1960
Apr. 27
Dec. 15

BETWEEN:

METEOR HOMES LIMITED ..... APPELLANT;

AND

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

Revenue—Income—Income tax—Payment by company to permit group of shareholders acquiring control not an expense incurred to earn income—Accounting—Whether payments recorded in company's books as owing for sales tax a contingent liability—Income Tax Act, R.S.C. 1952, s. 12(1)(a) and (b).

The appellant company was incorporated in January 1954 to acquire lands and build houses thereon for sale at a profit. This was pursuant to an agreement entered into between two groups, A and B, whereby each was to acquire a 50% interest and to have equal representation on the Board of Directors. The duration of the agreement was to be for at least five years unless a majority of the Board deemed an

[1] [1955] Ex. C.R. 83, 91

earlier dissolution advisable. Each of the parties before selling to a non-shareholder was required to offer his shares to existing shareholders at their book value. Shortly thereafter the two groups entered into a second agreement under which another company was incorporated with the same objects and under similar terms. By a third agreement the annual salaries to be paid by the appellant were fixed at $21,000 of which $14,000 was to be paid to Group A's representatives and $7,000 to Group B's. In July following dissension between the parties a final agreement was entered into whereby Group A agreed to sell to Group B its shares in both companies for the amount of its investment in them and Group B, in consideration of the cancellation of the partnership agreements, undertook to pay $32,500 to Group A. The appellant company was not a party to the agreement but it paid the $32,500 and in computing its income for 1954 claimed the sum as a deduction for salary payments and/or operating expenses. It also claimed a deduction of $3,978 for legal fees paid in connection with the termination of the partnership agreements. The Minister disallowed both claims as not being outlays incurred by the company taxpayer for the purpose of earning income within the meaning of s.12(1)(a) of the *Income Tax Act*.

The appellant also sought to deduct for the years 1955, 1956 and 1957, amounts recorded in its books as owing under the *Retail Sales Act*, S.Q. 1940, c. 14, but not paid pending determination of the constitutionality of the Act. The Minister ruled the amounts constituted contingent liabilities within the meaning of s. 12(1)(e) and were not deductible. On an appeal to this Court.

Held: That there was no evidence to establish that the appellant company was bound to fulfill Group B's obligation to Group A, or that the stipulations contained in the final agreement constituted any benefit to the appellant. In any event the $32,500 payment was not an expense made or incurred by the taxpayer for the purpose of producing income from the business of the taxpayer within the meaning of s.12(1)(a) of the *Income Tax Act*.

2. That for the same reasons the claim for legal fees was not deductible.

3. That the validity of a statutory law must be presumed until the contrary is proved and until then any monetary obligation which it imposes should be treated as an outstanding liability. At the date of the trial the contingency of the Quebec *Retail Sales Act* being declared unconstitutional was too remote to bring it within the purview of s. 12(1)(e) of the *Income Tax Act*. The deductions claimed for sales tax should therefore be allowed.

APPEAL under the *Income Tax Act*.

The appeal was heard before the Honourable Mr. Justice Kearney at Montreal.

Philip Vineberg, Q.C. for appellant.

Paul Boivin, Q.C. and *P. M. Ollivier* for respondent.

1960

METEOR HOMES LTD. v. MINISTER OF NATIONAL REVENUE

KEARNEY J. now (December 15, 1960) delivered the following judgment:

This is an appeal from a decision of the Minister of National Revenue, notice of which was given in conformity with s. 58 of the *Income Tax Act* to the appellant on January 28, 1959, whereby the Minister confirmed the following assessments previously issued against the appellant:

1954	$3,735.41
1955	6,123.59
1956	5,383.48
1957	1,990.36

The appellant claimed that a sum of $32,500 which it paid in 1954 in connection with the termination of two partnership agreements entered into by two groups of its shareholders, and $3,978.00 paid as legal fees in 1955, constituted ordinary operating expenses, and therefore deductible items, which the Minister had failed to take into account when assessing the appellant.

The deductibility of these two amounts, which are correlated, constitutes the primary claim in this case. The Minister disallowed them on the grounds that they were not outlays and expenses incurred by the taxpayer for the purpose of gaining and producing income, within the meaning of s. 12(1)(*a*) of the Income Tax Act, quoted hereunder:

> In computing income, no deduction shall be made in respect of
>
> (a) General limitation.—an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from property or a business of the taxpayer.

The appellant also sought to deduct from its taxable income $14,525.30 in 1955, $7,225.97 in 1956, and $4,855.97 in 1957, because they were liabilities consisting of moneys due and payable to the Comptroller of Provincial Revenue of the Province of Quebec as provincial sales tax. The Minister, on the grounds that the provincial sales tax charges were unsubstantiated and of a contingent nature, disallowed these amounts as deductions by reason of the provisions of s. 12(1)(*e*) of the Act which reads as follows:

> Reserves, etc.—an amount transferred or credited to a reserve, contingent account or sinking fund except as expressly permitted by this Part.

The deductibility of these amounts which total $26,607.24 constitutes the second point in issue.

The item of $32,500 in another connection has already been the subject of consideration by Fournier J. in *Minister of National Revenue* v. *Alfred Manaster*[1]. The following is an outline of the essential factors which in the instant case give rise to this disputed item.

Towards the end of 1953, a father and two sons, named Manaster, who through Century Construction Ltd. had been and continued to be engaged in building and selling houses, met a large family called Schouela who, with a son-in-law and an outsider, had formed a registered partnership under the name of Schouela Bros. & Co. of Canada. Most of the Schouelas were relatively new arrivals from Egypt. They had money to invest and, though without previous experience, were interested in establishing themselves in the real estate and building business. In January 1954 the two groups agreed to incorporate the appellant company for the purpose of acquiring land in the town of Dorval, Que., which involved an investment of $380,000, with the intention of building thereon small residences which they hoped to sell at a profit. Each undertook to acquire a 50% interest in treasury common stock and non-voting preferred shares to be issued by the company. Both groups vested one common share in the person of Notary Maurice J. Garmaise who thus held the balance of the voting power and was more or less in the position of an arbitrator.

The Manasters, apart from supplying the skill and experience, were to furnish some initial capital, but to a lesser extent than the Schouelas. The duration of the agreement was to be for not less than five years unless, in the opinion of the majority of the Board of Directors, they deemed it advisable to order an earlier dissolution of the company, either because of losses as shown in the operation of the company or because the majority of the Board of Directors were dissatisfied with the conduct towards the company of any of its directors or shareholders. The agreement also contained a restriction on the transferability of shares which required each of the parties before selling to a non-shareholder to offer his shares to existing shareholders at their book value, as established

[1] [1958] Ex.C.R. 314.

1960

METEOR HOMES LTD. v. MINISTER OF NATIONAL REVENUE

KEARNEY J.

by the last annual balance sheet rendered by the auditor of the company without regard to profit or loss in the interval. The Board of Directors consisted of two representatives from each group and Notary Garmaise constituted the fifth.

About two weeks later the same parties entered into another agreement to incorporate for like purposes a second company to be called Meteor-Century Builders Inc. The land to be acquired was located on Gouin Boulevard, Cartierville, in the city of Montreal, the purchase price whereof being $720,000. The stock ownership and voting control of the first and second company were similar. The first agreement of January 28, 1954, was slightly modified by a third agreement, and the three agreements were filed as exhibits A-1, A-2 and A-3.

By agreement A-1 Josef Manaster and Alfred Manaster were to be appointed president and treasurer respectively; and Ezekiel Schouela and Benjamin Azarut, secretary and vice-president, respectively, of the appellant company. But by agreement A-2 Ezekiel Schouela and Edouard Schouela were to become president and treasurer respectively; and Josef Manaster and Leon Manaster, vice-president and secretary of the second company. Exhibit A-1 contained a stipulation that yearly salaries totalling $35,000 were to be divided as follows: $21,000 between the Manasters who became active in the enterprise and the remaining $14,000 to be similarly divided between the Schouela interests. This was amended by A-3 which provided that total salaries would be reduced to $21,000—$14,000 to the Manasters and half that amount to the Schouelas. Exhibit A-2 stipulated that in Meteor-Century Builders Inc. the salaries of $21,000 were to be divided equally between the representatives of the two groups. It also contained a provision whereby the first and second parties agreed to subscribe $100,000 each for 100 shares of the company's common stock and 900 shares of preferred stock, both of a par value of $100 each, subject to the stipulation that each of the parties was to make an immediate payment of $20,000 and that the balance need not be paid until a notice was sent by any of the directors that a deed of sale for the Gouin Boulevard land was within one week of signature and that funds were required to make the initial

payment thereon. The last clause in this agreement contains a stipulation that, since the major portion of their assets is vested in Century Construction Ltd., the Manasters shall have the right to purchase any shares to be allotted to them in their own names or in the name of Century Construction Ltd., or in any combination of such ownership; and upon the undertaking of the latter to observe all the conditions of the agreement in regards to Meteor-Century Builders Inc.

The evidence reveals that in July 1954 the Schouelas developed suspicions that the Manasters were taking advantage of their position in the appellant company to further their interests in their own company, Century Construction Ltd., to the detriment of Meteor Homes Ltd., and they decided to suspend furnishing further capital to the new company so long as the Manasters retained their stock interests in it. There is no evidence that a majority of the Board of Directors were dissatisfied with the conduct of the Manasters or that the company was incurring losses, and I do not consider that the charges made against the Manasters were substantiated; but an agreement was reached, no doubt with the intervention of Notary Maurice Garmaise, and signed before Notary Max Garmaise on July 9, 1954, whereby the Schouelas bought out the Manasters. It is stipulated in this deed (Ex. A-5) that the agreements of partnership (Exs. A-1 and A-2) between the Manasters and the Schouelas, called respectively the first and second parties, are hereby cancelled and annulled *à toutes fins que de droit;* and it is stated further that the first parties sell to the second parties all of the common and preferred shares of the capital stock of the appellant company issued to them for $25,000, receipt whereof was acknowledged by the first parties, consisting of forty-nine common shares and 200 preferred, both of a par value of $100 each. It describes the similar transaction in respect of Meteor Century Builders Inc., whereby the first parties in consideration of the acknowledged receipt by them of $20,000 sell all the shares of the capital stock which, with the exception of one common share issued to Notary Maurice Garmaise, had been issued in equal proportions to the first parties and Century Construction Ltd.; and the second parties oblige themselves to indemnify and hold

1960

METEOR HOMES LTD. v. MINISTER OF NATIONAL REVENUE

KEARNEY J.

harmless the first parties against any claim of whatever nature arising from the fact of non-payment of the balance of the subscription price ($20,000), payment having been withheld with the consent of the second parties and of the directors of the said company.

From the two above-mentioned transactions the first parties simply received the return of the money they had invested in these two companies.

In paragraph 4 of the receipt, release and discharge (A-5) reference to an additional consideration of $32,500 is made in the following terms:

> In consideration of the termination of the Agreement between the parties and of the assumption by the Second Parties of the undertaking, the Second Parties agree to pay to the First Parties the sum of $32,500 which the First Parties acknowledge to have received to their satisfaction at the execution hereof and whereof quit.

In paragraph 5—

> The Parties agree that the termination of the said partnership and the payments hereinabove specified are made in full and final settlement of any claim of whatever nature of the First Parties against the companies involved or against the Second Parties and of any claim of whatever nature of the companies or of the Second Parties against the First Parties, the parties acknowledging to have settled all accounts between them and to be content and satisfied therewith.

A glance at exhibit A-5 shows that the appellant company, although referred to in this agreement, is not a party to it. It is to be noted that it was the second parties (Schouelas) who, by the terms of the agreement, undertook to pay to the first parties the above-mentioned sum of $32,500, but such payment was not made. Instead it was effected by two cheques of the appellant company, both dated July 9, 1954, and signed on its behalf by E. Schouela and Josef Manaster. It is claimed in the notice of appeal that this amount constituted salary payments and/or operating expenses of the appellant company. I will deal with the merits of that submission shortly. This agreement contains an *omnibus* clause that grants a mutual receipt, release and discharge between the parties *inter se* as well as with respect to the companies mentioned in the agreement; and the most that can be said for it is that the money was paid for multiple reasons and that only a small amount, if any, could be regarded as a payment by the

company to the Manasters in lieu of salary. In my opinion, any evidence to the contrary notwithstanding, the main consideration for which the Schouelas undertook to pay the sum of $32,500 was to break a deadlock of their own creation and to obtain absolute control not only of the appellant company but also of Meteor-Century Builders Inc.

It goes without saying that verbal evidence cannot be entertained to vary or contradict the terms of a valid written agreement. Counsel for the appellant submitted that the $32,500 was paid by the appellant company to get rid of the Manasters because, rightly or wrongly, in the opinion of the Schouelas the company would be ruined instead of benefitted by their services, but this is contradicted in the following evidence given by Alfred Manaster:

> Q. Did you also hear, Mr. Manaster, Mr. Schouela say that "at the time of the dissolution of the agreement, the Company Meteor Homes was in a worse position that it was when it was first formed?"
>
> A. I did hear him say so, but I will have to disagree with this statement, because at the time of the dissolution, we had under construction thirty-seven (37) homes in Dorval which were being built by us as a part of the greater project for approximately one hundred and sixty (160) homes. And according to my knowledge, the response we had received from the public was very good and the sales for these homes were foreseeable and the profit also was foreseeable. At the time, thirty seven (37) houses were built.

Mr. Edouard Schouela in his evidence sought to connect his undertaking to pay the Manasters' combined salaries of $14,000 a year for five years, with the payment by the appellant company of $32,500. He stated that this figure constituted a fair settlement of a $70,000 debt made up of $14,000 per annum for five years. If such payment had been intended to cover only salary, one would expect it to have been made with one cheque, but it was effected without explanation with two cheques of July 9, 1954, for $27,500 and $5,000.

An obvious weakness in the above statement is that the record contains no evidence whatsoever that the appellant company undertook to pay $14,000 per annum for five years to the Manasters who were president and treasurer of the appellant company. Section 178 of the *Quebec Companies Act*, R.S.Q. 1941, c. 276, states that, in the absence of other express provisions, the election of directors shall

1960

METEOR HOMES LTD. v. MINISTER OF NATIONAL REVENUE

KEARNEY J.

take place yearly. So, at most the appellant company could only be held liable for the Manasters' salaries for a period of six months, the unexpired portion of the current year, since it appears that they had been paid up to July 1954; and, if misfeasance on the part of the Manasters as charged by the Schouelas were provable, the appellant would have been justified in dismissing them for cause without further compensation. If the appellant failed to make payment to the Manasters of $14,000 per annum for the four subsequent years, their recourse would be against the Schouelas who had assumed the responsibility of paying such sum, and not against the company.

A person, according to Art. 1028 C.C., cannot by a contract in his own name bind anyone but himself, his heirs and legal representatives; and Art. 1029 C.C. provides in part that a party, in like manner, may stipulate for the benefit of a third person, when such is the condition of a contract which he makes for himself, or of a gift which he makes to another.

In my opinion the evidence does not establish that the appellant was bound to fulfill the obligations of the Schouelas towards the Manasters; or that the multiple stipulations contained in exhibit A-5 constituted a benefit to the appellant. In any event, from the proof I am led to believe that the sum of $32,500 paid by the taxpayer was certainly not an expenditure in the ordinary course of business.

Fournier J. in *Minister of National Revenue* v. *Manaster* (*supra*) held that the receipt of the $32,500 by the Manasters was not income to them but a payment of a capital nature and consequently deductible; but the payment in question should be considered in relation to the instant taxpayer only, because cases can arise where payments may be deductible to the payer and not taxable to the payee, but I do not think that this is such a case.

Counsel for the appellant assimilated the present case to *B. W. Noble, Ltd.* v. *Mitchell*[1]. In that case the moneys were expended in consideration of the cancellation of an agreement between the company and a particular shareholder, and it was held that the amount paid was "no more than a payment to get rid of a servant in the course of the business in the year in which the trouble comes." In

[1] 11 T.C. 372, 420.

the present case we are dealing with two groups of shareholders who had agreed to go into business together and, unlike the above case, the agreement makes no reference to the riddance of a servant of the company. The same may be said of *Commissioner of Inland Revenue* v. *Patrick Thomson, Ltd.*[1] and two other subsidiary companies of a common parent company, wherein it appears that certain sums were paid by the companies to their managing directors in connection with the cancellation of their contracts, the payments being expressed in the first two cases to be in satisfaction of rights to future remuneration, and in the third to be in lieu of notice.

Although the amount of $32,500 was paid by the company, the prevailing circumstances were unusual and I am far from satisfied that, as contemplated in s. 12(1)(*a*), it was an expense "made or incurred by the taxpayer for the purpose of gaining or producing income from . . . a business of the taxpayer."

The claim for $3,978 covering legal fees paid in 1955 in connection with the termination of the partnership was not raised during the hearing, but it follows in my opinion that it is likewise non-deductible for income tax purposes.

The second point in issue is whether or not the amounts of $14,525.30, $7,225.97 and $4,855.97 claimed by the appellant as deductions from income for the years 1955, 1956, 1957, respectively, constituted a reserve within the meaning of the Act and were properly or improperly disallowed. The reasons given for disallowance of these deductions rest on very narrow and what I consider to be tenuous grounds, namely, that the amounts in question did not constitute deductible liabilities as claimed by the appellant, but constituted a reserve for contingent liabilities which was not expressly permitted under s. 12(1)(*e*).

The arithmetical correctness of the deductions claimed are not in issue, and it is conceded that these sums represent sales tax imposed under the *Retail Sales Tax Act*, S.Q. 1940, 4 Geo. VI, c. 14. Under this Act the appellant as a member of the building trade is required to pay a provincial and municipal sales tax on the price of materials purchased for conversion into residences or other things built for the purpose of sale. No person may effect such sales unless he has first obtained a certificate of registration

[1] 37 T.C. 145.

1960

METEOR HOMES LTD. v. MINISTER OF NATIONAL REVENUE

KEARNEY J.

from the Comptroller of Provincial Revenue. It is not disputed that the appellant had conformed to the requirements of the Act and that the system of accounting in use by it was the accrual method.

Mr. Joseph Roston, a qualified chartered accountant with some thirty years' experience, testified in his quality of auditor of the appellant company that each month the amount of provincial sales tax was calculated and recorded in the appellant's books not as a reserve but as an ordinary liability; and, speaking from his experience and knowledge, he was definitely of the opinion that it constituted a liability. The witness, when asked how in general practice such sales tax indebtedness was treated, added that he had quite a few other clients in the real estate and building business, all of whom set it up in the same way as a liability but that most of them paid it monthly. Counsel for the respondent neither cross-questioned the witness nor led any evidence to contradict his testimony.

I think Mr. Roston's evidence establishes that the appellant by showing the sales tax in its books of accounts as an ordinary liability was conforming to usual commercial and good accounting practice, and such practice must prevail unless there are statutory provisions to the contrary. *Vide Royal Trust Co.* v. *Minister of National Revenue*[1]; *Imperial Oil Ltd.* v. *Minister of National Revenue*[2]; *Consolidated Textiles Ltd.* v. *Minister of National Revenue*[3].

Edouard Schouela, whose evidence is uncontradicted stated in substance that month by month the amount of the sales tax was recorded in the company's books as a liability in favour of the Provincial Government; that the latter had never demanded payment or sent an inspector to find out what monthly amounts the appellant had set up in its books for sales tax; that the company admits the amounts are owing but that it had not paid them because its lawyer in the present case, who was also acting for another client in an action in which the validity of the *Retail Sales Tax Act* was contested, advised it "to wait for a while until he sees the outcome of his case."

Counsel for the respondent in argument also mentioned, but not by name, a Quebec case which, I gathered, was pending, and in which the constitutionality of the *Retail*

[1] [1957] C.T.C. 32, 40. [2] [1947] Ex.C.R. 527.
[3] [1947] Ex.C.R. 77.

Sales Tax Act was attacked. He added that judgment had not yet been rendered and that the taxpayer did not recognize any liability for the sales tax until a decision was rendered. The only case resembling that description which I could find is the unreported action of *The Attorney-General of the Province of Quebec* v. *Louis B. Magill Co.*[1], wherein the plaintiff instituted action against the defendant, a building contractor, for the recovery of sales tax payable by the defendant on materials admittedly purchased for use in its building operations. The case was heard before Ralston J. who by judgment No. 306,791 of the records of the Superior Court, dated May 27, 1957, dismissed it on the grounds that the action was improperly instituted, having been brought in the name of the Attorney-General of the Province of Quebec instead of in the name of the Comptroller of Provincial Revenue; and the above judgment has not been appealed. The grounds on which that case was decided render it of little value in the instant case.

Mr. Schouela's evidence clearly indicates that we are not here dealing with a case wherein the appellant set up an amount in its books as a reserve and claimed it was deductible but counsel for the respondent submitted that, regardless of how the account was set up, the amount of sales tax is not an account payable but a contingent account, within the meaning of s. 12(1)(*e*) and cannot be claimed as a deduction for income tax purposes. In support of the foregoing contention he referred, *inter alia,* to the case of *Robertson Limited v. Minister of National Revenue*[2]. In that case the taxpayer had received in certain taxation years commissions which were unearned and which it might have to refund. It set up in its books certain reserves against such contingency and claimed unsuccessfully that, so long as such commissions remained paid, they were deductible items. In the present case the appellant, far from acknowledging that the amount sought to be deducted constitutes a reserve set aside against a contingency, claims that it is a liability created by statute and incurred in the ordinary course of business.

[1] (May 27, 1957, Unreported). [2] [1944] Ex. C.R. 170.

1960

METEOR HOMES LTD. v. MINISTER OF NATIONAL REVENUE

KEARNEY J.

The Court was also referred to *Eli Lilly and Co. (Canada) Limited v. Minister of National Revenue*[1]. The *Lilly* case concerns payments for goods sold and moneys loaned by the appellant, a Canadian company and wholly owned subsidiary of an American corporation, payable in American funds. The Minister added to the revenue of the appellant an amount which included savings effected in the repayment of the indebtedness made possible because the Canadian dollar, which had formerly sold at a discount, was at the time of repayment selling at a premium. A majority of the Supreme Court held in part that the fact that the appellant in prior years had been allowed to deduct the amount of exchange necessary to bring the cost of the goods to cost in Canadian dollars was an inapplicable criterion. No one will deny that the time and extent of fluctuations in currency exchange rates is uncertain; but such contingencies are not to be compared, in the absence of proof to the contrary, with a mere possibility of the unconstitutionality of a statutory enactment.

Other cases cited dealt with reserves set aside to cover contingent obligations in respect of outstanding milk tickets and returnable milk bottles left with customers, and the refund by a book distributor to the vendor of the purchase price of unsold books subject to reimbursement. But these cases are of little assistance because they deal with situations where the amounts sought to be deducted were by reason of the terms of the contract obviously contingent amounts and only exigible when the contingency had ceased to exist.

Referring in argument to the foregoing cases, counsel for the respondent stated:

> All the above cases serve to illustrate the principle that, in the case of a taxpayer on an accrual basis, where an expense is incurred and the amount is definitely ascertainable and legally liable or payable in the year in which it is incurred, such amount may be claimed as an expense of the year.
>
> On the other hand, where a liability is not definitely ascertainable and the amount is not legally liable or payable because of a factor of contingency involved, an amount claimed as deduction from income to take care of such contingent liability cannot be allowed.

[1] [1955] S.C.R. 745.

I do not think there is any doubt that the expense was incurred and payable in the same year because the amount of the obligation and the terms of payment were imposed on the appellant by statute. There cannot be any question of ascertainment of the amounts due since the accuracy of each amount was conceded. There remains the question which in my opinion constitutes the main issue in this case, namely—because of a factor of contingency, was the appellant legally liable for the expense which had been thrust upon it? Much depends on the meaning to be attached to the words "contingent" and "legally liable."

The *Shorter Oxford English Dictionary,* third edition, defines liability as follows:

> *Law*—The condition of being liable or answerable by law or equity.

It has been said that the word "liability" is a very general one and will, as a rule, include even contingencies. See *J. D. McArthur Co. Ltd. v. Alberta & G.W. Ry. Co.*[1] referred to by Sanagan and Drynan in *The Encyclopedia of Words and Phrases Legal Maxims,* Vol. III, p. 347. Kohler, *A Dictionary for Accountants,* second edition, p. 290, defines a legal liability as—

> A responsibility for some obligation, enforceable at law, as distinguished from a moral responsibility.

Counsel for the respondent referred to the definition found in the *Shorter Oxford English Dictionary,* second edition, of the word "contingency," i.e., "liable to happen or not . . . Dependent on a probability; conditional; not absolute . . . " Apart from drawing attention to the words "liable," meaning apt to, and "probable," signifying likely, I think this last definition requires elaboration, as there are several types of contingencies, some of which would operate in favour of the allowance as a deduction of the items claimed and others against it. Mertens, *Law of Federal Income Taxation,* Vol. 2, c. 12, p. 127, considers "the problem of *when* items are . . . deductions to the taxpayer on the accrual basis," and deals with it at p. 132 in these terms:

> Not every contingency prevents the accrual of income; the contingency must be real and substantial. A condition precedent to the creation of a legal right to demand payment effectively bars the accrual of income until the condition is fulfilled, but the possible occurrence of a condition *subsequent* to the creation of a liability is not grounds for postponing the accrual. (Emphasis mine).

[1] [1924] 2 D.L.R. 118

1960

METEOR HOMES LTD. v. MINISTER OF NATIONAL REVENUE

KEARNEY J.

Kohler, at page 120 (*supra*), defines contingent liability as—

> An obligation, relating to a past transaction or other event, that may arise in consequence of a future event now deemed *possible* but not *probable*. If probable, the obligation is not contingent but real (ordinarily, a current liability), and recognition in the accounts is required, . . . (Emphasis mine)

In *Simon's Income Tax*, second edition, Vol. II, pp. 203 and 204, Viscount Simon, commenting on *Peter Merchant, Ltd. v. Stedeford (Inspector of Taxes)*[1], states:

> For income tax purposes it was held that a distinction must be drawn between an actual, i.e., legal, liability, which is deductible, and a liability which is future or contingent and for which no deducton can be made . . . The basis of the decision was that the real liability under the contract was contingent, not actual, since the obligations of the company were not such that it might be sued for the cost of replacements at current prices, but only for possible damages for breach of contract . . .
>
> In cases, however, where an actual liability exists, as is the case with accrued expenses, a deduction is allowable; and this is not affected by the fact that the amount of the liability and the deduction will subsequently have to be varied. A liability, the amount of which is deductible for income tax purposes, is one which is actually existing at the time of making the deduction, and is distinct from the type of liability accruing in *Peter Merchant, Ltd.* v. *Stedeford* (*supra*), which although allowable on accountancy principles, is not deductible for the purposes of income tax.

In the above-mentioned case, Singleton J., after quoting Lord Haldane in *Sun Insurance Office v. Clark*[2] to the following effect:

> It is plain that the question of what is or is not profit or gain must primarily be one of fact and of fact to be ascertained by the tests applied to ordinary business. Questions of law can only arise when (as was not the case here) some express statutory direction applies and excludes ordinary commercial practice, or where, by reason of its being impracticable to ascertain the facts sufficiently, some presumption has to be invoked to fill the gap,

goes on to say that "the ordinary commercial practice in arriving at the profits of a fire insurance company was what was being considered in that case," and I think the same conditions exist in the present case. In the case of *Peter Merchant, Ltd. v. Stedeford (H.M. Inspector of Taxes)*, p. 505 (*supra*), Singleton J. states:

> Before me the case of the Company is that it ought to be allowed to make deductions in respect of possible losses or possible claims. I do not think that is permissible in the circumstances of this case. As I have said, I see no reason for the departure from the ordinary accepted principles, and this appeal must be dismissed.

[1] (1948) 30 T.C. 496, C.A.

[2] 6 T.C. 59, 78.

In the present case there was no condition precedent to prevent the provincial authorities from preferring a claim against the appellant; and whether the law under which the claim was instituted might later be declared *ultra vires* constituted a condition subsequent. In my opinion the validity of a statutory law must be presumed until the contrary is proved, and until then any monetary obligation which it imposes should be treated as an outstanding liability. In this case there is evidence that contractors in the province of Quebec generally set up the retail sales tax as a liability and paid it monthly. Whether some one contractor has attacked the Act on several counts including its constitutionality is not the criterion by which the instant case is to be judged.

Counsel for the appellant suggested that perhaps the reason why the Quebec Government had been lenient and had not pressed its claim against the appellant was because of a Saskatchewan case pending in the Supreme Court of Canada, which *inter alia* involved the constitutionality of an Act not unlike the *Retail Sales Tax Act*. Be that as it may, there was nothing to prevent such action from being taken and there is no evidence that the appellant, if sued, would risk the expense of defending the action; and the only thing it stood to lose by delaying payment as long as possible was interest charges at five per cent which would accrue in the meantime. I have no doubt that the Saskatchewan case alluded to is *Cairns Construction Ltd. v. The Government of Saskatchewan*[1]. Counsel for the respondent made no reference to the *Cairns* case and, though perhaps unnecessary for me to do so, I will comment on it. That case dealt with the validity and applicability to the person sued of *The Education and Hospitalization Tax Act*, R.S.S. 1953, c. 61, which imposes a tax on consumers and users of tangible personal property purchased at retail sales prices in the province for consumption and use, and not for resale. The Supreme Court of Canada which rendered judgment on June 13, 1960, found unanimously that the Act in

[1] 1960) 24 D.L.R. (2d), 1, 2.

1960

METEOR HOMES LTD. v. MINISTER OF NATIONAL REVENUE

KEARNEY J.

question was constitutional and applicable. Martland J., who wrote the judgment of the Court, referring to the decision in the courts below, said:

> The appellant bases its claim upon two grounds: first that the Act in question is *ultra vires* of the Saskatchewan Legislature and, second, that even if it is valid, the appellant is not, under the terms of the Act obligated to pay this tax.
>
> Both the learned trial Judge [9 D.L.R. (2d) 721] and all the members of the Court of Appeal [16 D.L.R. (2d) 465] of Saskatchewan decided the first issue in favour of the respondent. A majority of the Court of Appeal also decided the second issue in its favour. The learned trial Judge and Gordon J.A., who dissented on this point in the Court of Appeal, held in favour of the appellant in respect of the second issue.

The terms of the Saskatchewan Act differed from those of the Quebec Act, and it is not the applicability of the statute to a particular individual but its constitutionality which may be of interest in the present case. The judgment of our court of last resort was not known at the time the instant case was heard but the judgments of the trial court and the provincial Court of Appeal had been rendered; and I think the unanimity of opinion therein expressed on the constitutional issue has added importance. Had the five learned judges of the Saskatchewan courts expressed an opposite opinion, it could have been argued that at least insofar as the *Cairns* case was concerned, such judgments would have been sufficient to neutralize any previous presumption in favour of the validity of the Act in question. The opinions which were actually expressed, I think, far from rebutting the presumption serve to strengthen it.

Since we are here dealing with a statutory liability concerning which no contingency in the nature of a condition precedent existed at the time such liability was incurred, I do not think a *post hoc* contingency requires consideration, but in any event I believe on the known facts at the date of trial that the *post hoc* contingency of the Quebec *Retail Sales Tax Act* being declared unconstitutional was too remote to bring it within the purview of s. 12(1)(*e*). In my opinion it would have been little short of foolhardiness or wishful thinking on the part of the appellant or its auditor to have shown the disputed items at anything less than their face value and otherwise than as a real liability.

1960

METEOR HOMES LTD. v. MINISTER OF NATIONAL REVENUE

KEARNEY J.

For the foregoing reasons I dismiss the appeal as to the items of $32,500 and $3,978; but maintain it for the amounts of $14,525.30, $7,225.97 and $4,855.97 which I consider were improperly disallowed as deductions from taxable income. The case will be referred to the Minister of National Revenue for reassessment, and I think the appellant is entitled to its costs.

Judgment accordingly.