High Court Abstract
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DAVIES & FEHON LTD.

v

COMMISSIONER OF TAXATION.

JUDGMENT. ISAACS J.

Delivered 9.9.1926

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v

COMMISSIONER OF TAXATION

JUDGMENT. MR. JUSTICE ISAACS.

This is an income tax appeal by Davies and Fehon Limited against a federal assessment for income tax for the financial year ending June 30th., 1924, that is, in respect of income during the year beginning July 1st., 1922 and ending June 30th., 1923.

The relevant Assessment Act is No. 37 of 1922, with applicable amendments.

The appeal comes before me under Section 51 A of the Assessment Act, by force of Section 16 of No. 28 of 1925. The powers of the Court are very wide, extending even to the increase of the Assessment (sub-Section 5). The appellant, however, is limited so far as his objection goes to the grounds stated (sub-Section 3).

The only concrete matter remaining in issue is this:- Is the Company entitled to a deduction for the year in question of a sum of £12,698 as a bad debt ?

The Commissioner has disallowed the whole of it, and the Company claims the whole of it.

The Company has the burden of establishing its right to all or some of that amount as a statutory deduction for bad debts.

The deduction is claimed primarily under Section 23 (1)(a) as a "loss not being in the nature of loss of capital."

And as it is claimed as a "bad debt", it must be shown to come within the exception mentioned in Section 25 (g), namely, "proved to be such to the satisfaction of the Commissioner and "to have been incurred in and actually written off by the tax-"-payer in the year in which the income was derived."

The appellant contends that the whole of the sum of £12,698 satisfies all those conditions.

The appellant also urged before me that it had alternatively a right under Section 26 to deduct the sum from the assessable income otherwise taxable, because it was a loss in carrying on a business separate from the business in which the other income was earned.

The Commissioner maintains:-

(1) That the loss claimed was a loss of capital;

(2) That it was not a loss actually incurred "in gaining or "producing the assessable income";

(3) That it was not "incurred" in the year in which the income was derived;

(4) That it was not written off in that year;

(5) That Section 26 is not open to the appellant in this appeal in view of the terms of the objection;

(6) That, assuming Section 26 is open, the amount is not shewn to be a loss within the meaning of the Section.

The matter presents some unusual complications, arising from the vagaries of the Company's business operations.

I should at this point say something about the nature of the evidence. Section 39 makes the notice of assessment prima facie evidence in an appeal of this nature. That is, it throws the burden on the appellant to establish his right to the benefit he claims. It is apparent that the weight of the statutory evidence must vary according to the circumstances. The weight of all evidence is subject to that consideration.

It was laid down a century and a half ago by Lord Mansfield in Blatch v Archer (Cowp. 63 at 65) that:- "All evidence is to "be weighed according to the proof which it was in the "power of one side to have produced, and in the power of the "other side to have contradicted."

The crucial facts affecting the issue in this appeal are peculiarly in the power of the appellant to elucidate; and the burden of displacing the prima facie force given by the Statute to the Commissioner's assessment is correspondingly great.

The Company could in my opinion have given much clearer and more definite evidence in explanation of the items in its balance sheet, and especially of the grounds of the objection.

I do not mean by this to impugn the honesty of the two witnesses called, Mr Ross, a director, and Mr Dunnett, a former accountant.

Mr Ross, I am satisfied, gave the Court candidly all the information in his power, without any attempt to colour it. But that was information only of a very broad and general character, and though useful up to a certain point, was by no means definite on other important features. He admitted he did not know as much about the business as Mr Dunnett. I presume he meant as to the detailed office working of the business in Sydney.

Mr Dunnett, on the other hand, told me that Mr Ross knew more about the advances in question than he did. Mr Dunnett's knowledge is not precise, and although I believe he stated only what he thought was correct, he was a little confused, his impressions as to a crucial matter varied, and he appeared to me ultimately to rely to a great extent on his inferences from the balance sheet and from what he was told. I think his evidence quite honest, but I am unable to build very much on it.

The governing director, Mr Davies, and the second director,

Mr Hughes, who actually directed Mr Dunnett to write off the sum in question, were not called, though they were in Sydney. The Melbourne manager, Mr Laver, who was in a position to know a good deal about the progress and condition at all essential times of the Australian Trading Company's affairs, was not called. Whoever framed the objection might have been called to state the materials supporting it.

Still, I have to make the best of the materials before me so as to arrive at the true position of affairs. And in this, Mr Ross, so far as his evidence has gone, has given reliable and substantial assistance.

The appellant Company was incorporated on August 8th., 1903. Its authorised capital is £75,000, divided into 75,000 shares of £1 each. Of these, 50,000 shares were taken up many years ago, and the full amount on them has been paid up. At what date the full payment took place I do not know, but it is clear that it was prior to the advances to the Australian Trading Company, and the share money went partly in payment for shares in other companies, and partly for general trading purposes.

No allocation of paid up capital has ever been made to any specific purpose.

The remainigg 25,000 shares remained unissued up to September 22, 1923, when a special resolution respecting their issue was passed.

The objects of the Company as set out in the Memorandum are so voluminous and detailed as to fall within the observations of Lord Wrenbury in Cotman v Brougham (1918 A.C. at page 528).

Mr Manning relies very strongly on paragraph (d), which states one of the objects to be:- "To advance, deposit or lend "money, securities or property to or with such persons or com- "-panies, and on such terms as may seem expedient."

That gives much point to Lord Wrenbury's distinction between "purposes" and "powers", a distinction of some importance here.

No doubt paragraph (d) clears the ground as to ultra vires but it by no means settles the question as to Section 26 of the Assessment Act.

For many years the Company carried on business as a wholesale timber merchant, having no business premises except offices. The war made a great difference. The timber business was relinquished for at least a couple of years, and the Company has not resumed the wholesale business.

On relinquishing the wholesale timber business, the Company started on another and direct field of enterprise. It purchased shares in other companies and paid for them partly, that is, more than half, out of bank overdraft.

It may be that at first advances were made on an ordinary footing, but I am not informed as to this. At any rate, if that were so, the idea was soon grasped by the Company that by purchasing shares in controlling numbers, the appellant Company could virtually annex other companies and carry them on as an investment.

For instance, when in January 1920 there were only 746 shares issued in the Australian Trading Proprietary Company, the appellant Company consented to a maximum advance of £4250 on the terms (among others) that it should receive 750 new shares and should have a majority of nominees on the Board. In the Australian Commercial Company in about 1918 or 1919, the appellant held 11,825 shares at £1 each, there being only 6 other shares issued. The Australian Commercial Company really belonged to the appellant Company. To speak of advances to such companies in such circumstances may be legally correct, but from a business standpoint the word is insufficient and misleading.

Mr Ross was quite right in calling the combined system of share purchase and advances a system of investment. The advances, be it understood, were not made in the ordinary way, in a large sum, leaving the disposal to the borrower. They were made, for the most part at least, by cheques drawn by the appellant Company on its bankers to pay current expenses of the subsidiary companies as those expenses arose.

I asked Mr Ross:- "What do you mean by an investment?" A.: 'Buying shares in the Company and making advances to it, as 'the case may be.' Q.: "What were the advances for?" A.: 'For the trading purposes of that particular company.' Q.: "Were you carrying on these companies or carrying on your "own Company?" A.: 'We thought we were carrying on the other 'companies to some extent, but we made a mistake.'

No doubt legally the appellant's status in the other companies was that of shareholder, and legally the advances were made in the outside character of lender.

But when we come to consider the nature of the transaction of loan, the actualities of the situation as a whole are important.

Either the transactions -- numberless transactions of advances by way of cheques -- were part of a systematic investment in that company, that being the dominant character of the matter - or else they were part of a larger systematic business of lending money to companies --- not one, but several.

In the first alternative the advances were not in a "business" of any kind belonging to the taxpayer, and the bad debt was not a business loss within the meaning of Section 26. In the second alternative the mere fact of this amount being the sum total of a number of bad debts, would not suffice to constitute them a "loss in carrying on the business". For all that appears, the

relevant business may have been on the whole a prosperous one for the relavant year, or at all events, the loss may not have been so great. Certainly, dividends were received from other companies, and these would in the second alternative go in the profit and loss account of the assumed business. The intrinsic value of the shares in the various companies to which the business extended does not appear. It would be absurd to say that the dealings with each company constitutes a separate business within the meaning of Section 26.

I therefore put all claim based on Section 26 out of consideration, even if it be open in view of sub-Section (3) of Section 51(A).

I then have to deal with the claim for deduction on the first ground, which as I think was the only ground relied on in the first objection, that is, the ground founded on Section 23 (1) (a), and not excluded by Section 25 (g).

Mr Ross proceeded to state that looking at the balance sheet he could say that besides the scheme of investment just mentioned, the appellant Company in 1923 re-entered the timber business, necessitating premises. The balance sheet for the income year relevant to this case shows that business to be of considerable magnitude, the stock in hand being £31,621, and the goodwill at £11,000. No doubt the balance sheet of the Company mingles the two sets of ~~objections~~ operations so as to exhibit its total assessable income, but that is as compatible with distinctness of businesses in the case of a company as in the case of an individual. The profit and loss account however, shows the gross profit and commission from the timber business to be £38,778/7/7, while the dividends from other companies were £3,593/14/7, the two sums making up the total gross income of £42,372/2/2. Further, the dividends have been excluded under Section 16 (b) (iii), apparently because divided.

The first essential to the appellant's successis to establish that the sum claimed, or some part of it, is a "loss", not being a loss of capital.

If paragraph (d) of the Memorandum be regarded as a distinct "object" in the proper sense, and if the advances to the Australian Trading Company could be considered as mere advances, unconnected with any relation but that of debtor and creditor -- as in the case of banker and customer -- then I should be disposed in the circumstances to apply the observations of Lord Atkinson in Farmer v Scottish Investment Company (1912 A.C. at page 127), and treat the money advanced as not capital.

Had the same money when borrowed from the bank been applied to the timber business and lost, it would not have been capital of the appellant Company. Applied, as it was, to the business of the Australian Trading Company, it was not capital of that Company.

As I regard the operations of the appellant Company in relation to paragraph (d), I think the Company ~~continued~~ COMBINED its powers, such as in paragraphs (m) and (y), on a systematic extension of activities in a somewhat unique department which Mr Ross called "investment by buying shares in a company and making "advances to it as the case may be", and which may, I think, appropriately be described as "Investments in Company Undertakings".

The total debt or accumulated indebtedness of £12,698 was entirely unconnected with the assessable income included in the return, except so far as it formed part of the investment scheme adverted to.

It was not "incurred in gaining or producing the assessable "income" -- so far as the timber business was concerned. Nor except as part of one general investment business, was it so incurred in relation to the dividends included in the return and excluded from the assessment.

If this case depended upon whether the words in Section 23 (1) (a), relied on by the Commissioner, attach themselves to the word "loss", I should, in view of the case of the Allied Assurance Company (29 C.L.R., 424), decline so to hold on my own responsibility, but should refer the matter to the Full Court.

Further, the application of Section 25(h), if vital, would be sufficiently doubtful to induce me to take the same course.

Assuming, however, but certainly without so holding, that the debt is a "loss" within the meaning of Section 23 (1)(a) and Section 25(h), it is still a "bad debt", and the appellant must bring it, if it can, within the ~~exception~~ exception.

The word "incurred" has been much debated with a view to allocating its being "incurred" to the income year.

Mr Manning contends "incurred" has no reference to the origination of the debt, but to its existence as a "bad debt".

I need not determine that question, particularly as the word is found in other Sections, notably in Section 23 (1)(a).

And the reason I need not determine it is because, assuming the interpretation put upon the sub-Section by Mr Manning to be correct, I am not only not satisfied that the debt became a bad debt -- either in a business sense or in any stricter legal sense (if there be, as he contends, a stricter legal sense) -- in the year in which the income was derived, but I am satisfied that it was in fact a "bad debt" before that year commenced.

I have no distinct, or indeed, any direct evidence as to the state of the Australian Trading Company, apart from the admission that the debt is wholly uncollectable. But Mr Manning stated certain matters as to its progress and state, which I took to be acquiesced in with qualifications.

Mr Manning said:- "As a matter of fact, after the appellant

"Company commenced making advances to the Proprietary Company, "the latter got into rather deep water, and the result was that "only one actual debit for interest was made to the Proprietary "Company.....The Proprietary Company had varying kinds of "fortune up to the year 1923, and ultimately went into liquidation. "The Company started to sink in 1921, and ultimately went down."

Mr Cohen said:- "It has not actually ceased to exist; it "is only water-logged, as a matter of fact; it has not been "wound up."

The Proprietary Company was virtually carried on by the appellant Company. Not only does this appear from the oral evidence, but it is transparent from the Melbourne ledger entries put in, Exhibits "D" and "E". Exhibit "D" is an account called "Australian Trading Company", headed "General Account". It does not commence until March 1, 1920, though the agreement was made in the previous January. It consists mostly of ordinary business expenditure. It includes some advances, and by May 11 the debit reached £5,000 less 1/3.

On that date the debt of £5,000 was transferred to Sydney, leaving the Melbourne account clear. By the end of May the balance was "Nil".

A gap then occurs in the account until July 1920, when in another folio the general account is resumed, and continues to April 1923.

But two significant entries appear, under date June 30, 1922. One is:

'To D.& F. Reverse .....£4,825/11/4 (amount in debit column)
(In final column)..D..£4,825/11/4.'

The other is:

'By D.& F. Bad Debt.....£4,825/11/4 (amount in credit column)
(In final Column)..... Nil.'

That so far clears the Australian Trading Company's Melbourne General Account.

The word "reverse" has reference to a previous entry of June 27'D.& F.' and in credit column £4,825/11/4, leaving a final balance of £6/11/9 owing on this account by the Proprietary Company. That sum was cleared by the next entry, a cash credit of £6/11/9, leaving the account stand at "nil". A pencil note on the line of June 27th says "Bad Debt written off." The rest of the £12,698 did not find its way into the account. The sum of £4,825 included a sum of £598 for interest up to December 31, 1921.

It appears from Exhibit "E", headed "Australian Trading Company Proprietary Ltd. Advance Account", that in June 1920 a debit was entered up £4250, the balance of the £5,000, namely, £750, having been appropriated to purchasing 750 shares. One item of £85 interest was debited on June 30th., 1920, and written off at the end of December.

No interest is charged on the advances to make up the £12,698.

The advance account shows nothing advanced during 1922, the last item being £6/5/- on July 21, 1921, and this is borne out by Exhibit "C", a copy of the Sydney Ledger Account with the Australian Trading Company.

On July 21st., 1921 the Advance Account showed an indebtedness of £15,697/19/1.

On June 27, 1922 an entry in ink stands t hus:

"By D.& F. £12,697/19/1
(leaving in the final column)..... 3.000/-/-."

I would understand by that, even apart from further elucidation, that of the £15,697/19/1, Melbourne, on June 27,1922, thought £12,697/9/1 worthless, and that £3,000 was so far not

to be regarded as bad, and that the larger sum was transferred to Sydney Head Office to be dealt with there.

In pencil is a note along this entry, and as coming from the possession of the appellant, and unexplained, I read it. It says:-

"Transfer to D.& F., Sydney A/c Bad Debt".

That simply confirms the conclusion I would draw without the pencil note.

The next entry is June 30th., 1923: "P. and L. Bad Debt £3000".

The evidence shows that there was a personal guarantee, which at first was thought to save the £3,000, but ultimately this was abamdoned too.

Affirmatively, from the circumstances proved, and negatively from the absence of any sufficient explanation by the appellant Company, I entertain not the least douht that its management of the Proprietary Company had not saved that Company, but that the Proprietary Company had rapidly sunk during 1921 and 1922, previous to June 27 of the latter year, and that not only had any hope of interest but also -- save what the personal guarantee might be worth up to £3,000 -- the principal advanced up to £12,697/19/1, had long before June 27, 1922 irretrievably gone. Indeed, from the early part of 1921, the transfusion of financial blood had practically ceased, and the Proprietary Company was with comparatively slight, and very temporary assistance, allowed to fade away.

The actual writing off at the Head Office took place as to the £12,698, on June 30 1923. The Melbourne office entry of "Bad Debt, £4,825/11/4" in the general account, is not only evidence of bad debt pro tanto, and of general badness of the whole indebtedness, but might possibly be considered a

writing off pro tanto also. However, I do not rely on that as the writing off.

The Commissioner admits that the debt is a bad debt and has been written off, but does not admit the date of writing off. I accept the evidence for the appellant that Sydney Head Office wrote the amount off, £12,698, on June 30 1923.

But I cannot accept the view presented by the appellant that the whole £12,698 was a perfectly good business debt up to the year beginning July 1 1922 and ending June 30 1923, and suddenly in that year became bad, and was written off at its end.

The real loss occurred in my opinion, as I have said, a considerable time before -- certainly long before the end of June 1922, and that, in the absence of the Commissioner's allowance, ends the matter against the appellant.

The appeal is dismissed with costs
