1959

*Feb. 10, 11
Apr. 28

OXFORD MOTORS LIMITED ..... APPELLANT;

AND

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

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Taxation—Income tax—Distributor of automobiles receiving rebates from supplier—Whether rebates forgiveness of debt or trading profit—The Income Tax Act, 1948 (Can.), c. 52, ss. 3, 4.

In 1951 the appellant, a distributor and retailer of foreign-made automobiles, had a large inventory of cars on hand and was heavily indebted to its supplier. The supplier granted to the appellant a rebate of $250 on each automobile in stock and subsequently sold. The rebates were to be applied to retire the appellant's outstanding indebtedness to the supplier. The minister included the rebates in the appellant's income. The appellant contended that the rebates were a capital gain arising from a forgiveness of debt. The assessment was confirmed by the Exchequer Court.

Held (Cartwright J. dissenting): The rebates were taxable as income earned in the course of the appellant's trading operations. Each rebate was in the nature of a discount granted or a subsidy paid to supplement the appellant's trading receipts: *Lincoln Sugar Ltd. v. Smart,* [1937] A.C. 697. The fact that the rebates took the form of credits against the appellant's indebtedness did not alter their true character or make them merely the forgiveness of a debt previously incurred: *British Mexican Petroleum Ltd. v. Jackson* (1932), 16 T.C. 570, distinguished.

Per Cartwright J., *dissenting*: The substance of the transaction was the forgiveness of a past-due debt incurred in a previous year. The evidence did not support the view that the rebates were the equivalent of payments made in the nature of subsidies. This case was brought within the principle of the decision in *British Mexican Petroleum Ltd. v. Jackson, supra.* No part of the total amount of the rebates should have been treated as a receipt from the appellant's business in calculating the profit therefrom.

APPEAL from a judgment of Dumoulin J. of the Exchequer Court of Canada[1], affirming the decision of the Minister. Appeal dismissed, Cartwright J. dissenting.

D. N. Hossie, Q.C., and *J. G. Alley,* for the appellant.

W. R. Jackett, Q.C., F. J. Cross, and *G. W. Ainslie,* for the respondent.

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

[1] [1958] Ex. C.R. 261, [1958] C.T.C. 184, 58 D.T.C. 1104.

The judgment of Locke, Fauteux, Abbott and Martland JJ. was delivered by

ABBOTT J.:—Since 1936 appellant has been a distributor and retailer of Morris motor cars in British Columbia and in the adjoining States of Washington and Oregon, purchasing its cars from Nuffield Exports Limited of Oxford, England.

In the summer of 1951 appellant had a large inventory of cars on hand, for which it had not paid Nuffield, and by reason of the imposition of severe Consumers Credit Restrictions in March of that year was experiencing great difficulty in disposing of its inventory. Following discussions which took place between officers of the Nuffield company and its Canadian dealers during the summer of 1951, Nuffield offered to all its Canadian dealers a special arrangement in virtue of which it agreed to give a rebate of $250 on each car in stock in Canada on September 1, 1951, and subsequently sold in Canada, such rebate to be available upon payment being made to Nuffield of an amount equal to the c.i.f. value of the cars on which rebate was claimed. The amount of all rebates was to be applied on the dealer's outstanding indebtedness to Nuffield. In February 1952, this arrangement appears to have been modified; the grant of the rebate was dissociated from actual sales but it continued to be applicable only with respect to the cars on hand in Canada at September 1, 1951, and to cars sold in Canada and not in the United States. In essence this allowance does not seem to differ from the discount on prompt payment commonly allowed by wholesalers of a great variety of merchandise to retailers all over Canada. The arrangement here was in reality, simply the granting of a discount of $250 upon the sale price of cars sold or upon their purchase price if paid between the dates stipulated by Nuffield.

In fact most of the cars on hand at September 1, 1951, were sold prior to September 30, 1952, which was the end of appellant's taxation year, and during that twelve month period the appellant obtained rebate credits from Nuffield in the amount of $483,185.91. In its books these credits were reflected in its profit and loss account for the year under various income and expense items. It filed its income

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tax return for the 1952 taxation year, reporting taxable income as being $10,469.42 and was assessed tax in the amount of $5,275.67.

It should perhaps be mentioned that during the period from October 1, 1951, to September 30, 1952, appellant carried on its business in partnership with a related company under the firm name of "British Motor Centre" but the existence of that partnership is of no significance to this appeal.

Appellant appealed from the assessment to the Exchequer Court of Canada[1] and upon that appeal took the position that the application of the rebates in its books had been made in error; that the total amount of these rebates, was in law the forgiveness of a debt, and as such should have been credited as a capital accretion to its surplus account. That appeal was dismissed with costs and the present appeal is from that judgment.

The relevant provision of the *Income Tax Act* is s. 4 which reads as follows:

> 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 issue here is whether the admitted profit, realized by appellant in its financial year ending September 30, 1952, as a result of the special rebate arrangement with Nuffield, was a profit earned in the course of its trading operations as contended by the Crown, or a capital gain as contended by appellant.

The principal business of appellant is the buying and selling of new and used motor cars. The circumstance which gave rise to the special rebate arrangement with Nuffield was the imposition by the Federal Government of consumer credit restrictions. It was not suggested that the imposition of these restrictions (which were cancelled in May 1952) had the effect of decreasing the value of the cars held by appellant nor was it suggested that they were ultimately sold at reduced prices. What the restrictions did do was to make sales on credit more difficult. In other words, in the language of trade, the appellant had a slow moving inventory.

[1] [1958] Ex. C.R. 261, [1958] C.T.C. 184, 58 D.T.C. 1104.

It was to meet this situation that Nuffield offered to all its Canadian dealers the special rebate arrangement of $250 with respect to each Morris car on hand on September 1, 1951, and subsequently sold in Canada.

Nuffield was, of course, faced with a situation, where not only appellant but its other Canadian distributors, held large inventories of cars not readily saleable and for which they were unable to pay, and being unwilling to go into the selling business in Canada itself, the rebate scheme was no doubt instituted in order to assist these dealers to continue in business, dispose of their cars, and discharge their obligations to Nuffield.

One effect of the rebate arrangement was to enable appellant to extend more generous terms to its customers, by increasing its trade-in allowances for used cars. That appellant took advantage of this, is indicated by the fact that the sum of $51,856.10 appears as an item of expense in the 1952 accounts under the head "Over allowances—Used Cars". No similar item appeared in the accounts for the previous year.

The result of the offer made by Nuffield was that appellant's inventory of cars, if sold in Canada, would yield to it an additional gross profit of $250 per car. Put alternatively, the cost of every car sold in Canada was reduced by $250. The fact that the rebates took the form of credits against appellant's indebtedness to Nuffield, did not alter their true character, or make them merely the "forgiveness" of a past due debt incurred in a preceding year, as that term was used in the *British-Mexican Petroleum* case to which I shall refer presently. These rebates were intimately related to the appellant's trading operation, and in my opinion the profit realized from them was clearly a trading profit from the business.

Viewed in another aspect, it could be said that Nuffield agreed to pay to its Canadian dealers a subsidy of $250 on each car sold in Canada and such a subsidy has been held to be part of revenue for the purpose of computing profit: *Lincoln Sugar Limited v. Smart*[1]. In that case at p. 704, Lord Macmillan referred to the payments made, as "intended artificially to supplement their (the taxpayer's)

[1] [1937] A.C. 697, 1 All E.R. 413.

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trading receipts so as to enable them to maintain their trading solvency". The same statement might appropriately be made with respect to the rebates in issue here. It would be immaterial in such a case, whether the subsidy were received in cash or in the form of credit notes against outstanding indebtedness.

In his able argument Mr. Hossie put his case squarely upon the basis that the benefit derived by appellant, was in law, a forgiveness of debt, and as such was to be treated as a capital accretion, and he relied upon the decision of the House of Lords in *British Mexican Petroleum Limited v. Jackson*[1], but in my view, that decision has no application in the circumstances of this case. In the *British Mexican* case the facts were as follows. The British Mexican company, in addition to certain other liabilities, actual and contingent, owed very large sums to two creditors who were also the principal shareholders in the company. This indebtedness represented oil purchased, and freight charges incurred, during a preceding accounting period. As the result of a sharp decline in prices, the value of the company's assets had decreased, its working capital was seriously impaired and it was in fact insolvent. In these circumstances the two shareholder creditors and a third creditor, with whom the debtor company had entered into a contract for the construction of ten tank steamers on which there was a large sum owing, entered into a written agreement for the partial remission by the three creditors concerned, of their claims against the debtor company. It was an express term of this agreement that the sum remitted should be applied by the debtor to reduce the amount shown in its books in respect of its assets "to a figure more nearly representing the present value thereof". What really happened was that the three interested creditors assisted in restoring the capital position of the company by writing off claims which could no longer be paid out of the proceeds of available assets.

The main argument for the Crown was that the indebtedness remitted had been treated in the previous accounting period as an expense of trade deductible from gross receipts in that period but that, to the extent that

[1] (1932), 16 T.C. 570.

it was subsequently released, it was never in fact expended; and that in consequence the accounts for the previous period should be opened up and the deduction brought into conformity with the amount actually paid. Alternatively it was urged that the amount of the sum released ought to be brought into profit and loss account as a credit item in the period in which the release was granted. Both contentions failed in all Courts. As to the alternative submission (which Lord Thankerton stated was not seriously pressed), it seems clear that the amount remitted was properly considered as a capital item. As Lord Hanworth M.R., delivering the judgment of the Court of Appeal, stated at p. 588, the release was given "not by way of return of something which had been taken out from the Company in a previous accounting period, but which was, by a new bargain made, to afford new capital and was under the terms of that bargain to be placed to the relief of the depreciation account and not otherwise. It cannot be brought into the profit and loss account of either 1921 or 1922".

The *British Mexican* case did not decide, that under no circumstances can the forgiveness of a trade debt be taken into account, in determining the taxable profit arising from the carrying on of a business, and I have found no subsequent case in which it has been so held. No one has ever been able to define income in terms sufficiently concrete to be of value for taxation purposes. In deciding upon the meaning of income, the Courts are faced with practical considerations which do not concern the pure theorist seeking to arrive at some definition of that term, and where it has to be ascertained for taxation purposes, whether a gain is to be classified as an income gain or a capital gain, the determination of that question must depend in large measure upon the particular facts of the particular case.

For the reasons which I have given, I would dismiss the appeal with costs.

CARTWRIGHT J. (*dissenting*):—The facts out of which this appeal arises are stated in the reasons of my brother Abbot. The question for decision is whether the rebates totalling $483,185.91 given by Nuffield to the appellant in

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the course of the later's taxation year ending September 30, 1952, should be regarded as receipts from its trade or business during that year.

The difficulties of the problem are of fact rather than of law. The underlying rules are not in dispute; they are stated in the judgment of Kerwin C.J. in *Minister of National Revenue v. Anconda American Brass Ltd.*[1], as follows:

> The statement of Lord Clyde in *Whimster & Co. v. The Commissioners of Inland Revenue,* (1925) 12 Tax Cas. 813 as to the two fundamental matters to be kept in mind in computing annual profits is accepted in England and is applicable here. It appears at p. 823 of the reports:—
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> "In the first place, the profits of any particular or accounting period must be taken to consist of the difference between the receipts from the trade or business *during such year or accounting period* and the expenditure laid out to earn *those receipts.* In the second place, the account of profit and loss to be made up for the purpose of *ascertaining that difference* must be framed consistently with the ordinary principles of commercial accounting, so far as applicable, and in conformity with the rules of the *Income Tax Act,* or of that Act as modified by the provisions and schedules of the Acts regulating Excess Profits Duty, as the case may be."

If during the taxation year in question the appellant had received, or acquired any right to receive, payment of the $483,185.91 or any part thereof, as a trading receipt, the amount so received should be taken into account in determining the amount of its profit and this result would not be altered by the circumstance that the appellant elected, or was bound by some agreement, to apply the sum so received in reduction of a past due indebtedness. On a consideration of the whole record in the light of the full and helpful arguments of counsel, the conclusion appears to me to be inescapable that the substance of the transaction was the forgiveness by Nuffield of a past due debt incurred in a previous taxation year. The evidence does not support the view that the rebates were the equivalent of payments in the nature of subsidies. The case of *Lincoln Sugar Limited v. Smart*[2] is distinguishable on the facts.

The character of the transaction is not affected by the circumstance that Nuffield's decision to forgive the indebtedness was prompted not by solely philanthropic

[1] [1954] S.C.R. 737 at pp. 738, 739, [1954] C.C.T. 335, 54 D.T.C. 1179.
[2] [1937] A.C. 697, 1 All E.R. 413.

motives but rather by the desire to enable the appellant, a purchaser of large numbers of its cars, to remain in business.

It was not suggested that there should be a re-opening of the accounts of the previous taxation year. The evidence appears to me to bring the case within the principle of the decision in *The British Mexican Petroleum Co. Ltd. v. Jackson*[1], and particularly the following passages.

At p. 585, Rowlatt J., after stating that the trading profit for a year is to be arrived at by comparing the amounts received from selling goods with the amount paid out to put the trader in the position to do so by buying goods, with the necessary adjustments in the account to allow for the stock which is carried over from year to year, and that the profit is the difference between what is received and what is paid out in the year's trading, continues:

> How on earth the forgiveness in that year of a past indebtedness can add to those profits I cannot understand. It is not a matter depending upon the form in which the accounts are kept. It is a matter of substance, looking at the thing as it happened, as a man who knows nothing of scientific accountancy might look at it—it is the receipts against payments in trading.

At p. 592, Lord Thankerton says:

> I am unable to see how the release from a liability, which liability has been finally dealt with in the preceding account, can form a trading receipt in the account for the year in which it is granted.

And at p. 593, Lord Macmillan says:

> If, then, the accounts for the year to 30th June, 1921, cannot now be gone back upon, still less in my opinion can the Appellant Company be required to enter as a credit item in its accounts for the eighteen months to 31st December, 1922, the sum of £945,232, being the extent to which the Huasteca Company agreed to release the Appellant Company's debt to it. I say so for the short and simple reason that the Appellant Company did not, in those eighteen months, either receive payment of that sum or acquire any right to receive payment of it. I cannot see how the extent to which a debt is forgiven can become a credit item in the trading account for the period within which the concession is made.

In the case at bar, the substance of the transaction tends to be obscured, but is not altered, by the circumstance that the forgiveness was made piecemeal and that the individual items composing the total of $483,185.91 were

[1] (1932), 16 T.C. 570.

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related in time some to the sales of cars and some to the payment of drafts; each item was in substance nothing other than the voluntary forgiveness of a past indebtedness incurred in a previous taxation year.

In my opinion no part of the said sum of $483,185.91 should have been treated as a receipt from the appellant's business in calculating the profit therefrom for the taxation year in question.

I would allow the appeal, set aside the judgment of the Exchequer Court, and direct that the assessment be referred back to the respondent to be dealt with in accordance with these reasons. The appellant is entitled to its costs in the Exchequer Court and in this Court.

Appeal dismissed with costs, Cartwright J. dissenting.

Solicitors for the appellant: Davis, Hossie, Campbell, Brazier and McLorg, Vancouver.

Solicitor for the respondent: A. A. McGrory, Ottawa.