit N shows that the account in question is such an account, and shows the total expenditure and receipts and profits for each year and for all the years from 30th April 1912 to 30th June 1927. Any person intending to purchase the business of the Company would require to see such an account as the first steps in considering the amount to be paid for the business; and if the details of outgoings were required for any year or years they could be ascertained by references in the ledger to the journal entries which are referred to in the profit and loss account in the ledger. It is also important to mention that the references in the Company's journal to the profit and loss account are to the pages of the account headed *Profit and Loss* in the ledger commencing at p. 37, and not to any other statement or account. The account in the ledger is referred to by my brother *Higgins* as only a history or record of profit and loss—not an account. That applies to all accounts in the ledger. The day-book itself is a history of entries of all dealings each day. Entries are then made to the journal and ledger charging those dealings to the customers separately so as to have a concise and ready reference, or history, of the dealings of each individual showing the total amounts due by or to the credit of the different persons dealing with the Company. My brother *Isaacs* has dealt very fully with the law on the matters in dispute, and the recognized practice in book-keeping and accountancy; and, as I agree with the views expressed by him, I have thought it necessary to deal only with the admitted facts and the interpretation

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to be placed on the words *accumulated undistributed income* in sec. 16 and the words "carried forward" in the profit and loss account in the proviso to the same section. The dividend in question in this case paid in 1927 was admittedly paid out of the sum of £24,083 5s. 1d. carried forward in the profit and loss account in the ledger and in the balance-sheets of the Company on 1st May 1915 and continued to be carried forward in that account until 30th June 1916.

I further hold that the amount in question is liable to taxation whether the annual statement submitted to the shareholders is the profit and loss account Parliament intended in the first instance or not, because by an amendment of the proviso it was declared that if the accumulated income was carried forward in the profit and loss account or in other accounts or statements mentioned in the proviso the tax would be payable. The carrying forward of the amount in the Company's balance-sheet and/or in the profit and loss account in the ledger referred to would therefore render the dividend in question liable to the tax.

I therefore hold that the appeal should be dismissed.

*Appeal allowed. Assessment amended by excluding the amount received by the appellant in respect of the dividend of* 1s. 6*d. per share declared by the directors of Nicholson's* (1911) *Ltd. on* 5*th February* 1927. *Costs of the appeal to be paid by the respondent.*

Solicitors for the appellant, *Downing & Downing.*

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