

David Davidson, the Public Officer of the
Wallaroo and Moonta Mining and Smelting
Company - - - - - *Appellant,*

v.

The Commissioner of Taxes - - - - - *Respondent.*

FROM

THE SUPREME COURT OF SOUTH AUSTRALIA.

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE
OF THE PRIVY COUNCIL, DELIVERED THE 18TH JUNE, 1917.

Present at the Hearing :

EARL LOREBURN.
VISCOUNT HALDANE.
LORD ATKINSON.
LORD SUMNER.
LORD PARMOOR.

[*Delivered by* VISCOUNT HALDANE.]

In this appeal, the question is upon what amount the Wallaroo and Moonta Mining and Smelting Company (Limited), represented by the appellant as its Public Officer, is assessable for income-tax in the State of South Australia on the profits for the year ending the 31st December, 1903. "The Taxation Act, 1884," of the State Legislature imposes a general tax on incomes. This is to be levied on various descriptions of income specified in the first ten subsections of section 12. Subsection 11 provides that the net income, as ascertained in accordance with the rules laid down in the preceding sections, and after making the deductions therein provided, shall be the taxable amount, except in the case mentioned in subsection 12. This subsection prescribes the taxable amount of the income in the case of a company, making this amount depend on the profits, whether divided, carried to any reserve, or in any way capitalised. Its language is as follows :—

"In the case of the income of any taxpayer being a company dividing its profits amongst its members the taxable amount shall be deemed to be the amount of profits so divided, with the addition of any amount of profit carried to any reserved fund or capitalised in any way."

The appellant made a return of the taxable income within this definition as 8,000*l.* for the year in question. The Local Court of Full Jurisdiction at Adelaide, after a prolonged investigation, stated a Special Case for the Supreme Court, and the Supreme Court finally decided that the true amount was 147,694*l.* 10*s.* 4*d.*, made up of certain items detailed in the judgment as follows:—

	£	s.	d.
1. Profits divided—			
Dividend	8,000	0	0
2. Profits carried to a reserve fund—			
Depreciation written off	22,469	2	0
3. Profits capitalised in any way—			
Additions to fixed assets	16,007	5	1
Additions to fixed assets written off to working expenses	5,444	3	3
Debentures discharged (less 5,000 <i>l.</i> already taxed)	75,000	0	0
Deposits paid off... ..	20,774	0	0
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	147,694	10	4

As to the items of 8,000*l.* and 5,444*l.* 3*s.* 3*d.*, no question is raised by the appellant. The decision as to the other items depends on a single question of principle: "Were these sums profits made during the year 1903, whether divided, carried to reserve, or capitalised?"

The company, which came into existence in 1890, had acquired the Wallaroo and Moonta mines, and had carried on the business of mining, smelting, and extracting copper and precious metals from ores. The nominal capital was 400,000*l.*, divided into 200,000 shares of 2*l.* each, of which 40,000 had not been issued. A few years later it extended its works and plant, and for this purpose, in 1898, it raised 80,000*l.* in debentures. Its business prospered, and from time to time it divided large sums in dividends. Prior to 1903 it appears to have employed a substantial part of the profits in making additions to fixed capital to counterbalance amounts written off for depreciation. It also appears to have made further additions and improvements to the works, which were debited in the profit and loss accounts under the general heading of "working expenses." It was not, however, until the balance-sheet for 1903 appeared that the revenue authorities had their attention drawn to the fashion in which profits had been disposed of in capital expenditure of these and other kinds and in reduction of capital liabilities. No question has been raised in the present litigation as to the propriety of not including the part of the profits so disposed of during the years before 1903 in the annual returns for income-tax. The only question is whether in 1903 the profits of the year were applied in making up a reserve fund for depreciation, in adding to fixed capital, and in paying off debentures and deposits, in the mode described in detail at the end of the judgment of Way, C.J., in the Supreme Court. For if the

profits were so disposed of, it is plain that the company was liable to pay income-tax upon them under the words of section 12 (subsection 12) already quoted. Before going further, their Lordships desire to say, having regard to the character of the business and the way in which it was conducted, that an investigation of the accounts presented has satisfied them that there was nothing in any law forbidding the payment of dividends out of capital which in the year 1903 would have interfered with the treatment by the company of the amounts in question as profits available for division, had this course been decided on. Apart from the fact that the original capital raised by the issue of shares was in reality intact, the general assets appear to have been steadily increased by the accumulation of ore capable of being disposed of at a profit. When this ore was disposed of it seems to have been the practice of the company to apply, out of the prices received, substantial sums in reduction of loans and in other ways which increased the balance of assets over liabilities. The details of these operations, which were performed over a series of years, are nowhere to be found disclosed with fulness in the annual balance-sheets or profit and loss accounts. But when these documents are read in the light of the annual reports, it is not difficult to understand the operation of the method adopted.

Their Lordships now turn to the accounts. The balance-sheet of the 31st December, 1902, shows a liability on the debit side of 80,000*l.* in first mortgage debentures. This amount disappears in the balance-sheet of the 31st December, 1903. As to this disappearance, it is necessary to turn to two further documents in order to make it intelligible. The first of these is the profit and loss account of 1903, which shows the extinction of 5,000*l.* by means of a debenture redemption fund of that amount provided out of profits. This account also contains a credit item described as: "Balance of copper account, 312,452*l.* 11*s.* 4*d.*" What is meant by the use of the word "balance" does not appear in the account itself, but there is a directors' report annexed to it which makes clear what had been done. This report says:—

"The price obtained for copper during the year was 5*l.* 14*s.* 1*d.* more than during 1902. This, together with the gradual realisation of all surplus ores and products, has enabled the Board to pay off the whole of the debentures and nearly all the bank overdraft and deposits."

The latter amounted together to 20,774*l.*, and form the item of that amount which appears in the judgment of the Supreme Court.

The appellant gave evidence on behalf of the company before the Local Court, and in the course of it stated that—

"Including debentures, the liabilities of the company were reduced in 1903 by 100,774*l.* In addition, 15,700*l.* was spent on plant. The money

came from produce and realisation of assets on hand at beginning of the year, after paying all charges shown on p. 36, except some which were only estimated. The assets were substantially produce on hand from preceding years."

What these assets were is perfectly clear. They were mineral produce on which the cost of production had been paid and which were in hand for realisation as available profit of operations in the year 1903.

This disposes of the largest items in the list of those on which the Supreme Court decided that the company should be assessed for income-tax. There remain two further items appearing in that list, the 22,469*l.* 2*s.* written off for depreciation and the 5,444*l.* 3*s.* 3*d.* of additions to fixed assets written off to working expenses. As to the latter item, it has been admitted by the appellant that this must be taxed as being a payment out of profits. As to the former, the details which make it up appear in the report for 1903, and from this, supplemented by the profit and loss account for the year, it is evident that the whole amount was paid out of profit. It is true that in the accounts there is little that amounts to specific appropriation. The reason is the peculiar practice of the company in making out these accounts. That practice was, as pointed out by Way, C.J., to treat all the moneys of the company, whether derived from the original shareholders' capital, borrowed, got by the sale of products, or in any other way, as one mixed or common fund. Out of this common fund all payments were made, and the payments were not appropriated to any of the sources of the fund. One consequence of this practice is that there is nothing in the accounts to show the amounts of money attributable to these sources which were carried to reserve or spent in extensions or improvements of the works. But even if there had been such an appropriation, it would not have affected the fact that the amount thus written off for depreciation in 1903 was provided out of profits which quite legitimately could have been divided. Their Lordships agree with an observation made by Way, C.J., in this connection :—

"Moreover," said that learned Judge, "knowing that the Commissioner would have assessed the amounts expended on the extensions of the company's works if he had understood that a reserve had been created or was being capitalised, the company paid for such works out of the common fund and purposely refrained from appropriating the payments against what was written off for depreciation or any constituent portion of the common fund. Besides all this, the company had escaped taxation year after year by denying in its taxation returns that it had carried profits to a reserved fund or capitalised profits in any way. Although I disclaim imputing to the company any intentional misrepresentations, I do not understand how it justifies the denial year after year that it carried any profits to a 'reserved fund.' The reserve for depreciation was as much a 'reserved fund' as the 5,000*l.* expressly set aside in 1898 as a 'debenture redemption fund,' and the company could not help knowing that the Commissioner, in refraining from assessing the amount written off for

depreciation, was acting on the faith of the company's denial year after year that any profits were being carried to a reserved fund."

It is sufficient for their Lordships to say that with this view of the proceedings of the company they are in accordance, and that, for the reasons which they have given, they agree with the rest of the judgment of the Supreme Court and with the particular findings in which that judgment resulted.

They will humbly advise His Majesty that this appeal should be dismissed with costs.

In the Privy Council.

DAVID DAVIDSON, THE PUBLIC
OFFICER OF THE WALLAROO AND
MOONTA MINING AND SMELTING
COMPANY,

2.

THE COMMISSIONER OF TAXES.

DELIVERED BY
VISCOUNT HALDANE.