BETWEEN:

THE MINISTER OF NATIONAL REVENUE ..... APPELLANT;

AND

BRITISH AND AMERICAN MOTORS TORONTO LIMITED ..... *Respondent.*

1952
Nov. 25
1953
Apr. 14

*Revenue—Income Tax—The Income Tax Act, S. of C. 1948, c. 52, s. 20—Depreciable property—Minister not precluded from reconsidering previous assessment in light of subsequent evidence—Profit on sale of motor cars used as service cars and demonstrators—Whether capital profit—Whether inventory profit—Appeal from Income Tax Appeal Board allowed in part.*

Respondent carried on the business of buying and selling new and used cars and trucks, automobile parts, operating also a service department and service station. In assessing respondent to income tax for 1949 appellant added to its declared income the profit on the sale of (*a*) a 1942 Chevrolet car purchased in 1944, used as a service car until sold in 1949 to a car wrecker and which was always treated as a capital asset and depreciation thereon claimed and allowed annually; (*b*) nine new Chevrolet cars acquired in 1948, assigned to the use of respondent's personnel in that year, shown in the latter's income tax return for 1948 as capital assets, on which depreciation was also claimed and allowed and which were sold in 1949 but no depreciation thereon being claimed for that year. On an appeal from the assessment the Income Tax Appeal Board held that the profits were realized on the sale of capital assets, were therefore capital profits, and consequently allowed the appeal. From that decision the Minister appealed to this Court submitting that the vehicles in question constituted part of respondent's inventory and the profits realized on the sales were income from respondent's business.

*Held:* That the mere fact that a concession in the nature of a depreciation on property has been made to a taxpayer in one year, does not, in the absence of any statutory provisions to the contrary, preclude the Minister from taking another view of the facts in a later year when he has more complete data on the subject matter. The provisions of s. 42(4) of the Income Tax Act, S. of C. 1948, c. 52, empowering the Minister to re-assess or make additional assessments in certain cases within a period of six years from the day of the original assessment would indicate that a previous assessment is not in all cases final and conclusive, but may be reconsidered in the light of subsequent evidence. *Gloucester Railway Carriage and Wagon Co.* v. *Inland Revenue Commissioners* [1925] A.C. 469 referred to.

2. That where it is clearly established that a motor vehicle has been bought for use as a capital asset in the necessary service of the taxpayer, has been used in the same manner and to the same extent as a capital asset would normally be used, and has been treated and recognized as a capital asset, the profit which may arise upon its disposition is not an inventory profit but a capital profit. The 1942 Chevrolet car sold by respondent in 1949 falls within that category.

3. That the fact the nine 1948 Chevrolet cars were purchased and sold as inventory, that they were used substantially for the personal convenience of the employees rather than in the service of respondent,

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that they were held in inventory until the end of 1948 and that they were sold after a short period of use, is sufficient evidence if viewed with the other facts of the case to indicate that they were always considered as part of the inventory which would later be sold in the normal course of business. They were not service cars or "plant" in any ordinary or proper sense and the profit realized on the sales was an inventory profit that was properly included in the assessment.

APPEAL from a decision of the Income Tax Appeal Board.

The appeal was heard before the Honourable Mr. Justice Cameron at Toronto.

*T. Z. Boles* and *F. R. Duncan* for appellant.

*H. F. Parkinson, Q.C.*, for respondent.

The facts and questions of law raised are stated in the reasons for judgment.

CAMERON J. now (April 14, 1953) delivered the following judgment:

This is an appeal by the Minister of National Revenue from a decision of the Income Tax Appeal Board dated January 19, 1952 (1), allowing an appeal by the respondent from an assessment to income tax for the taxation year 1949. In assessing the respondent the appellant had added to its declared income the following two items:

| | |
|---|---|
| (*a*) Profit on sale of service automobile.. | $ 622.40 |
| (*b*) Profit on sale of demonstrators.... | 7,220.81 |
| | $ 7,843.21 |

The Income Tax Appeal Board was of the opinion that the profits realized on the sales of the ten automobiles in question were realized on the sale of capital assets, were therefore capital profits, and consequently allowed the appeal.

On this appeal the Minister submits that the said motor vehicles constituted part of the respondent's inventory, and that the said sum of $7,843.21 was income from the respondent's business. For the respondent it is contended that the vehicles were at all times capital assets, and that the profit realized was a capital profit. There is no dispute as to the amounts involved.

(1) (1952) 5 Tax A.B.C. 411.

The respondent was in business in a large way. It held a franchise from General Motors for the sale of Oldsmobile and Chevrolet cars and trucks, and for the sale of General Motors parts over a large area. It was also engaged in the sale of used cars and trucks, and in the operation of a service department and of a service station.

When it commenced business in 1944, it acquired the assets of a predecessor company, including one 1942 Chevrolet car. Until that car was sold in 1949 it was always treated as a capital asset and depreciation thereon was claimed and allowed in each year. As of December 31, 1948, its net depreciated value in the company books was $127.60. In 1949, having outlived its usefulness, it was sold to a firm of auto wreckers for $750. In assessing the respondent for 1949, the Minister added the difference between the selling price and such net depreciated value ($622.45). That is the first item in dispute.

The second item of $7,220.81 relates to nine new Chevrolet cars acquired by the respondent in 1948 and assigned to the use of company personnel in that year. In its income tax return for 1948, the respondent showed them as capital assets under the heading "Service cars and trucks," claimed depreciation thereon at the rate of 25 per cent of costs, and that claim was allowed in the assessment. All nine cars were sold in 1949 but no depreciation thereon was claimed for that year. Again the Minister added to the respondent's declared income the difference between the proceeds of the sales and the net depreciated value as of December 31, 1948 ($7,220.81).

The first question that arises is whether or not the vehicles in question—or any of them—were "plant" in the proper sense. It is submitted by the respondent that as depreciation had been claimed and allowed in one or more previous years, the Minister could not now allege that what he had then admitted to be "plant" was now, in a subsequent year, "inventory." This submission has given me some concern, but after giving it the most careful consideration, I have reached the conclusion that the Minister is not so precluded. In processing and approving the respondent's 1948 return, the assessor would have no knowledge of the facts except that the cars were claimed to be capital assets under the category of "Service cars and

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trucks." It was not until the 1949 return was received in 1950 that the full facts of the case were revealed and it became known that the cars, instead of being retained as service cars, had, in fact, been sold after being used for an average period of six months. The 1948 assessment was made under the provisions of the Income War Tax Act, whereas the 1949 return had to be considered under the new Income Tax Act (which came into effect on January 1, 1949) and by the terms of which new principles regarding depreciable property were provided. In my view, the mere fact that a concession of this nature had been made to a taxpayer in one year, does not, in the absence of any statutory provisions to the contrary, preclude the Minister from taking another view of the facts in a later year when he has more complete data on the subject matter. The provisions of s. 42(4) of the Income Tax Act, empowering the Minister to reassess or make additional assessments in certain cases within six years from the day of the original assessment, would seem to be a fair indication that a previous assessment is not in all cases final and conclusive, but may be reconsidered in the light of subsequent evidence.

On this point, reference may be made to *Gloucester Railway Carriage and Wagon Co.* v. *Inland Revenue Commissioners* (1). In that case, certain wagons were let out on hire by the taxpayer and the cost of such wagons was capitalized in the books of the company; certain sums were written off each year for depreciation and were allowed as a deduction in computing the profits for income tax in each year. Subsequently, the wagons were sold at a figure substantially in excess of the figures at which they were then carried on the books of the company. In respect of that excess, the company was assessed to corporation profits tax. The special commissioners, in maintaining the assessment, stated at p. 472:

> We do not regard ourselves as precluded by the fact that as long as the wagons were let, they were treated "as plant and machinery" subject to wear and tear, from deciding that they are stock in trade when they are sold, even though let under tenancy agreements, for they seem to us to have in fact the one or other aspect according as they are regarded from the point of view of the users or the company.

(1) [1925] A.C. 469.

Rowlatt, J. affirmed the decision of the Commissioners and his decision was affirmed by the Court of Appeal, by a majority. On appeal to the House of Lords, the order of the Court of Appeal was affirmed.

The two items in dispute must receive separate consideration. The first item has already been mentioned. That vehicle—a used Chevrolet car—was purchased and paid for in 1944. Thereafter, until sold, it was used in the service of the company by one of the employees engaged in soliciting sales of parts to independent garages throughout Toronto. Throughout it was treated as a capital asset in the category of "Service cars and trucks," and depreciation was claimed and allowed annually. It was acquired for the purpose of being used as a service car and was used for that purpose and no other. When it was practically worn out it was sold to a firm of wreckers and the proceeds were credited to the inventory of used cars. Under these circumstances, it is conceded that normally it would be properly treated as a capital asset. But it is contended that as the main business of the respondent was the buying and selling of cars, the sale of this car was within the normal course of business and that any profit realized was therefore an "inventory" profit.

I am unable to agree with that contention. In my view, the question to be answered is this, "Upon the evidence adduced has it been established that the things sold were in fact plant in the proper sense?" If that question be answered affirmatively, then I do not think that the profit on such sale is converted from a capital profit to an inventory profit merely because the taxpayer happens—as here—to be a buyer and seller of the same commodity as the depreciable capital asset itself. In the *Gloucester Railway Wagon and Carriage* case, to which I have already referred, the taxpayer was engaged in the business of buying and selling wagons. Lord Dunedin found that the wagons which were sold (and which had previously been hired out) were not "plant" in the proper sense. At p. 475 he said:

> There is no similarity whatever between these wagons and plant in the proper sense, *e.g.*, machinery, or between them and investments the sale of which plant or investments at a price greater than that at which they had been acquired would be a capital increment and not an item of income.

I think it is evident that had he been of the opinion that the wagons sold were "plant in the proper sense," or

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machinery, he would have found that the profit realized on the sale was a capital increment and not an item of income notwithstanding that the taxpayer was engaged in the business of buying and selling wagons.

Moreover, an examination of the provisions of s. 20 of the Income Tax Act would seem to lead to the conclusion that no distinction is there drawn between taxpayers who dispose of depreciable property which is in the same class as the goods which they buy and sell, and other taxpayers who dispose of depreciable property but are not engaged in the buying and selling of that class of goods. The rights and obligations which follow from a disposal of depreciable goods would seem to be precisely the same in each case. However, as the precise point was not discussed on the appeal, I do not think it desirable to make any definite finding thereon.

It is my opinion that where it is already established that a motor vehicle has been bought for use as a capital asset in the necessary service of the taxpayer, has been used in the same manner and to the same extent as a capital asset would normally be used, and has always been treated and recognized as a capital asset, the profit which may arise upon its disposition is a capital profit.

I am satisfied upon the evidence that the 1942 Chevrolet car sold by the respondent in 1949 falls within that category. For these reasons I find that Item No. 1—the sum of $622.40—was not an inventory profit but a capital profit.

I turn now to the second item, the profit of $7,220.81 made upon the sale of the nine Chevrolet cars. The respondent employed a large staff and for some time there had been a practice of furnishing certain of its key personnel with cars owned by the company. It was in accordance with that practice that between August 11, 1948, and October 7, 1948, the company assigned to certain of its personnel those nine new cars; in some cases these cars replaced other company-owned cars which the employee had previously used; in other cases a new employee (such as the witness Ross) was supplied with a car upon joining the company. As I have noted above, the company in its 1948 return claimed and was allowed 25 per cent depreciation on these cars. All were sold between January 8 and April 9, 1949, and the employees were given new cars

to replace the ones sold. On an average the nine cars in question were used by the key personnel for about six months before being sold.

The item itself refers to these cars as "Inventory demonstrators." In view of the evidence, I think that term is incorrect for they were not used as demonstrators in the ordinary sense except possibly on very rare occasions. It is established that in 1948 and 1949 the demand for automobiles was much greater than the supply; salesmen were instructed not to "push" sales of cars and demonstrators were not needed. The term "demonstrators" arose, I think, because of the fact—as will appear later—that the nine cars were carried for a time in Account 242 "Inventory demonstrators."

There is abundant evidence to establish that these vehicles in the main were not used exclusively as service cars. As stated by the secretary-treasurer, they were supplied to selected personnel for their own use as part of the contract of employment. Mr. McConnan described the use of a car supplied to one of the sales managers as follows: "Well I would say strictly personal transportation. Perhaps some on business but for transportation purposes only." The car supplied to the manager of the Service Department was stated to be "strictly personal for transportation. He is on duty at all hours." Still another of the employees had a car for "transportation for him on company business or his own personal use." I think it is a fair inference from Mr. McConnan's evidence that in each case when a car was so supplied it was intended for personal use of the employee—who could use it in any way he desired—but that it would also be used on company business when he or other employees might at times require it. The cost of gas and oil was divided equally between the company and the employee. The witness Ross stated that as soon as he was supplied with a company car he at once sold his own. He said in regard to the company car, "I took it home at night and used it the same as if it were my own car." In some cases a car was supplied to an employee who held an "inside" job and whose use of the car for company purposes would be only on rare occasions. In other cases the use on company business would be somewhat greater.

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It may be noted here that at January 1, 1948, the company had claimed depreciation on eighteen cars and trucks under the heading, "Service cars and trucks." By the end of the year that number had increased to twenty-five, but no explanation is given as to why the increase was necessary.

The bookkeeping entries of the respondent are significant as to the manner in which the company regarded these cars. Under its franchise the company was required to follow a standard system of bookkeeping laid down by General Motors for all its dealers, and in the main it followed that system. These particular vehicles were not purchased from General Motors as service cars, but were invoiced and delivered to the respondent with many other cars acquired in the normal way for sale. There is no evidence to indicate that they were paid for at the time they were assigned to key personnel. In the company books the cost was entered as a credit to Accounts Payable and as a debit to Inventory Account 240 "New cars and trucks" in precisely the same way as cars and trucks acquired for sale. It is said that as each car was allocated to an employee (normally within three days of its acquisition), it was licensed for the use of the personnel. At the end of each month in 1948, during the period when these cars were allocated, an entry of a lump sum of money was made in Account 242 "Inventory demonstrators," the sum so entered corresponding to the total cost of the cars allocated to key personnel in that month. Nothing was done to place the nine cars in Account 294 "Service cars and trucks" until the year end. As each car was sold in 1949, Account 294 was relieved of that item and at the time of sale was carried back through Account 240 "Inventory new cars and trucks," to "Costs of sales." Mr. McConnan explained that the latter step was done at the request of General Motors, and, he added significantly, "to keep the unit count correct of the *stock on hand.*"

It will be seen, therefore, that the nine cars in question, from the time of their acquisition were carried in the accounts "Inventory new cars and trucks," and "Inventory demonstrators," until the end of the year. Then, for the first time—and at a time when the question of depreciation would naturally arise—they were transferred to "Service cars and trucks." All were later retransferred to "Inven-

tory new cars and trucks" upon sale. The first car was sold on January 8, 1949, and therefore was in Account 294 for a period of only eight days.

As I understand the evidence regarding the bookkeeping method laid down in the General Motors Manual, there are three main accounts which are here relevant. Account 240 is an inventory account of cars which are not put to any use but are held for immediate sale.

Account 242 is also an inventory account called "Inventory demonstrators." It is the inventory of "New cars and trucks which are *temporarily* in the use of employees of the business." The instructions therein state:

> Debit this account with the cost of all new cars put into company service *except service cars.*
>
> The balance in this account represents the actual cost value of all cars and trucks which have been set aside for use as demonstrators, courtesy cars, or any other company use, *except service cars and trucks.*
>
> When a new car is put into company service it should not be handled as a sale but as a transfer of inventory.
>
> The car when actually sold should be treated as a new car and should be recorded in the usual manner as explained under sales of new passenger cars.

Account 294 is called "Service cars and trucks." The instructions in regard to that account include the following:

> Debit this account with cost value of all trucks and commercial cars put into service use and used cars permanently set aside for company use.
>
> Any profit on the sale to be credited to other income.

In addition to the inventory account for cars and trucks on hand for immediate sale (240), the bookkeeping system provided specifically in Account 242 "Inventory Demonstrators" for cars which were temporarily set aside for company use in one way or another—such as demonstrators, courtesy cars and the like—but which would at the end of the temporary use be returned to Account 240 "Inventory new cars and trucks," and be sold in the ordinary way as part of the dealer's inventory for sale. The respondent chose to consider the nine cars in question as falling within that category and reported monthly to General Motors on that basis. Mr. McConnan stated that in placing the cars in these accounts he was merely following the requirements and instructions of General Motors, but I do not think that is so. It was for the company itself to determine whether a car was placed permanently in the category of "Service cars and trucks," in which case it would be shown

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in Account 294, or whether it was to be diverted for temporary use only as an "Inventory demonstrator" and later returned upon sale to Account 240. It was only when that decision was made that the bookkeeping instructions had to be followed. The fact that the respondent carefully carried out the directions in regard to "Inventory demonstrators" is a very strong indication that it considered the nine vehicles as falling within that class and as cars which would eventually be sold in the ordinary course of business. The only deviation from the directions was the placing of the car in Account 294 at the end of the year. Once they were in that account, it was contrary to the instructions to return them upon sale to Account 240. If there had been no intention of selling the cars, they would have been placed immediately in Account 294 upon assignment for use as service cars and would have remained there.

The evidence also indicates that in the company's financial statements, the purchase, maintenance cost, costs of sale and sales of the nine cars were not segregated in any way from its normal buying and selling operations, as would usually be the case with capital assets. All these items were treated in precisely the same way as were the cars and trucks purchased for sale and sold in the normal course of business. The cost of the nine cars is included in the cost of sales, the selling price is in the general account of total sales; sales commissions or bonuses were paid to the salesmen for some if not all of the nine cars when sold, and these items of expense were included in the item of salesmen's salaries and commissions under the general heading, "Car selling expense"; expenses incurred in the operation of the cars were included in "Variable expenses" in the appropriate section. Moreover, the profit realized from the sales is not in any way segregated but is included in the net operating profits of the business as a whole. It is only in the auditor's letter accompanying the income tax return that it is claimed as a capital profit.

Mr. Ferguson, a member of the firm of accountants responsible for the preparation of the company's income tax returns for 1948 and 1949 was of the opinion that while ordinarily it would be good accounting practice to segregate all transactions regarding capital assets from the

general business of the company, such a practice was not here practical or necessary as the amount involved was less than one per cent of the total volume of sales. He said, "If it had been a significant factor we definitely would have pulled it out and shown it separately." It may be noted, however, that the amount in question is a very substantial part of the net taxable income of the respondent.

A few other matters are worth noting. Mr. McConnan said that the decision as to the sale of the nine vehicles was a matter for the general sales manager, who, of course, would have charge of sales of stock in inventory. Again, no reason is assigned for the sale of a substantial number of cars which it is contended were capital assets, except that the demand for cars was very heavy. They were not worn out or obsolete and inasmuch as they seem to have been sold at prices approximately equal to that of new cars, they were apparently kept in first-class condition and presumably ready for sale.

Taking all these facts into consideration and more particularly that the cars were purchased and sold as inventory, that they were used substantially for the personal convenience of the employees rather than in the service of the company, that they were held in inventory until the end of 1948, and that they were sold after a very short period of use, I find it impossible to reach any other conclusion than that they were always considered as part of the inventory which would later be sold in the normal course of business. It is true that they were temporarily removed from the stock of cars immediately available for sale. For a short period they were held for use of the employees pending sale, but the primary purpose of the respondent was that they would be sold. I find that they were not service cars or plant in any ordinary or proper sense.

It follows, therefore, that the profit realized on the sale of the nine cars was an inventory profit and that that item was properly included in the assessment made upon the respondent. The appeal as to that item will therefore be allowed and the decision of the Board in regard thereto will be set aside.

The assessment will therefore be referred back to the Minister to reassess the respondent on the basis of my

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conclusions, namely, that the item of $622.40 is a capital profit and the item of $7,220.81 is an inventory profit. In respect to the first item, it may be necessary for the Minister to take into consideration the provisions of s. 20 and of the regulations passed under s. 11(1)(*a*) of the Income Tax Act, as well as the transitional provisions regarding depreciation. For that reason, I have refrained from stating that the item of $622.40 forms no part of the taxable income of the respondent.

Inasmuch as each party has been successful in part, but as the appellant has succeeded on the main issue, I direct that the appellant will be entitled to be paid by the respondent two-thirds of his taxed costs.

*Judgment Accordingly.*