BETWEEN:

UNITED TRAILER COMPANY LIMITED ..... APPELLANT;

AND

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

1960
Apr. 7
1961
May 16

Revenue—Income—Income Tax Act, R.S.C. 1952, c. 148, ss. 11(1)(e)(i), 12(1)(e) and S. of C. 1952-53, c. 40, s. 28 enacting s. 75 B(1)(d)—Deductibility of doubtful debt reserves—No deduction allowed where no account owing to taxpayer—Absolute assignment by taxpayer—Appeal dismissed.

Appellant assigned all of its accounts receivable to a finance company allegedly as security for a loan. The appellant then set up an account as a reserve for doubtful debts and deducted that amount from its income for the years 1952 and 1953. These deductions were disallowed by the Minister and an appeal from his re-assessment to the Tax Appeal Board was dismissed. Appellant now appeals from that decision to this Court.

The Court found that the assignments to the finance company were absolute even though the payments by the customers to the finance company were guaranteed by the appellant and that there was no account receivable by the taxpayer.

The taxpayer contends that the amounts set up as a reserve against doubtful debts were deductible from income by virtue of s. 11(1)(e)(i) of the *Income Tax Act* R.S.C. 1952, c. 148, or that it was entitled to a deferred revenue reserve under s. 75B(1)(d), S. of C. 1952-53, c. 40, s. 28.

Held: That as the accounts were not assigned to the finance company as security for a loan but were absolute and hence no account was receivable by appellant, no reserve against doubtful debts could be taken.

2. That no deferred revenue reserve could be set up with respect to accounts that were paid in full, and since the finance company had paid the appellant in full s. 75B(1)(d) was not applicable.

3. That since s. 12(1)(e) of the Act limits the deduction of a contingency reserve appellant could not deduct any amount which would represent its contingent liability to the finance company with respect to bad debts accruing from the receivable accounts assigned to it.

APPEAL from the Tax Appeal Board.

The appeal was heard before the Honourable Mr. Justice Dumoulin at Calgary.

S. J. Helman, Q.C. and *R. R. Neve* for appellant.

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R. L. Fenerty, Q.C. and *T. E. Jackson* for respondent.

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

DUMOULIN J. now (May 16, 1961) delivered the following judgment:

This is an appeal from a decision of the Tax Appeal Board, dated April 10, 1957[1], affirming income tax re-assessments of United Trailer Co. Ltd., for taxation years 1952 and 1953.

The Company just mentioned, a body corporate, with registered office at Calgary, Province of Alberta, carries on business of manufacturing mobile homes, also referred to as "residential trailers", for subsequent sales to people engaged in road construction work, digging natural gas or oil wells and other transient operations.

For taxation years 1952 and 1953, United Trailer Ltd., took upon itself to set up reserves for "bad or doubtful debts", these reserves amounting to $20,232.14 in 1952, and to $19,036.72 in 1953. Both these contingent provisions were disallowed by the Minister and included in the appellant's taxable income for the material times.

The customary and well known mechanics of this line of trade consist of two connected steps: first, a vendor-purchaser contract of sale, second, an assignment of the latter by the vendor to some finance company with the purchaser's consent. It is trite to add that after payment of the balance price to the vendor concern, the payer, i.e. the financing corporation, becomes entitled to each and every right vested in the original vendor, plus a substantial rate of interest until fully reimbursed.

Such were, in broad outline, the practice followed by the actual appellant as suggested, though with questionable accuracy, in parts of paragraph 7 and 8, hereunder, of the Statement of Facts:

> 7. In each year in question, in order to obtain additional operating capital for its business, the appellant obtained a loan from Industrial Acceptance Corporation Limited, to secure the repayment of which the

[1] (1957) 17 Tax A.B.C. 156.

appellant assigned to said lender as security a number of the said lien notes which it had received from its customers . . .

8. In the alternative, the appellant discounted the said lien notes with Industrial Acceptance Corporation Limited (hereinafter referred to as the "corporation"), but, by the terms of assignment by which the lien notes were so discounted, the appellant was made at all times primarily liable to the corporation as a principal debtor and not as a surety for the full balance owing under such lien notes . . .

In the appellant's view of the matter, there would be no difference "in substance (para. 7) between the relationship of the appellant to Industrial Acceptance Corporation Limited and what appellant's position would be if the money had been borrowed from a bank and the lien notes assigned as collateral security . . . and for this purpose the appellant set up a reserve for doubtful debts . . ." supposedly permitted by s. 11(1)(*e*)(i) of the *Income Tax Act*.

What preceded partakes not only of a recital of facts, but also of argument, possibly tinged with a dash of wishful thinking.

A perusal of the documentary evidence filed, might lead one to a different, and from the company's standpoint, less optimistic conclusion.

On this first objection to the ministerial re-assessment, based upon the propriety of a contingent reserve, the respondent's attitude may be summarized in paragraph 7 of its "Reply to Amended Notice of Appeal" reading thus:

7. Says that the sums of $20,232.14 and $39,268.86 (according to the department's computation) claimed by the Appellant as part of its reserve for doubtful debts in the 1952 and 1953 taxation years were in respect of debts which were not owing to the Appellant.

Hence the initial issue raises the oft-recurring distinction between an absolute assignment of debts due or accruing due under a contract, and a charge or mortgage whether disguised or not.

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The evidence of the sole witness heard, Mr. Albert James Hill, United Trailer's manager until November, 1959, lays out the facts that serve as a preamble to the written exhibits.

Mobile homes, says Mr. Hill, sold at prices ranging from four to eight thousand dollars, the six-thousand-dollar model being the best seller. Cash payments of 20% to 33%, in keeping with individual circumstances, attached to each sale, the balance price secured through the usual conditional contract of sale, exhibit 5, actually. Monthly instalments generally spread over a period of 24 months until 1943, when hardened trade conditions required an 18-month extension.

Industrial Acceptance Corporation, a well known organisation throughout the land, upon formal assignment of this purchaser's contract, pursues Mr. Hill, "would immediately pay to United Trailer the outstanding balance due by client on that contract. The I.A.C. (for short) then acted as collecting agents (in the witness' interpretation) in pursuance of these assigned contracts. When legal proceedings, or re-possession were resorted to, this was done by and in the name of United Trailer Co. Ltd. I.A.C. would not expose themselves to litigation. Of course, in the event of bad sales remaining unpaid, United Trailer's liabiltiy to I.A.C. persisted for any amount owing. Each assignment to the Corporation, continues Mr. Hill carried with it a right of redemption by United Trailer Co. against payment by it to I.A.C. of the unsatisfied balance on a particular contract: the deed of sale would then be handed back to United Trailer". Under the conditions above an appropriate synonym for "redemption" could possibly be "guarantee".

Exhibit "5", a copy of appellant's "conditional sale contract", should provide the clue.

On this document's reverse side appear the stipulations of two separate contracts:

a) A "conditions of Sale Contract", between purchaser and vendor, viz. United Trailer Co. Ltd., and;

b) A "Vendor's Assignment" made by United Trailer Co. to Industrial Acceptance Corporation Limited.

Out of the ten clauses in the contract of sale, number 8 only is pertinent to the matter under consideration; I quote:

8. Purchaser takes notice that this agreement, *together with Vendor's title to property in and ownership of said goods*, (all italics are mine) and said note are *to be forthwith assigned and negotiated by Vendor to Industrial Acceptance Corporation Limited, and that said Corporation shall be entitled to all of the rights of Vendor free from all equities existing between Vendor and Purchaser.* Purchaser hereby accepts notice of such transfer and further accepts notice that Vendor is not an agent of said Corporation for any purpose *and that said Corporation will accept no evidence of payment other than its official receipt.*

Section (*b*) is the interlocking covenant, herein intituled "Vendor's assignment" most of whose context bears reproduction; its terms enacting that:

For Value Received *the undersigned vendor does hereby sell, assign and transfer* to Industrial Acceptance Corporation Limited *his right, title and interest in and to the within contract* and promissory note therein referred to. *Vendor does also hereby sell to said Corporation the goods referred to in the within contract,* subject to the rights of the Purchaser as set out therein.

.....

Vendor guarantees the performance of said contract and jointly and severally with Purchaser agrees to pay the Corporation on demand the entire amount unpaid under said note and/or contract and any deficiency arising out of the repossession and resale of said goods as provided therein. Vendor agrees that his liability hereunder shall not be affected by any settlement, extension of credit or variation of terms of said contract, nor additional security taken by the Corporation . . . and that nothing but full payment in cash to the Corporation of the amount owing by Purchaser shall release Vendor from his liability hereunder.

If said goods be repossessed Vendor agrees to store same safely for the account of said Corporation without charge *and Vendor agrees not to sell or use said goods except upon written instructions from the Corporation.* In the event of resale, all moneys, goods and securities paid or delivered on such resale shall be the property of said Corporation and Vendor shall hold same in trust at Vendor's risk and shall promptly pay over and deliver same to the Corporation.

A last paragraph foresees an automatic reassignment to Vendor of all rights and title to the contract and property thereby sold, upon full payment to Industrial Acceptance of the pecuniary obligations; such repossession, in compliance with clause "2" of the sale contract, eventually vesting Purchaser with definitive ownership.

Notwithstanding the plain language of exhibit "5", reiterating an intended assignment and sale of the deed with, should I repeat, all rights attaching, it is the appellant's contention that it retained a perfect title against the

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purchaser, and simply obtained a loan from the Corporation, secured by the lien notes as collateral security, or, alternatively, discounted those customer's notes with Industrial Acceptance, contingencies that might authorize the constitution of a reserve fund.

The proposition at issue does not require an attempt to ear-mark in exhibit 5 the several characteristic traits of its effective sale, factual and legal, transacted between appellant and Industrial Acceptance Corporation. A few instances will suffice. Added to repetitious mentions of outright sale to the Corporation of the contract and goods included, the Purchaser agreeing (clause 8), it is explicitly stipulated (clause 8, last line) "that said Corporation will accept no evidence of payment other than its official receipt".

If then, United Trailer Co., still remains a creditor, it is shorn of a creditor's essential right and correlative duty of giving the debtor, upon payment of the debt, a full and valid receipt. And, on the other hand, highly imprudent would seem that debtor-purchaser who, assenting to clause 8 of the contract (ex. 5), should be satisfied with a receipt issued by United Trailer Co., in despite of his previous agreement that Industrial Acceptance alone could indite the requisite acquittal.

Referring anew to Mr. Hill's evidence, this official fully substantiated the above interpretation, when he asserted that: "to his personal knowledge the appellant company's books contained no mention of amounts receivable from any particular client during the period in question", a policy or mode of operation hardly consistent with any creditor-debtor notion.

Another indication might be found in the appearance at the left hand side, on exhibit "5", of those initials I.A.C., well known to the business community, and which are not those of United Trailer Co. Ltd.

Disguised forms of mortgages are not new to the trading world; to this effect text writers concur, and Falconbridge, *The Law of Mortgages of Land* 1942 Ed. at pp. 47 and 48, for one, comments on this dubious device; quotation:

> In order to prevent a mortgagor's equity of redemption from being defeated by the ingenuity of conveyancers, the Court of Chancery was obliged sometimes to enquire whether a transaction in the form of an absolute conveyance or in the form of a conveyance with an option to repurchase was really a disguised mortgage, and as early as the seventeenth

century conveyancers seem to have been aware of the danger that a conveyance might be held to be a mortgage. If a conveyance absolute in form is intended to be a mortgage, the vendor will have the usual equitable right of a mortgagor to redeem; but the absence of evidence that the transaction is a disguised mortgage or of fraud . . . the vendor will receive no assistance from equity. *The evidence that the transaction is really a mortgage must be clear and conclusive, especially if it is contradicted by the recitals in the document* (italics are mine).

Indeed, quite our case, where redemption can be exercised only *in trust* for the Corporation.

The New Brunswick Supreme Court, in the matter of *Bank of Nova Scotia v. LeBlanc et al.*[1] dealt with an assignment to the Bank of all debts due or accruing due under a contract. For all purposes the latter assignment, in its effective tenor, can be assimilated with the present one, and on this point, the Court's pronouncement was as follows:

The assignment by its terms purports to be absolute and not by way of charge. In the case of *Hughes v. Pump House Hotel Co.*, [1902] 2 K.B. 190, the English Court of Appeal held that the assignment in question given to a bank by a contractor as security for the contractor's account, including a continuing security for monies due or to become due to the bank was an absolute assignment. Cozens-Hardy L.J. in that case said at pp. 197-8: "If, on the construction of a document, it appears to be an absolute assignment, though subject to an equity of redemption, express or implied, it cannot in my opinion be material to consider what was the consideration for the assignment, or whether the security was for a fixed and definite sum, or for a current account. *In either case the debtor can safely pay the assignee* . . . nor does it matter that the assignee has obtained a power of attorney and a covenant for further assurance from the assignor". And continues: "The real question, and, in my opinion, the only question is this: Does the instrument purport to be by way of charge only?" . . . *In my opinion that document is an absolute assignment, and does not purport to be by way of charge only. It assigns all moneys due or to become due under the contract.*

Were it not for a three years' hiatus, I could truly use the expression of "twin" causes in reference to the instant one and that of *Home Provisioners (Manitoba) Limited v. The Minister of National Revenue*[2], decided in 1958 by Mr. Justice Thurlow of this Court. Instead of Industrial Acceptance, the assignee then was Traders Finance Corporation Ltd., and the form of assignment, though much more concise, conveyed the selfsame rights, remedies and guarantees to the assignee that are conferred time and again by

[1] [1954]2 D.L.R. 579 at 584-585. [2] [1959] Ex. C.R. 34 at 35-42.

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our own instrument (Cf. official report at p. 38 for text of deed). After thoroughly scrutinizing facts and arguments submitted, the learned Judge held that:

> The transactions with the finance company were not loans on the security of the conditional sales contracts but outright sales since the appellant had no right to repay the finance company and demand the return of the property assigned.
>
> 2. That since the appellant was not the owner of the unpaid purchasers' accounts . . . it was not entitled to a reserve in respect of any portion of that amount.

On page 42, Thurlow J. continues:

> It was argued that the fact that the finance company would return a contract, *when requested and repaid,* indicates that the appellant had a right to redeem the contracts, *but in my view, this fact is consistent with other explanations* as to why the finance company would return a contract, and in the absence of evidence of a term of the arrangement giving the appellant a right of redemption, I do not regard it as indicative of such a right.

The financial operations entered into by the appellant and Industrial Acceptance invariably were absolute assignments and "guaranteed" sales of customers' contracts to the assignee. Thereafter, appellant's status passed from that of a creditor to that of assignee's warrantor, and I do not conceive of a surety setting aside a reserve for the payment of its own contingent indebtedness. This first section of the appeal fails.

When the case was called, October 7, 1959, the appellant moved for and obtained leave to amend its Statement of Facts, presumably in the expectation that s. 75B(1)(*d*) of the *Income Tax Act,* R.S.C. 1952, as enacted by Statutes of Canada 1952-53, c. 40, s. 28, might afford a "further alternative" or second ground of appeal. The amendment is worded in these terms:

> 6. In the further alternative, the Appellant says that there has been included in its income in respect to the taxation years 1952 and 1953 amounts in respect of property sold in the course of business that are not receivable until a day more than two years after the day on which the property was sold and after the end of the respective taxation years, and the Appellant is accordingly entitled to deduct a reasonable amount as a reserve in respect of that part of the amount so included in computing such income that can reasonably be regarded as a portion of the profit from such sales pursuant to section 75B(1)(*d*).

Effectively, the section just invoked permits of a reserve fund in the material conditions of paragraph "6", which, as shown throughout these notes, differ, in fact and law, from those revealed by the oral and written evidence.

The regular practice was to have United Trailer's purchasers assent, practically with the one stroke of the pen, to an assignment and sale of the contract, ex. 5, unto Industrial Acceptance Corporation against "immediate payment to United Trailer of the outstanding balance due by the customer on that contract (Manager J. A. Hill dixit)". How then can the appellant, *fully paid,* and who, understandably so, did not take the trouble of entering in its ledgers "the amounts receivable from any particular customer", lay any claim to the provisions of s. 75B(1)(*d*).

The appellant never negotiated loans nor obtained discounts from the Corporation, but sold and assigned to it outright conditional sales indentures, guaranteeing their fulfilment.

Any reserve funds accumulated during taxation years 1952-53 were purportless, since United Trailer's clients passed on at once to Industrial Acceptance as contractual debtors. This other ground cannot succeed.

For the reasons outlined, this appeal should be dismissed with all taxable costs allowed to the respondent.

Judgment accordingly.