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Correspondence

WHAT ARE NET PROFITS?

Editor, The Journal of Accountancy:

SIR: Speaking of a letter from a correspondent printed in your issue of January, 1929, you say that some readers may care to exercise their ingenuity and display their wisdom by attempting to reply.

Not ingenuity but ingenuousness, not wisdom but simplicity and candor are needed.

The quotation from *The Accountant* says, in part, "Thus the 'net profits' of a company were described in *Lambert v. Neuchatel Asphalte Co.*, etc." That definition, in rather clumsy legal verbiage, is fairly correct. It is not a definition of "net profits," but of "net profits of a company"—and the definition means something although the two words "net profits" by themselves were truly just two words.

Similarly, in *Frances v. Bullfontein Mining Co.*, where "the articles of a company provided a percentage to the directors on the 'net profit' of each year," the term was held to mean "the net profits made by the company as a going concern, but did not comprise a profit made by the sale of the whole undertaking and assets." The percentage to the directors was not said to be a percentage on "net profit" but on "net profit of each year." The profit on sale of the business was not a profit of the year when sold, but was goodwill, etc., accumulated over the whole life of the business, definitely ascertained only on sale. True, American tax laws consider such profit as taxable in the year when it is realized; but accounting under our tax laws is an arbitrary device for the assessment of taxes. Would your correspondent include such a profit in an annual profit-and-loss account?

In any case the profit from the viewpoint of the company was the profit after paying the directors' percentage, so that the idea that in this case the profit to the company and the 'net profit of each year' for the purpose of computing directors' percentage could be the same is absurd. In prospectuses of reorganizations, where businesses are sold and the stock of the successor offered to the public, annual profits for a series of years are stated. The profit on sale is never included and if any promoter should try to include it he would be considered dishonest or demented.

Then, *in re British Columbia Co.*, "commission on net profits of stated contracts was construed to mean such profits as arose on each contract, minus only the expenses thereon, but not deducting anything on account of the general management of the company." Very proper; any cost of general management could be guessed at but not positively known, and no change could be made to a contract, unless specially provided in the agreements, in which the amount of the charge should be indicated.

This is the plan followed in contracts wherein a percentage of net profits on specified motion pictures is paid to actors or others; no charge for the general management of the distributing company is made; and the profit to the distributing company is after deducting the percentage payable to the actor. So far as the actor is concerned "net profit on the picture" means something

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quite different to the profit as viewed by the company. In all such cases the general management expense is chargeable against that part of the profit accruing to the company.

It is to be noted that in each case the words "net profits" were further qualified, the complete phrase being "net profits of a company," "net profits of each year," "net profits of stated contracts."

The partnership matter is less clear; in the absence of further information I would not care to comment on or endorse the decision.

Your correspondent implies that only a professional humorist could be expected to say that "a different meaning may competently be assigned to the same word or phrase although occurring in the same deed," and asks what an accountant should do when members of the privy council, judges, and a distinguished editor plainly tell us that English words are as changeable as a chameleon. If they did plainly tell him that I would suggest that he reply that they said the thing that was not. But they did not plainly tell him that, and only the editor said anything that could be interpreted as hinting at it.

Any two words, no matter how definite their meaning when standing alone, may have somewhat differing but not inconsistent meanings when qualified by further words within the phrase.

The childish wish for unmodifiable definitions of such terms and for rules for their use, to be applied blindly, is, I think, an indication of mental slothfulness. Effort to satisfy such a wish can affect our language only to its detriment.

Finally, every definition of "net profit" given agreed that net profit is the residue of income after applying to it all expenses that are properly to be so applied; but *The Accountant*, and your correspondent, have a quarrel only with the decisions as to what expenses are, in each case, chargeable against certain income—another instance of failure to distinguish between words and ideas.

Yours truly,

F. W. THORNTON.

Newark, N. J., January 9, 1929.