of its obtaining leave to appeal, the order for a new trial should be set aside and a verdict entered for the defendant.

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Pursuant to the order giving leave to appeal the order for a new trial discharged and in lieu thereof judgment of nonsuit entered. Appeal dismissed with costs.

Solicitors for the appellant, *Sly & Russell.*

Solicitors for the respondent, *Campbell, Campbell & Campbell.*

J. B.

[HIGH COURT OF AUSTRALIA.]

DAVIES COOP AND COMPANY PROPRIETARY LIMITED . . . . . } PLAINTIFF;

AND

THE COMMONWEALTH . . . . . DEFENDANT.

Bounty—Cotton yarn—Computation of bounty—Power to withhold bounty where "net profits" exceed ten per cent of capital employed in manufacture—Cotton Industries Bounty Act 1930-1932 (*No.* 13 *of* 1930—*No.* 17 *of* 1932), *sec.* 13.

In ascertaining, for the purposes of sec. 13 of the *Cotton Industries Bounty Act* 1930-1932, whether the "net profits" of any person, firm or company claiming bounty under the Act exceed ten per cent of the capital employed in the manufacture of cotton yarn the amount payable as Federal and State income tax in respect of the profits of manufacture cannot be deducted from the profits.

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MELBOURNE, *Nov.* 21 *Dec.* 12.

Latham C.J., Rich, Starke, Dixon and McTiernan JJ.

CASE STATED.

In an action in the High Court by Davies Coop & Co. Pty. Ltd. against the Commonwealth of Australia for a declaration that in the computation of its net profits for the purposes of the

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Cotton Industries Bounty Act 1930-1932 in respect of its business as a manufacturer of cotton yarn for the year ending 30th June 1932 there should be deducted as outgoings of such business all sums payable by it by way of income tax, both Federal and State, in respect of its income for such year from such business, the parties agreed in stating for the opinion of the Full Court a case which was substantially as follows :—

1. The plaintiff is a company duly incorporated in Victoria under the *Companies Act* 1928.

2. The plaintiff has continuously since the month of January 1931 down to the commencement of this action carried on in Melbourne the business of manufacturing or spinning cotton yarn and of manufacturing or knitting cotton and other textile goods.

3. The plaintiff claims from the defendant payment of bounty under the provisions of the *Cotton Industries Bounty Act* 1930-1932 of the Commonwealth of Australia in respect of the manufacture by it of cotton yarn during the year ending 30th June 1932. The defendant does not dispute that the plaintiff became entitled to payment of a certain amount as bounty as aforesaid and has in fact paid to the plaintiff the sum of £10,298 2s. 11d. as such bounty.

4. Sec. 13 of the said Act is as follows : "If the net profits of any person, firm or company claiming bounty under this Act on cotton yarn exceed, in any year, ten per centum of the capital employed in the manufacture of cotton yarn, the Minister may, after inquiry and report by the Tariff Board, withhold the whole of the bounty for that year, and, where the payment of bounty at the rates provided by this Act would cause the net profits to exceed ten per centum, the Minister may withhold so much of the bounty as would cause such excess."

5. The plaintiff prepares its ordinary balance-sheet and trading and profit and loss accounts for its business as a whole and does not keep separate accounts of the capital employed in the manufacture of cotton yarn or of the expenses and profits of such manufacture nor does it ordinarily prepare a separate balance-sheet or profit and loss account in respect of its business of manufacturing cotton yarn. A large part of the cotton yarn manufactured by it is used by it in manufacturing or knitting cotton goods. No part

of the shareholders' capital is separately invested in or allocated to the business of manufacturing cotton yarn and dividends are declared out of the general profits derived from the whole business of the company.

6. For the purpose of its claim for bounty the plaintiff has caused to be prepared a separate balance-sheet as at 30th June 1932 and a separate trading and profit and loss account for the year ended 30th June 1932, made up to show only the assets and liabilities of the cotton-yarn manufacturing section of the plaintiff's business and the receipts, outgoings, expenses and profits of that section. The balance-sheet was made up by bringing into it the assets employed in, and the liabilities incurred in respect of, the cotton-yarn manufacturing section of the business at their values as shown in the general balance-sheet of the plaintiff, estimated apportionments as between that section and the other sections of the plaintiff's business and other adjustments being made when necessary, the surplus of the assets over the liabilities so ascertained being shown under the heading "Davies Coop & Co. Pty. Ltd." The amounts debited to the separate trading and profit and loss account under some heads are the result of estimated apportionments of the total expenses of the whole business under those heads as between the cotton-yarn manufacturing section and the other sections of the plaintiff's business.

7. For the purpose only of this case both parties admit that the separate balance-sheet shows as nearly as possible the capital employed by the plaintiff in the manufacture of cotton yarn at 30th June 1932, for the purposes of sec. 13 aforesaid and that the items debited and credited respectively to the separate trading and profit and loss account, other than the items "Provision for income taxes payable in respect of income for the year, £2,054 19s. 1d.", "Net profit for year, £7,353 19s. 8d." and "Bounty payable, £12,440 17s. 9d.", are to be accepted as sufficiently correct for the purpose of ascertaining the net profits of the plaintiff from its business of manufacturing cotton yarn.

8. For the purpose only of this case both parties admit that the sum of £2,054 19s. 1d. debited to the said separate trading and profit and loss account as "provision for income taxes payable in

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respect of income for the year" is the estimated amount which would have been payable by the plaintiff as Federal and State income taxes in respect of its income for the year ended 30th June 1932 if its business of manufacturing cotton yarn had been its only business and only source of assessable income for that year and is the amount which should be charged to its business of manufacturing cotton yarn if the question raised in this special case be answered in the affirmative. In fact, the sum of £2,054 19s. 1d. was not the amount of income tax for which the plaintiff was assessed or which the plaintiff actually paid (except as part of a larger sum), but the plaintiff was assessed for and paid income tax for the financial year 1932-1933 in a larger sum than £2,054 19s. 1d., being the income tax assessed to be payable by it upon the whole of its taxable income for the year ended 30th June 1932 derived by it from its business as a whole and from all sources.

9. In balance-sheets and profit and loss accounts of the companies in Australia which carry on trading businesses the item "income tax paid" or "provision for income tax payable" as a matter of practice sometimes is debited to the profit and loss account before the item net profit is ascertained and is sometimes debited to a separate "appropriation of profits account" to which is credited the net profit as ascertained by the profit and loss account and any balance of undivided profit brought forward and to which are also debited any dividends paid out of such profits and any amounts transferred to reserve accounts. The item of income tax as a general practice represents either the amount or the estimated amount of income tax payable by the company on its taxable income for the period which the profit and loss account covers.

10. The plaintiff contends that, for the purposes of the *Cotton Industries Bounty Act* 1930-1932, in ascertaining the net profits of the plaintiff in respect of its business as a manufacturer of cotton yarn for the year ending 30th June 1932 the sum of £2,054 19s. 1d. should be deducted from the plaintiff's gross receipts or income from its said business before arriving at the net profits. The defendant contends that the sum should not be so deducted.

11. The question submitted for the opinion of the Court is:

Whether in the computation of the net profits of the plaintiff company for the purposes of the *Cotton Industries Bounty Act* 1930-1932 in respect of the company's business as a manufacturer of cotton yarn for the year ending 30th June 1932 the sum of £2,054 19s. 1d. should be deducted as an outgoing of such business before arriving at the said net profits.

12. It is agreed by the parties hereto that if the Court shall be of the opinion that the above question should be answered in the affirmative then judgment shall be entered for the plaintiff for the declaration sought with costs of this action to be taxed. If the Court shall be of the opinion that the above question should be answered in the negative then judgment shall be entered for the defendant with costs of this action to be taxed.

The amounts shown under the heading " Davies Coop & Co. Pty. Ltd." in the balance-sheet referred to in par. 6 of the case stated showed as a liability :—

Davies Coop & Co. Pty. Ltd.		
Balance at 1/7/1931	£39,835 8 6	
Add further advances made during year less cash received	42,925 6 5	
Net profit for year as per profit and loss account	7,353 14 7	
Balance at 30th June 1932 ..		£90,114 14 7

Wilbur Ham K.C. (with him *Dean*), for the plaintiff. The question raised by the special case is whether in determining whether a bounty should be paid under the *Cotton Industries Bounty Act* the amount payable for income tax on the profits of the industry should be taken into account before arriving at the net profits. The question depends on the meaning of the expression " net profits of any person " occurring in sec. 13 of the Act. Where a percentage is to be arrived at having regard to the net profits of a business that tax is always deducted before the net profits of the business are ascertained. Income tax is a debt of the company and the net profits cannot be

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ascertained before the debts are paid (*In re Condran*; *Condran* v. *Stark* (1); *Patent Castings Syndicate Ltd.* v. *Etherington* (2); *Vulcan Motor and Engineering Co.* v. *Hampson* (3); *Tilt* v. *Tilt's Cafés Ltd.* (4)). These cases decide that "net profits" means what is left after all charges or debts are paid. No company would be capable of distributing profits without taking into account its liability for income tax. Rates and land tax would be taken into account in ascertaining the net profits, which means that which is clear of all debts, liabilities and expenses.

[LATHAM C.J. referred to *Ashton Gas Co.* v. *Attorney-General* (5).]

Income tax in England is not a tax on the company, but is paid by the company for the taxpayer. This differs from a tax which is one of the company's debts and which must be taken into account in ascertaining the profits, such as excess profits tax (*Patent Castings Syndicate Ltd.* v. *Etherington* (6)).

[STARKE J. referred to *Inland Revenue Commissioners* v. *Blott* (7); *Jolly* v. *Federal Commissioner of Taxation* (8).].

In so far as *Inland Revenue Commissioners* v. *Blott* (9) decides that income tax is a debt of the company, it should have been deducted in *In re Condran*; *Condran* v. *Stark* (10) and *Patent Castings Syndicate Ltd.* v. *Etherington* (11), just as the excess profits tax was deductible in the later cases. In Victoria income tax is clearly a debt of the company and is deductible.

Tait, for the defendant. The English decisions do not extend beyond the particular subject matter with which they deal. Income tax is not deductible in ascertaining net profits. In this case the profits in question are only part of the total profits of the business, and the bounty is limited to the profits of that section of the business relating to spinning cotton yarn. Sec. 13 means net profits from the manufacture of cotton yarn. This is not a case of a company carrying on separate businesses. Income tax is payable on the

(1) (1917) 1 Ch. 639, at pp. 644, 645.
(2) (1919) 2 Ch. 254, at pp. 267-269, 274, 275.
(3) (1921) 3 K.B. 597, at pp. 602, 603, 605.
(4) (1930) V.L.R. 31.
(5) (1906) A.C. 10, at p. 12.
(6) (1919) 2 Ch., at pp. 268, 273.
(7) (1921) 2 A.C. 171; 8 Tax Cas. 101.
(8) (1934) 50 C.L.R. 131.
(9) (1921) 2 A.C. 171; 8 Tax Cas. 101.
(10) (1917) 1 Ch. 639.
(11) (1919) 2 Ch. 254.

profits of the business as a whole, not on the profits of part of the business. In this it differs from war-time profits tax. Income tax is paid on income, not on profits, and the two may be very different. Limiting words must be read into sec. 13. Profits from any source are not the net profits spoken of. Income tax also differs from war-time profits tax in that it arises after you find out what the profits are. It attends their distribution. It is necessary to look at the connection in which the word "profit" is used before its meaning can be ascertained. In this Act the word "net" is put in to make it clear. There are two groups of English cases: (1) The income tax cases such as *Attorney-General* v. *Ashton Gas Co.* (1) and *Johnston* v. *Chestergate Hat Manufacturing Co. Ltd.* (2); (2) the excess profits cases such as *Collins* v. *Sedgwick* (3) and *In re Condran*; *Condran* v. *Stark* (4). In *William Hollins & Co. Ltd.* v. *Paget* (5) it was held that excess profits duty should not be taken into consideration in determining what were referred to as "excess profits" in that case. So in *Thomas* v. *Hamlyn & Co.* (6) it was held that excess profits duty could not be deducted in computing "net profits." This view was also taken in *Vulcan Motor and Engineering Co.* v. *Hampson* (7), which overruled *William Hollins & Co. Ltd.* v. *Paget* (5). The only deductions which can be made are those which can be made whether there are profits or not, and charges which can only be imposed if there are profits cannot be considered. Income tax has nothing to do with the profits derived from manufacturing cotton yarn and is irrelevant to the amount to be ascertained under sec. 13 of the *Cotton Industries Bounty Act* (*Thomas* v. *Hamlyn & Co.* (8)). There is in fact no income tax payable in respect of this fund, because the income in question is derived from part only of the business and the plaintiff cannot establish that the sum in question is an outgoing at all. Interest on capital cannot be charged against profits (*Rishton* v. *Grissell* (9)). There could still be a profit though the excess of receipts over expenditure did not amount to sufficient to pay the interest due on borrowed capital.

(1) (1904) 2 Ch. 621; (1906) A.C. 10.
(2) (1915) 2 Ch. 338.
(3) (1917) 1 Ch. 179.
(4) (1917) 1 Ch., at p. 645.
(5) (1917) 1 Ch. 187.
(6) (1917) 1 K.B. 527, at p. 530.
(7) (1921) 3 K.B. 597.
(8) (1917) 1 K.B. 527.
(9) (1868) L.R. 5 Eq. 326.

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Wilbur Ham K.C., in reply. The provision for income tax of £2,054 should be taken as a real figure and as though it were payable in respect of this part of the business (*In re Condran*; *Condran* v. *Stark* (1)). Prima facie, "net profits" means profits after everything has been deducted in ascertaining them.

Cur. adv. vult.

Dec. 12.

The following written judgments were delivered :—

LATHAM C.J. Under the *Cotton Industries Bounty Act* 1930 bounties may be paid upon cotton yarn manufactured in Australia and delivered from a factory. Sec. 13 of the Act provides that if the net profits of a claimant for bounty exceed in any year ten per cent of the capital employed in the manufacture of cotton yarn the Minister may withhold the whole of the bounty or so much of the bounty as would cause the net profits to exceed ten per cent. The question for decision is whether, in ascertaining the profit of the plaintiff company for the year ending 30th June 1932, a deduction should be made in respect of State and Federal income tax.

The plaintiff company manufactures cotton yarn and uses a large portion of the yarn in the manufacture of cotton goods. The whole enterprise is conducted as a single business; no part of the shareholders' capital is separately invested in or is limited to the business of manufacturing cotton yarn, and dividends are declared out of the general profits derived from the whole business of the company. Income tax is paid on the taxable income derived from the whole business. For the purposes of this case a separate account has been prepared showing the amount of capital employed in manufacturing cotton yarn and the profits derived from that branch or part of the business. A calculation has been made of the amount of income tax which would have been payable for State and Federal income taxes if the business of manufacturing cotton had been the only source of income of the company. This amount is £2,054 19s. 1d. It is not an amount of income tax actually assessed. The company in fact paid, on its whole income, a larger amount. The question is whether this sum of £2,054 19s. 1d. should be deducted in ascertaining profits for the purpose of the Act.

(1) (1917) 1 Ch., at p. 645.

On the one hand it is said for the company that income tax is a debt or outgoing which the company must pay and that profits can be ascertained only after all the debts and outgoings have been paid. On the other hand it is said for the Commonwealth that income tax is an imposition upon profits, taking away a portion of the profits for the public revenue, and that therefore profits must be calculated before income tax can be assessed, so that what is paid in income tax is really a share of the profits. To this argument it is replied that while it may be proper not to deduct income tax for the purpose of ascertaining the income which is subject to income tax, it does not follow that, when profits must be ascertained for other purposes, income tax should not be deducted.

The practice of accountants does not assist the Court in determining the question. The practice varies in the manner set out in par. 9 of the special case in the following words :—" In balance-sheets and profit and loss accounts of the companies in Australia who carry on trading businesses the item ' income tax paid ' or ' provision for income tax payable ' as a matter of practice sometimes is debited to the profit and loss account before the item net profit is ascertained and is sometimes debited to a separate ' appropriation of profits account ' to which is credited the net profit as ascertained by the profit and loss account and any balance of undivided profit brought forward and to which is also debited any dividends paid out of such profits and any amounts transferred to reserve accounts. The said item of income tax as a general practice represents either the amount or the estimated amount of income tax payable by the company on its taxable income for the period which the profit and loss account covers."

Similar questions have arisen in England in cases where a company is limited to the distribution among shareholders of a fixed percentage of profits or where an employee is entitled under a contract to a percentage of profits. After some conflict of opinion, a distinction has been drawn between income tax and excess profits duty. It has been settled that, apart from special circumstances, income tax should not be deducted in such cases, and that excess profits duty should be deducted. This distinction has been based upon the view taken that, under the law relating to income tax in England, a

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company pays income tax not on its own behalf, but upon behalf of the shareholders, so that, in making such a payment, the company actually pays away part of the profits which are available to the shareholders, the shareholders obtaining the benefit of such payment under the provisions which enable them to obtain a rebate in the amount of their own income tax. Excess profits duty, on the other hand, has been held to be a debt due by the company, which earns the profits in carrying on a business, and not by the shareholders, who do not carry on the business and do not earn the profits. Thus excess profits duty should be deducted before profits are ascertained or at least before profits of the company available for distribution among shareholders are ascertained. The history of the decisions which have brought about this result can be seen in *Patent Castings Syndicate Ltd.* v. *Etherington* (1) and *Vulcan Motor and Engineering Co.* v. *Hampson* (2). If the matter should come up for further consideration in England it may be necessary to reconsider the basis of this distinction in the light of the clear explanation by Lord *Cave* in *Inland Revenue Commissioners* v. *Blott* (3) that " plainly, a company paying income tax on its profits does not pay it as agent for its shareholders." (See *Jolly* v. *Federal Commissioner of Taxation* (4)—the cases cited by *Dixon* J. at pp. 145, 146.)

In Victoria the Full Court decided in *Tilt* v. *Tilt's Cafés Ltd.* (5) that in estimating the net profits of a company for the purpose of a manager's service agreement Federal and State income tax should be deducted. It was pointed out that Federal and Victorian income taxes are taxes upon the company itself, so that the principle of *Etherington's Case* (1) was held to be applicable.

It should be observed that all the authorities to which reference has been made relate either to a special act dealing with a company or to an agreement made with a particular company. In most of them it was held that the question which arose was a question as to the amount of profits available for distribution between shareholders, or between shareholders and a servant of the company. In *Tilt's Case* (5) it was said that the position would be different in the case of an individual. " With regard to income tax it is clear

(1) (1919) 2 Ch. 254.
(2) (1921) 3 K.B. 597.
(3) (1921) 2 A.C., at p. 201.
(4) (1934) 50 C.L.R. 131.
(5) (1930) V.L.R. 31.

that if this contract had been made with an individual as employer, instead of with a limited company, the income tax payable by the employer would not enter into the account of net profits" (1).

It may also be mentioned that all the agreements dealt with in the cases relating to excess profits duty were agreements made before that duty was imposed. In *Vulcan Motor and Engineering Co.* v. *Hampson* (2) reference is made to the argument that the company must earn profits before any excess profits duty becomes payable and that therefore the "profit earned by the company" must include the amount which is payable as excess profits duty. *Bankes* L.J. says: "That is very true, and I think that it is an argument which might possibly prevail in reference to language used by parties in an agreement made after the coming into operation" of the Act imposing the duty (3). Thus these authorities cannot be relied upon as necessarily applicable to legislation referring to profits where that legislation has been passed years after the legislation which has imposed a tax upon profits.

In the matter now before the Court it is necessary to consider, not a statutory provision applying to or an agreement made with a particular company, but a statutory provision applying equally to persons, firms and companies. The terms of sec. 13 of the Act are as follows: "If the net profits of any person, firm or company claiming bounty under this Act on cotton yarn exceed, in any year, ten per centum of the capital employed in the manufacture of cotton yarn, the Minister may, after inquiry and report by the Tariff Board, withhold the whole of the bounty for that year, and, where the payment of bounty at the rates provided by this Act would cause the net profits to exceed ten per centum, the Minister may withhold so much of the bounty as would cause such excess." Presumably this section applies in the same sense to persons, firms and companies. In the case of a person or a firm it would be difficult to contend that the income tax of that person or of the partners constituting the firm should be deducted in arriving at profits for the purpose of the Act.

It is common ground that the section must be read as applying only to the profits derived from the manufacture of cotton yarn

(1) (1930) V.L.R., at p. 33. (2) (1921) 3 K.B., at p. 602.
(3) (1921) 3 K.B., at p. 602.

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and not to all the profits derived from all sources by a claimant person, firm, or company. In this case, and doubtless in other cases, the manufacture of cotton yarn is only a branch of the business carried on by the claimant. Thus it is necessary to prepare a separate account showing the capital employed in the manufacture of cotton yarn and the profits derived therefrom.

It is quite possible that there should be a profit exceeding ten per cent on such capital and yet that there should be a loss on the business as a whole. In such a case no income tax would in fact ever be payable by the company in respect of income derived during that year. But it follows from the propositions submitted for the plaintiff company that a calculation should be made of the amount of income tax which would have been payable if the manufacture of cotton yarn were the sole business of the company, that this amount should be deducted in ascertaining profits, and that bounty should be paid on the basis of the profits so calculated. The result would be that the company would receive by way of bounty a payment measured by an amount of income tax which it had not paid and which it could never be required to pay. Such a result makes it proper to inquire whether there is any other construction of the section which can be properly adopted.

If it is sought to avoid this result by rejecting the idea of a notional payment of income tax in respect of the profits of part of a business or of different businesses, an alternative would be found in apportioning between the various sources of income the amount of income tax actually paid. The application of this principle would, however, lead to quite divergent results in the case of different claimants for bounty even though the financial results of the manufacture of cotton yarn were absolutely identical. If one such claimant had other profitable businesses, so that he paid a large amount of income tax, he would receive more by way of bounty than another claimant who had other unprofitable businesses, so that he paid little or no income tax. These suggested difficulties of apportionment of tax are aggravated by the existence of graduated scales of taxation at a higher rate on a larger income and at a lower rate on a smaller income.

In my opinion the subject of income tax is irrelevant to this section of the Act. The section contemplates the ascertainment of the profits of a person, firm or company derived from a particular business. Income tax legislation looks at the income of a taxpayer —that income being the result of a balance in which allowance is made for profits and losses of all the enterprises carried on by the taxpayer, and, in the case of an individual, for the number of his children, his place of residence, possibly for his medical expenses and many other matters. In my opinion, in the case of a section dealing indifferently with persons, firms and companies in relation to their profits from a particular form of business, the method of approach is quite different from that of legislation which imposes a tax, not upon the profits of each separate business, but upon the taxable income of a taxpayer as "taxable income" is artificially defined for the purposes of income tax legislation. The section looks to the profits of a business—not to the total income of a person, firm or company. In my opinion the only interpretation which can be applied in all cases is that which regards the section as dealing with the profits at the point of commercial attainment before Governments take any share of them by way of income tax.

This interpretation is, in my opinion, supported by the last part of the section, which provides that "where the payment of bounty at the rates provided by this Act would cause the net profits to exceed ten per centum, the Minister may withhold so much of the bounty as would cause such excess." This provision shows that bounty payments are to be included in profits for the purposes of the section. But bounty payments must be ascertained before this provision can be applied. If income tax is not deducted before the ascertainment of profits, no difficulty arises in the application of this provision. If, however, income tax is to be deducted on the basis urged in this case, the difficulty arises that bounty cannot be calculated until income tax has been calculated and deducted from the profits, though income tax cannot be calculated until the amount of bounty (which is part of the profits) is known. The other interpretation has at least the merit of not raising this problem.

For these reasons I am of opinion that the question asked should be answered in the negative by saying that the sum of £2,054 19s. 1d.

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should not be deducted in the computation of the net profits of the company for the purposes of the Act.

RICH J. Special case stated in an action.

Among other manufactures the plaintiff manufactured cotton yarn. For the purpose of this case the parties admit that the sum of £2,054 19s. 1d. is the estimated amount which would have been payable by the plaintiff as Federal and State income taxes in respect of its income for the year ending 30th June 1932 if its business of manufacturing cotton yarn had been its only business and only source of assessable income for that year and is the amount which should be charged to such business if, in the computation of the net profits of the plaintiff for the purposes of the *Cotton Industries Bounty Act* 1930-1932 in respect of that business for the year ending 30th June 1932, that sum should be deducted as an outgoing of the business before arriving at the net profits. The answer to the question depends upon the meaning of the expression "net profits" as it occurs in sec. 13 of the Act. There are numberless cases on the meaning of the expression in other statutes and instruments but they afford no assistance to its construction in its present context. The section in question reads: "If the net profits of any person, firm or company claiming bounty under this Act on cotton yarn exceed, in any year, ten per centum of the capital employed in the manufacture of cotton yarn, the Minister may, after inquiry and report by the Tariff Board, withhold the whole of the bounty for that year, and, where the payment of bounty at the rates provided by this Act would cause the net profits to exceed ten per centum, the Minister may withhold so much of the bounty as would cause such excess." The Act in which the section is found is designed to encourage the employment of capital in the manufacture of cotton yarn. For this purpose a bounty is provided, limited in amount and restricted to the capital actually employed in the manufacture of cotton yarn. Income tax, unlike, for example, the war-time profits tax, is not imposed on a business. It is not an element in the ascertainment of net profits. It is a tax which becomes attracted by a net profit when that net profit is accompanied by those other concomitants

which make it income within the meaning of the *Income Tax Act*. In my opinion there is nothing in the section of the *Cotton Industries Bounty Act* 1930-1932 which justifies the deduction claimed.

The question in the case stated should be answered: No.

STARKE J. The question whether the provisions of the *Cotton Industries Bounty Act* 1930-1932 confer any legal rights or attract the jurisdiction of the Courts of law was not argued, and is not, I understand, the subject of decision by this Court. Subject to this observation, I have nothing to add to the judgment of the Chief Justice, which I have had an opportunity of reading and considering and with which I agree.

DIXON J. The question which, by this case stated, the parties have submitted for the decision of the Court arises under sec. 13 of the *Cotton Industries Bounty Act* 1930-1932. The purpose of that provision is to authorize a limitation upon the total amount of bounty upon the production of cotton yarn paid to a manufacturer during a year. After his profits for the year reach ten per cent upon the capital employed in the manufacture of yarn, no more bounty need be paid. The last year in which bounty upon cotton yarn was payable under the Act was that ending 30th June 1932. During that year the plaintiff company received payments of the bounty, but its profits from the section of its business devoted to the manufacture of cotton yarn were sufficient to raise a question whether the limitation was applicable. It appears, however, that its profits earned by the manufacture of cotton yarn would not reach ten per cent of the capital employed therein, if in the computation of those profits a deduction was made of the estimated amount of State and Federal income tax payable in respect of taxable income derived in the year by the plaintiff company from that manufacture. The question is whether such a deduction should be made.

The income taxes which the plaintiff company seeks to bring into account are those arising out of the earning of income for the year the profits of which are under computation. The actual assessment and payment of these taxes could not, of course, take place until the close of the year. But, except in so far as any uncertainty

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might exist as to the rates of tax that might be imposed, all the facts determining the amount of the taxes had occurred by the end of the year of account. Thus the taxes did not in contemplation of law differ from any other liabilities of the plaintiff company which accrued during the year but at the end of the year still awaited final ascertainment and payment. (See *United States* v. *Anderson* (1).)

The undertaking of the plaintiff company extended to other manufactures besides that of cotton yarn. The estimate of the taxes is confined to income derived from that manufacture. This does not mean that the estimate is a notional amount of tax never actually payable. It is that part of the taxes payable by the company to which it would have been liable if it had no other source of income. For its other operations increased the amount of tax, so that the estimated amount payable on the income from the manufacture of cotton yarn is contained in the tax actually payable by the plaintiff company. Thus the question raised may be stated in an abstract form. In calculating the profits referred to in sec. 13, should a deduction be made on account of so much of the State and Federal income tax payable by the manufacturer as is levied upon that part of the taxable income which is derived from the manufacture of cotton yarn ? This question depends upon the terms of the section, its subject matter and its purpose. Its text is as follows : " If the net profits of any person, firm or company claiming bounty under this Act on cotton yarn exceed, in any year, ten per centum of the capital employed in the manufacture of cotton yarn, the Minister may, after inquiry and report by the Tariff Board, withhold the whole of the bounty for that year, and, where the payment of bounty at the rates provided by this Act would cause the net profits to exceed ten per centum, the Minister may withhold so much of the bounty as would cause such excess." It is to be noticed that, although the expression " employed in the manufacture of cotton yarn " qualifies " capital," there is no corresponding qualification of the expression " net profits." But the net profits of the person, firm, or company, referred to cannot mean his or its net profits from all sources, or net profits on a balance of all accounts. It must be understood as confined to the net profits arising from the manufacture of cotton

(1) (1926) 269 U.S. 422, at p. 441 ; 70 Law. Ed. 347, at p. 351.

yarn. But, even if the meaning were expanded into such a description as " the net profits of a person, firm or company derived in any year from the manufacture of yarn," an ambiguity would remain. Does it refer to the profits returned from that manufacture considered as if the person, firm, or company, had no other source of profit or loss ? Or does it mean so much of the final net profit obtained by him or it as on a proper apportionment is referable to the operation of manufacturing cotton yarn ?

The choice between these two meanings has an important bearing upon the question at issue. For income tax is a liability imposed, not on a business, but on a person or company. It is imposed, moreover, in respect of his or its taxable income, a single sum arrived at by taking the allowable deductions on all accounts from the total assessable income derived from all taxable sources. An interpretation which makes the section refer to the net profits returned from the business tends against the prior deduction of income tax in assessing them. An interpretation by which it means that part of the actual net gain on all accounts of the person, firm, or company, which, on apportionment, is referable to the yarn-manufacturing operations, tends rather the other way. In my opinion this preliminary question should be decided in favour of the first meaning. The evident purpose of the provision is to stop the bounty when the return on capital from the manufacture of yarn reaches ten per cent. This purpose is concerned with what arises from the cotton-yarn enterprise. There is no apparent reason why the actual net result to the manufacturer on a balance of gains and losses from all his enterprises should influence the payment of bounty on cotton yarn production.

I commence, therefore, by understanding the expression " the net profits of any person, firm or company claiming bounty on cotton yarn " to mean the net profits which arise in the hands of any person, firm or company from his or its operations in manufacturing cotton yarn on which bounty is claimed. In dealing with the question whether this implies net profits after the deduction of income tax, or before the deduction of income tax, I think little assistance is to be obtained from the English decisions upon the deduction of income tax and of excess profits duty in computing

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net profits for the purpose of ascertaining what amount is payable to an employee remunerated by a percentage thereon. Much help might be derived from a decision that income tax or super-tax was, or was not, deductible in ascertaining for such a purpose the profits of a business conducted by a person or firm, as opposed to a corporation. But there is no such case. *Johnston* v. *Chestergate Hat Manufacturing Co. Ltd.* (1) was the case of a company, and the decision was affected by the view that a payment of income tax by a company operates in relief of the shareholders (2). That decision and *Attorney-General* v. *Ashton Gas Co.* (3) have been explained as depending upon the view that "when the company in fact pays income tax it pays income tax, and is to be treated as paying income tax, on behalf of and on the part of the shareholder, thus relieving the shareholder from the liability to the income tax to that extent" (per *Peterson* J., *Collins* v. *Sedgwick* (4); *Patent Castings Syndicate Ltd.* v. *Etherington* (5)). No doubt this is the explanation of the decisions, although there has been some departure in later cases from the view of the relation between the company's and the shareholder's tax which they adopt. But, as to this, see *Jolly's Case* (6) and *Neumann* v. *Inland Revenue Commissioners* (7). On the other hand, the cases establishing that excess profit duty is deductible are not in point because that was a tax on the profits of a business considered independently, not upon the income gains or profits of a person.

With reference to the deduction of such items as income tax and interest on capital, the method of computing "net profits" must depend, not on any fixed meaning of those words themselves, but upon a consideration of the purpose of ascertaining profits and of the description of the profits according to the source whence they arise and according to the point prescribed for their ascertainment during their flow from that source towards ultimate enjoyment or consumption.

The purpose here is plain enough. As I have already said, in effect, the object is to obtain a standard for the remuneration of

(1) (1915) 2 Ch. 338.
(2) (1915) 2 Ch., at p. 344.
(3) (1904) 2 Ch. 621; (1906) A.C. 10.
(4) (1917) 1 Ch., at p. 185.
(5) (1919) 2 Ch., at p. 268.
(6) (1934) 50 C.L.R., at pp. 140-150.
(7) (1934) A.C. 215, at pp. 235-238.

capital invested in a manufacture under the encouragement of a bounty which may secure a return up to that standard. The source is a form of production which is not necessarily the only business, nor, indeed, an important section of the business carried on by the person, firm or company. The point at which the profit is to be measured is when it has arisen in the hands of the proprietor, that is when it has become a profit detachable from the circulating capital of that part of his business or activities. It is a point before it is mixed and confused with the results of any other activity of the proprietor, in order to ascertain what is the balance of his ultimate profit or loss for the year, that is, at a point before the net profit is ascertained which may be enjoyed or consumed.

These considerations all appear to me to tell against the prior deduction of income tax. For, in the first place, in computing a fair rate for the reward of capital, the deduction of income tax would be illogical. The purpose is by means of a subvention towards profit to assure capital of an adequate return, but to limit the rate of remuneration arising from the subvention to what appears reasonable. But into whatever income-producing investment the capital was transformed it must have borne income tax. Why, when a percentage is named as the limit of its remuneration, should that remuneration be free of income tax ?

In the second place, " income tax is a personal expense and not an expense of the concern " (per *Duke* L.J., *Patent Castings Syndicate Ltd.* v. *Etherington* (1)). This statement means that it falls, not upon the profits of a business as such, but upon the person or company as a consequence of his or its net gain computed in a special and somewhat artificial manner, and his net gain in all accounts, not upon the profits of a particular business. Accordingly, the fact that the profits of a business, or section of business, are to be calculated and that the profits are calculated before the flow into the reservoir of distributable or consumable clear profit, negatives the deduction of a tax which depends upon such elements.

The profits ascertainable under sec. 13 are not yet " the fund which in any year is capable of being applied to the payment of a

(1) (1919) 2 Ch., at p. 262.

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dividend or capable of being divided between partners as the fruit of the year's operations" (per *Peterson* J., *In re Condran* (1)).

In my opinion the question in the case stated should be answered against the plaintiff.

McTIERNAN J. The solution of the question whether income tax should be deducted before net profits can be ascertained is governed by the language and necessary intendment of the statute or agreement for the purposes of which net profits are to be calculated. Income tax is not a constant deduction in every such calculation. There is no definition of net profits in the *Cotton Industries Bounty Act* 1930-1932. Nor is there any express indication in sec. 13 of the Act whether income tax should be deducted or not before it can be said that the profits of the manufacturer have reached the limit after which the Minister may withhold the payment of bounty. Sec. 13 was enacted to limit the amount of bounty payable to manufacturers under the Act. It is, I think, more consistent with this manifest purpose and in the absence of any expression of a contrary intention necessarily to be inferred, that it was not the Legislature's intention that income tax should be deducted before net profits were ascertained.

The question should be answered in favour of the Commonwealth.

Question submitted in special case answered in negative. Judgment in the action for the defendant with costs.

Solicitors for the plaintiff, *Bullen & Burt.*

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

H. D. W.

(1) (1917) 1 Ch., at p. 645.