
BETWEEN:

1958 Dec. 8, 9, 10 — 1959 Sept. 21

CANADIAN GENERAL ELECTRIC COMPANY LIMITED .... APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE .... RESPONDENT.

Revenue—Income—Income tax—Foreign exchange profits—Method of computing income—Must reflect real profit or loss—The Income Tax Act, 1948, S. of C. 1948, c. 52; R.S.C. 1952, c. 148, ss. 3, 4 and 14(1).

The appellant company borrowed funds from its parent United States company to purchase goods from it and other suppliers in the United States indicating its indebtedness by promissory notes payable in U.S. funds. Due to the fact that during the currency of the notes the Canadian dollar rose from a discount to a premium over U.S. funds the appellant was able to pay off all the notes at a saving of some $512,847. Notes totalling $1,567,847 were paid off in 1951 at a saving of $81,744 and the balance totalling $9,225,326 in 1952 at a saving of $431,072.

1959

CANADIAN GENERAL ELECTRIC CO. LTD. *v.* MINISTER OF NATIONAL REVENUE

The respondent added the latter amount to the appellant's declared income for 1952 as "foreign exchange on notes payable". In an appeal from the assessment the appellant contended that the profit should be computed on an accrual basis by revaluing the amount of foreign exchange originally provided for, at the end of each fiscal year and including such amounts and the amounts actually realized by payment, in income. On this basis it submitted the profit should be apportioned as $64,675 for 1950; $259,820 for 1951 and $188,351 for 1952. It argued that the system was followed in 1952 and the preceding years in regard to outstanding obligations to other U.S. suppliers, the "profit" due to the lower rate of exchange being taken into account at the end of each year and treated as taxable income. To be consistent it urged that the same practice should be followed in regard to the notes.

Held: That the issue before the Court was one of law and not of accounting. The profits in question were neither made nor ascertained by the mere revaluation downward on December 31, 1950 and 1951 on the books of the company, of the amount of the premium in Canadian dollars necessary to pay the outstanding notes, but that such were made only upon actual payment of the several notes.

2. That no taxable profit in respect of foreign exchange was made by the appellant until the time at which the several notes payable in U.S. currency were actually paid.

3. That the giving of a renewal note cannot be considered as payment of the debt any more than the giving of the original.

4. That the word "method" used in s. 14(1) of the *Income Tax Act* is not limited to those methods referred to as the "cash" and "accrual" methods.

5. That a taxpayer can invoke the provisions of s. 14(1) only when the method which he has adopted in an earlier year to compute his income (and which he proposes to follow in the taxation year in question) is one which is computed in accordance with the provisions of the Act and truly reflects his real profit or loss for the year.

APPEAL from an assessment under the *Income Tax Act* 1948, S. of C. 1948, c. 52 and the *Income Tax Act,* R.S.C. 1952, c. 148.

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

A. D. McAlpine and *W. L. N. Somerville* for appellant.

W. R. Jackett, Q.C., J.D.C. Boland and *G. W. Ainslie* for respondent.

CAMERON J. now (September 21, 1959) delivered the following judgment:

By a re-assessment dated August 6, 1957, the respondent added to the declared income of the appellant for its taxation year ending December 31, 1952, the sum of $431,072.68, described as "Foreign exchange profit on notes payable", and an appeal is now taken therefrom. In its original

1959

CANADIAN GENERAL ELECTRIC CO. LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

Notice of Appeal, the appellant took the position that to the extent that any such profits were made in that year, they were profits on capital rather than on revenue account and therefore not taxable. By amendments to the Notice of Appeal and doubtless because of the decisions of the Supreme Court of Canada in *Tip Top Tailors Ltd. v. M.N.R.*[1] and *Eli Lilly & Co. (Canada) Ltd. v. M.N.R.*[2], the appellant now admits that to the extent that it made "foreign exchange profits on notes payable" in 1952, such profits are of a revenue nature and are to be taken into consideration in computing its taxable income. As will be seen later, the dispute has to do with the quantum of such profits in 1952.

The facts are not in dispute. The appellant is an incorporated company having its head office at Toronto, most of its shares being owned by the General Electric Company of Schenectady, New York. It is engaged in the business of manufacturing and selling electrical machinery and supplies of all sorts and purchases substantial quantities of needed supplies from General Electric, as well as from other suppliers in the United States. In 1950, the appellant had borrowed very substantial amounts from its Canadian bankers in the form of overdrafts. In August of that year, General Electric offered to make U.S. funds available to the appellant at a rate substantially lower than that paid to the appellant's Canadian bankers. The initial arrangement was that General Electric would defer payment of accounts for goods purchased from it by the appellant, carrying them on open account and at an interest rate of 2 per cent. Within a few weeks, however, General Electric required that any such indebtedness should be evidenced by promissory notes of the appellant payable to General Electric and all in U.S. currency.

These arrangements were duly carried out (the appellant, however, as before, continuing to pay cash for a portion of its purchases from General Electric) and, as will be seen from Exhibit 13, some 25 notes were issued between August 20, 1950 and May 20, 1952. All of these notes were in respect of goods or services supplied by General Electric to the appellant except for one dated May 9, 1952, for

[1] [1957] S.C.R. 703.

[2] [1955] S.C.R. 745.

1959
CANADIAN GENERAL ELECTRIC CO. LTD.
v.
MINISTER OF NATIONAL REVENUE
Cameron J.

$500,000 in U.S. funds supplied by General Electric to the appellant and used by the latter for the purchase of goods in the United States. Exhibit 13 gives the date and amount of each note, the dates of payment on account, as well as the rate of exchange of U.S. and Canadian dollars existing at the date of each note and at the time of each repayment. Exhibits 7 and 10 are respectively photostatic copies of the notes and of the cheques issued in repayment, the latter all being drawn on the appellant's account at the Guaranty Trust Company of New York.

Due to the fact that during the currency of these notes the premium on U.S. funds over the Canadian dollar was sharply reduced, and that in 1952 the Canadian dollar was at a premium over such U.S. funds, the appellant, as shown by Exhibit 13, was able to pay off all the notes at a saving which the parties have agreed upon at $512,847.12. Five of the notes issued in 1950, and aggregating $1,567,149.20, were paid off in 1951 at a saving of $81,774.44; the remaining notes, issued in 1950, 1951 and 1952 and aggregating $9,225,326.87, were paid off in 1952 at a saving of $431,072.68. It is the latter amount which was added to the appellant's declared income and which is now in dispute.

It is now submitted on behalf of the appellant that the total amount of the agreed profits should be apportioned over three years as follows:

1950	$ 64,675.17
1951	259,820.23
1952	188,351.72
	$512,847.12

In order to understand this contention, it is necessary to state what the appellant did in relation to its liability on the notes in question. At the time that each note was given, there was set up in the books not only the liability for the face value of the note, but a further item under "Foreign exchange" of an amount in Canadian funds which, together with the face amount of the indebtedness, would be necessary to pay the note in U.S. funds. That, of course, was based on the premium from time to time of the U.S. dollar over the Canadian dollar. It is not disputed that

1959

CANADIAN GENERAL ELECTRIC CO. LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

such entries were correct, the total of the two amounts truly representing the appellant's then liability for the goods purchased. As shown by the schedule attached to the Notice of Appeal, the amounts so set up for "Foreign exchange" in 1950 totalled $300,573.15. The exchange rate in that year had varied from a high of 10½ per cent to a low of just less than 4 per cent. On December 31, 1950, the exchange rate was 6 per cent and the appellant on that date (which was the end of its fiscal year) revalued the amount of the "Foreign exchange" premium which it would have had to provide if it had paid the existing notes in full at that date, namely, at the then rate of exchange of 6 per cent.—a total of $235,897.98. The difference of $64,675.17 between the total amounts it had originally set up to meet the exchange premium ($300,573.15) and that fixed for the year end ($235,897.98) was said to be "profit" for that year, notwithstanding the fact that no payments whatever were made on the notes. In its income tax return for the year 1950, this "profit" of $64,675.17 was disclosed, but as it was considered by the appellant to be a gain on account of capital, it was not taken into income. The Minister, however, added it to the declared income, but an appeal to the Income Tax Appeal Board was allowed. From that decision, the Minister lodged an appeal which was later abandoned. I am not directly concerned with the 1950 income tax return and have pointed out the facts relating thereto merely to indicate that the appellant then considered that the item in dispute was a profit (although not on revenue account) and that the Minister had re-assessed the appellant on the ground that it was in fact on revenue account as now submitted by the appellant.

Again, the second schedule to the Notice of Appeal sets forth the computation of the appellant in respect of the "profit" in question for 1951. The item of $235,897.98 set up by revaluation on December 31, 1950, as the amount necessary to pay the exchange on the outstanding notes on that date was carried forward to the beginning of 1951 and to it was added the amount of foreign exchange premium necessary to pay all the new notes issued in 1951 at the rate of exchange prevailing when each note was given, the total of both sums aggregating $404,793.26. From that aggregate, there was deducted (*a*) the actual exchange premiums paid on the notes which were redeemed in that year, and (*b*) the total of the revalued amounts of exchange necessary to pay the outstanding notes at December 31, 1951, at the then current rate of $1\frac{1}{4}$ per cent.—a total of $144,973.03. The difference of $259,820.23 is said to have been the "profit" for the taxation year 1951. In its return for that year, the appellant showed that amount as exchange profit on notes, but considered it to be a gain on capital account.

Schedule 3 to the Notice of Appeal relates to the year 1952 in which further notes were issued, and these, together with all outstanding notes, were paid in full before December 31, 1952. The Canadian dollar throughout the year was at a premium. Accordingly, from the "credit" in exchange on the new notes issued totalling $68,789.34, there was deducted the "debit" established by revaluation of the notes unpaid on December 31, 1951, namely, $62,196.80, leaving a balance of $6,592.54. That amount was deducted from $194,944.26, the amount of the actual benefits accruing to the appellant upon payment of its several notes in 1952, due to the premium on the Canadian dollar. The difference of $188,351.72 is now said to be the "profit" for 1952 relating to "exchange on the notes". In its income tax return for that year, the appellant attached Schedule 28 thereto with the same particulars as in Schedule 3 of the Notice of Appeal. In computing its taxable income, however, the full amount of $188,351.72 was deducted from net income, the appellant then being of the opinion that such "profit" was not on revenue account. It is now conceded, however, that whatever profit was made in 1952 upon payment of the notes, was a profit on revenue account.

The contention of the appellant may be stated as follows:

It is said that the only suitable system of accounting for a trader such as the appellant is that frequently called the "accrual" system. The expert accountants called by the appellant are in agreement on that point and there can be no doubt that that is so, the "cash" system being wholly unsuitable for such a business. Then it is said that under the "accrual" system, it is necessary to value not only receivables, but payables, at the balance-sheet date, in order

1959

CANADIAN GENERAL ELECTRIC CO. LTD.
v.
MINISTER OF NATIONAL REVENUE

Cameron J.

to reach a true position of profit or loss. It is therefore necessary, it is contended, to show accurately on that date the true amount of Canadian dollars necessary to retire the outstanding notes by taking into consideration the then existing rate of exchange and to substitute that figure for the one used at the time the actual transactions took place. To disregard the fluctuating rate of exchange until actual payment would, it is said, result in an over-statement or under-statement of actual liabilities and thus bring about an under-statement or over-statement of profits for the year. Then it is pointed out that the system now advocated was followed in 1952 and the preceding years in regard to outstanding obligations (not represented by notes) to other suppliers in the United States, the "profit" due to the lower rate of exchange being taken into account at the end of each year and treated as taxable income. To be consistent, it is urged that the same practice should be followed in regard to the notes.

I find it unnecessary to state in full the opinion of the expert accountants who gave evidence for the appellant, for, with great respect, I have come to the conclusion that the issue before me, and which I shall state shortly, is one of law and not of accounting. These accountants were all in agreement that the "accrual" system was the only suitable one for the appellant company and that from an accounting point of view it was proper, in order to give a true picture of the company's position, to revalue the amount of Canadian dollars necessary at each balance-sheet date to pay off the outstanding notes.

Most, if not all, in reaching that conclusion, placed great stress on the undoubted fact that the appellant, had it so desired, could at all relevant times have paid the notes (which admittedly were current liabilities) in full by having recourse to the line of credit which it had with its Canadian bankers. That fact, they said, eliminated any contingency as to a future gain or loss in exchange due to the fluctuating rates.

The submission made by counsel for the Minister may be summarized briefly. He says that no profit arose at the end of the fiscal years 1950 and 1951 by the mere revaluation downwards on the books of the appellant company of the amount of Canadian dollars necessary to pay the outstanding notes in U.S. dollars. A trade, it is said, is only taxable in the year for profits made in that year in respect of realized profits. Here it is submitted that the profit arose only upon actual payment of the notes and that profit was the difference between the amount of Canadian dollars set up in the company's books when each note was given to General Electric and the actual amount paid to retire the notes. No notes were paid off in 1950 and accordingly the profit on exchange should be apportioned to the years in which the notes were actually paid, as follows:

1951	$ 81,774.44
1952	431,072.68

If this submission be correct, then the re-assessment must be upheld, there being no dispute as to the amounts computed on that basis.

It will be seen, therefore, that the issue is one of amount only, the appellant's main contention being that the profit on exchange in 1952 was $188,351.72 and not $431,072.68, the amount added by the Minister.

In my view, the broad issue to be determined here is this—"When did this profit arise?" That question, as I have suggested, is one of law, to be answered by a consideration of the Act and the relevant decisions of the Courts. By s. 3 of the 1948 *Income Tax Act*, "The income of a taxpayer for a taxation year . . . is his income from all sources . . . (and) includes income for the year from all . . . businesses." Then, by s. 4, "Income for a taxation year from a business . . . is the profit therefrom for the year."

The problem will, I think, be made clearer if a specific example is considered. Certain of the notes issued to General Electric in 1950 were wholly unpaid until 1952. Notwithstanding this fact, the appellant on December 31, 1950, and on December 31, 1951, in relation to these notes revalued downwards on its books the amount of Canadian dollars necessary on those dates to pay the premium then in effect on U.S. exchange. In 1951, nothing else was done in connection with these liabilities. The question, therefore, is whether in these circumstances a trader who in one year has incurred a debt in foreign currency and has left it

1959

CANADIAN GENERAL ELECTRIC CO. LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

wholly unpaid throughout the following year, is taxable under *The Income Tax Act* by reason of the single fact that its liability in terms of Canadian currency has decreased during that subsequent year as the result of the change downwards in exchange rates.

After most careful consideration of the arguments of counsel and of the authorities cited in support of their submissions, I have come to the conclusion that the appeal on this point is not well founded and must be dismissed. I do so for the reason that the profits in question, in my opinion, were neither made nor ascertained by the mere revaluation downwards on December 31, 1950 and December 31, 1951 on the books of the company, of the amount of the premium in Canadian dollars necessary to pay the outstanding notes, but that such profits were made only upon actual payment of the several notes.

It may be stated that, in general, income tax is calculated on the basis of the receipts of a business. In *Johnson v. W. S. Try Ltd.*[1], Lord Greene, M.R. stated:

> 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 . . . a trader is not entitled to say: you must not tax me on these debts because I have not 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 on the same basis as if they were 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 that connection, reference may also be made to *Ken Steeves Sales Ltd. v. M. N. R.*[2]. A further exception to the general rule is the statutory provision now found in s. 14(2) of *The Income Tax Act* which provides that in computing income, property described in an inventory shall be valued at its cost to the taxpayer, or its fair market value, whichever is the lower, or as may be permitted by regulation. There a profit or loss may result without actual disposition of the stock-in-trade.

In the instant case, however, the subject-matter has to do with foreign exchange on debts payable and is related in no manner to debts receivable or to inventory. It is significant to note that in all of the cases cited to me, not

[1] 27 T.C. 167 at 181-182. [2] [1955] Ex. C.R. 108.

one was found in which a taxable profit was made in relation to current debts payable in foreign exchange, except at the time of payment of the debt.

1959
CANADIAN GENERAL ELECTRIC CO. LTD.
v.
MINISTER OF NATIONAL REVENUE
Cameron J.

In my view, the decision of the Supreme Court of Canada in *Eli Lilly and Co. (Canada) v. M. N. R.*[1], while more directly related to the question as to whether the profit was or was not on revenue account, is of assistance in the problem now before me. The facts in that case are summarized in the headnote as follows:

The appellant, the Canadian subsidiary of an American corporation, for the years 1940-1945 inclusive, purchased goods from the parent company totalling $640,978.29 in American currency. During that time the United States dollar was at a premium and the appellant, though it made no payments on account, set up in its books the amount of its indebtedness in Canadian dollars (as if the two currencies were at parity) plus the amount required each year to cover the premium on exchange for the purchases made in that year. At the end of 1945 the amount of Canadian dollars required to cover the premium totalled $67,302.77. In filing its income tax returns in each of these years the appellant included the premium so computed as an expense and it was allowed by the taxing authorities. In July 1946, the Canadian dollar attained a position of parity with the United States dollar and the appellant in its 1946 profit and loss account included the said sum of $67,302.77 as income under the heading of "Foreign Exchange Premium Reduction" and, in filing its income tax return for that year, treated the amount as a capital rather than an operating profit and deducted it in determining its net income subject to tax. The deduction was disallowed by the Minister. Appeals by the taxpayer to the Income Tax Appeal Board and to the Exchequer Court were each dismissed. In its appeal to this Court the appellant contended that as all the goods were purchased prior to 1946 it, in making settlement of the indebtedness in that year (which it effected with $640,978.29 in Canadian dollars by the issue of additional shares to the parent company without payment of any exchange) realized neither a profit, gain nor gratuity within the meaning of s. 3 of the *Income War Tax Act* and therefore the amount in question was not properly included in the word "income" as defined in that section.

In delivering judgment for the majority of the Court, Estey J. said at p. 747:

It is contended that as all of the gods were purchased prior to 1946 the appellant, in making the settlement of that year, realized neither a profit, gain nor gratuity within the meaning of s. 3 of the *Income War Tax Act* (R.S.C. 1927, c. 97) and, therefore, the amount here in question was not properly included within the word "income" as defined in that section.

The agreement that the invoice price in the total sum of $640,978.29 was payable in United States dollars introduced a contingency, or a factor of uncertainty, in the purchase price that could only be settled or determined by payment and, therefore, upon the date of payment. In reality the amounts set up in each year totalling $67,302.77 were a reserve to provide for this contingency. If, at the date of payment, no premium was required,

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

1959

CANADIAN GENERAL ELECTRIC CO. LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

the reserve set up would be unnecessary. If the premium was lower than the rate at which it was computed, only a part of the reserve would be necessary, but if, on the other hand, a higher premium was required, an additional item of expense would be incurred.

It will be observed that in that case consideration was given to the very question now before me, namely, whether the profit did arise in the actual year of payment, all trading transactions having been carried out in prior years. There, as here, the rate of exchange fluctuated from time to time and the taxpayer set up a reserve against the contingency of having to pay an exchange premium. It was held that the factor of uncertainty regarding the actual amount to be paid as a premium on foreign exchange could only be settled or determined "by payment and therefore upon the date of payment". The appeal of the taxpayer was dismissed.

In the *Eli Lilly* case, Estey J. referred with approval to the opinion of Dixon J. in *Texas Co. (Australia) Ltd. v. Federal Commissioner of Taxation*[1]:

> For where liabilities are not fixed in their monetary expression, whether because of contingencies or because they are payable in foreign currency, a difference between the estimate and the actual payment must be borne as a business expense, and where the continuous course of a business is divided for accounting purposes into closed periods it is a reduction of the net profit, which otherwise would be calculated for the period.

That case had to do with the deduction of expenses in the year of payment, in excess of the foreign exchange premium as estimated at the time the transaction took place. The measure of the additional expense was the difference between the original estimate and the amount actually required *at the date of payment.*

In *Davies v. The Shell Co. of China Ltd.*[2] a unanimous decision of the Court of Appeal in England, rendered by Jenkins L. J., a part of the headnote is as follows:

> Owing to the subsequent depreciation of the Chinese dollar with respect to sterling, the amounts eventually required to repay agency deposits in Chinese currency were much less than the sums held by the company to meet the claim, and a substantial profit accrued to the company.

[1] (1940) 63 C.L.R. 382 at 465. [2] (1951) 32 T.C. 133.

Jenkins L. J., in referring to *Landes Brothers v. Simpson*[1], a decision of Singleton J., said:

All the transactions between the appellants and the company were conducted on the dollar basis and owing to fluctuations in the rate of exchange between the dates when advances in dollars were made by the appellants to the company against goods consigned and the dates when the appellants recouped themselves for the advances on the sales of the goods, a profit accrued to the appellants on the conversion of repaid advances into sterling.

Later, on the same page, he quoted with approval the comment of Singleton J. in that case in referring to *McKinley v. H. T. Jenkins & Sons Ltd.*[2]:

I pause there to say that in my view the profit which arises in the present case is a profit arising directly from the business which had to be done, because, as is found in para. 6 of the Case, the business was conducted on a dollar basis and the Appellants had, therefore, to buy dollars in order to make the advances against the goods as prescribed by the agreements. The profit accrued in this case because they had to do that, thereafter as a trading concern in this country re-transferring or re-exchanging into sterling.

And then Jenkins L. J. added:

That is accepted by both parties as correctly stating the law and if I may say so, in my view it was clearly a right decision on the facts of that case.

In my opinion, that case is further authority for the view that the profit on foreign exchange here in question arose only upon the actual payment of the liability of the taxpayer.

Counsel for the Minister also cited *Tip Top Tailors Ltd. v. M. N. R.*[3]. That case also had to do with the profits made on foreign exchange due to the revaluation of sterling. I find it necessary to refer only to two extracts from the opinion of Rand J., in which Fauteux J. concurred. At p. 709 he said:

Up to devaluation the rate was 4.04 to the pound, but the bank overdraft was paid on an exchange rate of $3.0875. The net profit was approximately $160,000 and the question is whether that profit is taxable as income.

* * *

A number of authorities were examined by both counsel which bear more or less directly upon dealings involving foreign exchange. Those relied on by the Crown were cases in which the exchange was encountered as part of the transaction of purchase and sale as between the buyer and seller themselves: the exchange benefit or detriment was immediately

[1] 19 T.C. 62.
[2] 10 T.C. 372.
[3] [1957] S.C.R. 703.

1959 CANADIAN GENERAL ELECTRIC CO. LTD. v. MINISTER OF NATIONAL REVENUE — Cameron J. —

involved in the actual payment to the seller of the price of goods purchased. Admittedly in such a mode of dealing the rate of exchange at the time of payment and not at any other time controls: the actual outlay by the purchaser to the seller for the goods received, in terms of the domestic currency, is the amount which must be taken into the account.

The "profit" there referred to was unquestionably that realized by actual payment of the debt; it is made abundantly clear that the exchange benefit or detriment was made at the time of the *actual* payment, and that the rate of exchange at such date was the controlling factor.

Even in cases where contracts for the sale of goods are made in one year and the vendor's profit is ascertainable in that year, it does not follow in all of such cases that the profit is one which fails to be taxable for income tax purposes in that year. It was so decided in *J. P. Hall & Co. Ltd. v. C. I. R.*[1]—a decision of the Court of Appeal. The facts in that case are summarized in the headnote as follows:

In March, 1914, the Appellant Company entered into a contract to supply certain electric motors, complete with control gear, to be delivered between the 1st July, 1914, and the 30th September, 1915, payment to be made one month after delivery. In accordance with the provisions of the said contract, the Appellant Company in April, 1914, made a sub-contract for the purchase of the control gear at a price which would yield them a profit of £1,064. Owing to the war, deliveries of the control gear, which were to be made direct from the sub-contractors to the purchasers under the main contract, were delayed and were actually made at various dates between August, 1914, and July, 1916.

It was held that the taxpayer's profit arose in the accounting period in which deliveries were made and not in in the period in which the contracts were made.

In that case the taxpayer in keeping its accounts brought the profit of the contract into the accounts on the various dates on which deliveries were made, and payment therefore became due. The result was that they became liable to payment of an amount of Excess Profits Tax on the comparison of the accounting period and the pre-war period. In the appeal, however, they made up their accounts in a different way and sought to carry into the pre-war period

[1] (1920) 12 T.C. 382.

the whole of the £1,064 profit eventually realized from the sub-contract. In allowing an appeal from Rowlatt J., Lord Sterndale, M. R., said at p. 388 ff.:

What happened was this: both the contract with the Kirkcaldy firm and the contract with the firm who made the control gear for the Respondents stipulated for delivery at various times at future dates, which were in fact extended in consequence of the war, but they were to be future dates in any case. The Respondents in keeping their accounts brought the profit of the contract into their accounts on the various dates on which deliveries were made, and payments, therefore, became due, and as all the firms concerned in the matter were of good financial standing and perfect solvency all these debts were treated quite properly at their face value. The result of doing that is that they would have to pay a certain amount of Excess Profits Duty on the comparison of the accounting period and the pre-war period. But what they seek to do, and what Mr. Justice Rowlatt has said they are entitled to do, is to make up their accounts in a different way and to carry into the profits of the pre-war period the whole of the £1,000 eventually realised upon the contract for the control gear. The accountant who was called, the Respondents' auditor, said that that profit might well have figured in their accounts on the 30th June, 1914, but he admitted that in the ordinary way, and I rather think he meant the ordinary way of keeping business accounts, at any rate the ordinary way of keeping these people's accounts, such a profit would not be included in the accounts until the invoices were received, that is to say, the actual dates of delivery of the goods. As I say, Mr. Justice Rowlatt has said they are entitled to bring the whole of the profit upon these contracts for the control gear into the year in which the two contracts were made, and I suppose on the contention stated by the Respondents before the Commissioners that the profit on the transaction in question was ascertained and made on the completion of the contract for the purchase and sale. It seems to me the simple answer is, it was neither ascertained nor made at that time.

* * *

As I say, the short and simple answer to this, in my mind, is that these profits were neither ascertained nor made at the time that these two contracts were concluded. There are any number of contingencies that might have happened, by which the profit would not have turned out what it appeared on the face of it when the contracts were made. Any number of complications might have occurred that might have caused quite a different result to have accrued from these two contracts. I think that the Respondents did what was right in the way they carried these profits into their account: it is the ordinary commercial way of making up accounts, and in my opinion it is the right way, and the other would be the wrong way, because the other would be carrying into the accounts as profits of one year the estimated profits which would accrue in subsequent years that might perhaps never be made at all. As I say, I regret to say that I cannot agree with the learned Judge. I think the Commissioners, whose opinion he reversed, came to a perfectly proper conclusion, and that this appeal should be allowed, and the Commissioners' decision restored with costs here and below.

1959

CANADIAN GENERAL ELECTRIC CO. LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

The other learned Judges were of the same opinion, Atkin L. J. stating at p. 390:

It seems to me that no person here trying to ascertain these profits on the principles of ordinary commercial trading would dream of including profits in his yearly balance-sheet, which would not be made until the goods had actually been delivered in respect of some contract which was to run over a period of at least two years, and possibly more. To my mind the procedure of the Company was the ordinary commercial procedure in taking the profits that they made as and when the goods were delivered. Anything else, it appears to me, would be quite contrary to commercial procedure, and would not be profits in the natural and proper sense. I think, therefore, this appeal should be allowed.

Younger L. J., in a short judgment, said at p. 390:

I am of the same opinion. It appears to me that the principle sanctioned by the learned Judge in this case for the purpose of ascertaining these profits is justified neither for the purpose of Excess Profits Duty, nor for the purpose of Income Tax, nor as a matter of ordinary commercial trading. *In my view, on the facts in this case, the only proper way in which the profits arising from the working out of this contract ought to be brought into account is to ascertain them as and when they are realised.*

I turn now to two other cases in each of which an unsuccessful attempt was made by the taxpayer to treat future anticipated losses as actual losses in a taxation year. The first is *Whimster & Co. v. C. I. R.*[1], a decision of the Court fo Appeal. The facts and finding are stated briefly in the headnote as follows:

Part of the business of the Appellants consisted of hiring ships on time charter and carrying in them goods and merchandise as offered, and at 31st December, 1920, they had a number of such vessels on time charter under charter parties the currency of which did not expire until various later dates. In making up their accounts for the year 1920 they took the view that in 1921, in consequence of a depression in shipping business which had already set in, the rates payable for vessels on time charter and the amounts receivable as freights would fall very seriously, and they accordingly debited in the case of each vessel the hire payable from 31st December, 1920, to the end of the period of its charter, and credited the amount they would have had to pay if they had entered into a fresh charter at 31st December, 1920, for the unexpired period of the existing charter.

Held, that the difference between these sums was not a proper deduction in computing the profits of the accounting period ended 31st December, 1920, inasmuch as it was not a loss actually incurred in that period.

The Lord President (Clyde) said that the question to be answered was "What are the actual profits made during the accounting period?" (p. 825) and rejected the submission made on behalf of the taxpayer that the time-charters should be regarded as its stock-in trade.

[1] 12 T.C. 813.

At p. 823 he stated:

In computing the balance of profits and gains for the purposes of Income Tax, or for the purposes of Excess Profits Duty, two general and fundamental commonplaces have always to be kept in mind. 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.

Then at pp. 824-5, after referring to the facts, he said:

In this way, the Appellants seek to include *future* anticipated losses in the account of their profits for the accounting period.

Then he disposed of a submission, similar to the one made in the instant case, that the time-charters in question should be regarded as stock-in-trade and valued downwards in view of prospective losses in later years.

They figured the company as doing a business in time-charters, just like doing business in goods, whether raw or manufactured. They represented the unexpired portions of the time-charters as so much stock-in-trade, and said quite truly that it was proper in making up trading accounts to value the trading stock at the beginning and at the end of the year. This, they maintained, was just what they had done in their balance sheet and relative profit and loss account at the end of the accounting period. But it is not really possible to regard the time-charters as stock-in-trade, for in point of fact the company never dealt with them as such. They did not deal in time-charters, and neither bought nor sold them. All they did was to hire the services of the ships at so much a month for so many months, and use them for a profit; much as a man might hire omnibuses and horses, or motor conveyances, and either himself employ them in carrying passengers at a profit, or sub-let them to others. In all such cases the periodical payment of hire is just one of the incidents inevitable in order to the making of profit during the period to which the hire applies.

All other members of the Court were of the same opinion, Lord Sands stating 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

1959

CANADIAN GENERAL ELECTRIC Co. LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

the year's operations. In normal circumstances, and in business other than insurance, the matter might probably end here. Contracts entered into for execution in the future would not be taken into account. A prospective loss here would just be taken as set off by prospective profits there. But in abnormal circumstances, such as those of 1920-21, a prudent trader who had in the course of the year undertaken contracts upon which great loss seemed to be inevitable, would probably take these into account in making up his balance sheet. Though the losses are not realised in the year, they are losses incurred by the conduct of the business during the year, in respect that it was during the year and in the conduct of the business that the contracts are entered into.

The consideration of how it would be prudent for a trader to act does not solve the question here presented to us as one of Revenue law. Under this law the profits are the profits realised in the course of the year. What seems an exception is recognised where a trader purchased and still holds goods or stocks which have fallen in value. No loss has been realised. Loss may not occur. Nevertheless, at the close of the year he is permitted to treat these goods or stocks as of their market value. This exception to the general rule has never, however, been extended to the case of probable or indeed apparently inevitable loss to be incurred in the execution of future contracts entered into during the year in question, and the authorities are against it.

The case for the Appellants here depends upon their ability to assimilate their shipping commitments to goods or stocks, rather than to contracts for future fulfilment. But in my view they have failed to do so. The manner in which they have adjusted their accounts was probably quite reasonable as a domestic arrangement, but it would lead to great confusion if such haphazard and speculative estimates were to enter into the business of the collection of the public revenue.

The other case is *M. N. R. v. Consolidated Glass Ltd.*[1]. The facts are stated shortly in the headnote as follows:

The respondent, having elected under 95A of the *Income Tax Act*, 1948, as enacted in 1950, proceeded to compute its undistributed income in accordance with 73A(1)(*a*). In doing so it deducted some $114,000 representing a loss in value on shares owned by it in another company which was still in business. This deduction was disallowed by the Minister but restored by the Income Tax Appeal Board. The Minister appealed to the Exchequer Court and after service of his notice of appeal obtained, with the respondent's consent, an order permitting him to raise a new ground of appeal to the effect that if the respondent had sustained a capital loss in respect of these shares that loss was more than offset by a capital gain on other assets during the same period. The Exchequer Court held that it was too late to raise this new ground and affirmed the decision of the Income Tax Appeal Board.

It will be seen that the question there was whether a loss or gain had been sustained on assets still held by the taxpayer, and while the loss or gain in question was related to capital, I cannot see that any different principles should be applied to losses or gains on revenue account.

[1] [1957] S.C.R. 167.

1959

CANADIAN GENERAL ELECTRIC CO. LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

The case, as so reported, was on a re-hearing by the full Court. By a majority, it was held that the appeal should be allowed, and the original assessment restored.

Rand J., speaking also for Locke and Fauteux JJ., said at p. 173:

The narrow issue in this appeal is whether in the determination of "undistributed income" as defined by s. 73A of the Income Tax Act, as enacted in 1950, the amount by which the value of a capital investment has depreciated can be deducted under subs. (1)(*a*)(iii) which reads:

> "the amount by which all capital losses sustained by the corporation in those years before the 1950 taxation year exceeds (sic) all capital profits or gains made by the corporation in those years before the 1950 taxation year."

The deduction is one of a number to be made from the aggregate of incomes for the tax years from 1917 to 1949, including, among others, under cl. (i) income losses and cl. (vi) all dividends paid.

The phrase "capital losses sustained" or its equivalent appears in several provisions of the statute in a context from which it is apparent that, within the conceptions of accountancy underlying the Act, it means actually realized. For example, in s. 26(*d*) "business losses sustained"; s. 39(1)(*a*) "loss sustained"; s. 75, subss. (6) and (7) "losses sustained".

These instances, however, afford only a limited assistance to the question raised. What is much more significant, if not decisive, is that the capital losses sustained under cl. (iii) are the net capital losses, those that exceed the "capital profits or gains made" during the same period. "Losses sustained" and "profits and gains made" are clearly correlatives and of the same character; but how can profits and gains be considered to have been made in any proper sense of the words otherwise than by actual realization? This is no inventory valuation feature in relation to capital assets. That the words do not include mere appreciation in capital values is, in my opinion, beyond controversy. It is difficult if not impossible to say that where only value is being considered in which a variable inheres you can have any other than a fluctuating estimate. The word "loss" in the context means absolute and irrevocable, finality. That state of things is realized upon a sale; it can also be said to be realized in the case of stock in a company which is hopelessly insolvent and has ceased business. When, on the other hand, the business is maintained and all that can be said is that in the most likely prospect the value of the shares cannot exceed a maximum, there is still no more than an estimate: the actual loss cannot in fact be so determined and unless there is that determination the statute is not satisfied. The element of appreciation illustrates the quality of fluctuation more clearly perhaps than that of depreciation, but they are essentially of the same nature. If, then, appreciation must be ruled out, as I think it must be, similarly mere loss of some value while a company remains in business must be treated in the same manner.

Abbott J. was of the same opinion, stating at p. 183:

I have had the advantage of considering the reasons given by my brother Rand and I agree with the view which he has expressed that so long as a capital asset remains in existence, with the possibility of fluctuation in value up or down, the owner of such asset cannot be said to have sustained a capital loss or made a capital profit or gain within the meaning

1959

CANADIAN GENERAL ELECTRIC CO. LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

of the subsection. Such loss or gain, as the case may be, must be established by (i) a sale of the asset, (ii) the asset being proved valueless, or (iii) the asset being proved to be no longer susceptible of any fluctuation in value.

And Nolan J. at p. 184 agreed with the opinion of Rand J. Five of the members of the Court were therefore of the opinion that where a variable inheres, you can have only a fluctuating estimate of a capital loss or gain and that the word "loss" in the contents means absolute and irrevocable, finality; the actual loss or gain cannot be determined, and, unless there is that determination, the statute is not satisfied.

It seems to me, therefore, that without statutory authority, deductions are not permissible for merely anticipated losses or for contingent liabilities. In addition to the cases which I have cited, reference may be made to the following cases—*Edward Collins & Sons, Ltd. v. C. I. R.*[1]; *The Naval Collier Co. Ltd. v. C. I. R.* and *The Glamorgan Coal Co. Ltd. v. C. I. R.*[2]; *J. H. Young v. C. I. R.*[3]; and *Barnhard v. Cahan*[4].

Applying the principles above referred to, to the facts in this case, I must find that no taxable profit in respect of foreign exchange was made by the appellant until the time at which the several notes payable in U.S. currency were actually paid. It was then only when the profits were ascertained and realized. The fluctuations in the rate of exchange for U.S. currency introduced an element of uncertainty as to the precise amount that would be actually required to meet the obligations and that uncertainty could only be resolved by actual payment. The computations made by the taxpayer at the end of each year and based entirely on the then current rates of exchange were estimates only and however useful such computations may have been for the domestic purposes of the company, they could be of no assistance in computing the actual costs of the company for the purposes of ascertaining its taxable profit.

A simple illustration will, I think, point out the fallacy inherent in the submission made on behalf of the appellant. Let it be assumed that goods were purchased in the United

[1] 12 T.C. 773.
[2] 12 T.C. 1017.
[3] 12 T.C. 827.
[4] (1918) 13 T.C. 723.

States at a time when U.S. funds were at a premium of only 3 per cent., that notes similar to those above mentioned were given in payment and that such notes were still outstanding at the end of the following year, by which date the premium on U.S. funds had risen to 10 per cent. In my view, the taxpayer in such circumstances could not then successfully claim a deduction of an additional 7 per cent. as a further cost of goods purchased for the reason that such an expense had not actually been incurred and was a mere estimate of anticipated losses.

In my view, the proper method to be used by a trader-taxpayer in computing his profit or loss for income tax purposes and in relation to a fluctuating rate of exchange for goods purchased in another country, and not then paid for, is as follows: I think he is entitled to include in his costs for the year in which the goods were purchased the amount in Canadian dollars necessary to pay the costs in full, including any premium payable on foreign currency which he is required to pay. Then, upon actual payment of such obligations in a subsequent year, when the uncertainty as to the rate of exchange has been eliminated and the precise cost has been fixed by reason of the payment, he is entitled to deduct any further amount he may then be required to pay in excess of that originally set up in his books. If, on the other hand, the amount he is required to pay to meet the obligation is less than the amount originally set up, the difference, if within the principles of the *Tip Top Tailors* case and the *Eli Lilly & Co.* case (*supra*), will properly enter into the computation of profit and loss for tax purposes.

Two further matters must be referred to. The appellant alleges in the alternative that in addition to the profit of $81,774.44 which the respondent admits was made in the taxation year 1951 by actual payment of some of the notes, a further profit of $106,466.42 was made in the same year. The evidence establishes that on December 31, 1951, the appellant gave to the parent company a renewal note for $2,364,483.87.

Exhibit 20 provides the details for this computation. The renewal note of December 31, 1951 (Exhibit 8) replaced nine notes, all issued in 1950 and all due on December 31,

1959

CANADIAN GENERAL ELECTRIC CO. LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

1951, the total of such notes being for the same amount as the new note, and the new note providing for payment on or before June 30, 1953. In the computation made in Exhibit 20, the total amount of the premium for U.S. exchange as of the date when the several notes were given, totalled $136,022.48. As of December 31, 1951, when the premium had fallen to $1\frac{1}{4}$ per cent., the premium then required in respect of these notes was $29,556.06. It is submitted that the difference of $106,466.42 also constituted a profit for 1951, and if that were the case, that amount would be transferred from the taxation year 1952.

This alternative submission was not seriously pressed and in my view cannot be supported. It fails for the reasons which I have given above, namely, that it was not made nor realized in 1951. The giving of a renewal note cannot be considered as payment of the debt any more than can the giving of the original notes. In both cases, the notes were merely evidence of indebtedness with a promise to pay on or before a certain date at a fixed rate of interest.

I find it necessary to refer to only one case on this point—*The Commissioner of Income Tax v. The Maharajadhiraja of Darbhanga*—a case which arose in India[1]. In the Privy Council it was held that a creditor, when he receives promissory notes from his debtor in respect of unpaid interest, does not receive the interest. In that case, Lord McMillan stated at p. 161:

> . . . but the seventh item . . . consisting of the debtor's own promissory notes, was clearly not the equivalent of cash. A debtor who gives his creditor a promissory note for the sum he owes can in no sense be said to pay his creditor; he merely gives him a document or voucher of debt possessing certain legal attributes. So far then as this item of . . . rupees is concerned, the assessee did not receive payment of any taxable income from his debtor or indeed any payment at all.

The remaining point relates to s. 14(1) of the *Income Tax Act,* now repealed. In 1952 it was 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 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.

[1] [1933] L.R. 60, I.A. 146.

The witness, B. M. Thompson, a tax accountant employed by the appellant, said that for a number of years the assessors for the respondent knew that the appellant in preparing its income tax returns, had revalued downwards at the end of the fiscal year the amount necessary to provide for premiums on U.S. exchange on its outstanding open accounts (and possibly in 1950 on some of the outstanding notes), had approved of the practice, and that assessments and the re-assessments were made accordingly. The evidence on this point is not too clear, but as I understand it, the profits made on the downward revision of the premiums on U.S. exchange on December 31, 1951, were included as taxable income only in respect of its open accounts payable, the profits so made regarding the notes payable to General Electric being treated in the tax returns as gains on capital account. It is submitted, therefore, that this was a "method" which had been adopted by the taxpayer in one or more years prior to 1952 and accepted by the respondent, and that consequently, under s. 14(1) the 1952 income should be computed according to that method.

The subsection similarly numbered and similarly worded was first enacted by the 1948 *Income Tax Act*. I think it probable that it was enacted mainly to remove any doubt as to the right of certain taxpayers to file returns on a basis other than a "cash" basis (e.g., on that commonly referred to as the "accrual" basis) following the decision of the President of this Court in *Trapp v. M. N. R.*[1]. The subsection is silent as to the meaning of the word "method" and does not purport to lay down any rules "for computing income". It is expressly made "subject to the other provisions of this Part" and accordingly the method for computing income must be sought elsewhere. In my view, the object of the subsection was to permit and require taxpayers who had adopted a method of computing income which was in accord with the provisions of the Act and truly reflected the profit or gain for the year (s. 4), and which had been accepted by the respondent, to compute their income from a business or property in subsequent years by the same

[1] [1946] Ex. C.R. 245.

1959

CANADIAN GENERAL ELECTRIC CO. LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

method. No different method could be adopted without the consent of the Minister, that provision being necessary in order to prevent the use of another method which by reason of the change might allow certain items of income to go untaxed.

I do not think, however, that the word "method", used in s. 14(1), is in any way limited to those frequently referred to as the "cash" and "accrual" methods. Special cases may require special methods of computation as was pointed out in *Sun Insurance Office v. Clark*[1]. In that case, the problem was to determine the proper method of computing the profits of a fire insurance company, the premiums for a period of years being payable in advance but the risks of loss extending frequently beyond the three-year period on which the average profit was to be computed. In reaching the conclusion that one of several proposed methods of computation should be accepted, Earl Loreburn L.C. said at p. 453:

> In these circumstances it seems to me quite obvious that the third and not the second method must be applied here for the plain reason that upon the materials before us it is the fair and only way presented to us by which the truth can be approximately attained.

And at p. 454 he added:

> A rule of thumb may be very desirable, but cannot be substituted for the only rule of law that I know of, namely, that the true gains are to be ascertained as nearly as it can be done.

In my opinion, a taxpayer can invoke the provisions of s. 14(1) only when the method which he has adopted in an earlier year to compute his income (and which he proposes to follow in the taxation year in question) is one which is computed in accordance with the provisions of the Act and which truly reflects his real profit or loss for the year. If the method that has been used in previous years does not result in the ascertainment of the true gains as nearly as can be done, it is not a method sanctioned by the law. In the instant case, even if it be the fact that in the year or years prior to 1952 the appellant had used a method by which it showed as taxable income the difference between the cost in Canadian dollars of goods purchased on open account in the United States and the lesser amount which it estimated it would require to pay for such goods at the

[1] [1912] A.C. 443.

1959

CANADIAN GENERAL ELECTRIC CO. LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

end of its taxation year by reason only of the lessening in the rate of U.S. exchange, that method, in my view, and for the reasons which I have stated above, is not in accordance with the requirements of the Act. It is not, therefore, a method which it is entitled to adopt in a subsequent year even if the respondent's assessors had knowledge of it or if it had been accepted by the respondent in an earlier year. Accordingly, the appeal will be dismissed with costs and the re-assessment made upon the appellant for the year 1952 will be affirmed.

Judgment accordingly.