BETWEEN:

DOMINION STORES LIMITED .....APPELLANT;

AND

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

Toronto 1965 Dec. 13, 14

1966 Feb. 24

Income tax—Income Tax Act, R.S.C. 1952, c. 184, ss. 12(1)(e), 85B(1)(a)(i)(c)—Deductions—Chain store company—Reserve for unredeemed trading stamps—Reseasonable amount.

Operator of a chain of retail food stores, the appellant distributed in its stores trading stamps free as an inducement to customers. These stamps had a redeemable value of 1½ per cent of the purchase price which entitled the customer to present to the company for redemption either by way of premiums or the company's merchandise.

In each of the years 1959 and 1960, the appellant company sought to deduct, under the provisions of section 85B(1), a reserve in respect of the trading stamps that remained unredeemed at the end of the year.

The Minister disallowed the deductions, ruling that no reserve could be granted under section 85B(1)(*c*) because no amounts on account of goods not delivered before the end of the year had been included in the company's income as required by section 85B(1)(*a*). The Minister argued that the stamps were issued free, as advertised, and the cost of their redemption was not deductible until that event took place.

Held: The appellant company was entitled to deduct a reasonable amount for each of the two years in question as a reserve in respect of goods that it was reasonably anticipated would have to be delivered upon the redemption of trading stamps after the end of the year. Such amount being the amount that the parties agreed was reasonable.

2. In fact a portion of each amount received from the appellant's customers was received on account of goods not delivered and a reserve was therefore permissible under s. 85B(1)(*c*).

3. The requirements of section 85B(1)(*a*) having been met, the company was entitled to the reserve provided by section 85B(1)(*c*).

4. Appeal allowed.

APPEAL from assessments by the Minister of National Revenue.

S. E. Edwards, Q.C. and *M. L. Ainsley* for appellant.

M. A. Mogan for respondent.

CATTANACH J.:—These are appeals from assessments to income tax levied by the Minister in respect of the appellant's income for its 1959 and 1960 taxation years.

The appellant company, the head office of which is in Toronto, Ontario, operates a chain of retail food stores

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throughout Canada, except in the Province of Newfoundland, the Yukon and Northwest Territories. Approximately 62 percent of appellant's gross revenue is derived from its business conducted in the Province of Ontario and approximately 20 percent is derived from its operations in the Province of Quebec.

As a matter of policy the appellant does not usually resort to the device of distributing trading stamps to attract and retain customers but, as an executive of the appellant company testified, the appellant was obliged to do so in the Province of Quebec and in those portions of Ontario bordering on Quebec in order to compete effectively with its business rivals. I would assume that the appellant had no inherent objection to the adoption of such trading stamp plans if it were demonstrated to it that such a plan would increase its trade.

The method of operating the trading stamp plans adopted by the appellant is this:

The appellant conducts its business on a cash basis exclusively. A customer on purchasing merchandise from the appellant is given trading stamps to the value of 1½ percent of the price paid for the merchandise purchased. For example if the price of the merchandise was $10, the customer would be given 100 stamps having a redeemable value of 15 cents, or 3/20 of a cent each. The customer is also supplied with a small booklet in which the stamps are to be pasted. The booklet, when completely filled, has a redeemable value of $2.25. When a customer has filled booklets of these stamps he may then present them at the appellant's retail store where the merchandise was purchased where he is given a choice of articles illustrated in a catalogue which may have been given to him previously or is available for his inspection. The appellant then exchanges the article selected by the customer for a certain number of completed booklets, the number of booklets required being listed in the catalogue.

In all advertising media, and upon the catalogues and booklets the trading stamps and articles received by a customer in exchange therefor are described as being "free"-"gifts" and "free gifts".

I should have thought that the appellant would recoup itself for the cost of printing the trading stamps and the

redeemable values thereof as well as sundry related administrative expenses, by appropriate increases in the prices of the merchandise sold to its customers. I should also have thought that the appellant would realize a profit by supplying articles in exchange for booklets of stamps. However, no satisfactory evidence was adduced upon either of the above points. An executive of the appellant company who was called as a witness could not say whether prices in those stores of the appellant in which a trading stamp plan was in vogue were increased to cover the cost of the stamp plan, nor did he know whether the premium articles given in exchange for stamps were purchased by the appellant at manufacturer's or wholesale cost and redeemed by it at the retail cost. The witness did say that prices varied from store to store in the appellant's chain in different areas and from store to store in the same areas, but that such variations in prices were attributable to so many factors that he was unable to attribute any part of the prices at which merchandise was sold to the introduction of a trading stamp plan. Neither could this witness state that a specific part of each sales dollar received by the appellant was allocated to an account for the redemption of trading stamps, or that a specific part of each sales dollar was allocated to the purchase price of the merchandise sold by the appellant. No such system of bookkeeping or segregation was set up although accounts were kept of the numbers and amounts of trading stamps issued.

It was positively established by evidence that when a customer made a purchase of merchandise in one of the appellant's stores where a trading stamp plan was in effect, he paid the asking price for the merchandise he received, he received or was entitled to receive trading stamps to the extent of $1\frac{1}{2}$ percent of the purchase price and he was entitled to present those trading stamps for redemption by the appellant. These were the conditions under which merchandise was sold by the appellant. If a customer did not wish to take the stamps he could not thereby obtain any reduction in the price of the merchandise that he wished to purchase. If the customer did not wish to take the stamps proffered to him, and did not take them, he would, in effect, be making a gift of them to the appellant.

It was a condition of acquiring trading stamps that a customer must purchase merchandise from the appellant. A

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person could not acquire stamps from the appellant except in connection with a purchase of merchandise in the manner I have described.

In addition to its trading stamp plan, the appellant also had in effect in some of its stores in some areas a variation thereof which was described as a "save-a-tape" plan. This plan worked in a manner identical to the trading stamp plan except that instead of trading stamps the customer was given cash register receipts in a specified colour which were also redeemable in the same manner and to the same values as trading stamps.

I should also add that a customer was given a further option by the appellant. A customer could exchange the trading stamps received by him (or the cash register receipts as the case might be) for the premiums listed in the catalogue or if the customer wished he might redeem the trading stamps for merchandise, that is groceries, sold by the appellant.

The appellant, in addition to distributing trading stamps in its own retail stores, also sold a much lesser quantity of trading stamps than it distributed itself to other retail merchants to disseminate or distribute among their customers. The customers of those other retail merchants were also entitled to present the trading stamps so received by them to the appellant to be exchanged for the premiums listed in the appellant's catalogue at the rates therein listed and the appellant also undertook to redeem those stamps.

The appellant also sold "gift certificates". These certificates were purchased from the appellant at a price equal to a face value printed thereon and were redeemable at any of the appellant's retail stores by the bearer for merchandise only, that is to say, the merchandise normally sold by the appellant but not for premiums listed in the gift catalogue. During the Christmas season the appellant also offered for sale turkey gift certificates which were for the same purpose as the gift certificates except that the merchandise to be received therefor was limited to turkeys.

Owing to the operation of trading stamp plans by the appellant in the conduct of its business, a problem arises in dealing with what are known as "unredeemed" stamps, that is to say, stamps that were distributed in the current accounting year or carried over from former years and that

remain unredeemed at the end of the year. The problem is what account, if any, should be taken of such unredeemed stamps in computing the profits from the appellant's business for the year.

During the taxation years 1957 and 1958 the appellant operated its trading stamp plan under the name of the "Blue Chip Premium Stamp Plan". This plan was discontinued by the appellant in its 1958 taxation year and in its income tax return for that year the appellant deducted a reserve in respect of Blue Chip stamps then outstanding which the Minister disallowed as a deduction.

The appellant, in its 1959 and subsequent taxation years, continued to operate a premium trading stamp plan designated as the "Horizon Stamp Plan".

During its 1958 and subsequent taxation years the appellant also operated the "Save-a-Tape Plan" which has been described above.

In the appellant's 1959 and 1960 taxation years now under review, the Minister did allow claims for reserves with respect to trading stamps sold by the appellant to other retail merchants, and the issuance of gift certificates and Christmas turkey certificates, in amounts he considered to be reasonable, but he disallowed the claims for the reserves with respect to the "Blue Chip Plan", the "Horizon Stamp Plan" and the "Save-a-Tape Plan" made by the appellant for those taxation years by notification under section 58 of the *Income Tax Act*, dated July 30, 1964, on the particular ground that,

> reserves for premium stamps and tapes supplied to customers claimed as deductions from income have been propertly disallowed in accordance with the provisions of paragraph (*e*) of subsection (1) of section 12 of the Act; that no part of the taxpayer's receipts from customers represents an amount received in the year in the course of business that is on account of goods not delivered before the end of the year or that, for any other reason, may be regarded as not having been earned in the year or a previous year within the meaning of subparagraph (i) of paragraph (*a*) of subsection (1) of section 85B of the Act and accordingly the taxpayer is not entitled to a reserve under paragraph (*c*) of the said subsection (1) of section 85B.

By such notification the Minister confirmed his prior assessments to which objections had been filed by the appellant. It is from these assessments that the appeals to this Court result.

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The provisions of the *Income Tax Act* pertinent to the present appeals read 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 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.

12. (1) In computing income, no deduction shall be made in respect of

...

(*e*) an amount transferred or credited to a reserve, contingent account or sinking fund except as expressly permitted by this Part,

...

85B. (1) In computing the income of a taxpayer for a taxation year,

(*a*) every amount received in the year in the course of a business

(i) that is on account of services not rendered or goods not delivered before the end of the year or that, for any other reason, may be regarded as not having been earned in the year or a previous year,

...

shall be included;

...

(*c*) ... where amounts of a class described in subparagraph (i) or (ii) of paragraph (*a*) have been included in computing the taxpayer's income from a business for the year or a previous year, there may be deducted a reasonable amount as a reserve in respect of

(i) goods that it is reasonably anticipated will have to be delivered after the end of the year,

The issue is whether the appellant is entitled to deduct an amount as a reserve in respect of the trading stamps and cash register receipts which it had distributed among its customers and which had not been redeemed during the respective taxation years in question.

Upon the pleadings a further issue was raised as to whether, assuming the appellant is entitled to deduct an amount as such a reserve in computing its incomes for its 1959 and 1960 taxation years, the sums of $265,027.91 and $784,765.89, which were claimed by the appellant by its Notice of Appeal, are "reasonable" amounts as contemplated by section 85B (1)(*c*). As a result of an agreement made by counsel during the course of the trial the parties have

informed the Court that reasonable amounts for the two taxation years under appeal are as follows:

1959 -	Horizon and Blue Chip Reserve	$139,602.32
	Save-a-Tape Reserve	25,570.28
	Total	$165,172.60
1960 -	Horizon Stamp Reserve	$509,987.64

The appellant's principal contention is, in effect, that the manner in which the appellant conducted its business, which has been described above, falls within the precise terms of section 85B in that part of the purchase price received by the appellant in the course of each of its sales at a store where such a plan was in operation, was received on account of goods not delivered before the end of the year.

There is no question that the appellant is under a binding legal obligation to redeem trading stamps which it had issued under the plans that I have described when those stamps are presented to be exchanged for premiums in accordance with the terms of the respective plans under which they were issued. Counsel for the Minister readily concedes that such obligation is upon the appellant to redeem the trading stamps.

However, he submits that this obligation was voluntarily assumed by the appellant, that there was no evidence (as there was not) of an increase in price of the merchandise that the appellant sold in the normal course of its business to cover the cost of the premium plans when introduced and that there was no segregation or allocation of the revenue received to the merchandise sold, on the one hand, and to the trading stamps distributed on the other. He, therefore, suggests that the trading stamps were "free" as they were described in the appellant's advertising. On these grounds he submits that no amounts were received by the appellant in the years in question in respect of the trading stamps or the premiums to be given on their redemption. It would follow therefore that no amounts were included in computing the appellant's income and that a reasonable amount as a reserve was not permissible as a deduction under paragraph (*c*) of section 85B. In short, the contention on behalf of the Minister is, as I understand it, that the liability of the appellant to redeem the trading stamps

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issued by it cannot be related back to the period in which that liability arose, but rather any deductions should be brought into account when the trading stamps were actually redeemed and not before.

In my view the contention of the Minister cannot prevail.

The arrangement between the appellant and its customers is quite clear from the evidence. A customer paid the price demanded by the appellant when he purchased merchandise from the appellant. For this, he received the merchandise and in addition he received or was entitled to receive trading stamps which he was entitled to present to the appellant later for redemption either by way of premiums or the appellant's merchandise. The appellant was legally obligated to make this redemption. There was only one transaction and this was the only way in which the appellant would conduct its business at the particular stores. It does not follow that, because no specific amount is identifiable as being allocated to the cost of distributing and redeeming the stamps, the total amount is not attributable in part thereto. When two articles are sold together for one price without a price being put upon each separately, it does not follow that one article is free and that the price is attributable exclusively to the other article.

In my opinion, where the trading stamps and save-a-tape plans were in effect and trading stamps or premium tapes were issued to the appellant's customers, a portion of each amount received by the appellant from its customers was received on account of goods to be delivered on presentation of the trading stamps or tapes for redemption. All amounts received by the appellant in respect of such goods were included in the appellant's income in the year of receipt whether or not the trading stamps or tapes were redeemed in that year. Such amounts, with respect to trading stamps which remained outstanding at the end of each taxation year, were on account of goods not delivered before the end of the year. From this it follows that by virtue of section 85B the appellant is entitled to deduct a reasonable amount for each of the two years in question as a reserve in respect of goods that it is reasonably anticipated will have to be delivered upon the redemption of trading stamps or premium tapes after the end of the year.

The parties hereto have agreed that such reasonable amounts are as set out above.

Having regard to the conclusion I have reached on the appellant's principal contention there is no need to discuss its alternative contentions.

The appeals are, therefore, allowed with costs and the assessments are referred back to the Minister for re-assessment so as to allow as a deduction,

(*a*) for the appellant's 1959 taxation year an amount of $165,172.60, and

(*b*) for the appellant's 1960 taxation year an amount of $509,987.64,

as reserves in those respective taxation years in accordance with section 85B of the *Income Tax Act*.