

APP. 1925 VR. 1

APP at pp. 366, 368. 51. ALJR. 782.

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HIGH COURT

[1951.

DIST. 55. ALJR. 98.

Appl. 107 ALR 385.

[HIGH COURT OF AUSTRALIA.]

BALLARAT BREWING COMPANY LIMITED APPELLANT ;

AND

FEDERAL COMMISSIONER OF TAXATION. RESPONDENT.

H. C. OF A. *Income Tax (Cth.)—Assessment—Gross profits—Goods sold by taxpayer—Discounts and rebates on gross sale price—Sales in one accounting period, payment in succeeding period—Discounts and rebates brought into account in first period.*
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MELBOURNE,
March 29, 30;
July 3.

Fullagar J.

Referred to:—
86 C.L.R. 413

The appellant, a brewing company, sold its products to its customers on the terms that the customer should be entitled to a discount for prompt payment and a rebate on the agreed gross purchase price if he fulfilled certain conditions. The due date of payment for goods supplied was the twenty-eighth day of the month immediately following the month in which delivery was made to the customer. It appeared that instances in which a discount or rebate was in fact disallowed were rare. The Federal Commissioner of Taxation contended that, in the ascertainment of the appellant's gross profits in a given accounting period for the purposes of income tax, discounts and rebates should not be brought into account until they had been actually allowed by acceptance of the net price from the customer as payment in full for the goods to which they related. The appellant contended that its true gross profit for an accounting period would not be shown unless all discounts and rebates allowed or allowable in respect of sales made during the accounting period were brought into account.

Held that, in the circumstances of this case (discounts and rebates being so seldom disallowed that any discrepancy resulting from disallowance would be negligible), the appellant's contention was correct. If a discount or rebate treated as allowable in the accounts for one period was disallowed in the succeeding period and the gross price actually received, the amount treated as allowable in the first period should be added to the figure representing sales in the second period.

Sun Insurance Office v. Clark, (1912) A.C. 443, at p. 454, *Commissioner of Taxation (N.S.W.) v. Manufacturers' Mutual Insurance Ltd.*, (1931) 31 S.R. (N.S.W.) 575, at p. 585; 48 W.N. 215, and *Commissioner of Taxes (S.A.) v. Executor Trustee and Agency Co. of South Australia Ltd.*, (1938) 63 C.L.R. 108, at pp. 145, 153, 155, 156, referred to.

APPEAL under *Income Tax Assessment Act*.

This was an appeal by the Ballarat Brewing Co. Ltd. from an assessment to Federal income tax. The facts appear in the judgment hereunder.

G. Gowans K.C. and *J. R. Campton*, for the appellant.

J. B. Tait K.C. and *B. J. Dunn*, for the respondent.

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Cur. adv. vult.

FULLAGAR J. delivered the following written judgment:—

July 3.

This is an appeal against an assessment of income tax. The accepted accounting period of the taxpayer company is the year ending 31st May, and the assessment in question relates to income derived during the year ended 31st May 1946. The appeal came before me on an agreed statement of facts supplemented by certain oral evidence given by Mr. H. C. E. Evans, the manager of the company.

The company carries on in Victoria the business of brewing and selling beer and stout. It sells its products to its customers on the terms that the customer shall be entitled to (a) a “discount”, and (b) a “rebate” on the agreed gross purchase price, if he fulfils certain specified conditions. The conditions were in fact altered in certain respects in the course of the relevant year of income, but nothing turns on the precise nature or content of the conditions. It is sufficient to say that they are concerned with punctual payment for the liquor supplied, with the prices at which the customer is to sell or dispose of the liquor, and with certain aspects of the conduct of the customer’s business. The due date of payment for liquor supplied is the twenty-eighth day of the month immediately following the month in which delivery is made by the company to the customer. There is provision for the making of a statutory declaration by the customer that he has complied with the conditions, but the declaration is to be forwarded not to the company but to the Victorian Associated Brewers, an association of brewing companies of which the company is a member. Mr. Evans said that the “discount” was really a deduction for prompt payment, while the purpose of the rebate was to secure compliance with the other conditions.

Mr. Evans also said—and I have no hesitation in accepting his evidence—that, in the fifteen years during which he had been in the employ of the company, he could not remember, and an

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investigation of the books had failed to disclose, a single case in which the rebate had been disallowed to a customer. The rebate could not, he said, be disallowed without the authority of the Association. With regard to the discount, he said: "It is nearly as much a rule to allow discounts as rebates". The great majority of customers paid their accounts promptly. In the comparatively few other cases the company followed an indulgent policy, and, practically speaking, the discount was allowed in fact except to a customer whose account had run on for several months so that legal proceedings became necessary. He said that he had investigated the position over a period of eight years to 31st May 1950, and had found that the total amount of discount disallowed was 0.12 per cent of the total of discounts and rebates allowable.

The figure in the company's accounts which is affected by these discounts and rebates is, of course, the figure which represents "sales" in its trading account. The Commissioner does not contend, and plainly could not contend, that discounts and rebates are not to be brought into account for the purpose of arriving at gross profit. He does, however, contend, in substance, that they are not to be brought into account until they have been actually "allowed" by acceptance of the net price from the customer as payment in full for the liquor to which they relate. The company, on the other hand, contends that its true gross profit for an accounting period will not be shown unless all discounts and rebates "allowed" and "allowable" in respect of sales made during the accounting period are brought into account. For income-tax purposes, it says, either (1) its true assessable income consists of its gross profit so ascertained, or (2) if it be strictly correct to arrive at assessable income on the basis of gross prices for liquor sold in the period, then its outgoings incurred in gaining that assessable income include not only discounts and rebates "allowed" in respect of those sales but discounts and rebates "allowable" in respect of those sales. A discount or rebate treated as allowable in the accounts for one period may, of course, be disallowed in the succeeding period and the gross price actually received. This, however, creates no difficulty. The amount treated as allowable in the first period will simply be added to the figure representing sales in the second period. Before considering the question raised by these contentions, it is desirable to examine further the company's practice in dealing with its customers and keeping its accounts, although I think that the really essential facts are those which I have extracted above from Mr. Evans's evidence.

When a consignment of liquor is delivered to a customer, he receives a delivery docket or "cart note". This contains particulars of the liquor delivered, but contains no reference to price, discount or rebate. In the company's duplicate of the cart note are inserted the gross price, and the amount of discount and the amount of rebate allowable in respect of the consignment. At the end of the month an entry is made in a sales ledger showing the total quantity of liquor delivered to the customer during the month, the gross price, the total discount allowable, the total rebate allowable, and, in the last column, the net price, i.e. the gross price less discount and rebate. Also at the end of the month a statement is sent to the customer, which shows particulars of the liquor delivered during the month, the gross price, the total amount of discount allowable, and the total amount of rebate allowable. When the account is paid in the normal way, the customer is credited in the sales ledger with the net price, the amount of discount allowable and the amount of rebate allowable.

At the end of each month a "summary of sales dissections" is completed from a number of ledgers which are kept in respect of various districts and classes of customers. This shows, *inter alia*, for each day of the month on which deliveries were made to customers, the total gross price of liquor delivered and, in the final column, the total discount and rebate allowable. At the foot of the page the totals of the columns are added up, the total of discount and rebate allowable is deducted from total gross prices, and the "net monthly total" (i.e. the total of gross prices debited to customers during the month less the total of discounts and rebates allowable to those customers) is shown.

The company also kept in its books an account entitled "Discount and Rebate Allowable Account". This account showed, for each month of the accounting period, as a credit the total amount of discounts and rebates outstanding or "allowable" at the end of the month, and as a debit the total amount of discounts and rebates "allowed" on payment of customers' accounts. This account, for the accounting period in question, commences with a credit balance transferred of £6,163 11s. 4d. This figure represents the amount of discounts and rebates outstanding or "allowable" at the beginning of the period. At the end of the period the credit balance transferred is £9,478 13s. 1d., which represents, of course, the amount of discounts and rebates outstanding at the end of the period. The company accordingly, in its trading account submitted to the Commissioner, showed its sales for the accounting period as follows:—

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H. C. OF A.	" By Gross Sales	£727,127 19 7
1951.	Less Duty	471,775 4 9
<u> </u>		<u>£255,352 14 10</u>
BALLARAT	Less Provision for Discounts and	
BREWING	Rebates	9,478 13 1
CO. LTD.		<u>£245,874 1 9"</u>
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The commissioner maintains that the figure of £9,478 13s. 1d. should be replaced by the figure of £6,163 11s. 4d. The effect of this substitution would be to bring into the account all discounts and rebates actually allowed on liquor sold during the relevant accounting period and also the amount outstanding or "allowable" at the beginning of the relevant period on liquor sold during the preceding period, which amount is assumed to have been actually "allowed" during the relevant period. The assumption is most probably correct, or at least the percentage of error negligible, but to the extent, if any, to which it is not strictly correct, the Commissioner's view falls short of a strictly accurate application of his general contention as I have outlined it above. However, no importance attaches, I think, to this.

I am of opinion that the contention of the company is correct. That contention was, as I have said, put in two ways, the question being treated in the alternative as being (1) a question of the ascertainment of assessable income, (2) a question of allowable deductions from assessable income. It does not appear to me that any question of allowable deductions really arises, or that s. 51 of the Act has any bearing on this case. The matter seems to me to be a matter of arriving at the correct figure for a primary item in the relevant calculation, the correct figure to ascribe to "sales" for the relevant accounting period. The question does not depend upon any express provision to be found in the Act. It depends upon "the conceptions of business and the principles and practices of commercial accountancy" (per *Dixon J.* in *Commissioner of Taxes (S.A.) v. Executor Trustee & Agency Co. of South Australia Ltd. (Carden's Case)* (1)).

Carden's Case (2) was a case of a deceased taxpayer, who was a professional man, and who had in his lifetime returned his income from the practice of his profession on the basis of cash received during the financial year and not on the basis of fees earned. It was held that his professional income had been properly assessed

(1) (1938) 63 C.L.R. 108, at p. 153.

(2) (1938) 63 C.L.R. 108.

upon a receipts basis. *Dixon J.* (1) contrasted the case of a commercial undertaking, whose income can hardly be assessed upon any other basis than that of commercial trading and profit and loss accounts. He said :—" The basis of a trading account is stock on hand at the beginning and end of the accounting period and sales and purchases. In such an account book debts represent what before was trading stock, and it is almost inevitable that they should be taken into account upon an accrual and not a cash basis ".

It is as to that part of the item " sales " in the trading account in the present case which represents book debts that controversy exists. It is common ground that the account must, almost of necessity, proceed upon an " accrual " or " earnings " basis. It is the appropriate figure for book debts that is in question. This is in essence a matter of estimation, and (apart from express provision in the Act) it would be proper to make an allowance for bad and doubtful debts. In *Sun Insurance Office v. Clark* (2), Lord Loreburn said :—" There is no rule of law as to the proper way of making an estimate. There is no way of estimating which is right or wrong in itself. It is a question of fact and figures whether the way of making the estimate in any case is the best way for that case ". And (to quote again from the judgment of *Dixon J.* in *Carden's Case* (3)) " the admissibility of the method which in fact has been pursued must depend upon its actual appropriateness. In other words, the inquiry should be whether in the circumstances of the case it is calculated to give a substantially correct reflex of the taxpayer's true income ".

What I have said provides, in my opinion, the only proper approach to the question in the present case. And, when the question is so approached, the answer seems to me to be plain. Which figure—the Commissioner's or the company's—represents, or more nearly represents, the truth and reality of the situation ? The company's figure brings into account what the company will, in the light of all past experience and policy, almost certainly receive in respect of book debts—no more and no less. The commissioner's figure brings into account sums which the company will certainly, or almost certainly, not receive in respect of book debts. A trading account and profit and loss account based on the latter figure would be misleading, and there is nothing in the Act which requires the assessment of income on the basis of accounts which would be misleading in this respect.

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(1) (1938) 63 C.L.R., at pp. 155, 156.

(3) (1938) 63 C.L.R., at p. 145.

(2) (1912) A.C. 443, at p. 454.

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The case of *Commissioner of Taxation (N.S.W.) v. Manufacturers' Mutual Insurance Ltd.* (1) was a case in which the calculation of an "allowable deduction" was in question. The company's true position at the end of the accounting period could not be ascertained without bringing into account some amount in respect of liabilities under worker's compensation policies, which liabilities had not matured because, although accidents had happened, claims had not been made or, if made, had not been adjusted. The Commissioner maintained that only claims which had been paid during the year should be brought into account. The argument was rejected. *Ferguson J.* (with whom *Street C.J.* and *James J.* concurred) said (2):—"Any statement of the affairs of the company professing to show the result of the year's operations, which neglected to take into account this liability, would be grossly inaccurate and misleading". The present case is not, in my opinion, a case in which any question of allowable deductions arises, but the sentence which I have quoted, and indeed the whole of the paragraph in which it occurs, appear to me to be, *mutatis mutandis*, entirely appropriate to this case.

Mr. *Tait* invited me to suppose a case in which such discounts or rebates as we have here were habitually *not* allowed in fact, and suggested that such a case could not be different from the present case. But, in my opinion, that case would be entirely different from the present case. In that supposed case the truth and reality of the position would be revealed by bringing into account the gross prices for which the goods were sold, because it would be the gross prices which would certainly, or almost certainly, be realised. Here it is the net prices only which will certainly, or almost certainly, be realised.

One other matter should be mentioned. From the agreed statement of facts it appears that for each of the four years preceding the year in question here the Commissioner assessed the company on the basis which he now claims is correct, and the company did not object to any of those assessments. As to this it is sufficient to say that I agree with counsel for the company that this is an entirely irrelevant consideration.

I should perhaps add that it would seem (companies being taxed at a flat rate) that, if turnover remained constant or approximately constant, it could make little practical difference to the company which view was adopted. The present objection and appeal are occasioned by a steep rise in sales in the latter part of the accounting

(1) (1931) 31 S.R. (N.S.W.) 575; (2) (1931) 31 S.R. (N.S.W.), at p. 48 W.N. 215. 585; 48 W.N., at p. 218.

period and in particular by the fact that sales for May 1946 very largely exceeded sales for May 1945, with the consequence that the amount of discounts and rebates outstanding or allowable at the end of May 1946 greatly exceeded the corresponding figure at the end of May 1945.

It might perhaps be suggested that, in calculating the amount in issue, *some* allowance should be made for the possibility of "disallowance" of discounts. I think, however, that, on Mr. Evans's evidence, the amount which it would be proper to allow for this possibility would be negligible, and that for the accounting period in question the company's figure of £9,478 must be taken to be correct.

Appeal allowed. Order that assessment be reduced by deducting from the taxable income of the appellant from its business as assessed the sum of £3,315. Order that respondent pay appellant's taxed costs of appeal.

Solicitors for the appellant, *T. E. Byrne & Co.*, Ballarat, by *Eustace L. J. Murphy*.

Solicitor for the respondent, *K. C. Waugh*, Crown Solicitor for the Commonwealth.

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