1954
Dec. 6, 7 & 8
1955
Mar. 5

BETWEEN:

KEN STEEVES SALES LIMITED ....APPELLANT,

AND

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

Revenue—Income—Income tax—The Income Tax Act, 1948, S. of C. 1948, c. 52, as amended, ss. 3, 4, 11(1)(d) and (e), 14(1), 42(3) and (4)—Trader-sales made on credit—Accounts receivable—Notes receivable—Method for computing income—"Cash Receipts and Expenditure" method under which "receivables" excluded—"Receivables" part of income in the year in which goods sold and delivered—Deductions permitted only for doubtful and bad debts—Notice of assessment showing "nil" tax levied not an acceptance of "Cash Receipts and Expenditure" method—Meaning of word "accepted" in s. 14(1) of the Act—Minister's power of reassessment—Appeal from Income Tax Appeal Board dismissed.

Appellant is engaged in the retail business of selling hearing aids, a substantial part of its sales being on credit. At the end of its fiscal year, January 31, 1951, the amounts remaining unpaid on the purchase price were represented by accounts receivable and notes receivable, the latter having been pledged at appellant's bank as security for a loan of an equivalent amount. In its income tax return for that year appellant used the form of accounting known as "Cash Receipts and Expenditure" method under which only cash actually received is taken into account as income, all accounts and notes receivable being excluded, and the expenditure includes not only disbursements actually made but also accounts payable. A first notice of assessment sent to appellant showed "nil" tax levied but subsequently the Minister reassessed appellant by adding back to its declared income the amount of those "receivables". An appeal from the assessment to the Income Tax Appeal Board was dismissed. Hence the present appeal to this Court.

Held: That when trading stocks are sold and delivered the full price should be brought into account in the year in which the delivery is made irrespective of the time of payment, the trader in such cases having, however, the right to take advantage in proper cases of the provisions of The Income Tax Act, 1948, S. of C. 1948, c. 52, as amended, regarding bad and doubtful debts. *Absalom* v. *Talbot (H. M. Inspector of Taxes)* (1944) 26 T.C. 188; *British Mexican Petroleum Co. Ltd.* v. *Johnson* (1932) 16 T.C. 570 at 593; *Johnson (H. M. Inspector of Taxes)* v. *W. S. Try Ltd.* (1946) 27 T.C. 167 at 181.

2. That the "Cash Receipts and Expenditure" method purported to have been used by appellant is not permissible under the Income Tax Act. It excludes as an item of income all receivables which form a necessary part of any trader's profit and loss statement. Such a method is incomplete and misleading and one which fails entirely to show the true state of a taxpayer's position or to reflect his true profit and loss. It is not according to generally accepted accounting practice in

Canada. Its use in many cases would show a loss when in reality there was a profit. It brings in nothing on the receipts side to balance outgoing inventory which has not been paid for in full.

3. That there is no evidence that the Minister reassessed appellant in order to prevent s. 14(1) of the Act being effective in respect of a subsequent year, and the burden of proof is on appellant.
4. That it is always open to the Minister by a reassessment to correct errors made in the original assessment within the time limited by s. 42(4) of the Act.
5. That the original Notice of Assessment which levied no tax was not an acceptance by the Minister of the "Cash Receipts and Expenditure" method purported to have been used by appellant. The word "accepted" as used in s. 14(1) of the Act connotes a taking or receiving with consenting mind—something in the nature of an admission. Here the notice of assessment was merely a statement that "nil" tax was levied; it said nothing whatever about any method.
6. That the provisions of s. 14(1) of the Act (which in terms are "subject to the other provisions of this Part") must be read with those of s. 42, including those of subsection 4 relating to the Minister's power of reassessment. Here there was a reassessment which entirely set aside the original assessment and which clearly denied to appellant the right to deduct from its accounts the amount of its receivables.

APPEAL from a decision of the Income Tax Appeal Board.

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

Redmond Quain, Q.C. for appellant.

W. R. Jackett, Q.C., *Maurice Paquin, Q.C.*, *D. S. Maxwell* for respondent.

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

CAMERON J. now (March 5, 1955) delivered the following judgment:

This is an appeal from a decision of the Income Tax Appeal Board dated October 8, 1953 (9 T.A.B.C. 156), whereby the appellant's appeal from an assessment dated November 22, 1952, in respect of the appellant's taxation year ending January 31, 1951, was dismissed.

The facts are not seriously in dispute. The appellant is engaged in the retail business of selling hearing aids. It commenced operations on January 31, 1950, and in its income tax return for the year ending January 31, 1951,

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showed a net loss of $53.10. On August 15, 1951, a Notice of Assessment was forwarded to the appellant showing "nil" tax levied. Subsequently, on November 22, 1952, the appellant was reassessed and thereby there was added to its declared income the sum of $4,240.92. The appellant was assessed accordingly, the tax levied amounting to $506.75, and interest. An appeal was taken to the Income Tax Appeal Board and was disallowed; hence the present appeal. The sole question for determination is whether or not the sum added to the appellant's income forms part of its taxable income for the year in question.

In order to appreciate the nature of the dispute, it is necessary to refer to financial statements attached to the income tax return. In the operating statement gross sales for the year are stated to be $45,497.31. From that amount there is deducted an item of $4,240.92 called "Provision for uncollected accounts", and the balance of $41,256.39 only is used in computing the net profit or loss. Further details are given in the Statement of Assets and Liabilities as follows:

Accounts receivable—trade	$ 716.90
Notes receivable—pledged	3,524.02
	$4,240.92
Less provision for uncollected accounts	$4,240.92

The situation at the end of the fiscal year was that the appellant had accounts receivable of $716.90 and notes receivable of $3,524.02 (all the latter having been pledged or discounted at the appellant's bank as security for a loan of an equivalent amount), all arising from sales made by it during its fiscal year. Acting on the advice of its accountant, Mr. Lorenzen, it prepared its tax return in such a way as to state the nature and amount of these items, but excluded them entirely in the computation of its taxable income.

Mr. Lorenzen gave evidence on behalf of the appellant. He is a chartered accountant who has been practicing his profession for twenty-seven years. He had full charge of the appellant's books and was responsible for the form in which the tax return was made. He stated that the form of accounting used therein is known as the "Cash Receipts and Expenditure" method. He explained that under that method only cash actually received is taken into account as income, all items of accounts and notes receivable being excluded; but that on the expenditure side there are included not only disbursements actually made, but also accounts payable. Counsel for the appellant referred to it as a "hybrid" method and by that I think he meant that it embraces some of the features of two other methods which are sometimes referred to as the "Cash" method and the "Accrual" method. Mr. Lorenzen stated that in his opinion such a method, which excluded the receivables, was a proper one to determine the actual profit of a trader, but was unable to say that it was one which was in accordance with generally accepted accounting practice in Canada. He himself had prepared some accounts on that basis and said that it was particularly useful to a company with small capital which was just commencing business, the advantage being that if at the end of its first year it had little cash on hand, it could postpone payment of income tax in respect of the receivables to the following year in which it was anticipated that the receivables would actually be received. In that way it would not be necessary to borrow money for the purpose of paying taxes on receivables. He explained, also, that another advantage to all traders would be the elimination of difficulty in reaching agreement with the Revenue Department as to what amount, if any, should be allowed as a reserve for bad debts. His opinion also was that by the "Cash Receipts and Expenditure" method, the department over a period of years would not sustain any loss of revenue as the receivables here in question were normally payable in five or six months after the sales were made and would usually appear as cash receipts in the following year. He was quite frank in admitting that the method would necessarily result in the year end's statement showing a loss in respect of the goods taken out of stock and sold, and for which payment had not actually been received in the year, even though the goods had been sold at prices greatly exceeding the cost of sales.

The matter is to be determined under the provisions of The Income Tax Act, Statutes of 1947-48, chapter 52 as amended. Sections 3 and 4 thereof in 1951 were as follows:

3. The income of a taxpayer for a taxation year for the purposes of this Part is his income for the year from all sources inside or outside

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Canada and, without restricting the generality of the foregoing, includes income for the year from all

(a) businesses,

(b) property, and

(c) offices and employments.

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 main submission of Mr. Quain, counsel for the appellant, may be stated briefly. He says that the Act does not specify any particular method of computing income and that therefore a taxpayer may adopt any method (subject to the provisions of section 14(1) which I will refer to later) which accurately reflects his true income; that trade debts outstanding at the end of a fiscal year form no part of a taxpayer's income as there has been no "in-coming" in respect thereto; and that therefore the "Cash Receipts and Expenditures" method is one which should be accepted. Mr. Jackett, counsel for the respondent, submits that in the case of a trader, all accounts and notes receivable form part of his income in the year in which the goods are sold and delivered to the purchaser, and that in the case of short term debts (all the accounts and notes in question were payable in five or six months) the only deductions that could be made are those permitted by section 11(1) (d) (e) for doubtful and bad debts.

In considering the problem, I shall not attempt to deal with the general question as to whether the so-called "Cash" method of computing income for tax purposes is or is not permissible; that question is not before me. I shall confine myself to the problem raised by the facts of this case. The appellant herein is a trader engaged in the business of buying and selling goods. A substantial part of its sales were on credit; the sales were completed, the goods taken out of stock and delivered to the purchaser in the fiscal year ending January 31, 1951, but the full purchase price was not paid in that year. At the end of the year the amounts remaining unpaid were represented by Accounts Receivable or Notes Receivable. The neat question is whether these "receivables" should be taken into account in computing the income of a taxpayer who is a trader, for that year.

In my opinion, that question must be answered in the affirmative and the "Cash Receipts and Expenditures" method must be rejected as one which does not accurately

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reflect the true profit or gain of the trader. I was not referred to any case in Canada in which the problem in relation to a trader has been directly discussed, nor do I know of any such case. It is highly probable, I think, that the question has not previously been raised because of the general acceptance that such receivables should be included and that it would be contrary to generally accepted accounting practice to exclude them.

In *Scottish North American Trust* v. *Farmer* (1), Lord Atkinson, in delivering the unanimous judgment in the House of Lords, stated the general concept of the profit obtained in a trading transaction, as follows:

> The profits and gains of any transaction in the nature of a sale must, in the ordinary sense, consist of the excess of the price which the vendor obtains on sale over what it cost him to procure and sell, or produce and sell, the article vended, and part of that cost may consist of the sum he pays for the hire of a machine, or the services of persons employed to produce, procure, or sell the article.

To the same effect is the statement of Lord Sands in *Whimster & Co.* v. *The Commissioners of Inland Revenue* (2), in which he also dealt with the general principles to be followed in ascertaining the profit or loss. At p. 823 he said:

> In the first place, the profits of any particular year 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. For example, the ordinary principles of commercial accounting require that in the profit and loss account of a merchant's or manufacturer's business the values of the stock-in-trade at the beginning and at the end of the period covered by the account should be entered at cost or market price, whichever is the lower; although there is nothing about this in the taxing statutes.

It is correct to say that the Income Tax Act does not specify any particular method which must be followed in the account to be made up for the purpose of ascertaining the true profit or loss. In *Trapp* v. *Minister of National Revenue* (3)—a case decided under the Income War Tax

(1) (1911) 5 T.C. 693 at 705. (2) (1925) 12 T.C. 813.
(3) [1946] Ex. C.R. 245.

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Act—the President of this Court decided that under that Act the basis of taxability was that of income received. He held that under the Act as it then was, there was no place as a matter of right for the use of an accounting method on an accrual basis, even if it did reflect the true net profit or gain of a taxpayer. Following that decision, section 14(1) in the form to be referred to later was introduced into the law to remove any doubt as to a taxpayer's right to compute his income upon a basis other than that which is frequently referred to as the "Cash" basis.

Sections 3 and 4 of our Act provide that the income for a taxation year is the profit therefrom for the year. Do receivables, such as the accounts and notes receivable here in question, form part of the profit for the year ending January 31, 1951?

The English law is not in doubt on that point and I am greatly indebted to Mr. Jackett for an excellent summary of the cases. In the *Whimster* case to which I have referred, Lord Sands said at p. 826:

> Where a trader sits down to ascertain from his books his profits or losses for the year, it is not enough that he should set on one side the money he has paid out, other than capital outlay, and on the other the money he has received in respect of the year's business plus the price he paid for commodities now in his possession. There are at least three other things that he must take into account—the present value of these commodities, the debts he has incurred, and the debts due to him, in respect of the year's operations. In normal circumstances, and in business other than insurance, the matter might probably end here.

That case was followed in *Naval Colliery Co. Ltd.* v. *The Commissioners of Inland Revenue* (1) by Rowlatt, J. whose decision was affirmed in the House of Lords.

> Now, one starts, of course, with the principle that has often been laid down in many other cases—it was cited from *Whimster's* case (12 T.C. 813), a Scotch case—that the profits for Income Tax purposes are the receipts of the business less the expenditure incurred in earning those receipts. It is quite true and accurate to say, as Mr. Maugham says, that receipts and expenditure require a little explanation. Receipts include debts due and they also include, at any rate in the case of a trader, goods in stock. Expenditure includes debts payable; and expenditure incurred in repairs, the running expenses of a business and so on, cannot be allocated directly to corresponding items of receipts, and it cannot be restricted in its allowance in some way corresponding, or in an endeavour to make it correspond, to the actual receipts during the particular year.

(1) (1928) 12 T.C. 1017 at 1027.

The doctrine of the relation-back of trading receipts of a business to the year with which they are properly connected was established in the famous *Woolcomber's* case, *Isaac Holden & Sons Ltd.* v. *The Commissioners of Inland Revenue* (1), a case which has been repeatedly approved by the House of Lords. The company combed wool on commission for the Government, which controlled the wool trade, on the basis of a tariff fixed in 1917. In July, 1918, a provisional increase of 19 per cent in the tariff was agreed subject to revision when the accounts to December, 1918, had been examined. In July, 1919, a total increase of 20 per cent., to include the earlier increase was fixed *retrospective* to January 1, 1918. It was held that the total commission received for the company's year ended June 30, 1918, arose from the company's trade in that year and must be included in the assessable profits thereof, regardless of the fact that the final payment was both determined and made long afterwards. In that case, Rowlatt, J. said at p. 772:

Did not that (the extra commission under the 1919 agreement—A.F.) arise from the work that they did in their trade in the first half of 1918? If not, from what did it arise? . . . These profits arose from the business in that accounting period . . . As the fact which shows that the books were wrong has occurred after they have been closed, I do not see any difficulty in reopening them and putting them right.

The decision of the House of Lords in the case of *Absalom* v. *Talbot* (H. M. Inspector of Taxes) (2) is of special importance. There Viscount Simon, L. C. said at p. 189:

When a trader in the course of his trade makes a sale to a purchaser, whether the subject-matter of the sale be a house or any other asset in which he deals, his accounts for the year in which the transaction takes place should, for Income Tax purposes, normally include on the one side the cost of providing the asset with which he has parted to the purchaser and, on the other side, the price for the asset which the purchaser has paid or bound himself to pay. The figure to be entered on the credit side is ordinarily the full price and its face value. If at the end of the year the taxpayer can satisfy the Commissioners that such portion of the debt as has not actually been paid is a bad or doubtful debt, an adjustment under Rule 3(i) of the Rules applicable to Cases I and II may be obtained, though presumably this sort of adjustment is more likely to arise at a later stage. But from the point of view of the trader the relevant time is the time when he parts with his asset to the purchaser, and if the accounts are to set out correctly his profits and gains, the whole consideration must be brought in at that stage, notwithstanding that a portion of it will not be payable until later, while carrying interest in the meantime.

(1) (1924) 12 T.C. 768. (2) (1944) 26 T.C. 188.

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If the transaction took the unusual form of a sale in return for a payment, in whole or in part, of a lump sum in the future, with no interest in the meantime, I should be quite prepared to agree that the debt representing the true price required to be arrived at by taking the present value of the lump sum which is payable *in futuro*. But when the unpaid lump sum (as is usually the case) carries a commercial rate of interest until payment, it is the lump sum itself which enters into the calculation of the price.

Counsel for the appellant submits, however, that these cases—and many others which were cited by counsel for the respondent—are inapplicable as they were decided under the provisions of the Rules applicable to the English Income Tax Act. Schedule D levies tax under that schedule in respect of "the annual profits or gains *arising or accruing*" and the provisions of Rule 3(1) applicable to certain cases under Schedule D are sufficiently stated in the judgment of Viscount Simon in the *Absalom* v. *Talbot* case (*supra*) to which I am about to refer. In at least three cases, however, it has been pointed out that the reason for including "receivables" on the credit side of the accounts is not primarily because their deduction is barred by the Rule, but rather because they are elements in arriving at the true profits and gains and that it is in accordance with accounting practice to do so.

In the *Absalom* case, Viscount Simon said at p. 189:

As this appeal has been very fully and ably argued on both sides, I do not wish to leave it without making an observation on Rule 3, paragraph (i), which provides that, in computing the amount of the profits and gains to be charged, no sum shall be deducted in respect of "any debts, except bad debts proved to be such to the satisfaction of the commissioners and doubtful debts to the extent that they are respectively estimated to be bad." It is clear from the words used in the beginning of the Rule that it is concerned with prohibiting various claims for deduction from profits, and has nothing to do directly with declaring what are profits. Yet I cannot help suspecting that it must be sometimes rather hastily read as though it amounted to an assertion that trade debts are profits. The true view is that in cases like the present, profits (or losses) so far as due to the particular transaction, arise from the sale and at the time of the sale; the debt representing the price is created by the sale and at the time of the sale. Indeed, the second reason of the Respondent's case is that debts due to the Appellant from the purchasers of houses "were debts within the meaning of Rule 3(i)". If that were so, the only result would be that such debts necessarily enter into the calculation of profits. To my way of thinking, the reason why debts such as the £65 in this case are to be brought in on the credit side of the account, is because they are an element in arriving at the Appellant's profits and gains, and not because of anything stated in Rule 3(i) at all.

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In the same case Lord Atkin said at p. 191:

Now no one doubts that in ordinary commercial practice where goods are sold on terms of ordinary commercial credit, three or six months or even more, traders are in the habit of treating the debt so created as part of the profits of the year in which the debt is incurred. Thus, where the business accounts are made up at the end of the calendar year, a sale in December on credit terms which expire in March or April will be regarded as a profit made in December. And this commercial practice is treated by taxpayers and tax collectors alike as involving a just and accurate computation of profits. The obligations so incurred in ordinary trading are treated as firm obligations and as good as cash in hand, and no one is any the worse. If expectations are disappointed, an allowance for a bad debt can be claimed and will be granted. But when one leaves the realm of ordinary commercial credits and has to deal with credits extending over many years, the whole situation is changed.

The matter was also considered in *British Mexican Petroleum Co. Ltd.* v. *Jackson* (1), where Lord Macmillan stated:

If profit and loss accounts were compiled on the basis of entering only sums actually received and sums actually paid, then the debt of £1,270,232, incurred by the Appellant Company to the Huasteca Petroleum Company, would never have appeared in the accounts of the Appellant Company, for it was never in fact paid. But business men do not so prepare their accounts either for their own purposes or for the purposes of the Inland Revenue, and debts incurred by a trader as well as debts which have become due to him, though in neither case yet paid, are properly taken into account in ascertaining the profits of the year.

In *Johnson (H. M. Inspector of Taxes)* v. *W. S. Try Ltd* (2), Lord Greene, M. R. said this:

I may, perhaps, make one general observation with regard to those matters. I think it is generally true to say that the scheme of Income Tax legislation is based on the idea that the tax is assessed and paid year by year. The taxpayer makes his return for the year, he is taxed, and there is an end of it. It is perfectly true that there are powers in the Act, when the Surveyor makes a discovery, by which he may make an additional assessment, and in appropriate cases that is undoubtedly a proper way of proceeding. But that does not alter the fact that that is what one may call an exception on the general scheme by which a year is taken, finished and done with, and the taxpayer knows where he is. His profits are ascertained in general on what I may call sound and normal commercial principles. He knows exactly where he is. But, in the cases to which Mr. Tucker referred, the principles adopted are, in a sense, reopening a previous assessment in circumstances which will appear when I come to examine those cases. It should be noted that in general tax is calculated on the basis of the receipts of a business. There is one notable exception to that and that is the case of trade debts. I had occasion a few days age to refer to the rather peculiar language of the Rule relating to permissible deductions in arriving at the profits of a

(1) (1932) 16 T.C. 570 at 593. (2) (1946) 27 T.C. 167 at 181.

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business, and I pointed out that one of the things which it is not permissible to deduct is a debt owing to the trader (*Bristow* v. *William Dickinson & Co., Ltd.* p. 162 ante). All the other matters, the deduction of which is disallowed, are expenditure, liabilities and disbursements. It occurred to me to wonder what debts (which are not disbursements and not expenditure) have got to do in this particular context. The reason, I ventured to suggest, was this. A trader is not to be entitled to say: You must not tax me on these debts because I have not yet received payment. You can only tax me when I have received payment. The Legislature says: No, it is ordinary commercial practice in calculating your profits to bring in debts which are owing to you in connection with the business: therefore you are to be bound to bring in debts which are owed to you on the same basis as if they were receipts, subject, of course, to the allowance for bad or doubtful debts for which the Rule provides. But I venture to think in one sense that is an anomaly, because it is a departure from what I have always understood to be the fundamental conception of Income Tax legislation—that you ascertain your profits in reference to your receipts. The reason why that exception is brought in is that it is in accordance with ordinary commercial practice to treat debts in that way.

In Simon's Income Tax Second Edition, Vol. II, p. 153, the general rule for ascertaining the period in which an item is includible was stated thus:

Normally an item becomes a trade receipt on the day when it is receivable even though the date of receipt is postponed. Equally, an item becomes an admissible deduction for tax purposes on the day on which it becomes a debt due from the business, irrespective of the date of its actual payment.

Accordingly, when a sale is made, the sale price has to be brought into account at that date, and it will form part of the total of the sales in the profit and loss account for the then current period; and that will be so even if the sum is not paid to the trader until after the end of the current accounting period. The fact that the consideration for a sale is other than money, or is an asset not immediately realisable, is no reason for excluding it. It should be included at the relevant accounting date at its then value.

In *Minister of National Revenue* v. *Sinnott News Co. Ltd.* (1) I considered the right of a distributor to set up a "Reserve for loss on returns", being the estimated loss of profits on magazines not sold by the retailers and liable to be returned to the distributor in the following year. The main point for consideration there was whether or not there was a sale of the goods, but in my conclusion I said:

On these facts I find that the transactions in question were sales, and that the whole of the accounts receivable in respect thereof at the end of the fiscal year constituted part of the income of the respondent to be taken into account in computing its profit or gain. Moreover, it is clear that the respondent in seeking to deduct from its income the estimated amount of the profit which it might lose in the next fiscal year by reason

(1) [1952] Ex. C.R. 508.

of compensating the retailers for unsold goods then returned, was transferring or crediting to a reserve or contingent account a part of the income which it had earned, and that is forbidden by the terms of s. 6(1)(*d*).

I am of the opinion that the principles laid down on this point in the cases which I have cited, and more particularly those in *Absalom* v. *Talbot, Johnson* v. *Try* and *British Mexican Petroleum* v. *Jackson* are of equal application under our Act. The exclusion from an operating statement of the amount of the receivables of a trader would give a completely inaccurate and incomplete picture of the year's operations. Let me assume a case in which a trader has disposed of all his inventory on credit a month before the end of his fiscal year on terms which were very favourable to him and under which payment in full could be anticipated after three or four months. Under a "Cash" system or the "Cash Receipts and Expenditure" system, the year's operations would admittedly result in a loss. The inventory is reduced to the extent of the cost of the articles sold but not paid for, and nothing is shown as coming in to balance those items unless and until the price has been paid.

On this point, I would refer to the case of *Commissioners of Inland Revenue* v. *Gardner et al* (1)—a decision of the House of Lords. In that case Viscount Simon said at p. 93:

> In calculating the taxable profit of a business on Income Tax principles (and the same point has been constantly illustrated in calculating Excess Profits Duty—Volume 12 of Tax Cases contains a number of examples) services completely rendered or goods supplied, which are not to be paid for till a subsequent year, cannot, generally speaking, be dealt with by treating the taxpayer's outlay as pure loss in the year in which it was incurred and bringing in the remuneration as pure profit in the subsequent year in which it is paid, or is due to be paid. In making an assessment to Income Tax under Schedule D the net result of the transaction, setting expenses on the one side and a figure for remuneration on the other side, ought to appear (as it would appear in a proper system of accountancy) in the same year's profit and loss account, and that year will be the year when the service was rendered or the goods delivered . . . This may involve, in some instances, an estimate of what the future remuneration will amount to (and in theory, though not usually in practice, a discounting of the amount to be paid in the future), but in the present case the amount of the commission due to be paid on 31st March, 1941, as part of the remuneration for services rendered two years before was already known before the additional assessment was made. The Crown is right in treating this additional sum as earned in the chargeable accounting period 1st April, 1938, to 31st March, 1939.

(1) (1947) 29 T.C. 69.

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Supposing that in the illustration I have given, a partner had been interested in the profits of the taxpayer's business for the year in question. I ask myself whether he would have had a right to share in the "receivables" as part of his profit at the end of the fiscal year. I think the answer would clearly be in the affirmative. And just as those sums are part of the profits of the year so as to entitle a partner to share in them, so it appears to me they are profits, or at least items to be taken into consideration in computing profits, under the Income Tax Act.

In my opinion, therefore, when trading stocks are sold and delivered, the full price should be brought into account in the year in which the delivery is made irrespective of the time of payment. The trader in such cases has the right to take advantage in proper cases of the statutory provisions regarding bad and doubtful debts to which I have referred above.

The probable result of failing to include accounts receivable in the computation of profit is referred to by the learned President in the *Trapp case* (*supra*). At page 258 he said this:

> It is generally conceded that in many cases, if not in most, the true net profit or gain position of a taxpayer, particularly if he is in business, cannot be ascertained otherwise than by an accounting method on the accrual basis. A person who has accounts receivable at the end of the year that are attributable to the earnings of such year and owes accounts payable for debts relating to the earnings of such year but keeps his accounts only on a basis of cash received and cash expended will frequently arrive at an amount of income "received" during the year that is not a reflection of his true net profit or gain for such year. But under the Income War Tax Act, as it stands, there is no place, as a matter of right, for the accounting method on an accrual basis, even if it does reflect the true net profit or gain of the taxpayer, and it must give way to the express provisions of the Act. Income tax law in Canada in this respect lags far behind that of the United Kingdom and the United States and runs counter to well recognized principles of sound business and accountancy practice.

For these reasons I must reach the conclusion that the "Cash Receipts and Expenditure" method purported to have been used by the appellant in this case is a method which is not permissible under the Act. I say that because of the fact that it excludes as an item of income all receivables, which in my opinion form a necessary part of any trader's profit and loss statement. Such a method is incomplete and misleading and one which fails entirely to show the true state of a taxpayer's position or to reflect his true profit or loss. There is no evidence whatever that it is according to generally accepted accounting practice in Canada—and Mr. Lorenzen admitted that it was not. Moreover, he said that had he been the company's auditor, he would not have given the usual auditor's certificate which is attached to corporate returns without a special statement to indicate that it was based on the "Cash Receipts and Expenditure" method. Its use in many cases would show a loss when in reality there was a profit. It brings in nothing on the receipts side to balance outgoing inventory which has not been paid for in full.

In Hannan and Farnsworth's work on The Principles of Income Taxation, the following appears at page 210:

> The costs of manufacturing and acquiring trading stock are obviously a proper charge in arriving at the profits of a business. For similar reasons, the respective values of stock on hand at the beginning and end of each accounting period must also be taken into account, since these values represent the advantage gained by the costs of manufacturing or acquiring the goods. It follows, of course, that sales of goods which were on hand when the accounting period began or were manufactured or acquired during that period, will necessarily find a place in the accounts, whether the customers have paid for the goods or not. Payment by a customer in any subsequent accounting period is merely the realisation of what has already been brought to account—in other words, the realisation of income that has already "arisen".

I think that statement correctly sets out the law applicable to short term trading accounts such as those in the present case. It may be noted, also, that the notes receivable in this case all bore interest and all were discounted or pledged to the bank, the appellant receiving the full face value thereof in the fiscal year in question. In view of my finding that all the receivables should have been included in the accounts, it is perhaps not necessary to consider the further question as to whether the discounting of the notes at the bank and the receipt by the appellant of the full proceeds thereof was equivalent to "Cash Receipts", although I think that was the result.

A further point, however, is raised by the appellant. It rests on the provisions of section 14(1) which is as follows:

> 14. (1) When a taxpayer has adopted a method for computing income from a business or property for a taxation year and that method has been accepted for the purposes of this Part, income from the business or

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property for a subsequent year shall, subject to the other provisions of this Part, be computed according to that method unless the taxpayer has, with the concurrence of the Minister, adopted a different method.

As I have noted above, the appellant was sent a Notice of Assessment showing "nil" tax levied; subsequently, the respondent, acting under the provisions of section 42(4), reassessed the appellant by adding back the amount of the receivables. In the Notice of Appeal to this Court, the appellant alleges that the reassessment was made "for the purpose of preventing section 14 coming into effect whereby the method adopted by the appellant in respect of its 1952 return (said to have been also on the "Cash Receipts and Expenditures" method) would be conclusive and binding upon the respondent in view of the acceptance by the respondent of the method adopted in respect of the 1951 taxation year." It was stated therein that the respondent was not entitled to reassess in order to prevent section 14 being effective in respect of a subsequent year. The short answer to this submission is that there is no evidence whatever that the Minister reassessed the appellant for the reasons suggested, and the burden of proof is, of course, on the appellant. It is said, further, that "the respondent is not entitled to reassess merely because he changes his mind (without the emergency of new facts) in respect of the original assessment". Section 42(4) has no such requirement and I am of the opinion that it is always open to the respondent by a reassessment to correct errors made in the original assessment within the time limited by that subsection. Subsection (3) of section 42 specifically provides that liability for tax under this part is not affected by an incorrect or incomplete assessment or by the fact that no assessment has been made.

A further argument is made on the basis of section 14(1). It is said that in its return for the next fiscal year the same method of accounting was used, that it showed a loss and that the return was accepted. No Notice of Assessment for the year 1952 was produced at the hearing, but Mr. Lorenzen intimated that the usual Notice of Assessment showing "nil" tax levied was received. It is submitted that the first Notice of Assessment for the taxation year 1951 was an acceptance by the Minister of the "Cash Receipts and Expenditure" method and that the Minister allowed the same method to be used in assessing the appellant's return for the year 1952 before notice of reassessment for the year 1951 was sent out (later returns were also referred to but I am of the opinion that they are totally irrelevant to the issue). It is said that if the Minister accepts a return made under a certain method in 1952, he is bound by section 14(1) to accept that method in subsequent years; and that *a fortiori* he must be deemed to be bound by it in respect of the year 1951 when the same method is said to have been used.

This submission rests entirely on the theory that the Minister did accept the "Cash Receipts and Expenditure" method purported to have been used by the appellant, merely by sending out the original Notice of Assessment for the year 1951. There is no evidence of "acceptance" unless it can be said that the original Notice of Assessment which levied no tax was acceptance. I do not think that it was. It seems to me that the word "accepted" as used in the subsection connotes a taking or receiving with consenting mind —something in the nature of an admission. Now the first Notice of Assessment was merely a statement that "nil" tax was levied; it said nothing whatever about any method. In fact, it seems clear that the assessing officers were not aware even at the time the notice of reassessment was sent out that any such method as the "Cash Receipts and Expenditure" method was being put forward. On that reassessment it was noted that "Reserve for bad debts ($4,240.92) disallowed". It was assumed, I think, that the entry "Provision for uncollected accounts" was merely one way of attempting to set up a reserve for bad and doubtful debts. There is nothing in the return except this one item which differentiates it from the ordinary trader's return which includes all receivables, and they were set out but not carried into the computation. I am unable to find anything which supports the suggestion that the Minister accepted the "Cash Receipts and Expenditure" method for the year 1951.

Moreover, I am satisfied that the provisions of section 14(1) (which in terms are "subject to the other provisions of this Part") must be read with those of section 42, including those in subsection (4) relating to the Minister's power of reassessment. It is inconceivable that the Minister

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should have full power by a reassessment to correct an error made in the original assessment in order that the full tax liability should be collected, and still be bound by the method said to have been used in the tax return on which the original assessment was made. In this case there was a reassessment which, in my opinion, entirely set aside the original assessment and which clearly denied to the appellant the right to deduct from its accounts the amount of its receivables.

For these reasons the appeal must fail. It will be dismissed and the reassessment dated November 22, 1952, will be affirmed. The respondent is entitled to his costs after taxation.

Judgment accordingly.