

The order is that the assessment be amended accordingly. Costs of this appeal to be paid by respondent.

*Order accordingly.*

Solicitors for the appellant, *Whiting & Byrne*.

Solicitor for the respondent, *W. H. Sharwood*, Crown Solicitor for the Commonwealth.

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[HIGH COURT OF AUSTRALIA.]

JONES AND STEAINS . . . . . APPELLANTS ;

AND

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

[No. 1.]

*War-time Profits Tax—Assessment—Pre-war standard of profits—No pre-war trade year—Option of taxpayer—“Pre-war period,” meaning of—Profits of business—Sums withdrawn from banking account—Increase of capital—Deduction from profits where no pre-war trade year—Deduction in respect of partner devoting whole time to business—Whether deduction should be made in computing pre-war profits—War-time Profits Tax Assessment Act 1917-1918 (No. 33 of 1917—No. 40 of 1918), secs. 7, 11, 12 (1) (b), 15 (9), 16.*

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*Held*, by the whole Court, that for the purpose of assessing the war-time profits tax of a firm which had begun business on 31st March 1914 and which had exercised the option conferred by sec. 16 (6) of the *War-time Profits Tax Assessment Act 1917-1918*, the firm was entitled to have its pre-war standard of profits taken to be the amount prescribed by sec. 16 (6) (a), which was the greater of the two amounts mentioned.

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

The first balance-sheet and profit and loss account of the firm was made up as on 31st July 1914.

*Held*, by Knox C.J., Higgins and Starke JJ. (Isaacs and Gavan Duffy JJ. dissenting), that the period ending 31st July 1914, and not the period ending



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4th August 1914, the date when the War commenced, was "the pre-war period during which the business was carried on," within the meaning of sec. 16 (6) (a) of the Act.

In the deed of partnership there was no provision for the payment to the partners of wages or salary but certain sums had been withdrawn by the partners from the bank account of the firm for their individual use and appeared in the profit and loss accounts under the heading "wages."

*Held*, by the whole Court that the sums were profits of the business.

*Held*, also, by *Knox C.J.*, *Isaacs*, *Gavan Duffy* and *Starke JJ.*, that, notwithstanding the provisions of sec. 12 (5), the provisions of sec. 12 (1) (b) apply to cases where owing to the recent commencement of the business there has not been one pre-war trade year.

*Held*, further, by the whole Court, that, where both partners had devoted the whole of their time to the business but were not entitled under the partnership agreement to any salary or wages, in computing the profits of the pre-war trade year the Commissioner had no authority to make the deduction mentioned in clause (b) of the second proviso to sec. 15 (9):

By *Knox C.J.*, *Isaacs*, *Gavan Duffy* and *Starke JJ.*, on the ground that, notwithstanding the provisions of sec. 16 (1) and (11), the provisions of sec. 15 (9) (b) do not apply to the computation of the profits of a pre-war trade year;

By *Higgins J.*, on the ground that sec. 15 (9) is not a section creating a right to deduct sums as for salary but a section restrictive of that right for the purpose of the tax.

#### CASE STATED.

On the hearing of an appeal to the High Court by Ernest Leighton Jones and George Hamilton Steains, trading as Jones & Steains, from an assessment of the firm for war-time profits for the year ending 30th June 1917, a case was stated by *Isaacs J.* which was substantially as follows:—

1. The appellants are and always have been the sole members of the firm of Jones & Steains, which at all times material has carried on the business of cork merchants in Melbourne.

2. The said firm commenced business as aforesaid on 31st March 1914 and thenceforward each of the appellants devoted his whole time to the said business.

3. The said firm was assessed for war-time profits tax in respect of the war-time profits arising from the said business in the financial year commencing on 1st July 1916 and ending on 30th June 1917.

4. The first balance-sheet and profit and loss account of the said firm were compiled to show the results of the partnership trading



from 31st March 1914 up to and including 31st July 1914. The next balance-sheet and profit and loss account of the said business were compiled to show the results of the partnership trading from 1st August 1914 to 31st December 1914.

5. Each of the said profit and loss accounts included an item "wages." In the case of the first of the said accounts the sum of £165 shown against such item included the sum of £111, which represented moneys received from the banking account of the said firm by the respective partners, the appellants, for their individual use. In the case of the second of the said accounts the sum of £244 shown against such item included the sum of £172, which also represented moneys received from the banking account of the said firm by the respective partners, the appellants, for their individual use.

7. In neither of the said periods, 31st March 1914 to 31st July 1914 and 1st August 1914 to 31st December 1914, did the appellants receive any sum other than the said sums of £111 and £172 from the said business and neither of the said sums nor any part thereof was repaid or repayable to the said partnership account.

8. The appellants contend that in computing the actual profits of the said firm to arrive at a pre-war standard of profits for the purposes of the *War-time Profits Tax Assessment Act* 1917-1918 the actual profit during the pre-war period during which the said business was carried on should be taken as £124 0s. 8d. (made up of the sum of £13 0s. 8d. shown in the first of the said profit and loss accounts under the heading "Balance—Net profit" and the said sum of £111 referred to in par. 5 hereof) or alternatively that the profits up to 4th August 1914 from the commencement of the business should be assessed or computed by adding to the said sum of £124 0s. 8d.  $\frac{4}{153}$  of the sum of £1,015 0s. 4d. (made up of the sum of £843 0s. 4d. shown in the second of the said profit and loss accounts under the heading "Balance—Net profit," and the said sum of £172 referred to in the said par. 5) or in some other appropriate manner; whereas the respondent contends that, if the profit for the period from 31st March 1914 to 31st July 1914 be material at all for the purpose of arriving at a pre-war standard of profit, the said sum of £13 0s. 8d. is the actual profit for such purpose, and that the said sum of £111

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should not be added thereto and that no part of the profit for the period from 1st August 1914 to 31st December 1914 is material at all for such purpose, or alternatively that if it be material the said sum of £843 0s. 4d. and not the said sum of £1,015 0s. 4d. should be taken as the profit for the said period.

9. Prior to the said 31st March 1914 the appellants were not carrying on any trade, business, office, employment or profession of any sort in partnership, and there are no facts which would make the provisions of clause (b) of sub-sec. 6 of sec. 16 of the said Act applicable to the said business. The appellants requested the respondent to assess them for war-time profits tax for the said year in accordance with the provisions of sec. 16, sub-sec. 6 (a), of the said Act, but later asked that whichever of the modes of assessment authorized by the said sub-sec. 6 (a) or sec. 11 (1A) of the said Act resulted in less tax should be applied for the purpose of assessing them as aforesaid. The respondent considered that the provisions of the said sub-sec. 6 (a) were not capable of being applied to the said business and did in fact assess the appellants in accordance with the provisions of the said sec. 11 (1A). In so doing the respondent arrived at the pre-war standard of profit of the said business by taking a percentage of 13·5 on the sum of £5,250, which was the average amount of capital employed in the said business during the accounting period of the business consisting of twelve months ending 30th June 1917.

10. The capital of the said firm on the said 31st March 1914 was £800. On 29th June 1914 and 18th July 1914 the appellants added to the said capital the respective amounts of £35 and £137 5s. 10d. On 4th August 1914 there was also a sum of £28 13s. 1d. representing profits and interest on partners' capital which had not been withdrawn from the said business by the appellants.

11. The appellants contend that the application of the said sub-sec. 6 (a) of sec. 16 would have resulted in less tax being levied on the said firm than would the application of the said sec. 11 (1A), and accordingly that the respondent was wrong in applying the said sec. 11 (1A).

12. During the accounting period for the said financial year the capital employed in the said business exceeded the average amount



of capital employed therein at any time between 31st March 1914 and 1st January 1915. There was no borrowed money used in the said business at any time.

13. The respondent decided that the provisions of sec. 12 of the said Act had no application, and that accordingly no deduction should be made from the profits of the said accounting period for increased capital employed in the said business during such accounting period.

14. If sec. 12 of the said Act is applicable to the facts of this appeal upon any application thereof to the circumstances of this case, the greater of the respective sums ascertained pursuant to the provisions of clauses (a) and (b) of sub-sec. 1 of the said sec. 12 is that obtained by applying the provisions of the said clause (b), and the appellants contend that there should be a deduction made from the profits of the said accounting period of the sum ascertained in accordance with the said clause (b). The respondent contends that no material is available on which a computation can be made in accordance with sec. 16 (6) (a) of the said Act, and that on any method of computation possible on the facts the provisions of sec. 12 of the said Act have no application.

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

- (1) Should the pre-war standard of profits of the said business be ascertained in the manner provided by the provisions of clause (a) of sub-sec. 6 of sec. 16 of the *War-time Profits Tax Assessment Act 1917-1918* ?
- (2) In estimating the profits of the “pre-war period” is that period to be taken as ending on 31st July 1914 or on 4th August 1914 ?
- (3) Should both or either and which of the said sums of £111 and £172 mentioned in par. 5 hereof be treated as part of the profits of the said firm ?
- (4) Should a deduction be made from the profits of the said business earned in the accounting period for the financial year commencing 1st July 1916 and ending 30th June 1917 of the sum ascertained in manner prescribed by clause (b) of sub-sec. 1 of sec. 12 of the said Act ?

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(5) Should any and, if any, what amount be deducted from the profits of the pre-war period in pursuance of the provisions of sec. 15 (9), clause (b) of the second proviso, and sec. 16, sub-secs. 1 and 11 of the Act?

Under the deed of partnership between the appellants, which was part of the case stated, the net profits of the business were divisible between the partners equally, and there was no provision in it which entitled either of the partners to wages or salary.

*Owen Dixon* K.C. (with him *Russell Martin*), for the appellants.

*C. Gavan Duffy*, for the respondent.

*Cur. adv. vult.*

April 23.

The following written judgments were delivered:—

KNOX C.J. AND STARKE J. The first question for decision is whether the pre-war standard of profits of the business carried on by the appellants should be ascertained in accordance with the provisions of sec. 16 (6) (a) of the *War-time Profits Tax Assessment Act*. That enactment, so far as relevant to the determination of this question, is in the words following: “Where owing to the recent commencement of a business there has not been one pre-war trade year the pre-war standard of profits shall be taken to be . . . at the option of the taxpayer . . . an amount proportionate for the period of twelve months to the actual profits during the pre-war period during which the business was carried on.” In this case the business was commenced on 31st March 1914, the War began on 4th August 1914, and the taxpayer exercised his option by requesting the Commissioner to apply the provisions of sec. 16 (6) (a) to the assessment in question. The only conditions prescribed for the application of these provisions were (a) that owing to the recent commencement of the business there had not been one pre-war trade year, and (b) that the taxpayer should exercise his option. These conditions being fulfilled, it follows that the provisions of sec. 16 (6) (a) should be applied in ascertaining the pre-war standard of profits. Question 1 should therefore be answered “Yes.”



The next question as amended during the argument is whether, in ascertaining under sec. 16 (6) (a) the profits of the pre-war period, that period should be taken as ending on 31st July 1914, the day to which the balance-sheet and profit and loss account of the business were made up, or on 4th August 1914, the date of the commencement of the War. For the respondent it was said that what was to be ascertained was the actual profits during the pre-war period during which the business was carried on; that, giving these words their natural meaning, the pre-war period during which the business was carried on extended from 31st March to 4th August, and therefore it was necessary to ascertain the actual profits up to that date. For the appellant it was urged that the provisions of sub-sec. 1 of sec. 15, of sub-secs. 1, 11 and 12 of sec. 16 and of sub-sec. 4 of sec. 7 showed that Parliament intended that in ascertaining the profits of a business regard should be had to the periods for which the accounts of the business were in fact made up; and it was pointed out that, in order to ascertain the profits of a business up to a given day, it would be necessary to take stock as at that day, and that, except in the case of a business the accounts of which were made up to 4th August, it would be practically impossible to ascertain the profits of the business up to that date. It was pointed out also that the Act was not passed until the year 1917, some three years after the commencement of the War. It seems to us impossible to deny that the words "during the pre-war period during which the business was carried on," construed according to their natural meaning, import in the case of a business carried on up to 4th August 1914 a period ending on that day. But, having regard to the other provisions to which we have referred and to the practical impossibility of ascertaining years after the event the profits of a business up to a day other than that to which the accounts of the business had been made up, the word "period" in the expression quoted above should, we think, be construed as referring to a period for which the accounts of the business had been made up or, in other words, as equivalent to the expression "accounting period" used in sec. 7 of the Act. Construed according to their natural meaning, the words would impose on the Commissioner an obligation to do something which in many, if not in all,

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cases would be impossible, a construction which should be avoided if the words used are, as we think they are, reasonably capable of a meaning which would avoid this result.

Question 3 is whether two sums of £111 and £172 respectively or either of them should be treated as part of the profits of the business. These amounts were withdrawn by the partners from the bank account of the firm for their individual use—the sum of £111 during the period between 31st March and 31st July 1914 and the sum of £172 during the period between 31st July and 31st December 1914. These amounts appear to have been drawn, not as wages or salary, but in anticipation of profits which were in fact made. If the profits had not been sufficient to provide for these payments, each partner would have been liable to repay to the partnership the whole or part, as the case might be, of the sum drawn by him. It seems to us that the sums in question were none the less profits of the business by reason of the fact that the partners drew them in anticipation instead of after the amount of the profit for the period had been ascertained. In our opinion the answer to this question should be “Both.”

The next question is whether a deduction should be made from the profits of the business earned in the accounting period for the financial year commencing 1st July 1916 and ending 30th June 1917 of the sum ascertained in the manner prescribed by sec. 12 (1) (b) of the Act. The Act provides that, where during the accounting period increased capital has been employed in a business, a deduction shall be made from the profits of the accounting period of the percentage per annum (on the amount by which the capital has been increased) of the profits standard on the average capital used in the pre-war trade years by reference to which the profits standard has been arrived at. In the present case the capital employed in the business during the relevant accounting period exceeded the average capital employed in the business during the pre-war period, and, if we are right in thinking that the taxpayer was entitled to require the application of a profits standard, it would appear that the conditions imposed by the section on the right to have the deduction made have been fulfilled, unless the true meaning of the provision is, as the Commissioner contends, that the provision



applies only in cases in which the business has been carried on for at least one whole pre-war trade year. For the Commissioner it is said that this construction is rendered necessary by the terms of sub-sec. 5 of sec. 12. That sub-section provides that for the purposes of sec. 12 capital shall be taken to be increased when the pre-war standard is a profits standard if the capital employed in the business exceeds the average amount of capital employed *during the pre-war trade years or year* by reference to which the profits standard has been arrived at. It is said that this provision is an exhaustive definition of the cases in which capital may be taken to be increased and that its effect is to require as a condition that the profits standard shall have been arrived at by reference to the profits of the business during the whole of one pre-war trade year at least. The result of adopting this construction would be to exclude the operation of sec. 12 (1) in every case coming within the provisions of sec. 16 (6) (b). For the appellants it is said that the words of sec. 12 (1) (b) read according to their natural meaning apply to every case in which a profits standard is applied; that this shows the controlling intention to be that the deduction should be made in every such case; and that the definition contained in sub-sec. 5 of sec. 12 is not exhaustive or, if it be, that the use of the expression "during the pre-war trade years or year" is an attempt to cover by one phrase all cases in which a profits standard is to be applied. On the whole we think that, notwithstanding the provisions of sub-sec. 5, sub-sec. 1 (b) should be construed as extending to cases within sec. 16 (1) (a), i.e., cases in which owing to the recent commencement of the business there has not been one pre-war trade year. The scheme of the Act is to tax such portion of the profits made during the War as might fairly be regarded as attributable to the existence of the state of war. The method adopted for carrying out this scheme is by comparing the profits of the business made during the War with the pre-war profits of the same business, and it is clear that if no allowance were made for increase or decrease of capital employed during the war-time period one of the factors essential to the making of a true comparison would be absent. A comparison between the pre-war and war-time profits of a business in which the capital employed during the war-time period was

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double that employed during the pre-war period would, if no adjustment were made in respect of the increase of capital, be manifestly fallacious if used as a means of ascertaining what portion of the profits of the period during which the increased capital was employed was attributable to the existence of the war-time conditions. No reason was, or, we think, could, be suggested why the fact that the pre-war period selected for comparison was less than a year should affect the propriety of making the necessary adjustment in this respect in order to obtain a fair basis of comparison, and, having regard to the purpose of the Act as indicated by its provisions (e.g., sec. 7), to the obvious necessity for an adjustment such as that prescribed by sec. 12 (1) to be made in every case in which a profits standard is employed, and to the generality of the provisions of that sub-section, we do not think that we are compelled by reason of the expression used in sub-sec. 5 to adopt a construction of sub-sec. 1 (b) which would have the effect of excluding from its operation all cases coming under sec. 16 (6) (a) and thereby vitiating in all such cases in which there had been an increase or decrease of capital the comparison which is the basis of the method prescribed for ascertaining the amount of taxable profits. In our opinion question 4 should be answered "Yes."

The remaining question, which was added by amendment, is whether any and, if so, what amount should be deducted from the profits of the pre-war period in pursuance of the provisions of clause (b) of the second proviso to sec. 15 (9) and sub-secs. 1 and 11 of sec. 16 of the Act. Clause (b) of the second proviso to sec. 15 (9) provides that if the business is owned by a partnership a specified deduction shall be allowed in respect of each partner who devotes the whole of his time to the business. In this case each partner devoted the whole of his time to the business, and the Commissioner, in computing the profits of the war-time accounting period, has made the statutory deduction. Sec. 15 constitutes Part IV. of the Act, which is headed "Computation of profits." It deals with the deductions to be made in computing the war-time profits of the business and does not in terms relate to the profits of the pre-war period. But the Commissioner contends that by reason of sub-secs. 1 and 11 of sec. 16 deductions similar to those directed by sec. 15



to be made from war-time profits are to be made from profits of the pre-war period so far as possible. Sec. 16 (1) provides that the profits of any pre-war trade year shall be computed on the same principles and subject to the same provisions as the profits of the accounting period, and sub-sec. 11 provides that the provisions contained in Part IV. (i.e. in sec. 15) of the Act shall have effect with respect to the computation of the profits of a pre-war trade year. These sub-sections no doubt operate to introduce into the computation of the profits of a pre-war period such of the provisions of the Act as are capable of being so applied. But it is said for the appellants that sec. 15 (9) appears on its face to be incapable of application to the profits of a pre-war period. In support of this contention it is pointed out that the application of the provisions of the sub-clause now in question—sub-clause (b) of the second proviso—is by its terms made dependent on the pre-war standard of profits having been previously ascertained, and that it is therefore impossible to apply those provisions in computing the profits of a pre-war period for the purpose of ascertaining the pre-war standard of profits. This argument appears to us to be well founded. The allowance of a deduction under this provision depends on the fact that the pre-war standard of profits does not exceed £1,000, and the amount of the deduction varies according to the amount by which that standard falls short of £1,000. The argument is fortified by the terms of sub-clause (a) of the next following proviso, which clearly requires that the pre-war standard of profits shall be ascertained before the prescribed deduction can be made. Assuming, then, that the effect of sub-secs. 1 and 11 of sec. 16 is to introduce into the computation of the profits of a pre-war period such of the provisions of sec. 15 as can consistently with the words used in that section be applied in computing such profits, we are of opinion that the provisions of sub-clause (b) of the second proviso cannot be so applied because it is an express condition of their application that the pre-war standard of profits shall have been first ascertained and the pre-war standard can only be ascertained after making all deductions required or authorized by the Act to be made from the profits of the pre-war period. For these reasons we are of opinion that the answer to question 5 should be “No amount.”

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ISAACS J. (1) This question is, by common consent, to be answered in the affirmative. There has not been "one pre-war trade year," that is, one complete year, since the business began on 31st March 1914.

(2) There is no statutory definition of the expression "the pre-war period during which the business was carried on." The word "period" must have its ordinary natural meaning. Whatever else it may mean in other collocations, it is plain that the "period" intended in the phrase quoted is marked out, not by any act of accountancy, nor by any balance-sheet or book-keeping operations, but by the actual carrying on of the business. That being the specifically designated standard of measurement and adopted apparently as a just standard based on realities, I have no right to substitute any other.

(3) Both the sums mentioned in the third question are in fact part of the profits of the firm for the respective periods. Nothing has occurred to deprive them of that character. Consequently that question must be answered in the affirmative.

(4) Question 4 should, in my opinion, be answered in the affirmative. Par. (a) of sub-sec. 6 of sec. 16 deals specially with the case of a pre-war period actually less than a year, and makes provision for its results being brought up proportionately to yearly standard. Once the yearly standard is computed, then for all purposes of the Act it is to be treated as the standard of a pre-war year. The notional twelve months become by the prescribed process the pre-war year by reference to which the profits standard has been arrived at. Par. (b) of sub-sec. 1 of sec. 12 therefore applies to this case.

(5) As to question 5 I have had considerable doubt. In the end I think a negative answer is the right one. What ultimately influences me is the practical difficulty of coherently applying any part of the relevant proviso to the pre-war period. Further, an affirmative answer would so affect the operation of sub-sec. 3 of sec. 7 and the operation of sub-sec. 3 of sec. 16 as to make these provisions unintelligible to me.

My answers, therefore, are: (1) Yes; (2) 4th August 1914; (3) Yes; (4) Yes; (5) No.



I am authorized by my brother *Gavan Duffy* to say that he agrees with this judgment.

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HIGGINS J. To my mind the answers to the questions asked in this case stated are all reducible to the answer to question 3; and the answer to question 3 becomes obvious when the general scheme and purpose of the Act has been clearly grasped, along with the plain interpretation of sec. 16 (6) (a): “(6) Where owing to the recent commencement of a business there has not been one pre-war trade year the pre-war standard of profits shall be taken to be [the statutory percentage on the average amount of capital employed in the business during the accounting period, or] at the option of the taxpayer the greater of the following amounts:—(a) an amount proportionate for the period of twelve months to the actual profits during the pre-war period during which the business was carried on.” The other alternative (b) need not be elaborately considered; the taxpayer has exercised his option and (a) gives the greater amount. I have bracketed the words as to the statutory percentage which become inapplicable when the option is exercised.

The relevant facts are that the firm commenced business on 31st March 1914; that the War began on 4th August 1914; that the first balance-sheet with profit and loss account was made up as to 31st July 1914; that the profit and loss account appears as follows:—Profit and Loss Account from 31st March 1914 to 31st July 1914.—As shown by the books.—Wages, £165; Travelling expenses, £145 4s. 4d.; General expenses, £59 3s.; Rent, £49 16s. 8d.; Cartage, £17 7s. 7d.; Discount and interest (includes interest on partners’ capital, £15 12s. 5d.), £63 10s. 9d.; Balance net profit distributed equally (E. D. Jones £6 10s. 4d., G. H. Steains £6 10s. 4d.), £13 0s. 8d.: £513 3s. Gross profit, 4 months, £430 1s. 2d.; Commission £83 1s. 10d.: £513 3s.

It will be noticed that the first item on the expenditure side is £165 as for “wages”; but of this £165 the sum of £111 merely represented moneys drawn from the banking account of the firm by the partners for their individual use. There was nothing in the partnership articles entitling either partner to wages or salary as distinct from profits. This sum of £111 has been rejected by the



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Commissioners as “wages,” and no objection is now taken to such rejection. But if the sum does not represent wages, it cannot represent anything but profits. Therefore the profits for the four months amount, according to the figures, to £111 plus £13 0s. 8d., or £124 0s. 8d. in all. Now, applying sec. 16 (6) (a) to these facts, we have to find the sum which would be proportionate for twelve months to this £124 0s. 8d. for four months; and the sum is £372 2s. There was a similar error as to “wages” in the profit and loss account as from 1st August 1914 to 31st December 1914; but, as this accounting relates to the war period, not to the pre-war period, it is unnecessary to consider the figures in detail.

As for sec. 11 (1A), on which the Commissioner relies, the section is expressly made inapplicable except “on the application of the owner of the business”; and no such application has been made. The owner of the business did not want sec. 11 (1A) to be applied, although the subject was considered as a possible alternative.

Question 2, as now stated in an amended form, is as follows: “In estimating the profits of the ‘pre-war period’ is that period to be taken as ending on 31st July or on 4th August 1914?” In my opinion, sec. 16 (12) applies to the case, taken with sec. 16 (1) and sec. 7 (4). If there had been a full pre-war trade year, it would end at the end of the last accounting period before 5th August 1914; and, under sec. 16 (1) and (6) (a) and sec. 7 (4) the end of the accounting period for the fraction of the year must be treated in the same way. The period is to be taken as ending on 31st July, and there is no need to ascertain any profits made during the first four days of August 1914.

Question 3 has been dealt with under question 1.

As for question 4 the facts appearing in the case still do not enable us to give an answer. Par. 12 states: “During the accounting period for the said financial year” (1st July 1916 to 30th June 1917) “the capital employed in the said business exceeded the average amount of capital employed at any time between 31st March 1914 and 1st January 1915.” This does not tell us that the capital in the financial year—1st July 1916 to 30th June 1917—exceeded the average capital used in the pre-war period; and the average is useless as it takes account of the period August 1914 to



January 1915. For aught that we are told, the capital may have been increased to £10,000 on 1st June 1914, and decreased to £100 on 1st October 1915.

A new question has been asked as to the effect of sec. 15 (9) on the pre-war profits, now standing at £124 0s. 8d. The Commissioner seems to treat sec. 15 (9) as enabling or obliging him to deduct from the profits two sums of £300 each as for remuneration or salary during the War, and on the same principle (sec. 16 (1) and (11) ) before the War also at the same rate. In my opinion, this is a mistake. I should have regarded it as obvious that sec. 15 (9) and (10) were merely aimed at preventing artificial reduction of the profits of a business by means of artificial inflation of the salaries of the managers ; the salaries during the War are not to exceed the sums allowed in the last pre-war year unless the Commissioner otherwise direct ; and then there are provisions limiting the power of the Commissioner to direct. The first paragraph of sub-sec. 9 as well as sub-sec. 10 is taken bodily from the English Act (5 & 6 Geo. V. c. 89, Sched. IV., Part I.) ; and the object clearly is as I have stated : “ (9) *Any deduction allowed* for the remuneration of directors, managers, and persons concerned in the management of the business *shall not exceed* the sums allowed for those purposes in the last pre-war trade year or a proportionate part thereof as the case requires, unless the Commissioner, owing to any special circumstances or to the fact that the remuneration of any managers or managing directors depends on the profits of the business, otherwise directs.” These words do not give any *right* to any deduction for salary ; but if a salary has been provided for in the articles (of a corporation or partnership) the salary must be treated as profits of the business so far as it exceeds the salary during the last pre-war trade year *unless* the Commissioner direct otherwise. Then follow three provisions limiting this power of the Commissioner to direct otherwise. The first provision puts a limit in amount to the “ *total deduction* ” to be allowed for the remuneration of directors ; the second provision (applicable to the case of a partnership) says that if the pre-war standard of profits does not exceed £1,000 a deduction of £300 or such greater sum as the Commissioner directs “ shall be allowed ” in respect of each partner, but that the total sum to be

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deducted shall in no case be less than the difference between £1,000 and the pre-war standard of profits. These provisions merely prescribe limits to the Commissioner's power to direct, do not themselves direct or compel him to direct, even though the words are "shall be allowed." These words merely mean what is to be allowed in the circumstances, should the Commissioner exercise his powers to direct. But the object of the whole appears clearly in sec. 15 (10) of our Act, which is copied from the final part of sec. 5 of Part I. of Schedule IV. in the original English Act: "No deduction shall be allowed in respect of any transaction or operation of any nature, where it appears . . . that the transaction or operation has artificially reduced the amount to be taken as the amount of the profits of the business for the purposes of this Act."

In my opinion, the £111 is treated as part of the profits of the pre-war year without any deduction as for the wages of the partners : sec. 15 (9) is not a section creating a right to deduct sums as for salary but a section restrictive of the right for the purpose of this profits tax. The distinction is surely obvious between restriction of the power of the Commissioner to direct a variation of the ordinary rules as to deduction of salaries and a positive direction given by Parliament for such deduction. The clauses which follow the first paragraph of sec. 15 (9) are all provisoes to the first paragraph : "Provided that," "Provided further that," "Provided also that," and Parliament has of course made each proviso obligatory on the Commissioner—"shall be allowed," &c. Sec. 15 (9) does not use such phrases as "deductions shall be allowed" as in sec. 15 (3), or "deductions shall not be allowed" as in sec. 15 (2), (4), but "*any deduction allowed* for the remuneration . . . shall not exceed," &c., that is to say, any deduction otherwise legitimate shall not, in the computation of profits, exceed, &c.

This view of the section makes the whole of the elaborate argument inapplicable, as to the propriety of deducting salaries for the pre-war years as well as for the war years ; for no salaries are to be deducted for the war years, as there was no agreement for any salaries at all.

In my opinion, therefore, the answer to question 1 should be Yes ; to question 2 should be 31st July 1914 ; to question 3 should



be Yes as to the sum of £111; to question 4 no answer; to question 5 should be No.

Questions answered: (1) Yes; (2) 31st July 1914; (3) Both; (4) Yes; (5) No.

Solicitors for the appellants, *Dunlop & Dunstan*.  
Solicitor for the respondent, *W. H. Sharwood*, Crown Solicitor for the Commonwealth.

B. L.

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AND  
  
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War-time Profits Tax—Assessment—Recent commencement of business—Profits—  
“Pre-war standard of profits”—“Profits standard”—Deductions—War-time  
Profits Tax Assessment Act 1917-1918 (No. 33 of 1917—No. 40 of 1918), secs.  
7, 11, 12 (1) (b), 16.

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July 19, 25.  
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On a case stated by *Isaacs J.* the High Court decided that the pre-war standard of profits of the business carried on by the appellants was £372, being an amount proportionate for the period of twelve months to the actual profits during the pre-war period during which the business was carried on as provided by sec. 16 (6) (a) of the *War-time Profits Tax Assessment Act 1917-1918*, and that a deduction should be made from the profits of that business earned in the relevant accounting period of the sum ascertained in accordance with the provisions of sec. 12 (1) (b) of the Act.

*Held*, by *Isaacs J.*, that the phrase “pre-war standard of profits” was not identical with the phrase “profits standard” used in the Act, and that the provision in sec. 16 (3) that the profits standard “shall not in any case be less than the sum of five hundred pounds” was not applicable; and, consequently, that the sum of £372 was the profits standard to be applied when making the deduction from the said profits required by sec. 12 (1) (b) of the Act.

Order of High Court in *Jones & Steains v. Federal Commissioner of Taxation* [No. 1], (1928) 41 C.L.R. 83, explained.