[HIGH COURT OF AUSTRALIA.]

NEW ZEALAND FLAX INVESTMENTS LIMITED . . . . . APPELLANT;

AND

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

H. C. OF A. 1938.

SYDNEY, *Aug.* 26, 29; *Nov.* 22.

Rich, Starke, Dixon and McTiernan JJ.

Income Tax (Cth.)—Assessment—Assessable income—Deduction—"Losses and outgoings actually incurred"—Purchase and cultivation of land—Production and marketing of flax—Bonds—Payment by instalments—Deferred commission—Obligations to bondholders—Interest—Reserves for necessary future work—Income Tax Assessment Act 1922-1934 (*No.* 37 *of* 1922—*No.* 18 *of* 1934), *secs.* 23 (1) (*a*), 25.

The taxpayer company covenanted with the holders of bonds issued by the company that it would within five years complete the purchase of certain land and that it would cultivate the land for the purpose of growing thereon flax, and would erect a mill and necessary plant for the efficient milling, gathering and selling of the flax. The company was to provide sufficient working capital for the cutting, milling and marketing of the flax, whereupon the company's obligations to the bondholders ceased subject to obligations to manage and administer the property for which the company was to be entitled to 5 per cent of the gross return from the sales. Subscribers had the option of paying for their bonds either cash down on application or by instalments spread over two and a half years. For four years from the date of issue holders of fully subscribed bonds were entitled to interest at the rate of 7 per cent per annum. Commission for the sale of bonds was payable by the company to salesmen as and when the payment therefor, in lump sum or instalments, was received by the company. The company made up its accounts and returns by taking into the receipts side the entire sum representing the bonds sold, whether paid or not, and, on the other side of the account, making provision for the expenditure which ought to be made by the company at a subsequent time, if it performed its obligations, i.e., for purchase of the land, the clearing and cultivation of the land, the erection and running of the mill, and the payments of interest and commission. In making an assessment upon the company the Federal Commissioner of Taxation left standing the revenue side of the account but set aside the provision for future outlay.

H. C. OF A. 1938. NEW ZEALAND FLAX INVESTMENTS LTD. v. FEDERAL COMMISSIONER OF TAXATION.

Held that the assessment should be set aside and remitted to the commissioner.

Per *Rich*, *Dixon* and *McTiernan* J.J.: In a reassessment the commissioner should include only bond moneys received in the accounting period and should allow whatever part, if any, of the deductions claimed for future interest and deferred commission appeared referable to the accounting period.

Quære whether money received from the sale of bonds was income of the company for the purpose of the *Income Tax Assessment Act* 1922-1934 or was a receipt of a capital nature.

REFERENCE under sec. 18 of the *Judiciary Act* 1903-1937.

The business of New Zealand Flax Investments Ltd., a company incorporated in New South Wales, included the sale of bonds, for which it received payment either in cash or by instalments from the purchaser of the bonds, and which subjected it to certain future obligations towards the bondholders involving the expenditure of money and the application of knowledge, skill and services.

The company during the periods relevant to the appeal issued bonds of two series, called the first and second series respectively. Such bonds of the first series as were sold were issued under the terms and conditions of a trust deed of 28th March 1929. This deed recited, *inter alia*, that the company had entered into binding contracts for the purchase of 731 acres of freehold land situated in New Zealand and that it proposed to complete the purchase of the land and to establish, plant, cultivate and mill flax thereon; that for the purpose of providing funds therefor and also for the marketing of the flax the company was about to issue and sell to the public a series of bonds to the nominal value of £30 for each one-half acre of land; and that the Public Trustee had consented to act as custodian of the trust funds. By the deed the company covenanted to "use its best endeavours to procure the sale of flax investment bonds which shall have a face value of thirty pounds each for each half-acre of the said 731 acres and shall be issued and deemed to include the following terms and conditions, namely:— . . (*d*) The form of application for the said bonds as hereinbefore mentioned shall provide for the payment by the applicants therefor of the full face value or of the various instalments as the case may be at the times mentioned in the application and if any applicant falls into arrears in the payment of any instalments and fails within two months after the company has posted to him at his registered address a notifi-

cation specifying the amount of such arrears and requiring the payment thereof the company thereupon shall have a discretion to cancel the application and forfeit all moneys paid thereunder by the applicant and in such event the moneys so paid and the bond which was to have been issued thereon shall be the sole property of the company and shall be available for resale upon the same terms and conditions as herein appear and no claim shall be made against the company by the applicant in respect of such forfeiture or cancellation but this discretion shall not limit or otherwise affect the right of the company to sue for and recover any instalments due by applicants for bonds in terms of their applications therefor; . . . (*e*) When the face value of the bond is fully paid as aforesaid the company shall pay to the bondholder interest thereon at the rate of £7 per cent per annum for the period between the date of payment in full and the expiration of four years after the date of issue of the first series of bonds."

By the deed the company undertook obligations to bondholders, which included obligations with regard to, *inter alia*, (1) the acquisition of land and the vesting thereof in a trustee for bondholders; (2) the clearing and burning of the land in preparation for the planting of flax; (3) the draining of the land; (4) the ploughing and cultivating of the land; (5) the planting of the land with flax; (6) the maintaining of the area in proper condition; (7) the cutting, transporting, milling and selling of flax from the land; (8) the provision of working capital; (9) the payment of rents, rates and taxes in respect of such land during the period of development. Provision was made by the deed whereby as soon as the company had received nine-tenths of the face value of every bond it was to pay to the Public Trustee the remaining one-tenth as security for the erection of a mill by the company, such money to be repaid to the company on the erection of a satisfactory mill; the mill when erected was to be the property of the company but was to be transferred to the trustee of the deed as a security for the performance of the obligation of the company to furnish a mill; alternatively to transferring the mill, the company might satisfy the trustee that the company had made adequate arrangements for milling near the land. Further provisions of the trust deed are summarized in the judgment of *Starke* J. hereunder.

H. C. OF A. 1938. NEW ZEALAND FLAX INVESTMENTS LTD. v. FEDERAL COMMISSIONER OF TAXATION.

Such bonds of the second series as were sold were issued under the terms and conditions of a trust deed of 9th July 1930. The trust deed recited that the company had entered into binding contracts for the purchase by it of additional freehold land situated in New Zealand, and containing approximately 289 acres, and contained other recitals similar to those contained in the trust deed under which the bonds of the first series were issues, except that the face value of each bond issued in connection with the 289 acres of land was to be of £20 and was in respect of one quarter of an acre of land. The provisions of this deed were to the same effect as the provisions of the trust deed under which the first series of bonds was issued.

The two deeds of trust were varied by deeds of variation of trust of 17th August 1933, which provided that the moneys held by the Public Trustee as security for the performance by the company of its obligations to provide a mill should be made available, subject to the approval of the trustees under the deeds, for the purpose of establishing a mill which would not pass to bondholders.

As regards the assessment of the company for Federal income tax for the period 8th October 1928 to 30th June 1929 the position was as follows :—(i) The company duly forwarded a return which disclosed a net profit for the said period of £154 16s. 3d.; (ii) the company's trading account for the said period showed a gross profit of £1,599 18s. 11d., arrived at as follows :—

141 bonds sold (1st series £30 each)	..	£4,230	0	0	
Premiums on bonds :—					
15 " B " class at £1 10s.					
49 " C " class at £2 10s.	.. ..	145	0	0	
Freehold—731 acres less 70½ acres represented by 141 bonds	.. ..	4,041	19	8	
					£8,416 19 8
Less : Land purchases (731 acres)	..	4,473	8	3	
Commission paid on bond sales	..	581	1	0	
Reserves, etc.	.. .. ..	1,762	11	6	
					6,817 0 9
					£1,599 18 11

(iii) the full amount including premiums received or receivable in respect of the 141 bonds sold during the said period was brought into the said account. This amount included the sum of £2,134 10s. (of which £145 represented premiums outstanding) which sum was not actually received during the said period; (iv) in the trading account

the sum of £1,762 11s. 6d. was debited though none of that sum was expended in the period and the sum was in the account carried to certain reserve accounts as follows :—

Deferred commission				£264	19 0
Obligations to bondholders—					
Mill account	£423	0	0		
Interest	528	15	0		
Clearing and burning	61	8	9		
Draining	61	8	9		
Ploughing and cultivating	149	16	3		
Planting	273	3	9		
				1,497	12 6
				£1,762	11 6

As regards the assessment of the company for Federal income tax for the period 1st July 1929 to 30th September 1930, the position was as follows :—(i) The company duly forwarded a return which disclosed a net profit for the period of £3,598 4s. ; (ii) the company's trading account for the period made up in a manner similar to that of the previous period showed a gross profit of £19,834 ; (iii) the full amount including premiums received or receivable in respect of 1,452 bonds sold during the period was brought into the account. This amount included the sum of £13,640 10s. of which £1,026 represented premiums outstanding which were not actually received during the period ; (iv) in the trading account the sum of £17,899 6s. 6d. was debited, though none of the sums was expended in the period and the sum was in the account carried to certain reserve accounts as follows :—

Deferred commission				£684	19 0
Obligations to bondholders—					
Mill account	£4,163	0	0		
Interest	5,203	15	0		
Clearing and burning	593	0	7		
Draining	593	0	8		
Ploughing and cultivating	1,440	4	4		
Maintenance and general	2,595	1	3		
Planting	2,626	5	8		
				17,214	7 6
				£17,899	6 6

H. C. OF A. 1938. NEW ZEALAND FLAX INVESTMENTS LTD. v. FEDERAL COMMISSIONER OF TAXATION.

The amount set aside as deferred commission in each period was the amount of the balance of commission due to salesmen in respect of bonds sold by them in the respective periods which bonds were not wholly paid for by the purchasers in the periods. The company was liable to pay the balance of commission when sufficient instalments from the purchasers of the bonds had been received to pay the balance and not before ; the amounts set aside for mill account were to meet the obligations of the company to the bondholders under the two trust deeds in respect of the furnishing of a mill. Nothing was done or commenced to be done nor was any expenditure made or liability incurred in respect thereof during either period; the amount set aside for interest was to meet the obligations of the company under the trust deeds to bondholders. None of the bonds in respect of which the amounts were set aside in the two periods was paid in full in the respective periods ; the amounts set aside for clearing and burning, draining, ploughing and cultivating, maintenance and general and planting were to meet the obligations of the company to bondholders under the trust deeds. Nothing was done or commenced to be done, nor was any expenditure made or liability incurred in respect thereof in either of the two periods, except that in the second period the sum of £3,213 13s. 6d., part of the sum of £4,660 17s. 3d. referred to hereunder, was paid. So far as concerned the amounts set aside to meet obligations to bondholders the company made estimates based on experience and the opinion of experts of the amount required to carry out certain of the obligations of the company under the bonds issued during the period and the amounts set aside were the amounts so estimated. The estimates and amounts set aside were reasonable and proper estimates and amounts.

No part of the sum of £1,762 11s. 6d., debited in the trading account of the first period, was expended in the period. Of the sum of £17,899 6s. 6d., debited in the trading account of the second period, only £4,660 17s. 3d. was expended in the period. The said sum of £4,660 17s. 3d. was expended as follows :—

Mill account			Nil.
Interest to bondholders—			
First series of bonds			£1,447 3 9
Clearing and burning—			
First series			475 8 9
Draining—			
First series	£432 19 4		
Second series	21 18 8		
			454 18 0
Ploughing and cultivating—			
First series			470 15 6
Planting—			
First series			1,798 0 3
Maintenance and general			14 11 0
			£4,660 17 3

The commissioner assessed the company on a taxable income for the period 8th October 1928 to 30th June 1929 of £1,271, arrived at as follows :—

Profit disclosed in return			£154 16 3
Add reserve for—			
(*a*) deferred commission	£264 10 0		
(*b*) obligations to bondholders	1,497 12 6		
		1,762 11 6	
		£1,917 7 9	
Less expenses charged to establishment account		646 0 0	
Taxable income as assessed			£1,271 7 9

Notice of objection to the assessment was duly lodged by the company. The grounds of objection were (i) that the assessment was excessive, and contrary to law ; and (ii) that in arriving at the taxable income, the amount returned, namely, £155, was the only amount that the commissioner should have assessed, and that any deductions which had been disallowed, of which the taxpayer alleged it had not had notice, were allowable deductions under the Act, or, alternatively, any addition to the income returned, was not assessable income for the period under review.

H. C. OF A. 1938. NEW ZEALAND FLAX INVESTMENTS LTD. v. FEDERAL COMMISSIONER OF TAXATION.

The commissioner first assessed the company on a taxable income for the period 1st July 1929 to 30th September 1930 of £3,598. He subsequently assessed the company on a taxable income for the period of £15,552, arrived at as follows :—

Net income previously assessed			£3,598 0 0
Add—Legal expenses disallowed ..	£86 0 0		
Loss on investment	£100 0 0		
Reserves for—			
Obligations to bondholders ..	17,214 0 0		
Deferred commission	685 0 0		
		18,085 0 0	
			£21,683 0 0
Deduct—Expenses charged to establishment account	1,470 0 0		
Expenses charged to reserved accounts	4,661 0 0		
		6,131 0 0	
Taxable income ..			£15,552 0 0

Notice of objection to the assessment was duly lodged by the company. The grounds of objection were as follows :—(i) that the amended assessment was excessive and contrary to law ; (ii) that in arriving at the taxable income of the company for the year in question, the sum of £17,214, being amount set aside to meet the expenditure for clearing, burning, draining, ploughing, cultivating and planting, which work the company was bound to do by virtue of a deed of trust, was a proper deduction from the assessable income ; alternatively, that the amount in question was not assessable income for the period under review ; (iii) that in arriving at the taxable income for the period in question, the commissioner should have allowed the sum of £685, being amount set aside in respect of deferred commissions, which sum represented the actual amount remaining to be paid in respect of bonds sold on the instalment plan, and which commissions were paid as the instalments were received from month to month, and the amount was therefore a proper deduction from the assessable income. Alternatively, the

amount was not assessable income for the period; (iv) that the taxable income should not exceed £2,228, which amount was arrived at as under:—

Income as per audited profit and loss account ..		£3,598
Add: Loss on investments		£100
		£3,698
Deduct: Expenses incurred in the period ended 30th September 1930 and charged to establishment account		£1,470
Net taxable income		£2,228

The objections to the assessments for both periods were duly considered by the commissioner and were disallowed by him, whereupon the company, being dissatisfied with the decisions of the commissioner, requested that his decisions be referred to the board of review.

The appeal in respect of both assessments aforesaid came on for hearing before the board of review and was heard on 26th and 27th March 1935 and 7th March 1936.

On 15th June 1936 the board of review gave its decision. The board decided as follows:—"Period ended 30th June 1929:—(i) Further deduction to be allowed for interest accrued to the 30th June 1929; (ii) income assessed to be reduced by the sum of £969 18s. Period ended 30th September 1930:—(i) The amount of £1,447 3s. 9d. allowed as a deduction for interest to be amended by substitution of the amount of interest accrued from the 1st July 1929 to 30th September 1930; (ii) the amount disallowed as deduction for 'deferred commission' to be reduced from £684 19s. to £455 14s. 6d.; (iii) income as assessed to be reduced by the sum of £4,583 16s. 6d. Assessment of 2nd November 1933 to be amended accordingly. Amended assessment of 2nd November 1933 to be further amended accordingly."

The taxpayer appealed to the High Court against the decision of the board of review, and, upon the appeals coming on to be heard before *Rich* J., his Honour, under sec. 18 of the *Judiciary Act* 1903-1937, directed that the matters be argued before the Full Court upon agreed facts (stated substantially as appears above) from which

H. C. OF A. 1938. NEW ZEALAND FLAX INVESTMENTS LTD. v. FEDERAL COMMISSIONER OF TAXATION.

the court was to be at liberty to draw inferences. His Honour allowed the following questions of law appended to the statement of facts to remain as serving to indicate the topics to be argued:—

(1) Whether the taxable income of the appellant for the period 8th October 1928 to 30th June 1929 amounted to £155 or some other, and if so, what other sum.

(2) Whether in arriving at the taxable income for such period the sum of £265 being the amount set aside in respect of deferred commission should be allowed as a deduction.

(3) Whether in arriving at the taxable income for such period the amount of £1,498 being an amount set aside to meet obligations to bondholders should be allowed as a deduction in whole or in any, and if so, in what part.

(4) Whether the commissioner was justified in treating the amount of £2,134 as assessable income wholly or in any, and if so, what part.

(5) Whether the taxable income of the appellant for the income period 1st July 1929 to 30th September 1930 amounted to £2,228 or some other, and if so, what other sum.

(6) Whether in arriving at the taxable income for such period the amount of £687 being the amount set aside in respect of deferred commission should be allowed as a deduction.

(7) Whether in arriving at the taxable income for such period the amount of £17,214 being the amount set aside to meet obligations to bondholders should be allowed as a deduction in whole or in any, and if so, in what part.

(8) Whether the commissioner was justified in treating the sum of £13,640 as assessable income wholly or in any, and if so, what part.

Bowen, for the appellant. Immediately a bond was sold there was incurred a liability to be discharged *in futuro*. The amount estimated as proper to meet that liability is deductible under sec. 23 (1) (*a*) of the *Income Tax Assessment Act* 1922-1934 (*Sun Insurance Office* v. *Clark* (1)). Such a deduction is in accord with general principles and commercial practice. *General Accident, Fire and Life*

(1) (1912) A.C. 443, particularly at pp. 454 et seq.

Assurance Corporation Ltd. v. *McGowan* (1) is distinguishable because in that case there was not any accepted estimate proved to be receivable.

[STARKE J. referred to *Usher's Wiltshire Brewery Ltd.* v. *Bruce* (2).]

Taxable income should be ascertained in accordance with the principles of commercial trading, subject to any limitations prescribed by the Act (*Amalgamated Zinc (De Bavay's) Ltd.* v. *Federal Commissioner of Taxation* (3)). On the assumption that the amount received in respect of the bonds was assessable income, that is, assuming that the decision in *Webster's Case* (4) would force the appellant to bring in the whole of its gross receipts, then the estimated obligations were proper deductions under sec. 23 (1) (*a*) (*Commissioner of Taxation* v. *Manufacturers' Mutual Insurance Ltd.* (5)). It is the business of the appellant to deal with all the pending obligations in the same way as similar obligations were dealt with by the company concerned in *London Cemetery Co.* v. *Barnes* (6). In that case *Lush* J. declined to follow the decision in *Paisley Cemetery Co. Ltd.* v. *Reith* (7). Although the amounts deducted were not " actually expended " during the income year the obligation of the appellant was " actually incurred " in that year within the meaning of that expression in sec. 23 (1) (*a*). The expression " actually incurred " was considered in *Alliance Assurance Co. Ltd.* v. *Federal Commissioner of Taxation* (8), *W. Nevill & Co. Ltd.* v. *Federal Commissioner of Taxation* (9), and *Nonmus & Co. Ltd.* v. *Commissioner of Taxation* (10). *Nevill's Case* (9) is distinguishable on the ground that in that case it was not, and in this case it is, the business of the company concerned to enter into the contracts under consideration. The estimate made by the appellant has been accepted as reasonable, therefore the onus is not on the appellant to prove the facts of the case. The words " losses and outgoings actually incurred " in sec. 23 (1) (*a*) are sufficiently wide to include the obligations in this case

(1) (1908) A.C. 207.
(2) (1915) A.C. 433, at p. 467.
(3) (1935) 54 C.L.R. 295, at p. 307.
(4) (1926) 39 C.L.R. 130.
(5) (1931) 31 S.R. (N.S.W.) 575 ; 48 W.N. (N.S.W.) 215.
(6) (1917) 2 K.B. 496.
(7) (1898) 25 Rettie 1080 ; 35 Sc.L.R. 947 ; 4 Tax Cas. 1.
(8) (1921) 29 C.L.R. 424, at p. 434.
(9) (1937) 56 C.L.R. 290.
(10) (1928) 29 S.R. (N.S.W.) 209 ; 46 W.N. (N.S.W.) 60.

H. C. OF A. 1938. NEW ZEALAND FLAX INVESTMENTS LTD. v. FEDERAL COMMISSIONER OF TAXATION.

(See also sec. 37 (3)). A taxing statute should be strictly construed in favour of the taxpayer. If two interpretations of a statute are possible and one leads to a just result and the other to an unjust result, the former should be adopted. If a taxpayer is not within the letter of the statute notwithstanding that he is within the spirit thereof, he must go free (*Inland Revenue Commissioners* v. *Westminster* (*Duke*) (1)). If, on the other hand, although within the strict letter of the taxing statute, he is not within the spirit of it, then, again, he must go free (*Munro* v. *Commissioner of Stamp Duties* (2) ; *Astor* v. *Perry* ; *Duncan* v. *Adamson* (3)). Exemptions, *a fortiori* deductions, should be liberally construed in favour of the taxpayer (*Armytage* v. *Wilkinson* (4) ; *Burt* v. *Commissioner of Taxation* (5)). Alternatively, it is submitted that under the *Income Tax Assessment Act* those items only are assessable income which are either in their nature income or are expressly made income under the terms of the Act (*Scott* v. *Commissioner of Taxation* (6)). Here, the business of the appellant is that of converting capital into income and it is not properly to be included within the word " income " as used in the Act (*Perrott* v. *Deputy Federal Commissioner of Taxation* (*N.S.W.*) (7)). Money received should be allocated according to its commercial nature as to whether it is income or not in the particular year. A question which arises is whether in ascertaining assessable income the general income in relation to business means not gross receipts but gross proceeds arrived at in such a way as will exclude the amounts deducted ; gross proceeds are not the same as gross receipts (*Alliance Assurance Co. Ltd.* v. *Federal Commissioner of Taxation* (8) ; *Webster* v. *Deputy Federal Commissioner of Taxation* (*W.A.*) (9) ; *Shelley* v. *Federal Commissioner of Taxation* (10) ; *Federal Commissioner of Taxation* v. *Gordon* (11)). Here the receipts, to the extent to which the reserve was created, were liabilities converted from year to year; the fact that a receipt is of a capital nature is not the only ground

(1) (1936) A.C. 1.
(2) (1934) A.C. 61, at p. 68 ; (1933) 34 S.R. (N.S.W.) 1, at p. 7.
(3) (1935) A.C. 398, at p. 417.
(4) (1878) 3 App. Cas. 355, at pp. 369, 370.
(5) (1912) 15 C.L.R. 469, at p. 482.
(6) (1935) 35 S.R. (N.S.W.) 215; 52 W.N. (N.S.W.) 44.
(7) (1925) 40 C.L.R. 450, at pp. 453, 454.
(8) (1921) 29 C.L.R., at pp. 432, 433.
(9) (1926) 39 C.L.R. 130, at p. 135.
(10) (1929) 43 C.L.R. 208, at p. 225.
(11) (1930) 43 C.L.R. 456, at p. 461.

for excluding it from income. It follows from reading the word " income " in a commercial sense that if a sum is actually received, if its application is predetermined, even though there is no definite charge upon it, it cannot be treated as a free income receipt in the hands of the taxpayer.

Weston K.C. (with him *Holmes*), for the respondent. It was established in *Herald & Weekly Times Ltd.* v. *Federal Commissioner of Taxation* (1) that when an obligation to spend money is incurred in an income year the time at which that disbursement comes into account is the year in which it is discharged and not the year in which it is incurred (*W. Nevill & Co. Ltd.* v. *Federal Commissioner of Taxation* (2)). Having regard to the nature of the agreement the appellant was not bound to pay any part of these obligations during the income year. Sec. 23 (1) (*a*) of the *Income Tax Assessment Act* only authorizes the deduction of a certain sum of money which has become a debt certain in the accounting period; it is not enough that it is a debt contingent. There are distinctions between obligations to pay money. These distinctions are important (*Naval Colliery Co.* (1897) *Ltd.* v. *Inland Revenue Commissioners* (3)). That case was a very favourable one for the application of the principles of commercial usage and trading. *Webster's Case* (4) and the subsequent cases do not decide that if there be topics which are not dealt with by permission in sec. 23, or by prohibition in sec. 25, those topics may be dealt with on commercial principles. However, the question here involved is specifically dealt with in sec. 23 (1) (*a*) and in sec. 25 (*e*). The deductions were not in respect of moneys " laid out or expended " in the income year within the meaning of that expression in sec. 25 (*e*). Even if secs. 23 and 25, operating conjointly, do not restrict the deductions to debts certain, they restrict the deductions which are permissible to items which are debts even if they be contingent (*Nevill's Case* (2)). If the provisions of sec. 23 and sec. 25 are incapable of being reconciled then the provisions of sec. 25 (*e*) should predominate. Commission is at best a contingent debt. It is doubtful whether a considerable proportion

(1) (1932) 48 C.L.R. 113.
(2) (1937) 56 C.L.R. 290.
(3) (1928) 138 L.T. 593.
(4) (1926) 39 C.L.R. 130.

H. C. OF A. 1938. NEW ZEALAND FLAX INVESTMENTS LTD. v. FEDERAL COMMISSIONER OF TAXATION.

of the interest will ever be paid. The acquisition of the mill was a purely capital expenditure. *Commissioner of Taxation* v. *Manufacturers' Mutual Insurance Ltd.* (1) was wrongly decided ; that decision proceeded on a false basis and its application to a portion of the claims was erroneous. The appellant is limited to the grounds set forth in its objections to the amended assessments ; the respondent has no power to waive the objections (*Molloy* v. *Federal Commissioner of Land Tax* (2)).

Bowen, in reply. The case of *Naval Colliery Co.* (1897) *Ltd.* v. *Inland Revenue Commissioners* (3) is distinguishable on the ground that the facts are entirely different ; there the obligation incurred was one of an extraordinary nature resulting from damage caused in the preceding year. The case of *Herald & Weekly Times Ltd.* v. *Federal Commissioner of Taxation* (4) is distinguishable also ; the obligation there incurred was a liability for damages and possibly for costs ; it was not an obligation under a contract as in this case. Here, in order to earn the receipt the company brings into account, it had to incur the legal obligation under the bond, and it should be entitled to bring in as a deduction the estimated liability under that obligation. Each issue of bonds has been treated by the appellant on a separate footing. The type of receipt which, upon the application of commercial principles, should be excluded under the *Income Tax Assessment Act* is shown in *Harrison* v. *John Cronk & Sons Ltd.* (5). The estimated amounts are proper deductions, or, alternatively, they are not assessable income.

Cur. adv. vult.

Nov. 22. The following written judgments were delivered :—

RICH J. In this matter the company appealed from the decision of the board of review to this court.

On the appeals coming on to be heard by me I considered that it was preferable under sec. 18 of the *Judiciary Act* to direct the matter to be argued before the Full Court upon agreed facts from which

(1) (1931) 31 S.R. (N.S.W.) 575 ; 48 W.N. (N.S.W.) 215.
(2) (1938) 59 C.L.R. 608.
(3) (1928) 138 L.T. 593.
(4) (1932) 48 C.L.R. 113.
(5) (1937) A.C. 185.

the court was to be at liberty to draw inferences rather than to state a case as the parties had suggested. I allowed, however, the questions of law appended to the statement of facts to remain as serving to indicate the topics to be argued.

In the circumstances I think that the assessments should be set aside and remitted to the commissioner. In any reassessment he should include only bond moneys received in the accounting periods. With regard to the deductions claimed for future interest and deferred commission the commissioner should allow such part as is referable to the accounting periods under assessment. There should be no order as to costs.

STARKE J. Appeal from the decisions of a board of review upon assessments to income tax for the trading period from 8th October 1928 to 30th June 1929, and for the next trading period ended 30th September 1930, referred into this court pursuant to sec. 18 of the *Judiciary Act*.

The appellant, New Zealand Flax Investments Ltd., was a company incorporated under the *Companies Act* in New South Wales, and it carried on business there and in New Zealand. The objects of the company were, amongst others, to acquire lands suitable for growing New Zealand flax and clearing and cultivating the lands so acquired for the purpose of flax cultivation and to sell, issue and grant bonds, securities, certificates and the like giving such rights and privileges over the assets and property of the company as the company should decide and, upon such sale or issue of any such bonds, to transfer, assign and set over the same to such person or body as the company might decide.

The company during the period relevant to these appeals issued bonds of two series, called the first and second series, of the face value of £30 and £20 respectively. The issues were made under the terms and conditions of trust deeds. Each issue was, as I understand the facts, a separate and independent transaction from any other issue of bonds, though the various issues were together said to constitute the business of the company. But I shall only deal with the trust deed relating to the first issue. It recited that the company had entered into contracts for the purchase of 731 acres

H. C. OF A. 1938. NEW ZEALAND FLAX INVESTMENTS LTD. v. FEDERAL COMMISSIONER OF TAXATION. Starke J.

of freehold lands in the Bay of Plenty in New Zealand. It also recited that for the purpose of providing funds for the cultivation of such lands and the milling and marketing of flax produced therefrom the company proposed to issue and sell to the public a series of bonds upon the terms and conditions thereinafter appearing of a nominal value of £30 for each one-half acre of the said land. And it also recited that the company had requested the Public Trustee, which was a corporation sole under the *Public Trustee Act*, to act as trustee for the purpose of securing the due performance by the company of the terms and conditions by it to be performed as therein stated. The trust deed is attached to the reference, but I confine myself to a summary of the provisions I consider necessary for the consideration of these appeals. 1. The company covenanted to complete the purchase of the 731 acres of freehold land and to transfer the land to the trustee upon trust for the bondholders. 2. The company agreed that it should endeavour to sell the bonds, which should have a face value of £30 each for each half acre of the said 731 acres, and that the bonds should be subject to the following terms and conditions:— (*a*) that the company would not issue first series bonds representing an area greater in the aggregate than 731 acres; (*b*) that the bonds might be issued in respect of the aforesaid area of 731 acres; (*c*) each bond for £30 might be paid for on application or in monthly instalments; (*d*) when the face value of the bond was fully paid in manner stipulated then the company would pay interest to the bondholder at the rate of 7 per cent per annum.

The deed then made provisions for the company cultivating the lands, erecting a mill and necessary plant for the efficient milling of the flax, and gathering and selling the flax. The company was to provide sufficient working capital for the cutting, milling and marketing of the flax, whereupon the company's obligation to bondholders ceased, subject to obligations to manage and administer the property. The company was to keep proper accounts and furnish the bondholders with a copy of the accounts of the company in so far as they related to the bondholders' interest. A true account of the expenditure in working the property was to be kept and an addition thereto might be made of an amount representing 5 per cent of the gross return from sales as the company's charge for administration. Rates

and taxes and other incidental expenses and outgoings accruing against the land were to be paid by the company until such time as the first dividend was paid and then they were deductible from the moneys realized from the sale of the products so far as the same would extend. The net profits of the undertaking when ascertained were to be divided amongst the bondholders in proportion to their respective bond interests. The company also covenanted that in the event of its going into liquidation (except for the purpose of reconstruction) and there being any of the trust funds in the hands of the Public Trustee in the terms of the deed, then he should be at liberty upon such liquidation to return to the applicants for bonds the money in his hands in proportion to their interests. The deed also enabled the Public Trustee to take over the operations agreed to be carried out by the company and to apply any moneys held by the company in trust for the bondholders or due and payable to it from the sale of the bonds in the manner in which they should have been applied by the company. " Bonds are now recognized," stated the prospectus for the first series of bonds, " as an important vehicle of investment and flax investment bonds representing a co-operative interest in the profitable New Zealand flax industry are regarded as sound securities backed up by productive farm lands increasing in value year by year. The well-known New Zealand financial critic, ' Cambist,' writes :—The flax industry is exempt from income tax and in that case there is nothing to whittle down the large profits to be earned from this form of enterprise. A sound endowment principle which will return an income for small investors better than anything else hitherto available. Investors in this company first of all secure an immediate return of 7 per cent interest on fully paid bonds which covers the development period of the plantations," and there follows a table giving the estimated returns thereafter to the bondholders. The scheme is well enough devised for the profit of the company and its promoters if the " best endeavours " of the company to dispose of the bonds resulted in subscriptions well above the cost of the land and the contemplated operations. But it can hardly be described as offering a sound security for bondholders : indeed it was a hazardous adventure put forward in a form likely to mislead unwary investors. It is not surprising that the company according to statements made at the bar has ceased operation. But this reference is only concerned with the assessment of the company to income tax imposed by the Commonwealth.

H. C. OF A. 1938. NEW ZEALAND FLAX INVESTMENTS LTD. v. FEDERAL COMMISSIONER OF TAXATION. Starke J.

It appears that the 731 acres were purchased for £4,473. Bonds of the No. 1 series sold to 30th June 1929 amounted to £4,375, and in the next trading period I gather that 1,259 additional bonds of the No. 1 series were also sold. Pursuant to the income-tax Acts the company returned its gross profit or income for the trading period 8th October 1928 to 30th June 1929 as £1,599 13s. 11d., and its net profit as £154 16s. 3d. The trading account of the company thus shows the gross profit :—

141 bonds sold 1st series ..	£4,375	0	0	Land purchases 731 acres	£4,473	8	3
Freehold 731 acres less 70½ acres represented by 141 bonds ..	4,041	19	8	Commission paid on bond sales	581	1	0
				Reserves, etc. ..	1,762	11	6
					£6,817	0	9
				Balance ..	1,599	18	11
	£8,416	19	8		£8,416	19	8

The item reserves £1,762 11s. 6d. covered various items such as deferred commission, which represented the balance of commission due to salesmen in respect of bonds sold by them in the trading period but which were not fully paid in that period, and obligations to bondholders under the deed such as interest, and for clearing, cultivating and drainage of the land.

The sum of £2,314, part of the sum of £4,375, was not actually received during the trading period. But the reserves so far as they related to amounts set aside to meet obligations to bondholders were estimates based on experience, though they were reasonable and proper estimates and amounts.

The taxable income of the company was assessed at £1,271 7s. 9d. on the following basis :—

Profit disclosed in return				£154	16	3
Add (*a*) reserve for deferred commission	£264	10	0			
(*b*) obligations to bondholders ..	1,479	12	6			
				1,762	11	6
				£1,917	7	9
Less expense charged to establishments etc.				646	0	0
				£1,271	7	9

The board of review allowed a further reduction for interest and directed the assessment to be reduced for the period ended 30th June 1929 to £969 18s. The argument before this court had not proceeded far when the court inquired whether the sum of £4,375 received from the sale of bonds was income of the company for the purposes of the income-tax Acts, or a receipt of a capital nature, or moneys to which the bondholders were entitled. The bondholders were not parties to the proceedings and were necessarily unrepresented. The only answer the court received was that the Act taxes the gross income of the taxpayer—all that comes in—subject to certain statutory deductions and, in any case, that the matter was not raised by the objections to the assessments and the court was thus precluded from investigating it (Act, sec. 51 (2)). The former answer overlooks the fact that the *Income Tax Assessment Act* imposes a tax upon income. It is not a tax upon everything that comes in whether an income receipt or a capital receipt (*Ruhamah Property Co. Ltd.* v. *Federal Commissioner of Taxation* (1) ; *Premier Automatic Ticket Issuers Ltd.* v. *Federal Commissioner of Taxation* (2)). The case of *Webster* v. *Deputy Federal Commissioner of Taxation* (*W.A.*) (3) and some cases in which it has been mentioned were also referred to. The provisions of sec. 23 of the Act 1922-1934 prescribe that in calculating the taxable income of a taxpayer the total assessable income, that is, the gross income derived by the taxpayer, shall be taken as a basis and from it there shall be deducted certain items. It is asserted that these and any other deductions elsewhere found in the Act are the only deductions that can be made, and that *Webster's Case* (3) so decided. But the judgment of *Knox* C.J., in which *Rich* J. joined, merely asserts, so far as I understand it, that the deduction there claimed was an outgoing of a capital nature prohibited by sec. 23 (1) of the Act. I should have thought that sec. 23 did no more than enumerate various deductions to which the taxpayer was entitled but did not exclusively define those deductions. The prohibited deductions are to be found in other sections of the Act, such, for example, as secs. 25 and 23 (1). I do not know whether the matter is of any importance under the Act of 1936, but if it is

(1) (1928) 41 C.L.R. 148. (2) (1933) 50 C.L.R. 268.
(3) (1926) 39 C.L.R. 130.

H. C. OF A. 1938. NEW ZEALAND FLAX INVESTMENTS LTD. v. FEDERAL COMMISSIONER OF TAXATION. Starke J.

I hope the question is not finally closed, for the rule will not give the income of a person in the ordinary signification of that term. *Usher's Wiltshire Brewery Ltd.* v. *Bruce* (1), on the English Acts, is worth attention. The latter answer is, I think, well founded, but it seems strange that the sum of £2,314, part of the sum of £4,375 which had not "come in" in the trading period in question, should be treated as income of that period.

The argument that the appellant relied upon in these proceedings was that the deduction of £1,762 11s. 6d. claimed by it was wrongly disallowed. But the commissioner contends that the deductions are prohibited by the Act (secs. 23 (1) and 25). The former section allows a deduction for all losses or outgoings actually incurred in gaining or producing the assessable income. The latter section prescribes that a deduction shall not in any case be made in respect of money not wholly and exclusively laid out or expended for the production of assessable income. A good deal of argument was expended upon the meaning of these words. But I should like to refer to some observations of Lord *Sumner* in *Usher's Case* (2) upon the question whether a disbursement was "wholly or exclusively" laid out for the purpose of the trade or concern. It had been said that the question was one of law and not of fact. But the noble and learned Lord observed :—"With this I am not able to agree. Though the answer to the question may itself be an inference from a wide area of facts, it is an answer of fact. There is no suggestion here that the commissioners found the facts under any mistake in law, including in that term the view, conscious or unconscious, that a fact may be found which there is no relevant evidence to support." It is difficult in the face of sec. 25 to say that the board of review was in error in disallowing various items claimed as deductions. But it is open to doubt whether there is any evidence which justifies the precise sums arrived at by the board in respect of deferred commission and interest. The assessment has proceeded on a wrong basis from first to last and it is advisable in my judgment to set aside the assessments and remit them to the commissioner for reassessment. The assessment for the trading period 1st July 1929 to 30th September 1930 stands in the same position. The commissioner will doubtless

(1) (1915) A.C. 433. (2) (1915) A.C., at p. 466.

give consideration to the suggestions made by this court: his duty is to see that the taxpayer is assessed according to law and not according to some mistake or want of understanding on the part of the taxpayer. But it is also necessary if the taxpayer desires to rely upon any such suggestions that it take them clearly and precisely in its notice of objections.

In my judgment the assessments for the trading periods should be set aside and the matters remitted to the commissioner for reassessment and the parties should abide their own costs of the proceedings throughout.

DIXON J. If there is any ground upon which the plan adopted for conducting the operations of New Zealand Flax Investments Ltd. may be extolled, it must be for the manner in which it illustrates the difficulty of applying the provisions of the Federal income-tax law when a transaction takes more than a year to complete and the true profit arising from it cannot be ascertained until it is completed or carried further towards completion than a year allows. In such cases a satisfactory estimate of the position at the end of a year may often be made, but upon commercial principles. If that is done, a suitable provision for future outlay must be made against current receipts or credits. But, under the *Income Tax Assessment Act* 1922-1930, the assessment must begin by taking, under the name of assessable income, the full receipts on revenue account, and only such deductions must be made as the statute in terms allows. At all events that is the interpretation which the statute has received in this court (*Webster* v. *Deputy Federal Commissioner of Taxation (W.A.)* (1); and cf. *Shelley* v. *Federal Commissioner of Taxation* (2); *Federal Commissioner of Taxation* v. *Gordon* (3); *Amalgamated Zinc (De Bavay's) Ltd.* v. *Federal Commissioner of Taxation* (4)). To provide out of current receipts for future expenditure may involve making a reserve fund, and sec. 25 says that no deduction shall be made in respect of income carried to any reserve fund. This prohibition may, perhaps, be confined to reserves out of net income, but, in any case, positive authority seems to be needed before a deduction is allowable, and, unless the future outlay can be regarded as an outgoing or a loss

(1) (1926) 39 C.L.R. 130.
(2) (1929) 43 C.L.R., at p. 225.
(3) (1930) 43 C.L.R., at p. 461.
(4) (1935) 54 C.L.R., at p. 311.

H. C. OF A. 1938.

NEW ZEALAND FLAX INVESTMENTS LTD. v. FEDERAL COMMISSIONER OF TAXATION.

Dixon J.

already actually incurred within the meaning of sec. 23 (1) (*a*) although not yet met or discharged, it is not easy to find an authorization which will justify a proper provision.

New Zealand Flax Investments Ltd. looked to derive its profits from the making and, it is hoped, the fulfilment, of an elaborate contract with the subscribers for bonds issued by the company, or from a series of such contracts. The issue of every series of bonds involved a single transaction, an undertaking or enterprise to be kept separate and distinguished from others. There appear to have been three series issued, although it is only the first two series that concern the years of income in question. The central features of the transaction, at all events as viewed by the subscribers, were the furnishing by the company of a piece of land for growing New Zealand flax and of a mill for the treatment of the flax, its cultivation, cutting, treatment and sale by the company, and of the yearly distribution of the net proceeds among the bondholders. In arriving at the net proceeds, 5 per cent of the gross returns was to be deducted as the company's charge for administration. The number of bonds issued bore a direct proportion to the area of the land to be provided by the company. In the first issue, for every half acre of land there was one bond of £30: in the second issue, for every quarter of an acre one bond of £20. The subscriber might pay for his bond either cash down on application or by instalments. Different terms for payment by instalments were allowed, but the longest would cover two and a half years from the date of the subscriber's application, if the payments were made punctually. The bonds, each series of which were issued upon the terms and conditions of a trust deed, gave the holders no more than a contractual right to the performance of the obligations undertaken by the company. The money paid by the bondholder was not repayable. It was not a loan; it became part of the funds of the company and, subject to an exception which is really negligible, there was no express restriction upon the mode in which the company might apply it. It is true that each of the trust deeds recited that, in issuing the series of bonds, the company's purpose was to provide funds, in effect, for completing the purchase of the land and establishing, planting, maintaining, cultivating, milling and marketing New Zealand flax; but the body of the

instrument did not expressly confine the application of the money to those purposes.

Both the company and the commissioner concur in treating all the moneys obtained by the sale of bonds as received by the company on revenue account. The company has conducted its finances upon that footing and it is not an assumption that the commissioner might be expected to deny. What the bondholders think of it does not appear. They are not represented. It is evident, however, that, upon the assumption that the bond moneys form part of the company's revenue, a full and complete provision must be made thereout to enable the company to fulfil its obligations to provide the land, plant it with flax, make a mill available and so on, before it is possible to make any fair and just computation of the net profit of the company for the year in which such bond moneys are received. The necessity of setting aside, not merely notionally, but actually, sufficient of the proceeds of the sale of bonds to enable the company to perform in the future the obligations it has undertaken is not made less evident by the length of time which, as the trust deeds show, may pass before the company obtains any substantial return from the work of cultivating flax. Under the first trust deed, the company has five years before it is obliged to complete the purchase of the land and in the meantime, beginning in the year after the issue of the bonds, a date fixed as 28th March 1929, it is to plant in each year only one-third of the land. Under the second trust deed, the land must be vested in the trustee for the bondholders within two years, but the time and rate of planting are the same. The date of issue of the second series is fixed as 9th July 1930. For the first four years from those respective dates, a period presumably during which the flax is expected to grow sufficiently to provide a fund for distribution to bondholders, the company undertakes to pay the holders of fully paid bonds 7 per cent per annum. This means that, in the case of the first issue, until 28th March 1933, and, in the case of the second issue, until 9th July 1934, the company came under an obligation to pay 7 per cent per annum to every bondholder who completely paid his subscription; no source whence such payment could be met appears to have existed except moneys from the sale of bonds.

H. C. OF A. 1938. NEW ZEALAND FLAX INVESTMENTS LTD. v. FEDERAL COMMISSIONER OF TAXATION. Dixon J.

The company's obligation to furnish a mill left alternatives open and it might be fulfilled without transferring a mill to the trustee for either series of bonds. This might be done by satisfying the trustee that the company had made adequate arrangements for milling near the land. In any case, if a mill were erected on land transferred to the trustee, the latter held it only as a security for the performance of the obligation and not absolutely for bondholders.

Another security contemplated by the deeds was the deposit of the final 10 per cent paid for every bond with the Public Trustee to secure performance of certain conditions of the trust deeds. At a later stage, namely, on 17th August 1933, by deeds of variation made pursuant to a power reserved in the trust deeds, these funds were made available, subject to the approval of the trustees, for the purpose of establishing a mill which would not pass to bondholders.

The company's obligation of growing and marketing flax was limited under the second trust deed in respect of the second series of bonds to twenty years, but no limitation of time is contained in the first deed and apparently the company undertook a perpetual duty of growing flax for the holders of bonds of the first series; but it is noteworthy that the deed contains no express covenant to plant the land with flax a second time.

The first period under assessment is from 8th October 1928 to 30th June 1929, and the second from 1st July 1929 to 30th September 1930, although how it came about that such a period of fifteen months was adopted does not appear. In the first period, the company had done nothing in preparing or cultivating the land or providing a mill and had neither spent nor contracted to spend money in performance of those duties. In the second period, some actual expenditure was incurred in the work of preparing and cultivating the land. In both periods the company saw fit to make up its accounts and its returns by taking into the receipts side the entire sum representing the bonds sold, whether paid or not, and, on the other side of the account, making provision for the expenditure which ought to be made by the company at a subsequent time if it was to perform its obligations.

In making the assessments upon the company in respect of the two periods, the commissioner left standing the revenue side of the account but set aside the provision for future outlay. The company

objected and, upon the commissioner disallowing the objections, requested him to refer his decision to the board of review. From that board's decision the company appeals to this court.

The reasons of the majority of the board of review contain the remark that, if the company in making its returns had submitted accounts showing as income merely the amounts received from the sale of bonds and had not included as income the portion not received, there is little doubt that only the amount received would have been regarded as assessable income.

It appears to me that the company is entitled now to go back to the basis which the board, no doubt rightly, say would have been accepted if adopted in the first instance.

In making up the accounts on the footing actually adopted, the company followed a coherent, even if not a very satisfactory, method. They took anticipated receipts in on one side and provided, on the other, for anticipated outlay, part at least of which was attributable to the anticipated receipts. When the anticipated outlay is disallowed, the company ought in reason to be permitted to put out of the account the anticipated receipts. These, however, are general considerations affecting only the choice of a method of computation where more methods than one are open. In point of law I think that it was wrong to include the future instalments unpaid on bonds sold, whether it was done by the taxpayer or the commissioner. We are not here dealing with a trader's account where goods, or other subjects of trafficking, that are on hand at the beginning and end of a period must be accompanied by purchases and sales, whether for cash or long terms, in order to show the results of trading. In the point of view adopted by the respective parties for the purpose of the returns and assessments the bond moneys must be regarded as taking on the guise of consideration or remuneration paid or payable in return for services or a combination of services, to be performed by the company over a long period in the future. The plan formulated in the advertisement or prospectus for the sale of the bonds treated the proceeds of the flax once it had come into full growth as the source alike of the company's remuneration, consisting of 5 per cent of gross returns, and of the expenditure involved in maintenance and production. But, according to this view of the plan,

H. C. OF A. 1938. NEW ZEALAND FLAX INVESTMENTS LTD. v. FEDERAL COMMISSIONER OF TAXATION. Dixon J.

what the subscribers for bonds paid for was the establishment of the undertaking as a productive enterprise, the service involved in obtaining the land and plant, bringing the land to the stage of production and setting up the requisite organization for treatment and sale. This was to be done over a period even longer than the two and a half years given as the longest term for the payment of the bond moneys by instalments. Experience of selling securities on instalments teaches that a large percentage of purchasers may always be expected to default. In all these circumstances it appears to me to be wrong to take into the account any of the instalments not payable within the accounting period. The board of review, although sharing, as it would seem, this opinion, gave only partial effect to it. It is unnecessary to discuss in detail the course involved in their decision, which, briefly stated, consisted in allowing the company to deduct from the total amount of the bonds sold the proportion of future estimated expenditure referable or proportionate to the unpaid future instalments of bond moneys. It is possible that the board took this course owing to their view of the meaning of the relevant ground taken in the notice of objection. The commissioner contended that the ground did not cover the objection that future instalments formed no part of the assessable income. The ground is certainly obscurely and illogically worded, but its ambiguities should, I think, be resolved in favour of the taxpayer. I am, therefore, of opinion that, assuming the proceeds of the bonds to be a revenue item, only the amounts or instalments paid or payable within the accounting period should be taken into account. This means, as I understand the figures, that for the first period the figure £2,095 10s. should be substituted for £4,230, and, for the second, the figure £27,989 10s. for the figure £41,630 as the proceeds of bonds, or the figure £6,193 10s. for the figure £19,834 as the gross profit on trading account.

But, behind the assumption made by both parties for their respective purposes, there lies the question whether the bond moneys received formed a revenue item or were in whole or in part a capital receipt. I say " or in part," because it is, I think, possible that a single sum received in the course of the business of a company or of a natural person may be divisible and that part of it ought to be

treated as capital and part of it as revenue or assessable income. Thus in *Webster's Case* (1) itself, although it is said that the definition of assessable income as gross income clearly covered the gross proceeds of the sale of the wool in question, I should have thought that there was something to be said for the view that, as the sheep were purchased in wool only ten weeks before shearing, a proportion at least of the wool money should have gone into the same account as the purchase of the sheep, which was in fact a capital and not a trading account.

The plan of operations adopted by New Zealand Flax Investments Ltd. presents peculiar features, one of which is that the company bound itself to bring into existence capital assets which would, according to the expectation it avowed, earn distributable profits for the bondholders and a percentage remuneration for itself, and yet, at the same time, the company proposed to make a net profit in the course of establishing these capital assets, a net profit consisting in the amount by which its expenditure on doing so was exceeded by the proceeds from the sale of the bonds, after providing commission and so-called " interest " at 7 per cent per annum on paid-up bonds during the first four years. Further, some of the capital assets, such as the mill, would or might ultimately enure for the company's exclusive benefit. In these circumstances I have felt some hesitation in adhering without inquiry to the assumption that the bond moneys form wholly a revenue item. This hesitation is increased by the consideration that, in the event of a liquidation, the bondholders might be faced by the commissioner's claim upon the assets for tax, an event which cannot be regarded as a remote contingency inasmuch as the company is said to have ceased active operations. But the notice of objection does not raise the question and I think that we are not in a position to determine a matter which is outside the objection, outside the actual dispute *inter partes* and outside the argument and, moreover, a matter of much doubt and difficulty.

There remain, however, the questions to which at the outset I referred. To what extent can the provisions for future expenditure or outlay by the company in fulfilling its obligations to bondholders

(1) (1926) 39 C.L.R. 130.

H. C. OF A. 1938. NEW ZEALAND FLAX INVESTMENTS LTD. v. FEDERAL COMMISSIONER OF TAXATION. Dixon J.

under the trust deeds be deducted from the assessable income consisting of bond moneys? It is evident that, apart from any other difficulty in allowing such a deduction, the full provision claimed could not be allowed once it is decided that, not the full amount of the bonds sold, but only the payments receivable in the accounting periods, should be taken as assessable income. For the full provision claimed was for the total future expenditure out of the total amount of bond moneys. At best only that proportion could be allowed which was considered referable or attributable to the proceeds of the bonds taken into account as assessable income.

As to the principle which, if the statute allowed it, ought to be applied in reference to the deductions claimed, I agree that the statement of *Lush* J. in *London Cemetery Co.* v. *Barnes* (1) is in point. "It seems to me," his Lordship says, "that in a case like the present the true profit earned by the appellants is the profit which remains when they have discharged and met the expenditure they have undertaken to discharge and meet in consideration of the payments, and although—as the appellants admit—the sums received are income and not capital, yet it would be wrong to treat the whole of the moneys received as profit or money earned; but against the payments which the appellants receive ought to be set off the expenses they will incur in order to earn the money so paid."

But, as the *Income Tax Assessment Act* 1922-1930 has been interpreted, authority for the deduction must be found not in general principles but under some provision of the statute. In par. *ba* of the definition of income in sec. 4 "profit" is specially brought into the assessable income and this involves a preliminary account of the particular transaction, which, no doubt, is a departure from the general scheme ascribed to the Act. There may be other similar examples and perhaps, apart from such express provisions, instances of special businesses and transactions may be found where nothing but the net profit could be regarded as a revenue item. But, generally speaking, the gross receipts on account of revenue must be taken into the assessable income and therefrom the deductions allowed by the Act must be made and no others. For the purpose in hand I think that sec. 23 (1) (*a*) must be the source in which the

(1) (1917) 2 K.B., at p. 502.

company must seek authority for the deductions. To come within that provision there must be a loss or outgoing actually incurred. "Incurred" does not mean only defrayed, discharged, or borne, but rather it includes encountered, run into, or fallen upon. It is unsafe to attempt exhaustive definitions of a conception intended to have such a various or multifarious application. But it does not include a loss or expenditure which is no more than impending, threatened, or expected.

In the present case I regard the obligation to pay interest to bondholders who, within the four years from the date of issue, paid up the amount of the bonds, as a definite liability contingent only on the bondholders meeting their instalments, that is, in the case of bonds subscribed for in or before the respective accounting periods the subject of assessment. There is no reason why the future liability should not be treated as incurred, if otherwise it were proper to throw it against the revenue items, as it would clearly have been if the full face value of the bonds were included in the assessable income. But I find it difficult to say upon the information before us whether any of this liability should be considered as properly attributable to the years in question. There is, I think, no objection to the commissioner's taking into consideration the actual events of the subsequent years in order to see whether, under a method of accounting by which only actual receipts from the bonds are included, the liability for interest would naturally be provided out of revenue from that source accruing in the year when the liability would be met, or whether safe or proper practice required for the purpose an appropriation and retention of part of the sums received in the accounting periods under assessment. In the same way I think that the commissions payable on the sale of bonds but deferred until the receipt of later instalments involve an outgoing "incurred," but one which does not necessarily and as a matter of course fall into the assessment of the accounting period.

But the reserves on account of the mill and for the purpose of clearing, burning, draining, ploughing, cultivating, planting and for "maintenance and general" cannot be brought within the authority of sec. 23 (1) (*a*). The business propriety of making such an allowance may be made clear by stating the dilemma which affects the

H. C. OF A. 1938. NEW ZEALAND FLAX INVESTMENTS LTD. v. FEDERAL COMMISSIONER OF TAXATION. Dixon J.

use of the funds represented by the suggested reserves. For either they should be expended in the work described by the headings mentioned, or else they should be repaid to the bondholders as damages or otherwise. Clearly the company should not retain the money or divide it between the Crown and their shareholders under the respective descriptions of income tax and dividends, whether dividends in a liquidation or in a going concern. But the *Income Tax Assessment Act* is not framed to give effect to such considerations. It is for this reason that I began by remarking upon the manner in which the plan of operations adopted by the company illustrates the application of the Federal Act to transactions extending over a greater period than the accounting period assessed.

In my opinion the most satisfactory way of dealing with the appeal is to set aside the assessments and to remit them to the commissioner for reassessment, so as to enable him to include only bond moneys received in the accounting periods and to allow whatever part, if any, of the deductions claimed for future interest and deferred commission appears referable to the accounting periods under assessment.

The proceeding before us consists of the appeals from the board of review directed to be argued before us under sec. 18 of the *Judiciary Act* 1903-1937. We can, therefore, deal finally with the appeals. The specific questions mentioned in the statement of facts upon which the case was argued and described by the title "reference" afford guidance to the court but are not the questions of a stated case and do not require categorical answers.

McTiernan J. I agree, for the reasons stated by my brother *Dixon*, that the assessments should be set aside and that they be remitted to the Commissioner of Taxation for reassessment.

Appeals from the decisions of the board of review allowed. Assessments set aside and remitted to the commissioner for reassessment.

Solicitors for the appellant, *R. C. Cathels & Co.*

Solicitor for the respondent, *H. F. E. Whitlam,* Commonwealth Crown Solicitor.

J. B.