CANADIAN GENERAL ELECTRIC COMPANY ..... APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE ..... RESPONDENT.

1961
*June 7
Oct. 23

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Taxation—Assessment—Income tax—Foreign exchange profits—Promissory notes payable in United States currency paid off at a saving—Proper method of computing profits—The Income Tax Act, 1948 (Can.), c. 52 [R.S.C. 1952, c. 148, ss. 3, 4]

The appellant borrowed funds from its parent United States company to purchase needed supplies from it and other suppliers in the United States, the indebtedness being evidenced by promissory notes payable in U.S. funds. During the currency of these notes the Canadian dollar rose from a discount to a premium over the U.S. dollar, and, as a result, the appellant was able to pay off all the notes at a saving of $512,847.12. Some of the notes aggregating $1,567,149.20 were paid off in 1951 at a saving of $81,774.44; the balance aggregating $9,225,326.87 were paid off in 1952 at a saving of $431,072.68. The latter amount, described as "foreign exchange profit on notes payable", was added by the Minister to the appellant's declared income for 1952. The appellant contended that the profit should be computed on an "accrual" basis, as in order to give a true picture of the company's position, it was necessary, from an accounting point of view, to revalue the amount of Canadian dollars necessary at each balance-sheet date to pay off the outstanding notes. On this basis it submitted that the total amount of $512,847.12 should be apportioned over three years as follows: $64,675.17 for 1950; $259,820.23 for 1951 and $188,351.72 for 1952. The Exchequer Court having ruled in favour of the Minister, the appellant appealed to this Court.

Held (Abbott J. dissenting): The appeal should be allowed.

Per Locke J.: For the years 1950 and 1951 the Minister had permitted the appellant to estimate its costs of production by treating the cost of its purchases, in respect of which the price was payable in American exchange, at the rate then current. In the result, however, except to the extent that some of the notes were paid prior to December 31, 1951, these liabilities were discharged at a time when American exchange was at a discount and, accordingly, the manufacturing profits of the company for 1950 and 1951 were understated for very considerable amounts in each year. The claim of the Crown in this matter really amounted to an attempt to recover *qua* profit on exchange substantially the amounts by which the appellant's costs were overstated and its income accordingly understated for these years by adding such amounts to its income for the year 1952. This could not be done.

Per Cartwright, Martland and Ritchie JJ.: It was proper for the appellant to compute its profits, in relation to the notes, in the manner which it adopted. There would be no "profit" at all in respect of the notes

*PRESENT: Locke, Cartwright, Abbott, Martland and Ritchie JJ.

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in the year 1952, save for the fact that their value had to be estimated, under the "accrual" method of accounting, in 1950 in order to determine the appellant's profit for that year. Being a matter of estimate, the valuation of the liability should continue to be revised in each year thereafter until the year of actual payment. If the "profit" for 1952 was to be the difference between an estimate and the amount of actual payment, such profit in that year should be determined on the basis of the estimate at the beginning of that financial year.

The decided authorities did not preclude the appellant from adopting the "accrual" method—a method which, in relation to trade liabilities payable in U.S. funds other than the notes, the Minister had never challenged, but in which, according to the uncontradicted evidence, the Minister had acquiesced, and which he had required. *Eli Lilly & Co. (Canada) Ltd. v. The Minister of National Revenue,* [1955] S.C.R. 745; *Tip Top Tailors Ltd. v. The Minister of National Revenue,* [1957] S.C.R. 703; *Davies v. The Shell Co. of China, Ltd.* (1951), 32 Tax. Cas. 133; *J. P. Hall & Co. Ltd. v. Commissioners of Inland Revenue,* [1921] 3 K.B. 152; *Whimster & Co. v. The Commissioners of Inland Revenue,* [1926] S.C. 20; *The Minister of National Revenue v. Consolidated Glass Ltd.,* [1957] S.C.R. 167; *Whiteworth Park Coal Co. Ltd. v. Inland Revenue Commissioners,* [1959] 3 All E.R. 703; *Gardner, Mountain & D'Ambrumenil, Ltd. v. Inland Revenue Commissioners,* [1947] 1 All E.R. 650, distinguished.

Per Abbott J., *dissenting:* In 1952 the appellant was able to purchase or otherwise acquire for $9,032,382.61 Canadian, the $9,225,326.87 U.S. required to discharge the liability of $9,461,455.29 Canadian, which it had claimed and been allowed as a deduction from gross income in arriving at its trading profits in the two previous years. It thus realized in that year a gain of $431,072.68 Canadian which on the principle laid down in *Eli Lilly & Co. (Canada) Ltd. v. The Minister of National Revenue, supra,* and *Tip Top Tailors Ltd. v. The Minister of National Revenue, supra,* must be taken into the computation of profit and loss for tax purposes. This exchange gain must be taken into account in 1952, the year in which it became a reality.

APPEAL from a judgment of the Exchequer Court of Canada[1], dismissing an appeal from an assessment under the *Income Tax Act,* 1948 (Can.), c. 52 and the *Income Tax Act,* R.S.C. 1952, c. 148. Appeal allowed, Abbott J. dissenting.

L. Phillips, Q.C., P. F. Vineberg, Q.C., and *A. D. McAlpine,* for the appellant.

D. S. Maxwell and *G. W. Ainslie,* for the respondent.

LOCKE J.:—That the difference between the amount in Canadian dollars required to satisfy the liability for the notes, as estimated in the company's accounts on December 31, 1951, and that expended for that purpose in 1952 was income within the meaning of the *Income Tax Act* is, in

[1] [1960] Ex. C.R. 24, 59 D.T.C. 1217.

my opinion, settled by the decision of this Court in *Eli Lilly v. The Minister of National Revenue*[1]. That decision does not, however, touch the question as to whether the difference between the amount required to discharge these obligations at the time the notes were given and the amount which it would have been necessary to pay for that purpose on December 31, 1951, was also income.

I have read with care the evidence of the chartered accountants in this matter. It does not require expert evidence to demonstrate that, for the purpose of preparing a proper balance sheet and profit and loss statement for any manufacturing company, it is necessary to estimate throughout the year its costs of materials, raw or finished, purchased from other sources and used in manufacturing its products. A company such as the appellant is required annually to submit to its shareholders a statement as to its affairs at the end of its financial year. In a case such as the present, where the notes were payable in American exchange and the rate was fluctuating, it was necessary for the company to estimate its costs in accordance with the fluctuation of the rate from time to time during the year and to estimate the amount of the company's liability upon the notes at the rate current at the end of the fiscal year.

It is contended on behalf of the Minister that the fact that in the years 1950 and 1951 the amount necessary to discharge the notes given during these years was less at the end of the calendar year than that required to discharge them at the time they were given did not result in a taxable profit during those years. I agree with this contention and the contrary is not decided in *Lilly's* case. While the tax returns of the company for the years 1950 and 1951 showed these amounts as profit and treated them as capital gains and while the Crown contended as to the year 1950 that such so-called gains were part of the company's income, these circumstances do not affect the right of the Crown to take the stand that there was no such profit in these years.

However, accepting this as being correct, the position of the Crown is not assisted. Except to the extent that some of the notes were paid prior to December 31, 1951, the position was that though, of necessity, the liability in Canadian dollars for the purchases was estimated, neither profit nor gain was realized by reason of the variation of the exchange

[1] [1955] S.C.R. 745, 4 D.L.R. 561.

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rate. The Minister permitted the appellant to estimate its costs of production by treating the cost of its purchases, in respect of which the price was payable in American exchange, at the rate then current. In the result, however, these liabilities, with the exceptions noted, were discharged at a time when American exchange was at a discount and, accordingly, the manufacturing profits of the company for the years 1950 and 1951 were understated for very considerable amounts in each year.

In respect of this the Minister might, in my opinion, have made reassessments in respect of the years 1950 and 1951, when it was discovered that these amounts which might be described as exchange costs had not in fact been expended. There is no suggestion of any impropriety on the part of the taxpayer in this case but if, in the result, its costs were found to have been overstated in its returns for the years 1950 and 1951, the Minister might have made such a reassessment under the provisions of s. 42(4) of the *Income Tax Act*. The claim of the Crown in the present matter really amounts to an attempt to recover *qua* profit on exchange substantially the amounts by which the appellant's costs were overstated and its income accordingly understated for these years by adding such amounts to its income for the year 1952. This may not be done, in my opinion.

I have had the advantage of reading and I agree with the opinion of my brother Martland to be delivered in this case and with the disposition to be made of it which is proposed.

The judgment of Cartwright, Martland and Ritchie JJ. was delivered by

MARTLAND J.:—The facts involved in this appeal, which are not in dispute, have been fully and completely stated in the judgment of the Exchequer Court[1] and are here restated.

By a re-assessment dated August 6, 1957, the respondent added to the declared income of the appellant for its taxation year ending December 31, 1952, the sum of $431,072.68, described as "foreign exchange profit on notes payable". In its original notice of appeal, to the Exchequer Court, the appellant took the position that, to the extent that any such profits were made in that year, they were profits on capital rather than on revenue account and, therefore, not

[1] [1960] Ex. C.R. 24, 59 D.T.C. 1217.

taxable. By amendments to the notice of appeal the appellant admitted that to the extent that it made "foreign exchange profits on notes payable" in 1952, such profits are of a revenue nature and are to be taken into consideration in computing its taxable income. The only dispute has to do with the quantum of such profits in 1952.

The appellant is a corporation, having its head office at Toronto, most of its shares being owned by the General Electric Company of Schenectady, New York. It is engaged in the business of manufacturing and selling electrical machinery and supplies of all sorts and purchases substantial quantities of needed supplies from General Electric, as well as from other suppliers in the United States. In 1950, the appellant had borrowed very substantial amounts from its Canadian bankers in the form of overdrafts. In August of that year, General Electric offered to make U.S. funds available to the appellant at a rate substantially lower than that paid to the appellant's Canadian bankers. The initial arrangement was that General Electric would defer payment of accounts for goods purchased from it by the appellant, carrying them on open account and at an interest rate of 2 per cent. Within a few weeks, however, General Electric required that any such indebtedness should be evidenced by promissory notes of the appellant payable to General Electric and all in U.S. currency.

These arrangements were duly carried out (the appellant, however, as before, continuing to pay cash for a portion of its purchases from General Electric) and some 25 notes were issued between August 20, 1950, and May 20, 1952. All of these notes were in respect of goods or services supplied by General Electric to the appellant except for one dated May 9, 1952, for $500,000 in U.S. funds supplied by General Electric to the appellant and used by the latter for the purchase of goods in the United States. Thirteen of these notes, issued in 1950, were payable on or before December 31, 1951. Five notes were issued in 1951, of which three were payable on or before June 30, 1952, and two were payable on or before December 31, 1952. Seven notes were issued in 1952, payable on or before June 30, 1953. All of the notes issued in 1950, which had not been paid in 1951, were replaced by a new note dated December 31, 1951, payable on or before June 30, 1953.

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During the currency of these notes the premium on U.S. funds over the Canadian dollar was sharply reduced, and, in 1952, the Canadian dollar was at a premium over such U.S. funds. The appellant was able to pay off all the notes at a saving, on a comparison between the cost of payment, in Canadian dollars, as between the dates of issuance and the dates of actual payment, of $512,847.12. Five of the notes issued in 1950, and aggregating $1,567,149.20, were paid off in 1951 at a saving of $81,774.44; the remaining notes, issued in 1950, 1951 and 1952 and aggregating $9,225,326.87, were paid off in 1952 at a saving of $431,072.68. It is the latter amount, which was added to the appellant's declared income, which is now in dispute.

It is submitted on behalf of the appellant that the total amount of $512,847.12 should be apportioned over three years as follows:

1950	$ 64,675.17
1951	259,820.23
1952	188,351.72

In order to understand this contention, it is necessary to state what the appellant did in relation to its liability on the notes in question. At the time that each note was given, there was set up in the appellant's books not only the liability for the face value of the note, but a further item under "foreign exchange" of an amount in Canadian funds which, together with the face amount of the indebtedness, would be necessary to pay the note in U.S. funds. That, of course, was based on the premium from time to time of the U.S. dollar over the Canadian dollar. It is not disputed that such entries were correct, the total of the two amounts truly representing the appellant's then liability for the goods purchased. As shown by the schedule attached to the notice of appeal, the amounts so set up for "foreign exchange" in 1950 totalled $300,573.15. The exchange rate in that year had varied from a high of 10½ per cent to a low of just less than 4 per cent. On December 31, 1950, the exchange rate was 6 per cent and the appellant on that date (which was the end of its fiscal year) revalued the amount of the "foreign exchange" premium which it would have had to provide if it had paid the existing notes in full at that date, namely, at the then rate of exchange of 6 per cent—a total of $235,897.98. The difference of $64,675.17 between the total amounts it had originally set up to meet the exchange

premium ($300,573.15) and that fixed for the year end ($235,897.98) was considered to be "profit" for that year, although no payments were made on the notes in that year. In its income tax return for the year 1950, this "profit" of $64,675.17 was disclosed, but as it was claimed by the appellant to be a gain on account of capital, it was not taken into income. The Minister added it to the declared income, but an appeal to the Income Tax Appeal Board was allowed. From that decision the Minister lodged an appeal which was later abandoned.

The second schedule to the notice of appeal sets forth the computation of the appellant in respect of the "profit" in question for 1951. The item of $235,897.98 set up by revaluation on December 31, 1950, as the amount necessary to pay the exchange on the outstanding notes on that date was carried forward to the beginning of 1951 and to it was added the amount of foreign exchange premium necessary to pay all the new notes issued in 1951 at the rate of exchange prevailing when each note was given, the total of both sums aggregating $404,793.26. From that aggregate, there was deducted (a) the actual exchange premiums paid on the notes which were redeemed in that year, and (b) the total of the revalued amounts of exchange necessary to pay the outstanding notes at December 31, 1951, at the then current rate of $1\frac{1}{4}$ per cent—a total of $144,973.03. The difference of $259,820.23 was considered to be "profit" for the taxation year 1951. In its return for that year, the appellant showed that amount as exchange profit on notes, but claimed it to be a gain on capital account.

Schedule 3 to the notice of appeal relates to the year 1952 in which further notes were issued, and these, together with all outstanding notes, were paid in full before December 31, 1952. The Canadian dollar throughout the year was at a premium. Accordingly, from the "credit" in exchange on the new notes issued in that year totalling $68,789.34, there was deducted the "debit" established by revaluation of the notes unpaid on December 31, 1951, namely, $62,196.80, leaving a balance of $6,592.54. That amount was deducted from $194,944.26, the amount of the actual benefits accruing to the appellant upon payment of its several notes in 1952, due to the premium on the Canadian dollar. It is contended that the difference of $188,351.72 is "profit" for 1952 relating to "exchange on the notes". In its income tax return for that

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year, the appellant attached Schedule 28 thereto with the same particulars as in Schedule 3 of the notice of appeal. In computing its taxable income, however, the full amount of $188,351.72 was deducted from net income, the appellant then being of the opinion that such "profit" was not on revenue account. It is now conceded, however, that whatever profit was made in 1952, upon payment of the notes, was a profit on revenue account.

It is admitted that the appellant, had it so desired, could at all relevant times have paid the notes (which admittedly were curernt liabilities) in full by having recourse to the line of credit which it had with its Canadian bankers.

The expert accountants, who gave evidence for the appellant, were all in agreement that the "accrual" system was the only suitable one for the appellant company and that, from an accounting point of view, it was proper and necessary, in order to give a true picture of the company's position, to revalue the amount of Canadian dollars necessary at each balance-sheet date to pay off the outstanding notes.

The Court below decided in favour of the respondent. Its decision may be briefly summarized in the following quotation from the reasons for judgment:

> It will be seen, therefore, that the issue is one of amount only, the appellant's main contention being that the profit on exchange in 1952 was $188,351.72 and not $431,072.68, the amount added by the Minister.
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> In my view, the broad issue to be determined here is this—"When did this profit arise?" That question, as I have suggested, is one of law, to be answered by a consideration of the Act and the relevant decisions of the Courts. By s. 3 of the 1948 *Income Tax Act*, "The income of a taxpayer for a taxation year . . . is his income from all sources . . . (and) includes income for the year from all . . . businesses." Then, by s. 4, "Income for a taxation year from a business . . . is the profit therefrom for the year."
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> The problem will, I think, be made clearer if a specific example is considered. Certain of the notes issued to General Electric in 1950 were wholly unpaid until 1952. Notwithstanding this fact, the appellant on December 31, 1950, and on December 31, 1951, in relation to these notes revalued downwards on its books the amount of Canadian dollars necessary on those dates to pay the premium then in effect on U.S. exchange. In 1951, nothing else was done in connection with these liabilities. The question, therefore, is whether in these circumstances a trader who in one year has incurred a debt in foreign currency and has left it wholly unpaid throughout the following year, is taxable under *The Income Tax Act* by reason of the single fact that its liability in terms of Canadian currency has decreased during that subsequent year as the result of the change downwards in exchange rates.
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> After most careful consideration of the arguments of counsel and of the authorities cited in support of their submissions, I have come to the conclusion that the appeal on this point is not well founded and must be

dismissed. I do so for the reason that the profits in question, in my opinion, were neither made nor ascertained by the mere revaluation downwards on December 31, 1950 and December 31, 1951 on the books of the company, of the amount of the premium in Canadian dollars necessary to pay the outstanding notes, but that such profits were made only upon actual payment of the several notes.

From that judgment the appellant has appealed. Its position in the present appeal was stated by its counsel as follows:

> The only difference between the parties and the subject of the present litigation is whether a "*calculated* profit" of $431,072.68 on a combination of the "cash" and "accrual" methods of computing income is attributable to 1952 as income of the appellant for that year, which is the only one of the three years now under assessment and appeal, or whether the appellant's attribution of "income" to 1950, 1951 and 1952 on the "accrual" method of computing income as reflected in the appellant's financial statements and income tax returns is correct.
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> The appellant's accrual treatment of all its current obligations in U.S. currency (including the accounts payable in question represented by notes) was accepted throughout as reported but the current liabilities evidenced by notes were singled out for different treatment only in the re-assessment made in 1957 for the appellant's 1952 taxation year. The appellant had treated all foreign currency payables and receivables, and foreign currency bank accounts in the same way and took into its profit and loss statement any income or loss resulting from a change in the rate of exchange from that which was originally recorded.
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> Under the belief, acknowledged later to be mistaken, that the issue of the notes changed the character of the liability, the appellant for the 1952 year excluded the "gain" on the notes. The mistaken belief has been subsequently corrected and the appellant concedes that the issue of the notes did not in any way change the liability from an ordinary trade account payable for goods purchased the same as other trade accounts payable, so that the exclusion of the "gain" from income for income tax purposes is no longer justified. It is the appellant's submission that the gain should be treated in exactly the same way as the gain on the other foreign currency payables, receivables, and bank accounts.

The respondent contends that a taxable profit is not realized and does not arise by the mere revaluation in a trader's account of the cost in Canadian dollars, at any given time, of paying off an indebtedness payable in a foreign currency. A profit arising in this way would be an unrealized profit. In the present case the profit was only realized on actual payment of the notes and that profit consisted of the difference in the amount of Canadian dollars which would have been required to pay the notes at the time of their issuance and the amount actually required when the notes were paid. No notes were paid off in 1950. Some were paid in 1951 and

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the balance were paid in 1952 and accordingly the respondent contends that the profit on exchange should be apportioned to the years in which the notes were actually paid, as follows:

1951	$ 81,774.44
1952	431,072.68

The relevant sections of the *Income Tax Act* are ss. 3 and 4, which provide as follows:

> 3. The income of a taxpayer for a taxation year for the purposes of this Part is his income for the year from all sources inside or outside Canada and, without restricting the generality of the foregoing, includes income for the year from all
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> (*a*) businesses,
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> (*b*) property, and
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> (*c*) offices and employments.
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> 4. Subject to the other provisions of this Part, income for a taxation year from a business or property is the profit therefrom for the year.

The problem to be determined is as to what was the appellant's profit from its business in the year 1952. The judgment appealed from has held that, in computing its profit for that year, the appellant must take into account the "profit" resulting from the fact that in that year it was able to discharge notes, payable in U.S. funds, for a lesser number of Canadian dollars than would have been required to pay them at the time of their issuance, on the ground that the "profit" was realized by such payment. The appellant was not, in law, for income tax purposes, entitled to compute its "profits", in respect of the notes, in the years 1950 to 1952 inclusive in the way in which, under its system of accounting, it had actually done.

In considering the validity of this conclusion, reference may first be made to some general principles which have been stated regarding the meaning of the word "profit" and the method of its determination.

Viscount Maugham, in *Lowry (Inspector of Taxes) v. Consolidated African Selection Trust, Limited*[1], said:

> It is well settled that profits and gains must be ascertained on ordinary commercial principles, and this fact must not be forgotten.

In this Court, in *Dominion Taxicab Association v. The Minister of National Revenue*[2], Cartwright J. said:

> The expression "profit" is not defined in the *Act*. It has not a technical meaning and whether or not the sum in question constitutes profit must be determined on ordinary commercial principles unless the provisions of the *Income Tax Act* require a departure from such principles.

[1] [1940] A.C. 648 at 661, 2 All E.R. 545.

[2] [1954] S.C.R. 82 at 85, 54 D.T.C. 1020.

I do not understand the judgment appealed from to hold, nor did the respondent contend, that the method adopted by the appellant in computing its profits in the year 1952 was in contravention of any of the provisions of the *Income Tax Act* itself. What was held was that, on the basis of the decided cases, the appellant had realized a taxable "profit" of $431,072.68 in that year.

This raises the question as to what was the nature of the "profit" which the appellant has thus realized. Clearly, it consists of the difference in amount as between an actual expenditure of Canadian dollars and an estimated valuation of the cost of payment in those funds. The sole issue is as to whether, in computing taxable income for the year 1952, that valuation must necessarily be the one which was first made, when the note was issued, or whether the revised valuation, as of the beginning of the year 1952, is the one which should be used.

Taking as an example a note issued by the appellant to its parent company in 1950 and paid in 1952, the legal position is that a debt, payable in U.S. dollars, incurred in 1950, was paid off in 1952 in U.S. dollars. Thus far there can be no question of a "profit" in 1952. Had the appellant operated on a "cash" system of accounting there would merely have been an expenditure taken into account in that year. The "profit" which the respondent says the appellant realized in 1952 can only be said to arise because of the fact that the appellant, under its "accrual" method of accounting, included the note as a liability in computing its profit for the year 1950. In setting up that liability in 1950 the appellant had to estimate the value of the note in terms of Canadian dollars. An estimate was made at the time the note was issued, but further estimates were made at the end of each month and also at the end of the financial year, December 31, 1950. The estimate for that date was made on the basis of the rate of exchange existing at that time. In my view, as it was a matter of estimation, that was the best date in 1950 on which to value the liability for the purpose of computing profit for that year. It seems to me that there is no special significance attaching to the rate of exchange existing on the date on which the note was issued, because there was no likelihood that the note would be paid on that date.

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In 1951, at the commencement of the year, the appellant's estimate of the liability as of the end of 1950 was carried forward. At the end of each subsequent month it was revised in accordance with the then existing exchange rate and again an estimate was made at the year end. During that year there had been a decline in the premium payable on the U.S. dollar, so that by the year end the cost to the company of paying off the U.S. obligation had declined. The liability which had been taken into account in computing profit for the year 1950 was now less than it had been in that year. In order properly to show the appellant's position in the year 1951 it was necessary for it to make this revision of estimate and thereby it disclosed a "profit", which was really a reduction of the liability, as previously taken into account in 1950. The appellant's position, under the "accrual" method of accounting, had improved. It was only because of the application of that method, in the first place, that the liability had been taken into account in terms of Canadian dollars in 1950.

In my opinion it was proper for the appellant to do this. Its profit or loss during the 1951 accounting period had to be ascertained by a comparison of its position at the beginning and at the end of that period, based upon estimates of value and the accrual of debits and credits. Furthermore it should be noted that all of the 1950 notes, not paid in 1951, were due and payable by December 31, 1951. So far as the notes issued in 1951 are concerned, for the reasons already stated, I feel that the proper date on which to estimate their value in that year was at the end of the financial year on December 31, 1951.

In 1952 the notes were paid off and our problem is as to the "profit" which accrued in that year. In my view, the "profit" from its business, in 1952, in relation to the notes, should be the amount by which, in terms of Canadian dollars, the cost of payment was reduced in that year. This represented the difference between the estimate of the cost of payment as of the beginning of the year 1952 and the actual cost of payment in that year.

To summarize my view it is that there would be no "profit" at all in respect of the notes in the year 1952, save for the fact that their value had to be estimated, under the "accrual" method of accounting, in 1950 in order to determine the appellant's profit for that year. Being a matter

of estimate, the valuation of the liability should continue to be revised in each year thereafter until the year of actual payment. If the "profit" for 1952 is to be the difference between an estimate and the amount of actual payment, such profit in that year should be determined on the basis of the estimate at the beginning of that financial year.

It is now necessary to consider whether this conclusion is contrary to the principles established by the decided cases. There does not appear to be any decision which actually deals with this point, but reliance was placed, in the Court below, on the views expressed in a number of decisions.

Some reliance was placed upon the decisions of this Court in *Eli Lilly & Co. (Canada) Limited v. The Minister of National Revenue*[1], and *Tip Top Tailors Limited v. The Minister of National Revenue*[2]. However, in both those cases, as the judgment below points out, the question before the Court was as to whether certain profits resulting to the taxpayer from fluctuations in the foreign exchange rate constituted capital gains or taxable income. The point in issue now was never considered and, because of that fact, I do not think that either case is of any real assistance in determining the issue in the present appeal. Similarly, I do not think that cases such as *Davies v. The Shell Company of China, Ltd.*[3], which involved like issues, can aid materially in the present case.

Reference was made to *J. P. Hall & Co. Ltd. v. Commissioners of Inland Revenue*[4]. In that case, the company had contracted, in March 1914, to supply electric motors with control gear between July 1, 1914, and September 30, 1915, payment to be made one month after delivery. In April 1914 it placed sub-contracts for the control gear, but, owing to the war, deliveries of control gear by the company to its purchaser were delayed and were, in fact, made between August 1914, and July 1916. Initially, the company, in its accounts, had credited the sale price of the control gear as and when it was delivered. Subsequently, however, it contended that, for the purposes of excess profits duty, the profit from the purchase and sale of control gear should be

[1] [1955] S.C.R. 745, 4 D.L.R. 561.
[2] [1957] S.C.R. 703, C.T.C. 309.
[3] (1951), 32 Tax Cas. 133.
[4] [1921] 3 K.B. 152, 90 L.J.K.B. 1229.

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treated as arising in the accounting period in which the contracts were made. It was held, contrary to the company's contention, that the receipts in question were receipts of the accounting period in which the deliveries of control gear were actually made.

In that case the accounts in question were not yet receivable in the year in which the taxpayer sought to take them into income. As Lord Sterndale said, at p. 155, in answer to the contention that the profit on the transaction was ascertained and made on the completion of the contract: "It seems to me the simple answer is it was neither ascertained nor made at that time."

In that case the debts which the taxpayer sought to take into account were not yet receivable. The issue was different from that which arises here, where the liability is, admittedly, a current liability, taken into account at an estimated figure, and where the question is as to the propriety of subsequent revisions of that estimate in determining profits.

The Court below found an analogy between the present case and two cases in which the taxpayer had sought to take into account future anticipated losses as actual losses in a taxation year.

In *Whimster & Co. v. The Commissioners of Inland Revenue*[1], a shipping company sought to include, as a loss in a particular year, an allowance in respect of losses which it anticipated in future years, by reason of a depression in the shipping business which had already set in. It was held in that case that this was not a proper deduction in the period in question, because the loss had not actually been incurred in that period.

In *The Minister of National Revenue v. Consolidated Glass Limited*[2], in this Court, the issue was as to whether a reduction in the value of shares owned by the company, which it still retained, could be taken into account in computing its undistributed income in accordance with s. 73A(1)(*a*) of the *Income Tax Act*, 1948, the company having elected to be assessed and to pay tax under s. 95A of that *Act* as enacted in 1950. This Court decided that it could not be taken into account.

[1] [1926] S.C. 20, 12 Tax Cas. 813.
[2] [1957] S.C.R. 167, C.T.C. 78.

With respect, in my opinion, these cases are distinguishable from the present case because the situation here is not one which involves a question of anticipated future profits or losses. In the year 1951, when the appellant revised the estimate of the cost of repaying its notes, it was not doing so with a view to making an allowance in respect of anticipated profits or losses of this kind in the future. It was revising its estimate of the amount of a liability which it had actually incurred and taken into account in 1950. That liability had, in fact, reduced by the end of the year 1951, with the result that, so far as that year's operations were concerned, its profit for the year had increased by that amount.

The respondent cited in argument, among other authorities, *Whitworth Park Coal Co. Ltd. v. Inland Revenue Commissioners*[1], and *Gardner, Mountain & D'Ambrumenil, Ltd. v. Inland Revenue Commissioners*[2].

The first of these dealt with the question of the years in which certain income payments, payable to the company, should be assessed. The payments arose by virtue of the statutory provisions relating to the transfer of assets from the company to the National Coal Board under the *Coal Industry Nationalisation Act, 1946*. The issue was as to whether they were assessable in the years in which they were actually paid, or whether they should be assessed in those years in respect of which the payments became due. The House of Lords held that they were assessable in the years in which the payments were actually made, but it is clear that the important element in that case was that the company had to be treated as a non-trader.

Viscount Simonds, at p. 713, says:

> The word "income" appears to me to be the crucial word, and it is not easy to say what it means. The word is not defined in the *Act*, and I do not think that it can be defined. There are two different currents of authority. It appears to me to be quite settled that, in computing a trader's income, account must be taken of trading debts which have not yet been received by the trader. The price of goods sold or services rendered is included in the year's profit and loss account although that price has not yet been paid. One reason may be that the price has already been earned and that it would give a false picture to put the cost of producing the goods or rendering the services into his accounts as an outgoing but to put nothing against that until the price has been paid. Good accounting practice may require

[1] [1959] 3 All E.R. 703.

[2] [1947] 1 All E.R. 650, 29 Tax Cas. 69.

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some exceptions, I do not know, but the general principle has long been recognised. And if in the end the price is not paid it can be written off in a subsequent year as a bad debt.

But the position of an ordinary individual who has no trade or profession is quite different. He does not make up a profit and loss account. Sums paid to him are his income, perhaps subject to some deductions, and it would be a great hardship to require him to pay tax on sums owing to him but of which he cannot yet obtain payment.

He later goes on to say:

I certainly think that it would be wrong to hold now for the first time that a non-trader to whom money is owing but who has not yet received it must bring it into his income tax return and pay tax on it. And for this purpose I think that the company must be treated as a non-trader, because the *Butterley* case ((1956) 2 All E.R. 197) makes it clear that these payments are not trading receipts.

In *Gardner, Mountain & D'Ambrumenil, Ltd. v. Inland Revenue Commissioners* the House of Lords reaffirmed the doctrine of the relation back of trading receipts. The appellants were a firm of underwriting agents who, under their contract of service, were entitled to commission in respect of policies underwritten by them in any year, although the amount thereof could not be quantified or paid to them until two years after the close of the relevant year. It was held that the commission was earned in the year in which the policies were underwritten and must appear in the company's accounts as a trading receipt for such year; the assessment based on the original accounts for that year had accordingly to be re-opened so as to bring in the finally ascertained sum.

The present case involves liabilities on notes which were properly taken into account in the years in which they were made. Neither the amount of the liabilities in this case, nor the amount of the receipts in that case, could, at the time they arose, be finally determined. But there has been no suggestion by the respondent in the present case that the final determination of liability should be taken into account in the years in which the notes were issued. Had that been done in 1950 and 1951, the appellant's income in those years would have been increased, but its income in 1952 would have been even less than the appellant itself has admitted.

With respect, I do not reach the conclusion that the decided authorities precluded the appellant from computing its "profits", in relation to the notes, in the manner which it adopted—a method which, in relation to trade liabilities

payable in U.S. funds other than the notes, the respondent has never challenged, but in which, according to the uncontradicted evidence, the respondent had acquiesced, and which he had required.

In my opinion the appeal should be allowed and the respondent's assessment for the year 1952 should be adjusted to eliminate the respondent's inclusion in income of the amount of $431,072.68 and to include in income the amount of $188,351.72. The appellant should have the costs of this appeal and its costs in the Exchequer Court.

ABBOTT J. (*dissenting*):—The facts—which are not in dispute—are fully stated in the reasons of the learned trial judge and in those to be delivered by my brother Martland. I am in agreement with the reasons and conclusions of the learned trial judge and there is little I can usefully add to them.

During the period between August 25, 1950, and May 20, 1952, appellant issued to its parent company, notes as evidence of indebtedness, in the amount of 10,792,476.07 United States dollars. All these liabilities were incurred for stock in trade or services. During the taxation year 1951 appellant made payments on account of its U.S. dollar indebtedness amounting to $1,567,149.20 U.S., leaving a balance owing of $9,225,326.87 U.S. Since appellant maintains its accounts in Canadian dollars, a Canadian dollar equivalent of that amount, namely $9,461,455.29, had been taken into the trading accounts of appellant as a trading liability in the respective years in which the liabilities were incurred, and claimed and allowed a trading expense in determining taxable income for those years.

In 1952 appellant was able to purchase or otherwise acquire for $9,032,382.61 Canadian, the $9,225,326.87 U.S. required to discharge the liability of $9,461,455.29 Canadian, which it had claimed and been allowed as a deduction from gross income in arriving at its trading profits in the two previous years. It thus realized in that year a gain of $431,072.68 Canadian which on the principle laid down by this Court in the *Eli Lilly & Company* case and the *Tip Top Tailors* case must be taken into the computation of profit and loss for tax purposes. Put in another way, appellant had received goods and services worth $9,461,455.29 Canadian, which, by deferring payment until the exchange rate had moved substantially in its favour, it was able to acquire

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for $9,032,382.61 Canadian with a resulting profit of $431,072.68. I agree with the learned trial judge that this exchange gain must be taken into account in 1952, the year in which it became a reality.

The $9,461,455.21 Canadian, claimed as an expense in the respective years in which the U.S. dollar liabilities were incurred, could not be claimed as an expense in any other year, and the fallacy inherent in appellant's submission is clearly pointed out by the learned trial judge in the following terms:

> Let it be assumed that goods were purchased in the United States at a time when U.S. funds were at a premium of only 3 per cent, that notes similar to those above-mentioned were given in payment and that such notes were still outstanding at the end of the following year, by which date the premium on U.S. funds had risen to 10 per cent. In my view, the taxpayer in such circumstances could not then successfully claim a deduction of an additional 7 per cent as a further cost of goods purchased for the reason that such an expense had not actually been incurred and was a mere estimate of anticipated losses.

Particularly in the absence of a fixed exchange rate, a liability incurred by a Canadian debtor in terms of a foreign currency must always contain a contingent element and what the appellant did, in reality, in revaluing its U.S. dollar liability at the end of each fiscal period, was merely (1) to state from time to time in its balance sheet, a revised estimate of the Canadian dollar equivalent of what it owed to its parent company in U.S. dollars and (2) to write down the amount of that indebtedness as originally entered in its books and treat the resulting "gain" as a capital profit, apportioned over three years. The fact that appellant used the accrual system of accounting in calculating its trading profits for each year had no relevance to this purely bookkeeping operation. No doubt the entries made by appellant in its books were proper from an accounting standpoint in order to present from time to time, as accurate a balance sheet as possible, but in my opinion they had no bearing upon the appellant's liability for income tax.

I would dismiss the appeal with costs.

Appeal allowed with costs, ABBOTT J. *dissenting.*

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