[HIGH COURT OF AUSTRALIA.]

FEDERAL COMMISSIONER OF TAXATION . APPELLANT;

AND

MILLER ANDERSON LIMITED . . . RESPONDENT.

H. C. OF A. 1945-1946

ADELAIDE, 1945. *Sept.* 20, 21, 24.

SYDNEY, 1946. *April* 4.

Latham C.J. Starke and Dixon JJ.

*War-time (Company) Tax—Accumulated profits—Standing to credit of profit and loss accounts—Loss incurred in earlier years—Whether loss of capital—Commencement of new profit and loss appropriation accounts—Omission from new accounts of previous loss—Averaging of accumulated profits over accounting period—War-time (Company) Tax Assessment Act* 1940-1941 (*No.* 90 *of* 1940—*No.* 56 *of* 1941), *s.* 24.

A limited company carrying on business as a trading concern showed in its "Profit and Loss Appropriation Account to 31st January 1935" a debit balance of £13,107. An agreement was entered into between preference and ordinary shareholders, which provided that profits from 1st February 1935 should be used in a particular way. Pursuant to this agreement the debit balance of £13,107 was not carried forward into the profit and loss appropriation accounts for succeeding years. A new account, described as "Profit and Loss Appropriation Account from 1st February 1935" was opened, and this account, at 31st January 1941, showed a credit balance of £20,548. The company's accounting period, for the purposes of the *War-time (Company) Tax Assessment Act* 1940 ended on 31st January 1941. On 31st March 1941, 59 days of an accounting period then having elapsed, the company declared a dividend which absorbed £10,075. The company had resolved in general meeting to pay the dividend out of a sum of £14,528, the profits of the previous year. In fact, however, the dividend was paid out of the whole or part of the sum of £20,548 which represented profits earned since 1st February 1935.

*Held*, that "accumulated profits" for the purposes of s. 24 of the *War-time (Company) Tax Assessment Act* 1940 includes accumulated profits on a continuous account and that the accumulated profits of this company amounted to the sum of £7,441, being the sum of £20,548 less the sum of £13,107.

H. C. of A. 1945-1946.

Federal Commissioner of Taxation v. Miller Anderson Ltd.

*Held*, further, that for the purposes of averaging the accumulated profits over the accounting period as required by s. 24, the whole of the accumulated profits of £7,441, must be regarded as having been absorbed by the payment of the dividend on 31st March 1941, so that the company was to be treated as having the use of the sum of £7,441 for only 59 days of the year.

Case Stated.

On appeals to the High Court by the Federal Commissioner of Taxation from decisions of the Board of Review in relation to assessments of Miller Anderson Ltd. to the War-time (Company) Tax for the accounting periods ended 31st January 1941 and 31st January 1942, cases were stated by *Dixon* J. The same question arose on each case stated. The case stated in relation to the second assessment was substantially as follows :—

1. The respondent company is a company incorporated as a limited company under the law of and carrying on business in South Australia.

2. It was incorporated in March 1927.

3. At all relevant times the issued capital of the company consisted of 185,000 fully paid shares of £1 each of which 105,000 were ordinary shares and 80,000 were shares entitled by the original memorandum to a fixed cumulative preference dividend at the rate of 8 per cent per annum. The memorandum of association contained provisions for the modification of the rights of the holders of the preference shares, which provisions were resorted to in making the agreements hereinafter referred to.

4. The company made fair profits for each of the years ending 31st January 1928, 1929 and 1930.

5. After provision had been made for taxation, depreciation and bad debts, the payment of dividends left £820 in profit and loss account at the end of the accounting period ending 31st January 1930.

6. The company's operations during the next four years resulted as follows :—

| | | | | | |
|---|---|---|---|---|---|
| Period ending 31st January | 1931—Loss | £3,296 | 0 | 0 |
| ,, ,, | 1932— ,, | 11,834 | 0 | 0 |
| ,, ,, | 1933—Profit | 23 | 0 | 0 |
| ,, ,, | 1934— ,, | 1,195 | 0 | 0 |
| ,, ,, | 1935— ,, | 3,186 | 0 | 0 |

7. The following table shows the manner in which these losses and profits were dealt with in the "Profit and Loss Appropriation Account" of the respondent over the period in question.

Position as regards the Profit and Loss Appropriation Account as shown in Balance Sheets from 31st January 1930 to 31st January 1935.

| | | £ |
|---|---|---|
| Balance at 31st January 1930 .. .. .. .. | Cr. | 4,020 |
| Dividend paid February 1930 .. .. .. | | 3,200 |
| | | 820 |
| Net loss year ended 31st January 1931 .. .. | | 3,296 |
| | Dr. | 2,476 |
| Dividend paid August 1930 .. .. .. | | 3,200 |
| Balance at 31st January 1931 .. .. | Dr. | 5,676 |
| Net loss year ended 31st January 1932 .. | | 11,834 |
| Balance at 31st January 1932 .. .. | Dr. | 17,510 |
| Net profit year ended 31st January 1933 .. | | 22 |
| Balance at 31st January 1933 .. .. | Dr. | 17,488 |
| Net profit year ended 31st January 1934 .. | | 1,195 |
| Balance at 31st January 1934 .. .. | Dr. | 16,293 |
| Net profit year ended 31st January 1935 .. | | 3,186 |
| Balance as at 31st January 1935 .. .. | Dr. | 13,107 |

8. The position as at 31st January 1935 was as follows :—

(i) there were no free reserves.

(ii) existing reserves were :—

(*a*) Bad debts—£500,

(*b*) Taxes—£1,091 16s. 3d.,

(*c*) Stock—£600.

(iii) The profit and loss account showed a debit balance of £13,107 1s. 10d.

(iv) The arrears of dividends on preference capital amounted to £28,800.

(v) Ordinary shareholders had not received a dividend since 1929.

9. On 15th May 1935 an agreement was made between the company and Mr. Sidney Powell contracting on behalf of the preference shareholders. The agreement was confirmed at a meeting of preference shareholders held 6th June 1935, and became binding on the company and the two classes of shareholders.

10. This agreement recited (*inter alia*) that the rights of preference shareholders should be modified, abrogated and dealt with as therein appearing.

H. C. of A. 1945-1946.

Federal Commissioner of Taxation v. Miller Anderson Ltd.

The modifications provided were that :—

(1) The $4\frac{1}{2}$ years arrears of dividend that had accumulated at the rate of 8 per cent per annum were reduced to $4\frac{1}{2}$ years dividend at 5 per cent per annum. (This reduced the contingent liability from £28,800 to £18,000.)

(2) No payment on account of the arrears should be paid until after 1st February 1938.

(3) For the three years to 31st January 1938, the preference dividend rate was reduced to 6 per cent per annum cumulative.

(4) Profits which it should be determined to divide prior to 31st January 1938 should be first applied in paying the six per cent dividend to preference shareholders and secondly in paying a dividend not exceeding 3 per cent per annum on ordinary shares.

The agreement then expressed the intention of the parties that after 1st February 1938 the directors should review the affairs of the company and make a recommendation to the holders of preference shares.

11. As from 31st January 1935 the company made further profits and these profits were, as described in par. 14, carried to a separate profit and loss appropriation account in the " liabilities " column of the company's balance sheets, the account being described as :— " Profit and Loss Appropriation Account from 1st February 1935."

12. The amount of £13,107 continued as described in par. 14 to be shown on the assets' side of the company's balance sheets under the heading :—" Profit and Loss Appropriation Account to 31st January 1935."

13. The profits earned by the company from 31st January 1935 to 31st January 1941 and the manner in which they were divided and allocated is set out in the following table.

Details of Appropriation Account as shown in the Liabilities Column of the Balance Sheet for Years subsequent to the Year ended 31/1/35.

| | | |
|---|---|---|
| Balance at 31/1/36 representing net profit for year ended 31/1/36 .. .. .. .. .. | Cr. | £5,579 |
| Less dividend on preference shares 6 per cent per annum for year ended 31/1/36 .. .. .. | | 4,800 |
| | | 779 |
| Add net profit for year ended 31/1/37 .. .. .. | | 8,373 |
| Balance at 31/1/37 .. .. .. .. .. | | 9,152 |
| Less dividends : 6 per cent per annum on preference | | |

| | |
|---|---|
| shares and 3 per cent per annum on ordinary shares for year ended 31/1/37 .. .. .. | 7,950 |
| | 1,202 |
| Add profit year ended 31/1/38 .. .. .. .. | 9,584 |
| | 10,786 |
| Less dividends 6 per cent per annum on preference shares for half-year to 31/7/37 .. .. .. | 2,400 |
| Balance at 31/1/38 .. .. .. .. .. | 8,386 |
| Less dividends : 6 per cent per annum on preference shares for half-year to 31/1/38 and 3 per cent on ordinary shares for the year ended 31/1/38 .. | 5,550 |
| | 2,836 |
| Add net profit for year ended 31/1/39 .. .. .. | 12,004 |
| | 14,840 |
| Less interim dividend 6 per cent per annum on preference shares to 31/7/38 .. .. .. | 2,400 |
| Balance at 31/1/39 .. .. .. .. .. | 12,440 |
| Less dividends : 6 per cent per annum on preference shares for half-year to 31/1/39 and 2½ per cent per annum on preference shares account arrears for the year ended 31/1/39 and 3 per cent per annum on ordinary shares for the year ended 31/1/39 .. .. .. .. .. .. | 7,550 |
| | 4,890 |
| Add net profit for year ended 31/1/40 .. .. .. | 14,005 |
| | 18,895 |
| Less dividends : 6 per cent per annum on preference shares for half-year to 31/7/39 .. .. .. | 2,400 |
| Balance at 31/1/40 .. .. .. .. .. | 16,495 |
| Less dividends—being 6 per cent per annum on preference shares for half-year to 31/1/40, 2½ per cent per annum account arrears on preference shares for year ended 31st January 1940, | |

H. C. OF A. 1945-1946.

FEDERAL COMMISSIONER OF TAXATION v. MILLER ANDERSON LTD.

| | |
|---|---|
| and 3 per cent per annum on ordinary shares for year ended 31/1/40 .. .. .. .. | 8,075 |
| | 8,420 |
| Add profit year ended 31/1/41 .. .. .. .. | 14,528 |
| | 22,948 |
| Less interim dividend of 6 per cent per annum on preference shares for half-year to 31/7/40 .. | 2,400 |
| Balance at 31/1/1941 .. .. .. .. .. | £20,548 |

14. In the balance sheet as at 31st January 1936 in the company's private ledger there appears on the assets side the following item :—
" Profit and loss appropriation "—

| | | | |
|---|---|---|---|
| Balance as at 31st January 1935 | 13,107 1 10 | | |
| Less net profit for the year .. | 5,579 0 10 | | |
| | | £7,528 | 1 0 |

There is no item for profit and loss appropriation on the liabilities side of that balance sheet.

However, in the balance sheet as at 31st January 1936 issued to the shareholders with the notice of the annual general meeting of the company held on 20th March 1936 there appear the following items :—

Under " assets " :—
" Profit and Loss Appropriation "—
Balance as at 31st January 1935 .. £13,107 1 10

Under " liabilities " :—
" Profit and Loss Appropriation "—
From 1st February 1935,
Net profit for year ended 31st January 1936 .. .. .. .. £5,579 0 10

At 31st January 1935 the profit and loss appropriation account in the company's ledger showed a debit of £13,107 1s. 10d. and the £5,579 0s. 10d. was never credited to that account.

As at 31st January 1936 a new account was opened called " Profit and Loss Appropriation Account from 1st February 1935," while the old " Profit and Loss Appropriation " was renamed " Profit and Loss Appropriation Account to 31st January 1935 " with an opening debit of £13,107 1s. 10d. This latter account has at all material times remained unaltered.

These two separate profit and loss appropriation accounts entitled as above were kept in the company's ledgers from 1st February 1936.

The company considered it necessary to do this in order to carry out the terms of the said agreement dated 15th May 1935 which provided that profits after 1st February 1935 were to be used in a particular manner.

In no balance sheet (except that first above mentioned) either in the company's private ledger or published to shareholders have the said profit and loss appropriation accounts been combined.

15. At 1st February 1938 the balance sheet accordingly showed a debit of £13,107 in " Profit and Loss Appropriation Account to 31st January 1935 " and the " Profit and Loss Appropriation Account from 1st February 1935 " showed a credit of £2,836 after paying dividends for year to 31st January 1938. The contingent liability for arrears of preference dividend remained unchanged at £18,000, the amount to which it was written down pursuant to the agreement of 15th May 1935.

16. An agreement was made on 7th September 1938 between the company and Mr. Gordon Sunter contracting on behalf of the preference shareholders.

This agreement was confirmed at a meeting of preference shareholders held 6th October 1938, and became binding on the company and the ordinary and preference shareholders.

17. This agreement provided :—

(1) That from 1st February 1938 the cumulative preference dividend should be reduced from 8 per cent per annum to 6 per cent per annum.

(2) That profits which it should be determined to divide after 1st February 1938 should be applied in the following order :

(*a*) Paying the current 6 per cent per annum cumulative preference dividend and any arrears since 31st January 1938.

(*b*) Paying not less than 2½ per cent per annum on account of arrears of preference dividend for 4½ year period 1st August 1930 to 31st January 1935.

(*c*) Paying a dividend of not more than 3 per cent per annum on the ordinary shares unless the profits of the particular year exceeded £12,000, in which case the ordinary dividend could be increased by 1 per cent.

(3) Without in any way derogating from or otherwise affecting the powers of the directors or of the company with regard to the appropriation of the profits of the company it was thereby declared that the amount of £2,836 0s. 3d., being

H. C. OF A.
1945-1946.

FEDERAL COMMISSIONER OF TAXATION
*v.*
MILLER ANDERSON LTD.

the balance of the amount remaining to the credit of "Profit and Loss Appropriation Account from 1st February 1935" on 31st January 1938 after payment of the final preference dividend and the ordinary dividend declared at the annual general meeting of the company held on 5th April 1938 should be available for the purpose of paying any of the dividends referred to in par. 2 thereof and further that the aforesaid amount and any profits of the company earned after 31st January 1938 and not distributed under the aforesaid provisions might be retained used or applied by the directors at any time and from time to time as they in their discretion might think fit and in particular might in the absolute discretion of the directors be used in reducing the amount standing to the debit of "Profit and Loss Account on 31st January 1935" in making further payments on account of the arrears of preference dividend on that day or in writing off depreciation or might be retained and carried forward in the profit and loss account.

(4) Until there should have been paid to the holders of the preference shares a dividend at the rate of 5 per cent per annum on the capital for the time being paid up or credited as paid up on the preference shares in respect of the period from 1st August 1930 to 31st January 1935 (such rate being the rate to which the dividend was reduced by the said agreement of 15th May 1935) there should not be declared or paid to the holders of the ordinary shares a dividend in excess of the rate of £4 per cent per annum and thereafter until the whole of the sum of £13,107 1s. 10d. standing to the debit of the profit and loss account of the company on 31st January 1935 representing the accumulated deficit in profit and loss account up to that day had been restored to the capital of the company there should not be declared or paid upon the ordinary shares any greater dividend than a dividend at the rate of £5 per cent per annum.

(5) From and after the time when such arrears as aforesaid should have been paid and such debit should have been wholly restored there should (subject to the rights of the holders of the preference shares) be no limit to the amount of dividend which might be declared upon the ordinary shares in the company but the holders of the preference shares should notwithstanding anything contained in par. 1 thereof have the right whenever in respect of any year a dividend at a rate greater than 6 per cent per annum was

paid on the capital paid up on the ordinary shares to a further dividend (not exceeding 2 per cent per annum) on the capital for the time being paid up or credited as paid up on the preference shares at a rate equal to the difference between £6 per cent per annum and the rate of dividend declared in respect of the ordinary shares but the holders of the preference shares should not in any circumstances be entitled to a dividend at a greater rate than £8 per cent per annum on the capital for the time being paid up or credited as paid up on the preference shares.

18. On or about 25th August 1942 respondent filed with the Commissioner an income tax return in respect of the trading period of the company for the year ending 31st January 1942 accompanied by profit and loss account and balance sheets as at 31st January 1941 and 31st January 1942.

19. The following is an extract of the relevant items in the balance sheet as at 31st January 1941 :—

| | | |
|---|---|---|
| Liabilities : | | |
| Creditors. | | |
| Income tax provision .. .. | £12,200 0 0 | |
| Various other items (including bank) totalling .. .. .. | £32,765 7 3 | |
| | | £44,965 7 3 |
| Capital. | | |
| Nominal capital 300,000 shares of £1 each .. .. .. | £300,000 0 0 | |
| Less unallotted capital .. .. | 115,000 0 0 | |
| | | 185,000 0 0 |
| Profit and Loss Appropriation Account from 1st February 1935. | | |
| Balance as at 31st January 1940 .. | 16,495 3 10 | |
| Less dividend No. 15, being 6 per cent per annum on preference shares for half-year to 31st January 1940, $2\frac{1}{2}$ per cent per annum on account of arrears on preference shares for year to 31st January 1940 and $3\frac{1}{2}$ per cent per annum on ordinary shares for year to 31st January 1940 .. | 8,075 0 0 | |
| | £8,420 3 10 | |

| | | | |
|---|---|---|---|
| Add net profit for year to 31st January 1941 .. .. .. | | 14,528 5 9 | |
| | | 22,948 9 7 | |
| Less dividend No. 16 being interim dividend at rate of 6 per cent per annum for half-year to 31st July 1940, on preference shares .. | | 2,400 0 0 | |
| | | | 20,548 9 7 |
| | | | £250,513 16 10 |
| Assets. | | | |
| Cash on hand .. .. .. | | | 160 0 0 |
| Debtors. | | | |
| On open account .. .. | | 38,693 10 11 | |
| London agency .. .. | | 4,603 6 8 | |
| | | 43,296 17 7 | |
| Less bad debt reserve | £1,000 0 0 | | |
| ,, hire purchase reserve .. | 92 3 4 | | |
| | | 1,092 3 4 | |
| | | | 42,204 14 3 |
| Stock— | | | |
| Goods .. .. .. .. | | 89,022 14 7 | |
| Sundries .. .. .. .. | | 646 17 4 | |
| | | 89,669 11 11 | |
| Less stock reserve .. .. .. | | 4,500 0 0 | |
| | | | 85,169 11 11 |
| Freehold land and buildings (Net—details omitted) .. .. .. | | | 75,840 4 2 |
| Fixtures and Fittings— do. .. | | | 20,224 14 2 |
| Lifts do. .. | | | 2,500 0 0 |
| Machines and motor fleet do. .. | | | 3,124 8 6 |
| Prepayments .. .. .. .. | | | 1,183 2 0 |
| Goodwill .. .. .. .. | | | 7,000 0 0 |
| Appropriation to 31st January 1935 | | | 13,107 1 10 |
| | | | £250,513 16 10 |

20. The following is an extract of the relevant items in the balance sheet as at 31st January 1942 :—

H. C. of A. 1945-1946.

Federal Commissioner of Taxation v. Miller Anderson Ltd.

| | | | |
|---|---|---|---|
| **Liabilities.** | | | |
| Creditors. | | | |
| Income tax provision | 6,010 13 0 | | |
| Add provision for year .. .. | 22,500 0 0 | | |
| | | 28,510 13 0 | |
| Various other items (including bank) totalling .. .. .. | | 36,790 18 0 | |
| | | | 65,301 11 0 |
| **Capital.** | | | |
| Nominal capital: 300,000 shares £1 each .. .. .. .. | | 300,000 0 0 | |
| Less unallotted capital .. .. | | 115,000 0 0 | |
| | | | 185,000 0 0 |
| **Profit and Loss Appropriation Account from 1st February 1935.** | | | |
| Balance as at 31st January 1941 .. | | 20,548 9 7 | |
| Less dividend account No. 17 being:—6 per cent per annum for half-year to 31st January 1941 on preference shares; paid 31st March 1941 .. | £2,400 | | |
| $2\frac{1}{2}$ per cent per annum for year to 31st January 1941 on account arrears of preference dividend: paid 31st March 1941 .. | £2,000 | | |
| $3\frac{1}{2}$ per cent per annum for year to 31st January 1941, on ordinary shares; paid 31st March 1941 .. | 3,675 | | |
| $2\frac{1}{2}$ per cent on account arrears of preference dividends; paid 30th May 1941 .. .. .. | 2,000 | | |
| | | 10,075 0 0 | |
| | | 10,473 9 7 | |
| Add net profit for year .. .. | | 12,737 5 2 | |
| | | 23,210 14 9 | |
| Less dividend account No. 18 being interim dividend for half-year to | | | |

| | | | |
|---|---|---|---|
| 31st July 1941 on preference shares ; paid 10th October 1941 .. | | 2,400 0 0 | |
| | | | 20,810 14 9 |
| | | | £271,112 5 9 |
| Assets. | | | |
| Cash on hand .. .. .. | | | 161 0 0 |
| Debtors. | | | |
| On open account .. .. .. | | 43,002 13 2 | |
| London agency .. .. .. | | 12,172 10 8 | |
| Claims .. .. .. .. | | 193 10 9 | |
| | | 55,368 14 7 | |
| Less bad debt reserve | 1,000 0 0 | | |
| ,, hire purchase reserve .. .. | 113 15 2 | | |
| | | 1,113 15 2 | |
| | | | 54,254 19 5 |
| Stock. | | | |
| Goods .. .. .. .. | | 100,610 0 1 | |
| Sundries .. .. .. .. | | 604 11 10 | |
| | | 101,214 11 11 | |
| Less stock reserve as at 31st January 1941 | 4,500 0 0 | | |
| Less stock reserve for this year .. .. | 3,500 0 0 | | |
| | | 8,000 0 0 | |
| | | | 93,214 11 11 |
| Freehold land and buildings (Net—details omitted) | | | 75,840 4 2 |
| Furniture and fittings (Net—details omitted) .. | | | 20,076 14 5 |
| Lifts (Net—details omitted) .. .. .. | | | 2,200 0 0 |
| Machines (Net—details omitted) .. .. .. | | | 2,025 16 3 |
| Hairdressing plant (Net—details omitted) .. | | | 469 5 7 |
| Motor fleet (Net—details omitted) .. .. | | | 1,107 19 0 |
| Prepayments .. .. .. .. .. .. | | | 1,654 13 2 |
| Goodwill .. .. .. .. .. .. | | | 7,000 0 0 |
| Appropriation to 31st January 1935 .. .. | | | 13,107 1 10 |
| | | | £271,112 5 9 |

21. The account referred to as " Appropriation to 31st January 1935 " was at all material times headed " Profit and Loss Appropriation Account to 31st January 1935 " in the company's ledgers.

H. C. of A. 1945-1946.

Federal Commissioner of Taxation v. Miller Anderson Ltd.

22. During the year ended 31st January 1942 the company paid the following dividends :—

A. Dividend for the half-year ended 31st January 1941 at the rate of 6 per cent per annum on the cumulative preference shares, payable 31st March 1941 .. .. £2,400

B. Dividend for the year to 31st January 1941 at the rate of $2\frac{1}{2}$ per cent per annum on account of arrears of preference dividend, payable 31st March 1941 .. £2,000

C. Dividend for the year ended 31st January 1941 at the rate of $3\frac{1}{2}$ per cent per annum on ordinary shares, payable 31st March 1941 .. .. .. .. £3,675

D. Dividend at the rate of $2\frac{1}{2}$ per cent on account of arrears of preference dividend, payable 30th May 1941, to shareholders registered in the books of the company as at 31st March 1941 .. .. .. £2,000

E. An interim dividend on the preference shares at the rate of 6 per cent per annum for the half-year to 31st July 1941 payable 10th October 1941 .. .. £2,400

23. On 9th April 1943 the Commissioner issued a notice of assessment to the respondent for war-time (company) tax for the financial year 1942-1943 based on taxable profit for the year ended 31st January 1942 for the sum of £5,761 10s. 4d.

24. The Commissioner supplied with the said assessment a statement showing how the amount of tax was assessed and how the "capital employed" was computed.

The following is a copy of the part of the said statement showing the computation of the "capital employed" :—

| | | |
|---|---|---|
| Paid up capital as at 31/1/41 .. .. .. | | 185,000 |
| Book value of assets subject to depreciation— | | |
| Fittings and fixtures .. .. .. .. | 20,225 | |
| Lifts .. .. .. .. .. .. | 2,500 | |
| Machines.. .. .. .. .. .. | 3,124 | |
| | 25,849 | |
| Less depreciated values as per schedule .. .. | 24,606 | |
| | | 1,243 |
| | | 183,757 |
| Appropriation account .. .. .. .. | 20,548 | |
| Less dividends declared 31/3/41 .. .. .. | 10,075 | |
| | 10,473 | |

| | | | |
|---|---|---|---|
| Reserves—Income tax .. .. .. | £12,200 | | |
| Stock .. .. .. .. | 4,500 | | |
| | | 16,700 | |
| Bad debts .. .. .. .. | | 1,092 | |
| | | 28,265 | |
| Less appropriation account at 31/1/35 .. .. | | 13,107 | |
| | | | 15,158 |
| £10,075 (dividend declared 31/3/41) for 59 days.. .. | | | 1,629 |
| Total .. .. .. .. | | | £200,544 |

25. On 15th June 1943 the respondent by its agents gave notice to the Commissioner of objection to the said assessment.

26. On 1st May 1943 the Commissioner gave to the respondent notice that its objection had been considered and disallowed.

27. On 3rd May 1943 the respondent by its agents gave notice to the Deputy Commissioner that it was dissatisfied with the Deputy Commissioner's decision and requested that the decision be referred to the Board of Review.

28. The Commissioner, as requested, referred the matter to the Board of Review.

29. On 20th May 1943 the Board of Review heard the reference.

30. On 27th October 1943 the Board delivered its decision on the said reference.

The decision of the Board of Review reads as follows :—The Board decides : (*a*) (by majority) that in calculating the amount of accumulated profits for each of the accounting periods under review the sum of £13,107 1s. 10d. shall not be taken into account ; and (*b*) that the sum of £2,000 representing the dividend payable on 30th May 1941 cannot be regarded as part of the accumulated profits after 31st March 1941 (the date on which the dividend was declared). Assessments to be amended accordingly.

31. On 25th November 1943 the appellant filed with the District Registrar of the High Court at Adelaide and served upon the respondent a notice of intention to appeal against the decision of the Board of Review.

32. The following questions were stated for the opinion and consideration of the Full Court :—Whether upon the true construction of s. 24 of the *War-time* (*Company*) *Tax Assessment Act* 1940-1941 :—

(1) The sum of £13,107 1s. 10d. standing to the debit of " Profit and Loss Appropriation Account to 31st January 1935 " in the books

of the respondent company on 1st February 1941 should have been taken into account in computing the capital of the company employed in the accounting period which ended on 31st January 1942 for the purposes of such section.

(2) If the said sum should have been so taken into account then to what extent should it have been taken into account and in particular whether :—

(*a*) the whole of the said sum should have been deducted from the sum of £28,265 appearing in the computation of capital employed in par. 24 above written, or

(*b*) only so much of the said sum should have been deducted from the said sum of £28,265 as exceeds the sum of £12,102 being the sum of the amounts of £10,473 and £1,629 mentioned in the said computation, or

(*c*) it should have been taken into account in the following manner : by adding to the sum of £183,757 mentioned in the said computation the following sums :—

(i) the sum of £17,792 being the sum of the amounts of the income tax reserve (£12,200), stock reserve (£4,500) and bad debts reserve (£1,092) ; and,

(ii) the sum of £1,203 which is obtained by multiplying the sum of £7,441 (the difference between the sum of £20,548—the amount to the credit of the respondent's " Profit and Loss Appropriation Account from 1st February 1935 " at the commencement of the accounting period—and the said sum of £13,107) by 59 and dividing the product by 365 (dividends in excess of £7,441 having been declared at the expiration of 59 days from the commencement of the accounting period).

*Ross* K.C. (with him *Bright*), for the appellant. The question is what are " the accumulated profits " under s. 24 (1) (*b*). The company relies on *Hooper & Harrison Ltd.* (*in Liquidation*) v. *Federal Commissioner of Taxation* (1). Before ascertaining accumulated profits you must take into account previous losses. A profit and loss account is not necessarily *the* profit and loss account contemplated by the section (*Meares* v. *Acting Federal Commissioner of Taxation* (2) ). If the profit and loss account is incorrect you have to look at the true position (*Stodart* v. *Deputy Federal Commissioner of Taxation* (3) ). " Accumulated profits " merely means profits

(1) (1923) 33 C.L.R. 458, at pp. 469, 481.

(2) (1918) 24 C.L.R. 369, at pp. 371, 372.

(3) (1928) 42 C.L.R. 106.

H. C. of A. 1945-1946.

Federal Commissioner of Taxation v. Miller Anderson Ltd.

that have not been distributed. The phrase is not limited to items transferred to reserves (*Forrest* v. *Federal Commissioner of Taxation* (1); *Stodart* v. *Deputy Federal Commissioner of Taxation* (2); *Resch* v. *Federal Commissioner of Taxation* (3)). You cannot ascertain accumulated profits without taking into account losses. Agreements with preference shareholders cannot affect the position as laid down by the Act, and the rights of the Crown do not depend on the book-keeping of the taxpayer (*Edinburgh Life Assurance Company* v. *Lord Advocate* (4)). No accumulation of profits could commence until previous loss was replaced.

*Piper*, for the respondent. The expression "capital employed" in s. 24 is an artificial expression, and the "capital employed" must be calculated strictly in accordance with that section (*Incorporated Interests Pty. Ltd.* v. *Commissioner of Taxation* (5)) and cf. per Lord *Atkinson* in *Ormond Investment Co.* v. *Betts* (6) adopted in *Stodart* v. *Deputy Federal Commissioner of Taxation* (7). [He also referred to *Sharp, Stevenson & Hare Ltd.* v. *Federal Commissioner of Taxation* (8) and *Redbank Meatworks Pty. Ltd.* v. *Commissioner of Taxes* (Q.) (9).] Reading the section as a whole :—"The basis of the legislation is that taxation should be imposed . . . in relation to the ratio of that profit to the money which *has been invested* by the shareholders in the company, either in actual contributions to capital or by allowing to be used in the business of the company moneys which represented profits which they might, if they had so elected, have distributed as dividends": Cf. per *Latham* C.J. in *Redbank Meatworks Pty. Ltd.* v. *Commissioner of Taxes* (Q.) (10). To "capital paid up" must be added "accumulated profits" "averaged over the accounting period." "Capital paid up" means the actual capital paid up, whether or not it has been lost or is unrepresented by assets (*Redbank Meatworks Pty. Ltd.* v. *Commissioner of Taxes* (Q.) (11)). "Accumulated profits" means "profits made and not distributed" (*Meares* v. *Acting Federal Commissioner of Taxation* (12); *Forrest* v. *Federal Commissioner of Taxation* (1); *Stodart* v. *Deputy Federal Commissioner of Taxation* (13)). The £13,107 had on 31st January 1935 actually been lost; and there being no accumu-

(1) (1921) 29 C.L.R. 441, at p. 447.
(2) (1928) 42 C L.R. 106, at pp. 112, 115, 134.
(3) (1942) 66 C.L.R. 198, at p. 231.
(4) (1910) A.C. 143, at p. 163.
(5) (1943) 67 C.L.R. 508, at p. 517.
(6) (1928) A.C. 143, at p. 162.
(7) (1928) 42 C.L R. 106, at pp. 118, 135.
(8) (1927) 39 C.L.R. 158, at p. 170.
(9) (1944) 69 C.L.R. 315, at p. 334.
(10) (1944) 69 C.L.R. 315.
(11) (1944) 69 C.L.R. 315, at pp. 326, 327, 328, 333, 334, 336.
(12) (1918) 24 C.L.R. 369.
(13) (1928) 42 C.L.R. 107.

H. C. of A. 1945-1946.

Federal Commissioner of Taxation v. Miller Anderson Ltd.

lated profits out of which it could be paid it was actually *lost capital.* The company was not bound to restore this lost capital out of subsequent profits (*Lee* v. *Neuchatel Asphalte Co.* (1); *Ammonia Soda Co. Ltd.* v. *Chamberlain* (2)). There is no rule that where capital has been lost subsequent profits are automatically turned into capital, to replace the capital lost (*Ammonia Soda Co. Ltd.* v. *Chamberlain* (3)). The company has elected not to apply the subsequent profits in replacing the lost capital. The balance in the "Profit and Loss Appropriation Account from 1st February 1935" was comprised of "profits earned and undistributed." They had an independent existence, and came within the words "accumulated profits" in s. 24 (1) (*b*). There is no authority in the section for the deduction of losses. The provisions as to deductions are exhaustive: "*expressio unius alterius exclusio.*" The shareholders have "invested in the company": (1) the original capital of £185,000 (of which £13,107 has been lost); (2) the profits made and undistributed since 31st January 1935. Section 24 requires these two sums to be added together. To add them together, without making any deduction in respect of the losses is in accordance with the basis of the legislation as set out in (2) above. It follows that the decision of the Board of Review was right and the £13,107 is not to be taken into account in computing the capital employed.

[Dixon J. referred to *In re Spanish Prospecting Co. Ltd.* (4).]

*Ross* K.C. in reply. Though s. 24 may create an artificial meaning of "capital employed" no artificial meaning is given to "accumulated profits." It is a question of fact to be determined in a business sense (*Hooper & Harrison Ltd.* (*in Liquidation*) v. *Federal Commissioner of Taxation* (5)). The company cannot start an accumulation at any time. It must be over the life of the company. As to the meaning of "profits," see *In re Spanish Prospecting Co. Ltd.* (6); *Long Acre Press Ltd.* v. *Odhams Press Ltd.* (7). [He also referred to *Dovey* v. *Cory* (8).]

*Cur. adv. vult.*

1946, April 4.

The following written judgments were delivered:—

Latham C.J. These are two cases stated in appeals by the Federal Commissioner of Taxation against decisions of a Board of Review in relation to assessments of the respondent company under the *War-time* (*Company*) *Tax Assessment Act.* One assessment

(1) (1889) 41 Ch. D. 1.
(2) (1918) 1 Ch. 266.
(3) (1918) 1 Ch. 266, at p. 296.
(4) (1911) 1 Ch. 92.
(5) (1923) 33 C.L.R. 458.
(6) (1911) 1 Ch. 92, at p. 98.
(7) (1930) 2 Ch. 196.
(8) (1901) A.C. 477, at p. 486.

H. C. of A. 1945-1946.

Federal Commissioner of Taxation v. Miller Anderson Ltd.

Latham C.J.

relates to an accounting period ended 31st January 1941, the relevant Acts in the case of this assessment being the *War-time (Company) Tax Act* 1940 and the *War-time (Company) Tax Assessment Act* 1940. The other assessment relates to an accounting period ended 31st January 1942, and in this case the relevant Acts are the *War-time (Company) Tax Act* 1940-1941 and the *War-time (Company) Tax Assessment Act* 1940-1941. The questions which arise upon the cases stated depend upon the interpretation and application of s. 24 of the *Assessment Act,* which has not been amended since its original enactment.

The procedure of appeal from an assessment to a Board of Review and from a Board of Review to the High Court is introduced by s. 34 of the *Assessment Act,* which applies the provisions of the *Income Tax Assessment Act* 1936-1941 relating to these matters.

War-time (company) tax is imposed upon the amount by which the taxable profit derived by any company during the relevant accounting period exceeds the percentage standard (s. 13). "Taxable profit" is defined in s. 3 of the Act. The percentage standard where the accounting period is a period of twelve months (as in the present case) is an amount equal to the statutory percentage of the capital employed or deemed to be employed during the accounting period (s. 19). The statutory percentage under the 1940 Act was 8 per cent, but was reduced to 5 per cent by the amending *Assessment Act* of 1941.

The greater the amount of the capital employed in any accounting period the higher the percentage standard, and the higher the percentage standard the smaller the amount of difference between the percentage standard and the taxable profit, and, therefore, the lower the tax. The company contends that in each assessment the Commissioner has wrongly calculated the capital employed during each accounting period, because he has deducted from the amount which the company claims to be correct an amount of loss incurred prior to 1st February 1935. The same question arises upon each case stated, and, following the course of argument, I propose to examine it in relation to the second assessment, i.e., for the accounting period ending 31st January 1942.

Section 24 of the *Assessment Act* contains the following provisions :—

"(1) Subject to section twenty-five of this Act, the capital employed in any accounting period shall, for the purposes of this Act, be ascertained by adding the following amounts, namely :—

(*a*) the capital paid up in money or by other valuable consideration, averaged over the accounting period ;

(*b*) accumulated profits, averaged over the accounting period, including amounts standing to the credit of the Profit and Loss Account at the commencement of the accounting period but not including any profit of the accounting period. . . ."

The amount to be included in the capital under par. (*a*) of s. 24 (1) is not in dispute. It is the amount of the paid up capital less an amount of £1,243, representing depreciated value of assets deducted under par. (*i*) of s. 24 (1). Thus it is agreed that under (*a*) the amount to be included in the capital employed in the accounting period is £183,757.

Certain profits were placed by the company to the credit of reserve accounts. There are three reserve accounts—income tax, stock, and bad debts, amounting to £17,792, which amount it is also agreed should be included in the capital employed. Deductions were made by the Commissioner in respect of a proportion of dividends declared during the accounting period and not paid until after the commencement of the period. As to this matter there is also no dispute.

Controversy arises with respect to the meaning and application of the following words appearing in par. (*b*) of s. 24 (1)—" accumulated profits . . . including amounts standing to the credit of the Profit and Loss Account at the commencement of the accounting period."

The company's year ended on 31st January. The company made profits for the years 1928, 1929 and 1930 (that is, the years ending on 31st January in each case) and, after provision had been made for taxation, depreciation, bad debts and payment of dividends, there was £820 to the credit of profit and loss account at the end of the accounting period ending 31st January 1930. In the five following years the results of trading were as follows :—

| | | | | | |
|---|---|---|---|---|---|
| " 1931 | .. | Loss .. | .. £3,296 | 0 | 0 |
| 1932 | .. | Loss .. | .. 11,834 | 0 | 0 |
| 1933 | .. | Profit .. | .. 23 | 0 | 0 |
| 1934 | .. | Profit .. | .. 1,195 | 0 | 0 |
| 1935 | .. | Profit .. | .. 3,186 | 0 | 0 " |

As at 31st January 1935 the debit balance in what was called the " Profit and Loss Appropriation Account " was £13,107.

At this time there were arrears of dividends on preference shares amounting to £28,800, and ordinary shares had not received a dividend since 1929.

On 15th May 1935 an agreement was made and duly confirmed by which the rights of the preference shareholders were altered. Arrears of dividend were reduced in amount and payment on account

H. C. of A. 1945-1946.

Federal Commissioner of Taxation v. Miller Anderson Ltd.

Latham C.J.

of arrears was postponed until after 1st February 1938. The preference dividend rate was reduced and it was agreed that profits should be applied in the first place to satisfying preference shareholders upon the reduced basis of the agreement.

Another agreement varying the rights of shareholders was made on 7th September 1938. It provided for the distribution of future profits as between preference and ordinary shareholders, and, as to profits not distributed, for their retention, use or application, at the absolute discretion of the directors in " reducing the amount standing to the debit of ' Profit and Loss Account on 31st January 1935,' in making further payments on account of the arrears of preference dividend on that day or in writing off depreciation " or such profits " might be retained and carried forward in the profit and loss account." In fact the power of applying profits to the reduction of the standing debit has not been exercised and the " Profit and Loss Appropriation Account on 31st January 1935 " still shows the same debit of £13,107.

After 31st January 1935 the company made profits, and these were " carried to a separate profit and loss appropriation account in the ' liabilities ' column of the company's balance sheets." This account was entitled " Profit and Loss Appropriation Account from 1st February 1935 " (par. 11 of case). Thereafter the company had two sets of entries in its accounts, each described as " Profit and Loss Appropriation Account." The older account was called " Profit and Loss Appropriation Account to 31st January 1935 " and at all times (with one exception) it has since shown merely a debit of £13,107 1s. 10d.

The exception appears in the company's private ledger in a balance sheet as at 31st January 1936. In that ledger the following entries appear :—

| | | | | |
|---|---|---|---|---|
| " Profit and Loss Appropriation— | | | | |
| Balance as at 31st January 1935 | 13,107 | 1 | 10 | |
| Less net profit for the year .. | 5,579 | 0 | 10 | |
| | | | | £7,528 1 0 " |

But the published balance sheet issued to shareholders with the notice of the annual meeting held on 20th March 1936 contained the following entries :—

Under " assets " :—

" ' Profit and loss appropriation '—
balance as at 31st January 1935, .. £13,107 1 10."

Under " liabilities " :—

" ' Profit and loss appropriation '—
from 1st February 1935
Net profit for year ended 31st January 1936 5,579 0 10."

The new account is called "Profit and Loss Appropriation Account from 1st February 1935." This account, made up from the liabilities column of the balance sheet (where alone the relevant entries appear), shows a credit balance in each year up to the latest accounting period, an application of part of the profit in paying dividends, and a credit balance as at 31st January 1941 of £20,548.

The company claims that this amount of £20,548 represents accumulated profits which should be included in the "capital employed" by virtue of the words "accumulated profits" in s. 24 (1) (*b*), and that no deduction should be made on account of the outstanding debit of £13,107 recorded in the older account. That debit balance, it is contended, should be regarded as a loss of capital. The statements of account show that there was nothing to meet the loss except capital assets. Section 24 (1) (*a*) entitles the company to have all the capital which has been paid up in money included in the calculation of "capital employed," even though the capital has been lost. Similarly, it is argued, no attention should be paid to the debit of £13,107.

Alternatively, the company contends that the amount of £20,548 is an amount standing to the credit of the profit and loss account at the commencement of the accounting period, namely on 31st January 1941, and that therefore it should be included in the "capital employed" by virtue of the express words of s. 24 (1) (*b*).

The Commissioner contends, on the other hand, that the amount of £20,548 does not represent accumulated profits because there has been no accumulation of this amount, inasmuch as it has not been set aside in any way from the general assets of the company. Further, it is contended for the Commissioner that the true amount standing to the credit of the profit and loss account is not £20,548, but that sum less £13,107. The section, it is said, refers to a true statement of accounts, and a true statement of the profit and loss account would show a credit balance, not of £20,548, but of £7,441.

The Board of Review by a majority decided in favour of the view submitted on behalf of the company.

Some guidance in interpreting the provisions of s. 24 (1) can be obtained from decisions of this Court upon somewhat similar provisions in other statutes. In *Meares* v. *Acting Federal Commissioner of Taxation* (1), the Court held that a true profit and loss account, strictly so called, was limited to the dealings of a stated period. It was also said, however, that companies frequently transferred balances from the profit and loss account for one year to the same account for the following year, and that if that were done such action

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

H. C. of A. 1945-1946.

Federal Commissioner of Taxation v. Miller Anderson Ltd.

Latham C.J.

might well be thought to be "inconsistent with an intention to treat the amount so dealt with as an accumulated fund." Thus this decision suggests that an amount carried forward in a profit and loss account should be regarded as not "accumulated."

But other views have been expressed in the Court as to the meaning of "accumulated profits." In *Forrest* v. *Federal Commissioner of Taxation* (1), the Court considered a provision in the *Income Tax Assessment Act* 1915-1916 referring to "undistributed income accumulated prior to 1st July 1914," with a proviso that amounts "carried forward by a company to the credit of the profit and loss account shall not be deemed to be accumulated income." The company in question revalued its assets, with the result that the value of assets was increased over their previously shown book values by an amount of £100,000. The company, treating this sum as representing a profit the existence of which had not previously been recognized, applied the amount for the purpose of enabling shareholders to pay for debenture stock issued by the company. The question was whether a shareholder was liable to income tax in respect of the debenture stock issued to him, or whether, on the other hand, he escaped tax because the debenture stock represented profits accumulated before 1st July 1914. It was held that the increase in value was undistributed income so accumulated. In the judgment of the Court this was said : "Considering the object of the proviso [that is, to exempt a shareholder from certain tax liability], we see no reason for attributing to the expression 'undistributed income accumulated' any meaning other than income which had not been in fact distributed and had in fact accrued to the Company before 1st July 1914" (2). It will be observed that the "income" in question had not been separated from the other assets of the company by being placed in a reserve fund or otherwise. It had been received, and still existed. Those facts were regarded as sufficient to show that it had been "accumulated." It may further be noted that it was thought necessary by the legislature to make a provision expressly excluding from "accumulated income" amounts "carried forward" by a company to the credit of profit and loss account.

In *Hooper & Harrison Ltd. (in Liquidation)* v. *Federal Commissioner of Taxation* (3), one of the sections under consideration was s. 17 (1) of the *War-time (Profits) Tax Assessment Act* 1917-1918, which provided that :—"The amount of the capital of a business shall be taken to be the amount of its capital paid up by the owner in money or in kind, together with all accumulated trading profits invested in the business,

(1) (1921) 29 C.L.R. 441.
(2) (1921) 29 C.L.R. 441, at p. 447.
(3) (1923) 33 C.L.R. 458.

with the addition or subtraction of balances brought forward from previous years to the credit or debit respectively of profit and loss account." This section, providing for the ascertainment of "the amount of the capital of a business," performs in relation to the Act in which it appeared the same function as s. 24 in the present Act. *Knox* C.J., *Higgins* and *Gavan Duffy* JJ. decided the case upon the meaning of the word "invested" (See (1)), and not upon the meaning of the word "accumulated." (The word "invested" is not used in s. 24 (1) of the present Act.) *Isaacs* and *Rich* JJ., however, did examine the meaning of the word "accumulated" and were of opinion (2) that the true import of the term "accumulated profits" was "that they are profits which the Company has appropriated to some reserve account, whether that account be of a capital nature or not. 'Accumulation' in that connection does not mean the mere existence of profits, even over a lengthened period, however they are employed; but it connotes the affirmative gathering of these profits, or such as may be selected, into a measured or measurable heap and allocated to a named reserve fund, whatever its nature may be." This view of the meaning of "accumulation" (differing from that expressed in the decision in *Forrest's Case* (3)) would exclude from accumulated profits a sum which existed only as a credit balance carried forward from one year to another in a profit and loss account, and not placed to any reserve. It is, I think, clear that the legislature had this possible view of the nature of accumulated profits in mind when it expressly provided in the present Act that an amount standing to the credit of a profit and loss account at the commencement of an accounting period should be included in the capital of the company. The words "accumulated profits" appearing at the beginning of par. (*b*) of s. 24 (1) might not have been effective to bring in such amounts.

In *Stodart* v. *Deputy Federal Commissioner of Taxation* (4), the Court had to deal with a section in the *Income Tax Assessment Act* 1922-1927. This section corresponded to the section which was the subject of decision in *Forrest's Case* (3). It excluded from income sums received by a shareholder out of "undistributed income accumulated prior to 1st July 1914," but varied the terms of the earlier section by including the following provision:—"For the purpose of this proviso, amounts carried forward by a company in its profit and loss account, appropriation account, revenue and expenses account, or any other account similar to any of the foregoing accounts shall

(1) (1923) 33 C.L.R., at pp. 469, 489, 490.
(2) (1923) 33 C.L.R., at p. 481.
(3) (1921) 29 C.L.R. 441.
(4) (1928) 42 C.L.R. 106.

H. C. of A. 1945-1946.

Federal Commissioner of Taxation v. Miller Anderson Ltd.

Latham C.J.

not be deemed to be accumulated income." The company in which the taxpayer was a shareholder showed in its public accounts only the actual profit in respect of a yearly period, not bringing forward any balances from preceding years. (In so doing it presented a profit and loss account in the sense held to be strictly proper and accurate in *Meares' Case* (1).) The company had in its ledger a profit and loss account in which balances were carried forward from year to year. It was unanimously held by the court that the amount so brought forward was accumulated income. *Knox* C.J. simply said: "The sum . . . represented trading profits earned by the Company in two preceding years and not distributed or otherwise dealt with, and, in my opinion, is properly described as accumulated income of the Company" (2). *Isaacs* J. in this case held that he was bound by *Forrest's Case* (3) to come to the same conclusion. In so doing he adopted and applied the view which he had rejected in *Hooper's Case* (4). There was an equal division of opinion in the Court as to whether the words "carried forward by a company in its profit and loss account" referred to the public accounts of the company, or to its books of account, which were not public.

Another case which was mentioned in argument was *Sharp, Stevenson & Hare Pty. Ltd.* v. *Federal Commissioner of Taxation* (5). But this case is an authority with respect to the meaning of the word "invested" and not with respect to the meaning of either "accumulated" or "carried forward."

The result of the decisions mentioned is that profits may be "accumulated," even if they are not placed to a reserve fund, but that no definite guidance has been afforded by the Court as to the meaning of the words "carried forward in a profit and loss account."

A profit and loss account strictly so called relates only to receipts and expenditure during a definite period; a profit and loss appropriation account is an account showing disposition of profit or method of dealing with a loss: *Meares Case* (1). Section 24 refers to a profit and loss account. But it has not been contended on behalf of the company that the "Profit and Loss Appropriation Account from 1st February 1935" is not a profit and loss account within the meaning of s. 24. Such a contention would prevent the company from relying upon the words "amounts standing to the credit of the Profit and Loss Account at the commencement of the accounting period," and would make it necessary for the company to rely only upon the words "accumulated profits." The cases cited show that

(1) (1918) 24 C.L.R. 369.
(2) (1928) 42 C.L.R., at p. 112.
(3) (1921) 29 C.L.R. 441.
(4) (1923) 33 C.L.R. 458.
(5) (1927) 39 C.L.R. 158.

a balance of profits may be held to be "accumulated" though they merely exist and have not been placed to a reserve fund. But "accumulation" plainly refers to the past and not to a current period. Thus *accumulated* profits must refer to a continuous account, and the words of the section show that the account is a loss as well as a profit account. Thus, if the matter is to be decided on the words "accumulated profits," it should be held that the loss of £13,107 must be deducted from the amount of £20,548. It is only this balance of £7,441 which can be regarded as accumulated profits.

The company contends, however, that the amount of £20,548 should be taken into account in full as an amount standing to the credit of its profit and loss account at the commencement of the accounting period, i.e., at 1st February 1941, without deduction of the amount of £13,107.

In s. 24 (1) of the *Assessment Act* the legislature, in addition to including "accumulated profits," has expressly included money standing to the credit of a profit and loss account at the commencement of an accounting period. This provision excludes any argument that such an amount is not to be calculated in capital employed for the reason that it is not "accumulated." Further, this provision also seeks to avoid the difficulties which arose from the use of the words "carried forward" by substituting the words "standing to the credit." The words "carried forward" almost inevitably raise an argument as to whether the reference is not merely to the bookkeeping of the company; the words "standing to the credit" are perhaps stronger to exclude this argument and to require an ascertainment of the amount which actually stands to the credit of the account, whatever may be the form in which the books of the company are kept.

The company has elected to draw a line across its accounts at 1st February 1935, and, by separating its life into two periods, has shown a loss of £13,107 in the first period, and what is called an accumulated profit of £20,548 in the second period. There were quite good reasons for doing this arising out of the necessity for making some arrangement with the preferential shareholders. That arrangement involved special provisions as to the application of profits earned during a period after the making of the arrangement. But though such an arrangement limited the power of the company in respect of the disposition of its profits, it did not affect the amount of profits nor could it, in my opinion, affect the application of taxation legislation. If the company, for purposes of its business, could separate its accounts at 1st February 1935 and thus affect its liability to tax, it could equally well separate them at any other time and so could,

H. C. of A. 1945-1946.

Federal Commissioner of Taxation v. Miller Anderson Ltd.

Latham C.J.

without any real change in its true financial position, radically affect its tax liability. It could put all the profits into one account and all the losses into another account, and then claim that the profits so shown were amounts standing to the credit of a profit and loss account within the meaning of s. 24, so that they should be added to the capital employed by the company.

I am of opinion that it is not open to the company to do this, not because such a course would disappoint the revenue authorities, but because the terms of s. 24 (1) (*b*) show that the legislature intended that the profit and loss account referred to in the section should be a continuous account, and not a series of separate accounts relating to separate years or to selected groups of years. The words " standing to the credit of the profit and loss account at the commencement of the accounting period " show that the profit and loss account referred to is not an account of the strict character referred to in *Meares' Case* (1), that is, an account limited to the transactions of a single period, with no balance brought forward from preceding years. A profit and loss account of such a character cannot have *any* amount standing to its credit at the commencement of an accounting period. Thus the profit and loss account which the section contemplates is a profit and loss account which does bring forward balances at the beginning of each year. The account, therefore, must be continuous and, being an account of losses as well as of profits, must bring forward debit balances as well as credit balances. The difficulties revealed in the cases as to the meaning of " carried forward " are avoided by the use of the words " standing to credit at the commencement of the accounting period." The only question to be asked is whether the amount in question really stands to the credit of the profit and loss account at the relevant time. I use the word " really " because the section does not say " shown as standing to the credit " &c. The words which are used mean " actually standing to credit upon a true statement in a continuous account."

The result is that, in my opinion, the two profit and loss accounts of the company must be regarded as a single account. The company cannot at will divide its profit and loss account into two or more profit and loss (or profit or loss) accounts and elect to ignore one or more for the purpose of s. 24. Thus, in my opinion, the debit balance of £13,107 must be carried forward, with the result that the credit balance of £20,548 is reduced to £7,441.

Argument was addressed to the Court as to whether the company was entitled to declare dividends before replacing the loss of £13,107

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

(*Lee* v. *Neuchatel Asphalte Co.* (1); *Ammonia Soda Co. Ltd.* v. *Chamberlain* (2) ). But this question does not appear to me to have any relevance to the first question in the cases before the Court.

Question No. 1 in the case relating to the accounting period ending on 31st January 1942 is :—" Whether upon the true construction of s. 24 of the *War-time (Company) Tax Assessment Act* 1940-1942 the sum of £13,107 1s. 10d. standing to the debit of ' Profit and Loss Appropriation Account to 31st January 1935 ' in the books of the respondent company on 1st February 1941 should have been taken into account in computing the capital of the company employed in the accounting period which ended on 31st January 1942 for the purposes of such section." In my opinion this question should be answered : Yes.

The amount standing to the credit of the profit and loss account should therefore be stated as £7,441, and not as £20,548, and the amount of accumulated profits at the commencement of the accounting period is therefore £25,233, the total of the reserve fund (£17,792) and £7,441.

A further question arises, however, as to the application of the provision in s. 24 (1) (*b*) that " accumulated profits " are to be " averaged over the accounting period." In my opinion this provision for averaging applies to all the accumulated profits to which the provision relates, that is to say, in the present case it includes not only the reserve funds mentioned, but also the amount of £7,441 standing to the credit of the profit and loss account at the commencement of the accounting period.

On 31st March 1941, that is, after 59 days of the accounting period had elapsed, the company declared a dividend of £10,075. The company did not draw upon the reserve funds, and the dividend was in fact paid out of other moneys, namely out of the whole or part of the amount of £20,548, which represented profits earned since 1935. The company was entitled to do this without replacing the accrued loss of £13,107 : See *Lee* v. *Neuchatel Asphalte Co.* (1). The question is as to the proper method of averaging the accumulated profits under the section. If the whole of the £7,441 is regarded as having been absorbed by the payment of the dividend, the company would be regarded as having the use of £7,441 (part of £25,233) for only 59 days of the year, and the proper addition to make to the reserve fund (£17,792) under the section would be 59/365 of £7,441, that is, £1,203.

This was the view taken by the chairman of the Board and it was in effect accepted on both sides upon the hearing of the appeal.

(1) (1889) 41 Ch. D. 1. (2) (1918) 1 Ch. 266.

H. C. of A. 1945-1946.

Federal Commissioner of Taxation v. Miller Anderson Ltd.

Latham C.J.

Subsequently, upon the invitation of the Court, counsel made submissions with respect to another possible method of applying the averaging provision of the section. The parties also agreed upon a further fact as to the declaration of the dividend which they desired the Court to take into consideration. This fact is that the company resolved in general meeting to adopt a recommendation of the directors that the dividend be paid out of a sum of £14,528, being the profits of the preceding year. According to the other possible method of applying the averaging provision the dividend would be regarded as paid either out of the whole credit balance of £20,548, or alternatively out of the amount of £14,528, and only a ratable proportion of the dividend would be treated as paid out of the amount of £7,441. There is, I think, much to be said in support of this view. But, though not without doubt, I have come to the conclusion that the former view is to be preferred. Section 24 adopts a special artificial method of determining the "capital employed" for the purposes of the Act. It is the part of *that* capital, determined in accordance with par. (*b*) of the section, that is to be averaged. The reference to averaging supposes that that part of such capital may be increased or diminished during an accounting period. Increases during the year are to be added to that capital and on the same principle decreases during the year should be charged against that capital, in each case in respect of the period during which the increase or decrease was effective in relation to the amount of that capital available for use by the company. The object of s. 24 is to ascertain how much capital is to be taken for the purposes of the Act as being used in the business of the company. Only the amount calculated in accordance with this section is regarded by the Act as being available for disposition by the company. Where, as in this case, part of the capital is made up of accumulated profits as ascertained under par. (*b*) of the section, expenditure chargeable against accumulated profits should, I think, be regarded as chargeable against the accumulated profits which are recognized by the Act as part of the statutory artificial "capital employed," and not against another fund which the section excludes from recognition as accumulated profits within the meaning of the Act. Thus the proper addition to make to the reserve fund (£17,792) is, in my opinion, the above-mentioned sum of £1,203.

The second question in the case, which suggests various methods of averaging, should be answered by stating that the method set out in par. 2 (*c*) of the question is correct.

A corresponding order should be made in the other case—No. 9 of 1943. The costs of the cases should be costs in the appeal and the cases should be remitted to *Dixon* J.

H. C. OF A. 1945-1946.

FEDERAL COMMISSIONER OF TAXATION v. MILLER ANDERSON LTD.

STARKE J. Cases stated pursuant to the *War-time* (*Company*) *Tax Assessment Act* 1940, the *Income Tax Assessment Act* 1936-1941, and the *Judiciary Act* 1903-1940.

The main question is whether a sum of £13,107 in round figures standing to the debit of " Profit and Loss Appropriation Account to 31st January 1935 " in the books of the company on 1st February 1940 and on 1st February 1941 respectively, should be taken into account in computing the capital of the company employed in the accounting periods which ended on 31st January 1941 and 1942 respectively.

That depends upon the construction of s. 24 of the *War-time* (*Company*) *Tax Assessment Act* 1940-1941.

" The Profit and Loss Appropriation Account to 31st January 1935 " in the books of the company shows a debit balance of £13,107 in round figures, which was not carried forward into the profit and loss appropriation accounts of succeeding years. But a new profit and loss appropriation account described as " Profit and Loss Appropriation Account from 1st February 1935 " was opened, which at 31st January 1941 showed a credit balance of £20,548 in round figures. These two separate profit and loss appropriation accounts were rendered necessary in order to carry out an agreement between preference and ordinary shareholders, providing that profits from 1st February 1935 were to be used in a particular way.

The Commissioner claims that the amount of £13,107 carried forward and at debit of the " Profit and Loss Appropriation Account to 31st January 1935 " should be deducted from the sum of £20,548 standing to credit of " Profit and Loss Appropriation Account from 1st February 1935 " in ascertaining the capital employed by the company in the accounting period of twelve months which ended on 31st January 1942.

The *War-time* (*Company*) *Tax Assessment Act* 1940, s. 24, provides " the capital employed in any accounting period shall, for the purposes of this Act, be ascertained by adding the following amounts, namely :— . . . (*b*) accumulated profits, averaged over the accounting period, including amounts standing to the credit of the Profit and Loss Account at the commencement of the accounting period but not including any profit of the accounting period."

Accumulated profits are simply profits that are amassed or collected and not distributed, including, as the Act prescribes, amounts standing to the credit of the profit and loss account of the company.

A profit and loss account is, as *Griffith* C.J. said in *Meares* v. *Acting Federal Commissioner of Taxation* (1), " an account showing

(1) (1918) 24 C.L.R. 369, at p. 372.

H. C. OF A. 1945-1946.

FEDERAL COMMISSIONER OF TAXATION v. MILLER ANDERSON LTD.

Starke J.

the transactions of the business adventure during a given period," but as a matter of book-keeping, the account may be kept as a continuous account bringing forward the amounts of profit or loss, the result of operations extending over a number of successive periods. It is not the form of the company's accounts that determines its accumulated profits, but the true result of its operations. To say that the accumulated profits of the company at the commencement of the accounting period in this case were £20,548 because that amount stood as at 31st January 1941 at credit of the " Profit and Loss Appropriation Account from 1st February 1935," although the company had incurred a loss of £13,107 by the end of the balancing period in 1935, which was carried forward in a special " Profit and Loss Appropriation Account to 31st January 1935 " for certain business purposes of the company, requires demonstration both as a matter of fact and of law. It was said that the sum of £13,107 was capital that had been lost and should not therefore be taken into account in ascertaining the accumulated profits of the company. But the argument is untenable, for no part of that sum was written off capital or otherwise, but was carried forward in a special account as a trading loss. And the contention that the Act itself prescribes that the sum of £20,548 standing to credit of the company in its " Profit and Loss Appropriation Account from 1st February 1935 " must be treated as capital employed by the company in the relevant period, is equally untenable. The Act contemplates the ascertainment of profits that have been accumulated over an indefinite period and does not preclude the ascertainment of that amount by means of a continuous account of operations extending over any number of successive years. The cases of *Hooper & Harrison Ltd. (in Liquidation)* v. *Federal Commissioner of Taxation* (1), *Sharp, Stevenson & Hare Pty. Ltd.* v. *Federal Commissioner of Taxation* (2), *Stodart* v. *Deputy Federal Commissioner of Taxation* (3), and some other cases were referred to upon the argument of this case, but were decided under other Acts in different language and do not conflict, I think, with anything that has been said. Indeed, the present section appears to have been enacted in its present form to meet some of those decisions or the opinions expressed in them.

The subsidiary questions raised by question 2 do not require elaboration, for the questions and the answers to them explain themselves.

The balance sheets and profit and loss accounts of the company from 1st January 1935 disclose a credit balance as at 31st January 1940 of £6,020 after dividend distributions, including a dividend of

(1) (1923) 33 C.L.R. 458.
(2) (1927) 39 C.L.R. 158.
(3) (1928) 42 C.L.R. 106.

£2,400 on preference shares for half-year to 31st July 1940. But if the sum of £13,107 were debited against this sum the accounts would disclose a debit balance of £7,087. Now the accounts of the company for the year which ended on 31st January 1941 disclose a profit of £14,528 or, taking into account the debit of £7,087, a credit balance of £7,441 or the accumulated profits of the company which in truth were amassed in the year which ended on 31st January 1941. The directors recommended and the company in general meeting resolved that various dividends amounting to £10,075 be payable on 31st March 1941 out of the profits of the year ended on 31st January 1941. Those profits, as already stated, were £14,528, but that excludes the debit balance of £7,087 which would have appeared in a continuous account of profit and loss the result of operations over a number of successive years. The profits in hand were short by £2,634 of the amount required to meet the dividends, but it is clear, in these circumstances, that the sum of £7,441, so far as it would go, was necessarily used in meeting the dividend for the year ended 31st January 1941. The sum of £7,441 is averaged over the accounting period as explained in question 2 (*c*) (ii).

The case stated in relation to the assessment for the accounting period of twelve months which ended 31st January 1941 involves the same considerations, but the figures are not identical.

The questions in both cases should be answered as follows :—(1) Yes ; (2) (*a*) and (*b*) No ; (2) (*c*) (i) and (ii) Yes.

Dixon J. The facts and issues in this rather complicated case are explained with great clearness and completeness in the valuable opinion given in the Board of Review by the chairman (Mr. *Gibson*), with whose conclusions I find myself in substantial agreement. In view of his explanation, it is enough to state the chief question we have to decide in general terms. It concerns the method of ascertaining, for the purpose of s. 24 (1) (*b*) of the *War-time* (*Company*) *Tax Assessment Act* 1940-1941, a company's accumulated profits including amounts standing to the credit of the profit and loss account at the commencement of the accounting period. The question is whether a company may exclude a past accrued loss which it has carried to, or carries in, a distinct account and bring into the computation of what, for the moment, I may call its undistributed profits, only the gains and losses of subsequent accounting periods. The contrary view is that it must bring into account the consecutive results of its trading over its history, that is, except in so far as it has effectually written off or otherwise disposed of any specific accrued loss, as for instance by reduction of capital.

H. C. of A. 1945-1946.

Federal Commissioner of Taxation v. Miller Anderson Ltd.

Dixon J.

The respondent company incurred losses which, taking into account a possibly unjustifiable distribution of dividend, amounted as at 31st January 1935 to £13,107. This, in consequence of arrangements between the company and its preference and ordinary shareholders, was segregated and placed to an account called "Profit and Loss Appropriation Account to 31st January 1935." As at the end of the next accounting period a new account was opened and called "Profit and Loss Appropriation Account from 1st February 1935." After the deduction of dividends, the relevant result of the company's operations from that date to 31st January 1941, the commencement of the second of the two accounting periods with which we are concerned, as appearing from the balance sheet, has been a credit to the last-mentioned account of £20,548 and the making of provisions which we may call reserves amounting to £17,792. In the balance sheet on the debit side was shown "Profit and Loss Appropriation Account from 1st February 1935 £20,548," and, on the credit side, "Profit and Loss Appropriation Account to 31st January 1935 £13,107." If the two profit and loss appropriation accounts had not been separated as at 31st January 1935 and instead there had been a continuous account, the amount at its credit would have been £7,441. No one denies that the reserves, amounting to £17,792, constitute accumulated profits within the meaning of par. (*b*) of s. 24. But the important issue is whether, for the purposes of the paragraph, what I may call its undistributed profits should, as the company claims, be considered as £20,548 or as £7,441. The claim of the company is maintained both by general reasoning and upon the precise structure of the paragraph. As to the latter, it will be noticed that the general words "accumulated profits" are followed, after the direction for averaging the amount over the accounting period, by the specific inclusion of amounts standing to the credit of the profit and loss account at the opening of the relevant accounting period. Can the respondent bring the balance at credit of the "Profit and Loss Appropriation Account from 1st February 1935" within the latter words? That is to say, can the company say that balance is specially provided for and falls outside the operation of the general descriptive expression "accumulated profits"? Or to state the question more generally, are unreserved or floating profits accruing before the opening of the accounting period governed by the words "accumulated profits" or by the special inclusion of amounts standing to the credit of the profit and loss account at the commencement of the period? These questions arise because, as is obvious, the descriptive character of the general words "accumulated profits" provides a justification for going behind the form of the

H. C. OF A. 1945-1946. FEDERAL COMMISSIONER OF TAXATION v. MILLER ANDERSON LTD. Dixon J.

accounts adopted by the company and independently ascertaining what, so to speak, is the net result of the company's profits, losses and distributions, and such a justification would not exist if the question depended exclusively on what was found standing to the credit of the profit and loss account. Like expressions, such as "income accumulated," "accumulated trading profits invested in the business," "amounts carried forward to the credit of profit and loss account," have been used *in pari materia* in prior legislation and they have been considered and discussed in this Court in *Meares* v. *Acting Federal Commissioner of Taxation* (1); *Forrest* v. *Federal Commissioner of Taxation* (2); *Hooper & Harrison Ltd.* (*in Liquidation*) v. *Federal Commissioner of Taxation* (3); *Sharp, Stevenson & Hare Pty. Ltd.* v. *Federal Commissioner of Taxation* (4); *Stodart* v. *Deputy Federal Commissioner of Taxation* (5), decisions which, as the chairman's analysis and comparison have shown, do not provide a consistent guidance in the meaning and application of the phrases. Indeed, I repeat what I said in *Resch* v. *Federal Commissioner of Taxation* (6) concerning *Forrest's Case* (2), namely, that how far that case is consistent with *Hooper & Harrison Ltd.* (*in Liquidation*) v. *Federal Commissioner of Taxation* (7) and *Sharp, Stevenson & Hare Pty. Ltd.* v. *Federal Commissioner of Taxation* (8) may be doubted.

I think that, perhaps, there has been a tendency to give both too much fixity of meaning and too much precision to expressions of the kind in question and that the purpose of the provision in which they occur and the principle upon which it proceeds will throw more light on their exact application. Broadly speaking, the legislature may be taken to be alive to the distinction between the two courses that a company may follow with reference to profits which have accrued but which it does not desire immediately to distribute or withdraw from its business. The directors may in some way earmark the profit or part of it as a reserve or provision for a special purpose and thus distinguish it by placing it in an accounting category so that to withdraw it and make it available for distribution would require a new and affirmative decision. On the other hand, they may carry it forward in the company's accounts in such a way that, subject to the increment or diminution the trading of the next period or later periods may bring, it still awaits the decision of the directors to distribute it, to earmark it as a reserve, or otherwise to dispose of it. If the latter course is followed the profit

(1) (1918) 24 C.L.R. 369.
(2) (1921) 29 C.L.R. 441.
(3) (1923) 33 C.L.R. 458.
(4) (1927) 39 C.L.R. 158.
(5) (1928) 42 C.L.R. 106.
(6) (1942) 66 C.L.R. 198, at p. 231.
(7) (1923) 33 C.L.R. 458, at pp. 480-482.
(8) (1927) 39 C.L.R. 158, at p. 172.

H. C. of A. 1945-1946.

Federal Commissioner of Taxation v. Miller Anderson Ltd.

Dixon J.

will, according to the usual practice, stand as a credit to an appropriation account. But, although a profit and loss account should be confined to the transactions of a single accounting period, sometimes the profit of the previous period is carried to the actual profit and loss account itself of the subsequent period. But in either case it may be said to be carried forward on account of profit and loss. It may sometimes be uncertain whether and how far it is the intention of a legislative provision dealing with the profits retained in a business to demand some decision or indication on the part of a company to segregate or earmark the profits. It may be a question of interpretation whether it demands so formal a course or regards it as enough for the company to ascertain the profits and in its accounts to identify them as belonging to an accounting period. When expressions like " accumulation " and " amounts carried forward to the credit of profit and loss " are used in such a legislative provision, it may be important to extract from the expressions an intention precisely to distinguish reservation or earmarking for a purpose or separation, on the one hand, from, on the other hand, carrying forward an account of profit and loss. Further, under the latter head, it may be found that a second distinction is made, namely, between crediting profits to an appropriation account and the less usual and unorthodox course of carrying them down to the next profit and loss account.

In *Meares' Case* (1) and *Stodart's Case* (2), the second distinction was drawn and the fact that it was credited to the appropriate account was considered enough to satisfy the purpose of that legislation in preserving the separate identity and chronological source of the profit. In *Forrest's Case* (3) and *Stodart's Case* (2), it was thought that none of these things was demanded by the particular provision and that, if a profit existed before the requisite time and remained, it was to be considered to have been accumulated; whereas, in *Hooper & Harrison's Case* (4), *Isaacs* and *Rich* JJ. regarded " reservation " in some form as necessary and, I think, it may be said that the judgments in *Sharp, Stevenson & Hare Pty. Ltd.* (5) tend in the same direction, more particularly those of the minority.

Now the object of the provision contained in par. (*b*) of s. 24 (1) appears to me to be to authorize the inclusion in the capital amount on which the percentage standard is calculated of all shareholders funds employed in the business at or over the relevant time, that is to say, funds put to employment in the business and not withdrawn.

(1) (1918) 24 C.L.R. 369.
(2) (1928) 42 C.L.R. 106.
(3) (1921) 29 C.L.R. 441.
(4) (1923) 33 C.L.R. 458.
(5) (1927) 39 C.L.R. 158.

This view is borne out by the general plan of the section and the nature of the other paragraphs as well as by the care shown to see that the funds mentioned in pars. (*b*) and (*c*) are averaged over the accounting period. When the legislature expressly included amounts standing to the credit of the profit and loss account at the commencement of the accounting period, I think that it meant exactly what it said and was referring to the distinction already drawn by this Court in the cases mentioned between the two ways in which profit is carried forward on account of profit and loss; viz., the orthodox crediting of an appropriation account and the loose practice of carrying down a profit into the next profit and loss account or showing it in connection therewith. It means that the line is not to be drawn at a profit and loss appropriation account so as to include nothing which had not at least gone into such an account and that there was to be no exclusion of an ascertained profit on the ground that it had been transmitted into the account of the next period to share with the net receipts of that period the burdens and chances to which the further transactions would expose it. I agree with the chairman—"that the inclusive words were inserted in order that companies should not be penalized for dealing" in this manner "with the unappropriated balances of their profit and loss account." More than that is not covered, I think, by the reference to amounts standing to the credit of the profit and loss account. The expression "accumulated profits" comprises all else down to and including balances to the credit of the profit and loss appropriation account.

I am, therefore, of opinion that the question whether the amount to be taken into account under par. (*b*) is £20,548 or £7,441 depends upon the meaning of those words and not upon the application of the words—"standing to the credit of the Profit and Loss account at the commencement of the accounting period," which are material only as part of the context in which the expression "accumulated profits" is to be interpreted. The argument that, under that expression, the accrued losses of the period up to 31st January 1935 should be excluded from consideration depends in some aspects upon the general purpose and policy disclosed by s. 24 and, in others, upon the principles governing the dealings of companies with their profits, principles which s. 24 may be taken to presuppose. In some degree, too, it claims support from the word "accumulated" on the footing that the word connotes or suggests some decision or course of action or of accounting on the part of the company. It is pointed out that, though s. 24 (1) speaks of "capital employed," it is clear from par. (*a*) that the chief element is the capital which the shareholders have in the past contributed to the company, not what at the opening of the

H. C. of A. 1945-1946.

Federal Commissioner of Taxation v. Miller Anderson Ltd.

Dixon J.

accounting period may be found still to be represented by the assets. The same policy is discernible in par. (*c*). It follows that, although share capital is not represented by assets, it forms part of the capital fund on which the percentage standard is calculated, and that, it is said, is because the purpose is to allow a standard of war-time profit commensurate with what shareholders have committed to the enterprise, whether it has been lost or not. In the same way, it is contended, par. (*b*) ought to be understood with respect to profits which the shareholders might have had but which it was decided to leave at risk in the enterprise. It is not, according to the argument, a question of what on a balance of gains and losses over an extended period of time, over a period, perhaps, from the establishment of the company, ought to be treated as the net accretion to its funds over and above share capital. The question, it is claimed, is rather what sums, annually ascertained as detachable profits which the shareholders might have taken out by way of dividend but preferred to leave at risk in the business, are shown by the accounts to remain. Are they not, it is asked, notionally as much contributions by the shareholders to the funds employed as premiums on the issue of shares or as paid up capital itself? When the loss of £13,107 was ascertained, what else could it mean but a loss of money subscribed as share capital? On what are now established principles of company law, why, it is asked, should subsequent profits be treated as replacing this loss? So far from appropriating subsequent profits to the purpose, a line was drawn, the loss was carried or suspended, and subsequent profits were treated as available for provisions in the nature of reserves and for dividend. The case is represented as one in which past losses are left unreplaced deliberately by a definite decision, while the company, in accordance with law, dealt with the net proceeds of subsequent trading by distributing profits, reserving them, or carrying them over on account of profit and loss as the wisdom of its directors and members might dictate. In other words, the law allowed the company to appropriate the profits as it thought fit and instead of dividing them or wiping out the loss with them, it decided to retain them as profits and that, it is said, amounts to "accumulating" them. Notwithstanding the closely reasoned argument of counsel for the respondent company, I think that the foregoing contention should not be accepted. In the first place, I reject the view that by "accumulated profits" par. (*b*) means to establish a test depending in any way on accountancy, or on the positive course the company may take in appropriating the profits it retains. For whatever purpose the like expressions may be used elsewhere, I think that those contained in par. (*b*) were intended to cover the profit actually ascertained and retained for employment in the business. They are intended as a descriptive category implying, no doubt, the ascertainment and retention of profit, but not otherwise depending on the accounting or on the volition of the company.

In the next place, it must be true that as part of the working capital of the company's business the subsequent profits did in fact replace the past losses. There was no reduction of share capital. The subsequent profits necessarily made up once more the fund which would answer share capital. Perhaps it is true that they were never placed beyond the power of the directors to divide them and, in that sense, they never came fully to " represent " share capital. But, except for the arrangement with shareholders which justified the division of the appropriation accounts as at 31st January 1935, there was nothing in the dealings with the profits or the assets of the company to segregate out, or to provide for, the loss, except by the actual use of the subsequent profits. When the placing of the respective balances of the two appropriation accounts, the debit of the one and the credit of the other, on opposite sides of the balance sheet is considered, it will be seen as an express acknowledgment of their necessary relation and as falling just short of an amalgamation of the two accounts by using the later to answer the earlier.

In my opinion the reality is that up to 31st January 1941 the company never accumulated more than £7,441 of profits and that sum, together with the addition of the reserves of £17,792, is the amount upon which the calculation under s. 24 (1) (*b*) should be based.

There is, however, a question arising under the words " averaged over the accounting period " contained in par. (*b*). For, on 31st March 1941, that is, within the accounting period, the company declared dividends amounting to £10,075. In addition, an interim dividend amounting to £2,400 was paid on preference shares on 10th October 1941. It does not appear, however, from what source it was paid or to what profits the payment has been attributed. It may amount to a distribution of the profits of the then current accounting period, that ending on 31st January 1942. If so, the distribution would not affect the period under consideration. I think, therefore, that we should ignore it and confine ourselves to the dividends amounting to £10,075 declared as on 31st March 1941.

The declaration of these dividends involved a reduction or diminution by £10,075 of the accumulated profits fifty-nine days after the opening of the accounting period. The question is how should this diminution of accumulated profits be averaged over the accounting period ?

H. C. of A. 1945-1946.

Federal Commissioner of Taxation v. Miller Anderson Ltd.

Dixon J.

In the first place, it is clear that none of it was in fact or in law paid out of reserves. The reserves as such were continued without increase or diminution throughout the accounting period. If it be proper to regard them separately, they require no "averaging." The chairman of the Board so regarded them and put them out of consideration in applying the averaging provision, on the ground that it was not necessary to average the reserves as their amount remained unchanged throughout the year. This position the Commissioner accepted on the hearing of the appeals before us and we need not consider its correctness.

The sum of £20,548, which the company's accounts showed as its balance of unreserved accumulated profits as at 31st January 1941, included a sum of £14,528, the profits of the year ending upon that date. It appears that, in proposing to the shareholders the declaration of the dividends amounting to £10,075, the directors recommended that they should be payable out of the profits of the year just closed, viz., out of the £14,528, and, as the shareholders resolved that the dividends as recommended by the directors be declared, we may assume that the source of the distribution of £10,075 was the £14,528 parcel of the £20,548. These sums of profit are recognized by company law as existing, notwithstanding that prior losses have not been recouped, and as being available as a source of dividend. But, for the purpose of the *War-time (Company) Tax Assessment Act* upon the foregoing interpretation of that Act, the only accumulation of profit recognized is £7,441. That sum may be considered to be contained within the £20,548 recognized under company law and perhaps it may be treated as altogether comprised within the £14,528, the profits last to be earned, forming part of the £20,548. It is clear that, after 31st March 1941, the amount declared as dividends ceased to be profits held by the company. In applying the direction to average the accumulated profits over the accounting period, should we throw the whole of the dividends so declared against the £7,441 with the consequence that we must treat no part of that sum as in the possession of the company for more than fifty-nine days of the accounting period and must then regard it as having been exhausted by contributing to the payment of £10,075? Or, on the other hand, should we treat the dividend as payable ratably out of each and every £1 of the £14,528, so that only so much in the £1 of the dividend should be considered attributable to the £7,441, treating the latter sum of course as forming part of the £14,528? Before the Board this question does not appear to have been raised and the chairman regarded the whole of the sum of £7,441 as distributed, or appropriated for distribution, as at the end of fifty-nine days in part

H. C. of A. 1945-1946.

Federal Commissioner of Taxation v. Miller Anderson Ltd.

Dixon J.

payment of the dividends amounting to £10,075. He, therefore, considered that the sum of £7,441 should be averaged as follows, viz. $\frac{59}{365} \times$ £7,441 = £1,203.

The opposing view is based on an application of the rule that where sums such as dividends are paid out of an aggregate sum without differentiation, they must be taken to have been paid ratably out of every part of it (*Resch* v. *Federal Commissioner of Taxation* (1) ). If this principle be applied the dividends amounting to £10,075 would be taken as paid out of a total sum of £14,528 without differentiation and, of every £1 of the latter sum, the dividends must be considered to have taken $\frac{£10,075}{£14,528}$. On the footing that the accumulated profits recognized by s. 24 (1) (*b*), viz. £7,441, form a part of the £14,528, the dividends would be taken to have been paid out of the £7,441 only to the extent of $\frac{£10,075}{£14,528}$, that is £5,160.

On the whole I have come to the conclusion that the principle of ratable attribution ought not to be applied, and that the chairman's method is the correct one. My reason for this conclusion, which I have not reached without some doubt, lies in s. 24 (1) (*b*) itself. In that section the words " averaged over the accounting period " are attached to the words " accumulated profits." I do not mean by this to exclude the possibility of them governing also the words " standing to the credit of the Profit and Loss Account." That is a question that can be put on one side. But I do mean that the conception of " accumulated profits " seems, by the juxtaposition of the words, to be one that ought to be carried into the process of averaging. If it is right, as for the reasons given, I think it is, to go to the actual accumulation of profits as ascertained from a consideration of the profits made, the losses made and the dividends distributed, I think it is also right to carry the same principle into averaging. This means, in effect, that we ought not to go to company law to find out what sum was consumed in distributing the dividends during the accounting period or, in other words, to determine the source of the dividends. We should continue, in averaging, just as in ascertaining the accumulated profits at the beginning of the accounting period to look to the actual balance of accumulated profits available. This means that we should treat the sum of £7,441 as the accumulated profits at the beginning of the accounting period against which the dividends paid during the accounting period should be primarily

(1) (1942) 66 C.L.R. 198, at pp. 230, 231.

H. C. OF A. 1945-1946.

FEDERAL COMMISSIONER OF TAXATION *v.* MILLER ANDERSON LTD.

Dixon J.

thrown. We are averaging the sum of £7,441 in the sense of ascertaining over what period of time that amount was retained as part of the funds of the company, and making an apportionment in accordance with time over the accounting period. I, therefore, think that the view of the chairman is correct, namely, that since 31st March 1941, the amount declared as dividends ceased to be profits held by the company, the accumulated profits not distributed or otherwise dealt with at the beginning of the accounting period amounted to £7,441 and, having been distributed at the end of fifty-nine days, this amount should be averaged as follows :—

$$\frac{59}{365} = £1,203.$$

I, therefore, answer the first question in the case stated in respect of the accounting period ending 31st January 1942, Yes, and the second question, that it should be taken into account to the extent and in the manner described in par. (*c*) of the question.

In the case stated for the accounting period ending 31st January 1941 the facts are the same, though, of course, the figures differ. The questions are in the same form and the answers should be the same.

*Questions in case answered as follows* :—(1) *Yes* ; (2) *The said sum should be taken into account in the manner stated in par.* (*c*) *of question* 2. *Costs of case costs in the appeal. Case remitted to* Dixon J.

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

Solicitor for the respondent, *F. E. Piper*.

C. C. B.