

I would, therefore, allow the appeal on the terms proposed by my brother Hudson.

Appeal allowed with costs.

Solicitors for the appellants: *Kerr, McNevin, Gee & O'Connor.*

Solicitor for the respondents: *A. L. Hanna.*

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HIS MAJESTY THE KING (PLAINTIFF). APPELLANT;

AND

DOMINION ENGINEERING COMPANY LIMITED (DEFENDANT) } RESPONDENT.

1944
*May 22.
*Oct. 3.

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Revenue—Sales tax—Contract of sale of machinery—Purchase price to be paid by monthly progress instalments during period of construction—Purchaser becoming insolvent before completion and delivery of machine—Claim by the Crown for sales tax on remaining instalments then not collected—The Special War Revenue Act, R.S.C., 1927, c. 179, s. 86

The respondent company entered into a contract, on June 5th, 1937, for the sale of a pulp-drying machine to the Lake Sulphite Pulp Company for the price of \$488,335 payable in nine monthly progress instalments of \$48,800 each commencing July 5th, 1937, and the balance of \$49,135 when the machine would be in operation, title to pass on payment in full of the price. Six instalments were paid to the respondent and the sales tax on them was paid by the latter to the appellant. On February 5th, 1938, a petition in bankruptcy was filed against the Pulp Company; and on the 11th of February, all work on the machine was stopped. On February 22nd, an order was made for winding up under the Dominion *Winding Up Act* and a liquidator was appointed. The Crown brought an action for the recovery from the respondent of the sum of \$10,844.46 for sales tax and penalties on the instalments payable on the 5th days of January, February and March, 1938, the tax being claimed under section 86 of the *Special War Revenue Act, R.S.C., 1927, c. 179*. The first proviso of that section enacts *inter alia* that "the tax shall be payable *pro tanto* at the time each of such instalments falls due and becomes payable in accordance with the terms of the contract, and all such transactions shall, for the purpose of the section, be regarded as sales and deliveries"; and the second proviso further enacts that "in any case where there is no physical delivery of the goods by the manufacturer or producer, the said tax shall be payable when the property in the said goods

*PRESENTS—Rinfret C.J. and Kerwin, Hudson, Taschereau and Rand JJ.

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passes to the purchaser thereof". The contention of the Crown is that the case is within the first proviso and that, as the agreement formally provided for instalments on specified dates, when these dates arrived the tax *eo instanti* became an absolute obligation to the Crown divorced wholly from the contract.

Held, affirming the judgment of the Exchequer Court of Canada, [1943] Ex. C.R. 49), that there was no liability on the respondent for sales tax as claimed by the Crown.

Per The Chief Justice and Kerwin, Taschereau and Rand JJ.—The language of the first proviso, appropriate to a contract performed according to its original terms, presents difficulties in its application to one which has been modified or disrupted; and, therefore, such language is subject to interpretation. If, for instance, after some instalments and the related taxes had been paid, the parties had altered the agreement by either increasing or reducing the price, the incidence of the tax must thereafter vary accordingly. And, in case of disruption of the contract, to sustain the right to the tax, the instalment become payable must remain an obligation of an executory contract. In the present case, the fact of bankruptcy intervening is a circumstance fatal to the right of the Crown to maintain the information. When, on February 22nd, 1938, the liquidation order was made, the instalments for the balance of purchase price ceased to be "due" and "payable" within the meaning of the statute; the respondent could not have enforced payment of the remaining instalments and the essential condition of the tax that they should continue as effective obligations of a contract of sale was not existing when the information was issued.

Per Hudson J.—The sales price, under the contract, was to be paid in instalments in the nature of progress payments although there was no provision that these instalments should be made in accordance with any particular rate of progress, but it must be assumed that it was the intention of the parties that the payments should not become payable until the respondent was making fair progress in its work. Therefore, it is doubtful, upon evidence of delays by the respondent, whether or not the instalments in respect of which the Crown claims ever fell "due" and "payable" in order to bring them within the terms of the first proviso. But, even if it were so, the second proviso must prevail, as the property in the goods never passed to the purchaser: the machinery was never completed, and thus was never capable of physical delivery in fulfilment of the contract. *Forbes v. Git* ([1922] A.C. 256) applied.

APPEAL from the judgment of the Exchequer Court of Canada, Angers J. (1), dismissing an information exhibited by the Attorney-General of Canada to recover from the respondent sales tax and penalties alleged due the Crown under the provisions of the *Special War Revenue Act*, R.S.C., 1927, c. 179.

The material facts of the case and the questions at issue are stated in the above head-note and in the judgments now reported.

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F. P. Varcoe K.C., Roger Ouimet and W. R. Jackett for the appellant.

Hazen Hansard for the respondent.

The judgment of the Chief Justice and of Kerwin, Taschereau and Rand JJ. was delivered by

RAND J.—This is an information brought to recover sales taxes claimed in respect of a contract of sale between the respondent as seller and the Lake Sulphite Pulp Company Limited as purchaser of an apparatus known as a pulp-drying machine. The machine was to be built according to plans and specifications, and delivery was to be made on or about March 5th, 1938, f.o.b. cars at Lachine, Quebec, with freight prepaid to the plant of the purchaser at Nipigon, Ontario. The erection of the machine was to be done by the purchaser. The proposal was under date of June 5th, 1937, and the acceptance by the purchaser made on August 3rd, 1937.

The price was \$488,335 payable in nine monthly progress instalments of \$48,800 each commencing July 5th, 1937, and the balance of \$49,135 when the machine was in operation but in no event later than six months from the date of final shipment or offer of shipment from the respondent's works at Lachine. Title was to pass on payment in full of the price.

Although the acceptance was not made until August 3rd, work was actually commenced on June 15th and at the outset consisted of the preparation of plans, ordering of materials and parts, making of moulds, castings, machinery, etc. The instalments due on July 5th and August 5th were paid on August 27th, that for September 5th on the 30th of that month, for October on the 7th and for November on the 13th. Some time in December it was made known that the purchasers were under the necessity of raising funds to carry on the completion of their plant by an issue of treasury notes. A subscription of \$50,000 by the respondent was made on terms that the instalment due on

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December 5th should be paid out of the funds realized, and that instalment was paid on January 11th, 1938. On February 5th, 1938, a petition in bankruptcy was filed against the Lake Sulphite Pulp Company and on the 11th of February all work on the machine was stopped. On February 22nd an order was made for winding up under the Dominion *Winding Up Act* and a liquidator was appointed.

On the 11th of February the purchaser had paid on account the sum of \$292,800. There remained of the price a balance of \$195,335. On the 6th day of April, 1938, the respondent by letter communicated to the liquidator the details of the contract, adding certain extras, sales tax and freight amounting to \$1,662.80 and stating that the "work under the contract" was approximately 75 per cent completed. With that was submitted a statutory proof of claim for the sum of \$202,820.76. The difference of \$5,622.96 was for three small additional contracts. There is no evidence of what, if anything, took place thereafter between the liquidator and the respondent. The information was filed on the 25th day of April, 1940.

The tax is claimed under section 86 of *The Special War Revenue Act*, c. 179 R.S.C., 1927, as amended. Subsection (1) is as follows:

1. There shall be imposed, levied and collected a consumption or sales tax of eight per cent, on the sale price of all goods,—

(a) produced or manufactured in Canada, payable by the producer or manufacturer at the time of the delivery of such goods to the purchaser thereof.

Provided that in the case of any contract for the sale of goods wherein it is provided that the sale price shall be paid to the manufacturer or producer by instalments as the work progresses, or under any form of conditional sales agreement, contract of hire-purchase or any form of contract whereby the property in the goods sold does not pass to the purchaser thereof until a future date, notwithstanding partial payment by instalments, the said tax shall be payable *pro tanto* at the time each of such instalments falls due and becomes payable in accordance with the terms of the contract, and all such transactions shall for the purposes of this section, be regarded as sales and deliveries.

Provided further that in any case where there is no physical delivery of the goods by the manufacturer or producer, the said tax shall be payable when the property in the said goods passes to the purchaser thereof.

It is contended by the Crown that the case is within the first proviso and that, as the agreement formally pro-

vided for instalments on the 5th days of January, February and March, 1938, when these times arrived the tax *eo instanti* became an absolute obligation to the Crown divorced wholly from the contract. It was conceded that, as the remaining balance was payable only after delivery or its equivalent, it could not be said to be due and payable and the tax had not arisen.

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The transaction is undoubtedly within the first part of the proviso. It is a contract for the sale of goods

wherein it is provided that the sale price shall be paid to the manufacturer or producer by instalments as the work progresses.

It contemplates the machine to be built or assembled by the respondent and the monthly payments are distributed evenly over the time allowed for construction. But there is nothing in the contract to indicate that the course of the work, whether as to plans or material or the production or assembly of parts, should follow any particular order or schedule or observe any uniformity of progress. That lay quite within the main obligation of the seller to furnish the apparatus at the time fixed.

By the proviso,

the tax shall be payable *pro tanto* at the time each of such instalments falls due and becomes payable in accordance with the terms of the contract, and all such transactions shall, for the purposes of this section, be regarded as sales and deliveries.

The words "such transactions" refer either to the contracts themselves or to the successive liabilities for instalments. But in either sense the expression "becomes payable" is not to be limited solely to the event of the day named for the payment of the instalment. What is contemplated is an obligation to pay arising from the legal effectiveness of the contract.

The language of the proviso, appropriate to a contract performed according to its original terms, presents difficulties in its application to one which has been modified or disrupted. If, for instance, after the first two instalments and the related taxes had been paid, the parties had altered the agreement by either increasing or reducing the price, there can be no doubt that the incidence of the tax would thereafter have varied accordingly. But what

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is the effect on unpaid taxes of a subsequent disturbance of the contract which affects the instalment obligations from which the taxes arose?

Although the section declares the "transaction" to be a constructive sale and delivery, the fundamental support of the tax is an executory contract leading to the transfer of title and possession. That contract is conceived as a potential sale to which in turn is related a potential total tax: "the tax shall be payable". *Pro tanto* portions of the tax are related to instalments of price and, when the latter become payable as parts of a whole, the right to the tax takes on the same character: but throughout, the tax depends for its efficacy upon the maturing contract. For the total tax there is only an inchoate liability created by the making of the agreement: and to sustain the right to the tax, the instalment become payable must remain an obligation of an executory contract.

The legal liability at any time for any portion of the tax in no degree restricts the parties in good faith from modifying the contract as they see fit, and *a fortiori* it does not prevent a modification by operation of law. If, in the legal result, the actual transaction ceases to be one of sale, then the necessary support for the tax disappears. That result, at least where the termination of the contract does not effect a total rescission, will not affect the right to taxes on any portion of the price paid to the seller nor does it touch those that have been collected or reduced to judgment by the Crown.

It is contended that, on the dates mentioned, the work was so far behind any schedule as to constitute a breach sufficient to give rise to a suspensive defence by the purchaser. To prove that state of things a graph was introduced showing lines of normal progress and actual progress in the shop work, and indicating that completion by March 5th was impossible. It may be that on December 31st, 1937, the work was at such a stage that, even with the capacity available to the respondent, the machine could not have been finished on time. The evidence does not clearly indicate that. It is admitted that there was a quick as well as an average schedule for the work at the Lachine plant, the former of six months and the latter of

nine. But assuming such a defence to be available under the Civil Code and on the footing that the contract was six weeks behind in its progress at the end of 1937, on January 11th, 1938, the instalment due on December 5th, 1937, was paid and the delay up to that time waived. It is not suggested that from then on until the insolvency appeared, a satisfactorily high rate of performance was not maintained.

But whether under the Act such a defence could have been interposed against the claim for the taxes, it is not necessary to decide. The fact of bankruptcy intervening is, in my opinion, a circumstance fatal to the right of the Crown to maintain this information. When, on February 22nd, the liquidation order was made, the instalments for the balance of purchase price ceased to be "due" and "payable" within the meaning of the statute. What remained to the respondent was to prove for unliquidated damages subject to the right of the liquidator to elect to complete the contract. It is not suggested there was any such election prior to the commencement of this proceeding. But the respondent could not have enforced payment of the remaining instalments and the essential condition of the tax that they should continue as effective obligations of a contract of sale was not existing when the information was issued. A right of election by the liquidator even then continuing could not affect the present proceeding.

This interpretation of the Act does not mean that either price or instalment of price in such a contract must be received before the tax is exigible but it does mean that where the obligation of such an executory contract is by operation of law destroyed, then unpaid taxes related to its terms, themselves suffer a corresponding effect. If that were not so, sellers with unsold property on their hands would be liable for taxes in respect of purchase price not only unpaid but the legal right to which had been annulled: and on the other hand a resale of the same property would attach to itself a new tax unrelated in any sense to that attributed to the first sale. What is created is a tax liability running parallel to executory commercial transactions

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which, before their completion, is exposed to the effect of contractual changes or fundamental legal infirmities to which they may become subjected.

For these reasons I would dismiss the appeal with costs.

Rand J.

HUDSON J.—This appeal concerns a claim on behalf of the Crown against the respondent in the sum of \$10,844.46 as sales tax, and for a penalty for non-payment thereof.

The claim arises out of a contract in writing concluded on 3rd August, 1937, whereby the respondent company agreed to manufacture and deliver to the Lake Sulphite Pulp Company Limited a pulp-drying machine with accessories and spare parts for a price of \$488,335, this amount to be paid in nine monthly progress payments of \$48,800 each, commencing on the 5th of July, 1937, and continuing until a total of \$439,800 should have been paid, and the balance of \$49,135 when the machine was placed in operation, but in no event later than six months from the date of final shipment or offer of shipment. It was further stipulated that the property in the goods should remain the personal property of the respondents until the price had been fully paid for in cash.

The machine to be constructed was very large and complicated. It required much planning and a great variety of materials and skilled workmanship in construction over a considerable period of time.

The work of construction had actually been commenced prior to the conclusion of the written contract, and thereafter was carried on but not at the rate expected by the parties, owing to various causes which need not be considered. However, five progress payments totalling \$244,000 had been paid by the Lake Sulphite Pulp Company by November 13th, 1937. Thereafter another instalment of \$48,800 was made in January, 1938, in respect of the sum falling due in December, 1937, but no instalments were paid in the months of January, February and March of 1938, and it is for the amount of these three payments that the present proceedings are taken.

It appears that the Lake Sulphite Pulp Company found difficulty in paying its obligations about the end of 1937 and eventually a winding-up order was made against it on the 22nd of February, 1938. The respondent's manager

learning of the Lake Sulphite Pulp Company's financial difficulties ceased work on the machinery entirely on February 11th, before the formal assignment.

The respondents paid sales tax to the Crown in respect of the payments actually made and the claim of the Crown is in brief that under section 86 (1) (a) of the *Special War Revenue Act* the respondents are liable for the tax in respect of the three payments above mentioned because these payments

fell due and became payable in accordance with the terms of the contract during the months of January, February and March.

There is no dispute as to any material facts and the whole question is as to the interpretation of the section in relation to the facts. It must be kept in mind that the machinery was being sold as a unit, that it was never completely manufactured, and that physical delivery had not been made of any, except a small part of the value of \$1,200 and that the property in such part of the machine as had been manufactured did not pass to the purchaser.

Section 86 is as follows:

86. 1. There shall be imposed, levied and collected a consumption or sales tax of eight per cent, on the sale price of all goods,—

(a) produced or manufactured in Canada, payable by the producer or manufacturer at the time of the delivery of such goods to the purchaser thereof.

Provided that in the case of any contract for the sale of goods wherein it is provided that the sale price shall be paid to the manufacturer or producer by instalments as the work progresses, or under any form of conditional sales agreement, contract of hire-purchase or any form of contract whereby the property in the goods sold does not pass to the purchaser thereof until a future date, notwithstanding partial payment by instalments, the said tax shall be payable *pro tanto* at the time each of such instalments falls due and becomes payable in accordance with the terms of the contract, and all such transactions shall for the purposes of this section be regarded as sales and deliveries.

Provided further that in any case where there is no physical delivery of the goods by the manufacturer or producer, the said tax shall be payable when the property in the said goods passes to the purchaser thereof.

This section requires careful analysis.

Under (a) the tax is payable on delivery of the goods.

In the first proviso, provision is made for earlier payments in cases where the contract calls for payment by instalments. In most of the cases falling within this proviso there would be an actual physical delivery of the goods agreed to be sold. For example, in cases of con-

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ditional sales and hire-purchase, this is almost invariably the case. In some, however, there would not be physical delivery and for such it is provided that a constructive or notional delivery should be assumed.

Hudson J. The second proviso does not apply to cases where there is an actual physical delivery, but in any other cases makes the tax payable when the property in the goods passes to the purchaser.

The facts in the present case may bring it within the language of the first proviso. By the contract the sales price was to be paid in instalments in the nature of progress payments although, there was no provision that these instalments should be made in accordance with any particular rate of progress. I think, however, that it must be assumed that it was the intention of the parties that the payments should not become payable until the respondent was making fair progress in its work. This was the interpretation of the Lake Sulphite Pulp Company officials because it appears from the evidence that that Company's manager protested against the delays of the respondent, and in fact held up the December payment for some time on that account.

It is a question whether or not the instalments in respect of which the Crown claims ever fell due and became payable but, even if this were so, I am of the opinion that the second proviso must prevail. The language is unqualified and it is clear that the property in the goods never passed to the purchaser. The second proviso does not destroy altogether the first but applies only to cases where there is no physical delivery. I think for that reason that the rule of construction approved of in *Forbes v. Git* (1) is applicable. The machinery was never completed and thus was never capable of physical delivery in fulfilment of the contract.

I would dismiss the appeal with costs.

Appeal dismissed with costs.

Solicitor for the appellant: *Roger Ouimet.*

Solicitors for the respondent: *Montgomery, McMichael, Common & Howard.*