

[HIGH COURT OF AUSTRALIA.]

ELDER SMITH AND COMPANY LIMITED . APPELLANT ;

AND

THE COMMISSIONER OF TAXATION (NEW }  
SOUTH WALES) . . . . . } RESPONDENT.

ON APPEAL FROM THE SUPREME COURT OF  
NEW SOUTH WALES.

*Income Tax (N.S.W.)—Assessable income—Deductions—Bad debts—“ Incurred ”—  
Income Tax (Management) Act 1928 (N.S.W.) (No. 35 of 1928), secs. 19 (1) (k),\*  
21 (f).\**

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SYDNEY,  
April 12.  
—  
MELBOURNE,  
May 30.

Rich, Starke,  
Dixon, Evatt  
and McTiernan  
JJ.

In a return of income made by the appellant company it claimed to be entitled to a deduction as a bad debt under sec. 19 (1) (k) of the *Income Tax (Management) Act 1928* (N.S.W.) of the amount of an advance made in the course of its business by the appellant to another company more than six years prior to the income year in question. The debt was proved to the satisfaction of the Commissioner to be a bad debt which became bad, and which had actually been written off as bad, in that income year.

*Held*, that, as the debt had not been incurred during the income year in question, the appellant was not entitled under sec. 19 (1) (k) of the *Income Tax (Management) Act 1928* (N.S.W.), to the deduction claimed.

\* The *Income Tax (Management) Act 1928* (N.S.W.) provides by sec. 19 that “ In calculating the taxable income of a taxpayer there shall . . . be deducted from the total assessable income derived by the taxpayer the following deductions:—(1) . . . (k) Bad debts proved to be such to the satisfaction of the Commissioner and to have been incurred in and actually written off by the taxpayer in the income year, but the Commissioner may allow a deduction for bad debts claimed in respect of any year if he is satisfied that the debts were not incurred more than six years prior to the commencement of the income year,

and that the taxpayer has in any previous year included those debts as assessable income in his return: Provided that all amounts at any time received on account of any such bad debts or of any bad debts allowed as a deduction under the previous Act shall be returned as income in the income year in which the same were received.” By sec. 21 it was provided that “ A deduction shall not in any case be made in respect of any of the following matters . . . (f) any bad debts except as provided for in paragraph (k) of sub-section one of section nineteen of this Act.”



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Decision of the Supreme Court of New South Wales (Full Court): *Elder Smith & Co. Ltd. v. Commissioner of Taxation*, (1931) 31 S.R. (N.S.W.) 639, affirmed.

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APPEAL from the Supreme Court of New South Wales.

On the hearing of an appeal by Elder Smith & Co. Ltd. from an assessment of that Company for income tax by the Commissioner of Taxation for New South Wales, his Honor Judge *Armstrong*, District Court Judge, sitting as a Court of Review, stated, under the provisions of sec. 51 of the *Income Tax (Management) Act* 1928 (N.S.W.), a special case, substantially as follows, for the determination of the Supreme Court:—

1. Elder Smith & Co. Ltd. (hereinafter called “the Company”) is a company incorporated and registered in the State of South Australia and registered in the State of New South Wales as a foreign company under the provisions of the *Companies (Amendment) Act* 1906. It is, and was at all material times, part of its business to make advances of moneys at interest against metals and metal ores to be shipped to London and elsewhere for realization.

2. In the course of carrying on its business in New South Wales and in order to produce income in that State the Company advanced certain moneys at interest to Mouramba Copper Mines Ltd., a company incorporated in the said State and carrying on the business of mining for copper therein. In respect of the unpaid balance of such advances and interest thereon the Mouramba Copper Mines Ltd. became and was indebted to the Company in the sum of £18,483, which sum has never been paid to the Company or otherwise satisfied.

3. In the return of its income for the income year ended 30th June 1929 the Company in respect of the debt aforesaid claimed the said sum of £18,483 as a deduction from its assessable income.

4. The respondent on 12th May 1930 issued an assessment of income tax in respect of the income of the Company for the said income year wholly disallowing the deduction.

5. On 26th June 1930 the Company, being dissatisfied with the assessment, duly lodged with the respondent an objection in writing against the assessment, the grounds of the objection being,



*inter alia*, that the sum of £18,483 claimed as a deduction represented a loss and outgoing (not being in the nature of a loss and outgoing of capital) actually incurred in gaining or producing the assessable income ; that such sum was a trading loss actually incurred in the taxable year in gaining or producing the assessable income ; that the said sum was a bad debt proved or deemed to have been proved to be such to the satisfaction of the Commissioner and to have been incurred in and actually written off by the Company in the income year, and was a bad debt within the meaning and operation of sec. 19 (1) (k) of the *Income Tax (Management) Act* 1928 ; that the said sum was not an investment, expenditure, loss or withdrawal of capital, or money used or intended to be used as capital, or capital used in the production of income ; and that the said sum represented the unpaid balance of moneys advanced or treated as moneys advanced from time to time by the Company on certain copper produced by the Mouramba Copper Mines Ltd. and interest thereon and otherwise secured or purporting to be secured under a certain security bearing date 14th July 1916, the Mouramba Copper Mines Ltd. having been wound up and the realization of its assets having definitely established in the income year that the said sum of £18,483 was, and continued to be, a bad debt wholly irrecoverable during the income year or at all.

6. The respondent considered the objection and allowed the same in part only, namely, by allowing as a deduction the sum of £170 portion of the said sum of £18,483, and gave to the Company written notice of his decision.

7. The Company, being dissatisfied with the decision of the respondent, duly requested the respondent in writing to treat such objection as an appeal, and to forward it to a Court of Review in order that the objection might be heard and determined.

8. The appeal came before me sitting as a Court of Review, and was heard on 26th May 1931.

9. On the hearing of the appeal it was admitted by counsel for the respondent (a) that the debt of £18,483 was a bad debt proved to be a bad debt to the satisfaction of the Commissioner ; (b) that the debt was proved to have become a bad debt in the

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said income year, and (c) that such debt was proved to have been actually written off as a bad debt by the Company in the said income year.

10. On the hearing of the appeal it was admitted by counsel for the Company that the debt except as to the sum of £170 was contracted as a debt and became due and payable more than six years prior to the commencement of the said income year.

11. It was contended by counsel for the Company that, on the true construction of sec. 19 (1) (k) of the *Income Tax (Management) Act 1928*, the word "incurred" where therein first appearing means incurred as a bad debt, and that it was immaterial when the debt in question was contracted as a debt provided that the bad debt was incurred in the income year, and was actually written off therein, and that a deduction ought therefore to be allowed in respect of the whole of the debt of £18,483.

12. It was contended by counsel for the respondent that the word "incurred" where first appearing in the said sub-section means incurred as a debt, and that the taxpayer is not entitled to the benefit of the provisions of the first part of the sub-section unless the debt was incurred as a debt within the income year.

13. I upheld the said contention of counsel for the respondent and dismissed the appeal.

14. In my opinion on the admitted facts the question which arose before me is a question of law and at the request of the Company I state and submit this case for decision by the Supreme Court.

The question for decision by the Supreme Court was whether the Company in respect of the said debt was entitled to a deduction of the said sum of £18,483 from its assessable income for the said income year.

The Full Court of the Supreme Court answered the question in the negative: *Elder Smith & Co. Ltd. v. Commissioner of Taxation* (1).

From that decision the taxpayer now appealed to the High Court.

*Flannery* K.C. (with him *Owen*), for the appellant. A debt contracted in the ordinary course of business remains a good debt until



it is realized that the debt is not recoverable ; at that stage a bad debt is incurred but not before then (see *Rydge and Collier's Commonwealth Income Tax Acts*, 1929 ed., p. 348).

[RICH J. In the grammatical construction of sec. 19 (1) (k) of the *Income Tax (Management) Act* 1928 the word "incurred" is referable to debts, not to their badness].

The whole section deals with losses, and debts are not, without more, losses which have been incurred by the taxpayer. A debt is an asset until it becomes bad, upon which event it becomes a loss and is deductible under sec. 19 (1) (k).

[DIXON J. referred to *Gleaner Co. v. Assessment Committee* (1).]

*Barton*, for the respondent. All difficulties are removed by the application to the sub-section of the ordinary principles of construction. The badness of the debt has been left to be determined by the Commissioner. The phrase "proved . . . to have been incurred in" means contracted in the income year, and does not mean that it is a bad debt incurred in the sense of a loss. The word "incurred" when secondly used in the sub-section is clearly referable to "debts," and the same meaning should be given to it where firstly used. The deduction authorized by the sub-section is in respect of a debt incurred or contracted in the income year and written off in that year by the taxpayer as being a bad debt. As to the course which should be followed in the case of a debt which becomes bad subsequent to its inclusion in the assessable income of a taxpayer, see *Gleaner Co. v. Assessment Committee* (1). The fact that a proper construction of the sub-section might impose hardship is the concern not of this Court but of the Legislature. When a debt becomes a bad debt such bad debt is referred to in commercial parlance as having been incurred at the time the debt itself was contracted.

*Cur. adv. vult.*

The following written judgments were delivered :—

RICH J. In my opinion the decision of his Honor Judge *Armstrong* was right and this appeal should be dismissed.

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Starke J.

STARKE J. The *Income Tax (Management) Act* 1928 of New South Wales provides by sec. 19:—"In calculating the taxable income of a taxpayer there shall, subject to this Act, be deducted from the total assessable income derived by the taxpayer the following deductions:—(1) . . . (k) Bad debts proved to be such to the satisfaction of the Commissioner and to have been incurred in and actually written off by the taxpayer in the income year, but the Commissioner may allow a deduction for bad debts claimed in respect of any year if he is satisfied that the debts were not incurred more than six years prior to the commencement of the income year, and that the taxpayer has in any previous year included those debts as assessable income in his return."

The appellant, the taxpayer, claimed to deduct from its assessable income for the income year 1928-1929 a sum of £18,483 as a bad debt. It was admitted that this sum (less £170) was contracted as a debt and became due and payable more than six years prior to the commencement of the income year. The taxpayer, nevertheless, claims that the opening words of the section entitle it to the deduction. The Supreme Court of New South Wales rightly, in my opinion, rejected that claim.

The section deals with debts having a particular character or quality, namely, debts that are bad or cannot be realized. But the debt must be proved to be of that character or quality to the satisfaction of the Commissioner. Next, the debt of the character or quality predicated must be incurred in, and actually written off by the taxpayer in, the income year. This is the grammatical and ordinary sense of the words, and any other construction uses the word "incurred" in the sentence in a most unusual and wholly inappropriate sense.

The appeal should be dismissed.

DIXON J. The question in this appeal is whether, under the *Income Tax (Management) Act* 1928 of New South Wales, a taxpayer is entitled to deduct from the assessable income derived by him during the income year debts which he satisfies the Commissioner are bad and which he has written off in that year unless the debts accrued to him in that year also.



Sec. 21 (f) of the statute enacts that a deduction shall not in any case be made in respect of any bad debts except as provided for in par. (k) of sub-sec. 1 of sec. 19. Sec. 19 (1) provides that "in calculating the taxable income of a taxpayer there shall . . . be deducted from the total assessable income derived by the taxpayer the following deductions . . . (k) Bad debts proved to be such to the satisfaction of the Commissioner and to have been incurred in and actually written off by the taxpayer in the income year, but the Commissioner may allow a deduction for bad debts claimed in respect of any year if he is satisfied that the debts were not incurred more than six years prior to the commencement of the income year, and that the taxpayer has in any previous year included those debts as assessable income in his return: Provided that all amounts at any time received on account of any such bad debts or of any bad debts allowed as a deduction under the previous Act shall be returned as income in the income year in which the same were received."

The debt which the taxpayer claims to deduct was in fact contracted more than six years before the commencement of the year of income. It follows that the taxpayer cannot obtain a deduction under the words of par. (k) beginning "but the Commissioner may allow a deduction," unless the words "incurred more than six years prior to . . . the income year" mean "found to be bad more than six years before the income year," and do not mean "accrued more than six years before." But if the words referring to the incurring of bad debts within six years do have the meaning "found to be bad," then a like meaning must be given to the expression in the earlier part of the paragraph, namely, "bad debts proved . . . to have been incurred in . . . the income year." Accordingly the taxpayer relies upon the earlier part of the paragraph, which he contends is a provision that if the Commissioner is satisfied that during the income year debts, whenever contracted, have proved to be bad debts and have actually been written off by the taxpayer, then a deduction from the assessable income of that year in respect of such debts shall be allowed. In support of this contention it is suggested that the expression "bad debts incurred" refers not to the contracting of the debts but to the

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accrual of the loss : that a creditor does not, although a debtor does, "incur" a debt, but that a creditor does "incur" a loss when a debt owing to him turns out to be worthless. Further, it is said that to confine the earlier part of the paragraph to debts which are contracted and turn out to be bad all within one income year is to give it a very narrow application.

Notwithstanding these considerations, I am unable to place the meaning sought upon the language of the paragraph. In the first place, the word "incurred" is appropriate to describe the contracting of a debt. In the next, it is not attached grammatically to the words "by the taxpayer" and the use of the word "in" after "incurred" as well as after the word "taxpayer" operates to attach the words "by the taxpayer" exclusively to the words "written off." Thus the word "incurred" is not used of the creditor. Then in the second part of the paragraph, beginning with the words "but the Commissioner may allow," the word "incurred" is applied to the word "debts," not "bad debts" and, even if it be possible to understand the expression "bad debts incurred" as equivalent to "loss suffered on account of bad debts," it is almost impossible to give any meaning to the words "debts incurred" except "debts contracted."

In the phrase "the Commissioner may allow a deduction for bad debts claimed in respect of any year" the words "any year" appear to be used in contrast with the reference to time which the paragraph has already made. But the contrast cannot be between allowance in an income year and an allowance in a year not an income year, for the whole provision is dealing with allowances from the assessable income of an income year. It seems clear that it points to the distinction between an allowance in an income year in which the debt was "incurred" and in an income year although it is not the year in which the debt was incurred. The effect of sec. 21 (f) and 19 (1) (k) considered together seems to be to require that all debts contracted in an income year shall be included in the income except debts which have within that year proved to be bad and been written off, but to allow the Commissioner to make a deduction in any of the six next succeeding years of any debt which has been so included but has since proved to be bad. The first part of the paragraph is devoted to allowing a debit in the accounts properly to be thrown



against the credit which par. (f) of sec. 21 impliedly compels, namely, the credit of all book debts made during the year. The second part of par. (k) of sec. 19 (1) is directed to the allowance in subsequent years of bad debts which, having been included among the assets, nevertheless afterwards become or turn out to be worthless. When this second part says that the Commissioner "may allow" the deduction, perhaps it gives him a discretion, but there is a good deal to be said for the view that if he is satisfied that the debts are contracted within six years and have in the meantime been included as assessable income of a previous year, and, if the debts are in fact bad, and perhaps also have been written off, then he must exercise his power to allow the deduction. This question, however, does not arise for decision in the present case, because the debt which the taxpayer claims to deduct was contracted more than six years before the year of income.

The decision of the Supreme Court was right and the appeal should be dismissed.

EVATT J. The appellant Company succeeded in satisfying the Commissioner of Taxation that a certain debt owing to it was proved to be a "bad debt." It was also admitted that such debt was proved to have "become a bad debt" and to have been actually written off as a bad debt in the relevant year. But it also appeared that the debt was contracted as a debt and became due and payable to the appellant some years prior to the commencement of such income year.

Claiming to have the debt in question deducted from its total assessable income, the appellant says that it answers the statutory description of a "bad debt proved to be such to the satisfaction of the Commissioner and to have been incurred in and actually written off by the taxpayer in the income year" (New South Wales *Income Tax (Management) Act* 1928, sec. 19 (1) (k)).

It is quite impossible to believe that the word "incurred" was intended to be employed in order to describe the relation between a creditor and what takes place when a debt owing to him "becomes bad." No doubt it is possible to identify a point of time when a debt owing may be said to "become" a bad debt. But treating

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the culmination of the process as an ascertainable event, it is a fantastic use of the language to say that, when the event happens, the creditor "incurs" the bad debt. But, as *Harvey* C.J. in Eq. pointed out, the word "incurred" can and naturally does relate to the word "debt" and not to the phrase "bad debt." As the debt in question was incurred long before the relevant income year, the Full Court and his Honor Judge *Armstrong* were right in denying the taxpayer's claim to the deduction.

The appeal should be dismissed.

McTIERNAN J. The appellant claimed under sub-sec. 1 (k) of sec. 19 of the *Income Tax (Management) Act* 1928 of New South Wales a deduction of £18,483 from his assessable income for the income year ending 30th June 1929. This sum represented the unpaid balance of moneys advanced from time to time by the taxpayer to Mouramba Copper Mines Ltd., and interest on those moneys, under a security dated 14th July 1916. This Company was wound up, and when its assets were realized it was definitely established in the income year ending on 30th June 1929 that the moneys advanced to the Company were irrecoverable by the taxpayer. It was admitted by counsel for the Commissioner of Taxation that this amount was a bad debt, proved to be bad to the satisfaction of the Commissioner; that it was proved to have become a bad debt in the income year which has been mentioned; and that it was proved to have been actually written off as a bad debt by the appellant in the income year. It was also admitted by counsel for the appellant that, except as to £170, this debt was contracted by the Company to which the moneys were advanced more than six years prior to the commencement of the income year ending on 30th June 1929. The question of law, upon which the appellant and respondent are at issue, is whether, upon the true construction of sub-sec. 1 (k), the appellant is entitled to claim to deduct the above-mentioned sum as a bad debt. Upon the admissions which have been made, the answer to this question turns upon the meaning of the word "incurred" appearing in the sub-section. In my opinion the word "incurred" means incurred as debts. It signifies the creation of the liability of the person who became a debtor. The contention



that the word "incurred" describes the meeting of a loss by the taxpayer when the debts became bad, cannot, in my opinion, be accepted without doing violence to the language of the sub-section. That contention involves reading the words "by the taxpayer" with the word "incurred" and when this is done there is no place for the word "in" appearing after "incurred." No such difficulty arises if the word "incurred" is construed to relate to the contracting by a person other than the taxpayer of the debt, which has become a bad debt. It is true that the Legislature has introduced the subject, about which it is legislating as "bad debts" and thereafter uses the word "incurred." But this express reference to "bad debts," which is a description of certain debts according to their present state, does not require that the word "incurred," where it first appears, should refer to the degeneration of those debts into bad debts, rather than to the creation of the debts. The use of the word "debts" following "bad debts" in the latter part of the sub-section shows that the Legislature recognized that the things which, in their present state, it describes as "bad debts" existed as debts. The view, therefore, that the word "incurred," where it first occurs, qualifies "debts" and not "bad debts," apart from the fact that it accounts for the presence of the word "in" immediately after "incurred" as well as in the phrase "in the income year," leads to uniformity with respect to what the Legislature must have intended to import by the words "bad debts" and "incurred," whenever they occur in the sub-section. In my opinion the Supreme Court correctly interpreted the sub-section.

The appeal should be dismissed.

*Appeal dismissed with costs.*

Solicitors for the appellant, *Sly & Russell*.

Solicitor for the respondent, *J. E. Clark*, Crown Solicitor for New South Wales.

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