1958
Sept. 8, 9
Oct. 30

BETWEEN:

HOME PROVISIONERS (MANITOBA) LIMITED ..... APPELLANT;

AND

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

Revenue—Income tax—Refrigerators sold on instalment plan subject to conditional sales contracts—Contracts assigned finance company to secure payment of unpaid balances—Reserve allowable on unpaid balance due more than two years after sale—The Income Tax Act, R.S.C. 1952, c. 148, s. 85B(1) as amended by S. of C. 1952-53, c. 40, s. 73.

The appellant company sold household deep-freeze refrigerators subject to conditional sales agreements which provided for a down payment of 10 per cent of the purchase price and the balance plus financing charges in 24 monthly instalments secured by purchaser's promissory note and his agreement title should not pass until all payments were completed. To finance its business the appellant assigned the conditional sales contracts to a finance company under an agreement whereby the latter advanced it 90 per cent of the unpaid purchase price forthwith and the balance on completion of payment by the purchaser, but reserved the right to withhold payment of the 10 per cent and credit it to a holdback account from which the appellant was entitled to receive from time to time the amount by which the balance in the account exceeded 10 per cent of the monies owing on the assigned contracts. In each case the appellant was required to guarantee payment by the purchaser.

In reporting its income for its 1954 fiscal year the appellant showed a gross revenue from sales of some $571,677 and a gross profit of some $248,375 from which it deducted some $99,677 as "deferred gross profit on instalment contracts." In its balance sheet it showed among its assets an item of some $23,926 as "Holdbacks on Lien Notes discounted with Finance Cos."

The Minister in assessing the appellant disallowed the whole of the deduction claimed but allowed a reserve of some $10,395 pursuant to s. 85B(1)(*d*) of *The Income Tax Act*. This figure was the proportion of $23,926—representing sums which the appellant had not received from the finance companies—which appellant's gross trading profit amounting to some $248,375 bore to gross revenue amounting to some $571,667.

In its appeal from the decision of the Income Tax Appeal Board[1] which affirmed the Minister's assessment, the appellant contended that the monies advanced by the finance company were loans for which it assigned the conditional sales contracts as security, that the amounts paid by purchasers continued its property, and that it was entitled to have the reserve to which it was entitled under s. 85B(1)(*d*), based on the total of such unpaid amounts. Alternatively, that if

the reserve was to be based on the $23,926 which appellant had not received from the finance company, the whole and not merely a portion of it, should be allowed as a reserve under s. 85B(1)(*d*).

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. *Re George Inglefield Limited,* [1933] 1 Ch. 1, followed.

2. That since the appellant was not the owner of the unpaid purchasers' accounts totalling some $344,665 it was not entitled to a reserve in respect of any portion of that amount.

3. That, assuming that the whole of $23,926 which the appellant had not received from either the purchaser or the finance company was profit from sales of refrigerators, on the evidence no basis was established for calculating the reserve in respect of such sum at any higher figure than that which had been allowed, and that it had not been established that the amount allowed was not a reasonable reserve in the circumstances.

APPEAL from a decision of the Income Tax Appeal Board.

The appeal was heard before the Honourable Mr. Justice Thurlow at Winnipeg.

G. C. Hall for appellant.

A. E. Johnston, Q.C. and *L. J. Hallgrimson* for respondent.

THURLOW J. now (October 30, 1958) delivered the following judgment:

This is an appeal from the judgment of the Income Tax Appeal Board[1], dismissing the appellant's appeal against income tax assessments for the years 1953 and 1954. The matter in issue is the amount of the reserve which the appellant is entitled to deduct for the years in question under s. 85B(1)(*d*) of the *Income Tax Act,* R.S.C. 1952, c. 148, as enacted by Statutes of Canada 1952-53, c. 40, s. 73. This provision is as follows:

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

* * *

(*d*) where an amount has been included in computing the taxpayer's income from the business for the year or a previous year in respect of property sold in the course of the business and that amount is not receivable until a day

[1] (1958) 17 Tax A.B.C. 149; 12 D.T.C. 1183.

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(*i*) more than two years after the day on which the property was sold, and

(*ii*) after the end of the taxation year, there may be deducted a reasonable amount as a reserve in respect of that part of the amount so included in computing the income that can reasonably be regarded as a portion of the profit from the sale, . . .

The appellant was incorporated in January, 1953 and from February 13, 1953 to March 31, 1954, the period with which the appeal is concerned, it engaged in the business of buying and selling household deep-freeze refrigerators and also of supplying the purchasers of the refrigerators with frozen foods. Most of the refrigerators were sold on terms requiring a down payment of 10 per cent of the purchase price and payment of the balance with finance charges in 24 monthly instalments, commencing from 30 to 45 days after the date of purchase. In each case the purchaser also gave his promissory note for the unpaid portion of the purchase price and the finance charges and agreed that the title to the refrigerator should not pass to the purchaser until all the payments had been made.

In order to finance its business, the appellant assigned these conditional sale contracts to a finance company pursuant to arrangements whereby the finance company would pay the appellant 90 or 95 per cent (depending on the particular finance company) of the unpaid balance of the purchase price immediately and the remaining five or 10 per cent after completion by the purchaser of his payments, but subject to the right of the finance company to withhold payment to the appellant of the five or 10 per cent, as the case might be, even after it had been paid by the customer and to credit it to a holdback account from which the appellant would be entitled to receive from time to time only the amount by which the balance in the account exceeded 10 per cent of the monies owed by the purchasers on contracts assigned by the appellant to the finance company. When taking assignments of the contracts, the finance company in each case obtained the appellant's guarantee that the purchaser would make the payments required by his contract, and in addition at least one of the finance companies held personal guarantees from all the shareholders of the appellant, guaranteeing the payments to be made by the purchasers.

The appellant, in collaboration with the finance company, maintained a close watch on the payments to be made by purchasers when such payments were overdue and employed a full-time collector, whose duties included the collection of such payments. Under the terms of the contracts, the payments were to be made at the office of the finance company, and until they fell into default the collector had no responsibility to collect them, but he would accept payments not in default when offered, and some purchasers also made payments which were not in default at the appellant's office. The appellant accounted to the finance company and paid over to it all such payments accepted by the collector or made at the appellant's office. If a purchaser fell seriously into default, the appellant would arrange for return of the refrigerator and repay the finance company the amount outstanding on the purchaser's contract. Occasionally, a purchaser would object to the assignment of his contract to the finance company and, if it had been assigned, the finance company would return it to the appellant on request and on repayment of the monies which had been paid to the appellant by the finance company in respect to it.

When recording these transactions in its books, the appellant customarily charged the purchaser with the price of the refrigerator and credited against this charge the 10 per cent down payment. When the initial proceeds of the assignment were received from the finance company, a further credit of the amount was entered in the purchaser's account, and at that time the appellant would also enter in the same account a credit of the balance and charge a corresponding debit to the finance company. In consequence, the purchaser's account would then show no debit balance in respect of the price of the refrigerator and no further entries would be made in respect thereto, even if it subsequently became necessary to repay the finance company and take back the refrigerator.

Apart from the assignment itself, which in each case was endorsed on the contract, there was no formal written agreement relating to the arrangements on which the contracts were assigned to the finance company. In giving

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evidence on the trial of the appeal, Mr. Keith Jensen, who was the president and chief shareholder of the appellant, referred to and characterized these transactions as loans. On the other hand, in a letter dated November 25, 1955, written by the appellant's auditors to the Director of Income Tax at Winnipeg, the auditors referred to and enclosed a copy of a memorandum from the Toronto office of the finance company to its branch offices, which indicates that that particular finance company regarded the transactions as purchases of the contracts, and Mr. Jensen in his evidence referred to this memorandum as setting out the arrangement between the appellant and the finance company. The arrangement referred to was between the appellant and Traders Finance Corporation Ltd., to whom from April, 1953 onward all the appellant's contracts were assigned. The form of assignment used in transactions with Traders Finance Corporation Ltd. was as follows:

> FOR VALUE RECEIVED undersigned hereby sells, assigns and transfers to Traders Finance Corporation Limited herein called "Traders" all undersigned's right, title and interest in and to the within contract and the property therein described. Undersigned warrants that the cash payment specified in the within contract was actually received by undersigned in cash and that no part of the said cash payment was loaned to the Purchaser by undersigned. Undersigned guarantees full performance of all covenants and agreements of the Purchaser named in the within contract and note and in the event of repossession and resale agrees that undersigned shall be jointly and severally liable with the Purchaser for any deficiency between the net amount actually received upon such resale and the amount secured by the said contract hereby assigned. Undersigned agrees that all guarantees are continuing guarantees and that Traders may grant extensions of time for payment of the moneys secured by the said contract and note and may give and accept any renewals thereof and may make any changes with respect to times for payment and the amount of the payments therein provided without notice to the undersigned, and without discharging or affecting the liability of the undersigned. Undersigned certifies that a true copy of the within contract was duly registered in the proper registration office.
>
> EXECUTED by the undersigned on the ..... day of ....., 19 .....

No evidence was offered as to the form used in assigning contracts to the two other finance companies to whom contracts were transferred prior to April, 1953, nor does the evidence indicate that the nature of the appellant's transactions with them differed from its transactions with Traders.

In reporting its income for the period from February 13, 1953, when it commenced doing business, to March 31, 1954, the end of its fiscal period, the appellant included a statement of trading operations showing gross revenue from refrigerator sales during the 13½ months' period totalling $571,677.28. The same statement showed a gross profit on refrigerator sales of $248,375.72, from which a sum of $99,587.92 was deducted as "deferred gross profit on instalment contracts." The latter amount, as explained by the auditor, Mr. Frank Lyle Green, was calculated by ascertaining the gross profit on each refrigerator sale and attributing one twenty-fourth of it to each of the 24 months over which the payments were to be made. The $99,587.92 was the sum of the portions of the gross profit on the sales so attributed to the months which each contract had yet to run. Thus, if the gross profit on a sale was $240 and at March 31, 1954 the contract had ten months to run, the amount of profit attributed to the unexpired period of the contract would be 10/24 of $240 or $100. In the balance sheet as at March 31, 1954, which also accompanied the returns, the appellant showed among its assets an item of $23,926.65 as "Holdbacks on Lien Notes Discounted with Finance Companies," and on the liabilities side a contingent liability to finance companies of $344,665.78. The latter figure was not added into the total liabilities on which the balance was struck nor, save for the $23,926.65, was the amount owed by customers on conditional sale contracts assigned to finance companies included in any corresponding item shown on the assets side either as accounts receivable from purchasers or otherwise.

The Minister, in assessing the appellant, disallowed the whole of the sum of $99,587.92 claimed as above mentioned but subsequently, after receiving notice of objection, allowed a reserve of $10,395.56 pursuant to s. 85B(1)(*d*). This figure was the proportion of $23,926.65—representing sums which the appellant had not received from the finance companies—which the appellant's gross trading profit on refrigerators, amounting to $248,375.72, bore to the gross revenue from refrigerator sales, amounting to $571,667.28. The effect of this was to treat each dollar of the revenue

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from refrigerator sales as 43.4476 per cent profit and to allow the appellant a reserve under s. 85B(1)(*d*) equal to that portion of the $23,926.65.

On the appeal to this Court, the appellant advanced two main contentions. The first was that the transactions in which the appellant assigned the conditional sale contracts to the finance companies were, in fact, loans, that in consequence the amounts to be paid by the purchasers pursuant to the contracts continued to belong to the appellant and that the appellant was, accordingly, entitled to have the reserve to which it was entitled under ss. (1)(*d*) of s. 85B, based on the total of such unpaid amounts. The second contention was that, if the reserve was to be based on the $23,926.65 which the appellant had not received from the finance companies, the whole of such amount, and not merely a portion of it, should have been allowed as the reserve under s. 85B(1)(*d*).

Turning to the first of these contentions, it may be noted that, even if the transactions with the finance company were in fact loans, the sum of $99,587.92, as claimed as a reserve by the appellant, does not appear to be related or confined either to the whole or to a part of what may reasonably be regarded as the profit portion of *amounts* which were *not receivable until a day more than two years after the day on which the property was sold.* On the contrary, the sum is calculated as the equivalent of the whole of the profit portion of all unaccrued payments, regardless of how long after the day of sale they would become due. Most of them must necessarily have been payments that would accrue due in less than two years from the date of sale. Nor does it seem probable on a rough calculation that the total of all unaccrued instalments which would accrue more than two years after the date of sale could reach even approximately the figure of $99,587.92, for it must be borne in mind that it was in no case more than the last two instalments on the contract which would accrue due more than two years after the date of sale. I am accordingly of the opinion that the figure of $99,587.92, claimed by the appellant, cannot be taken in any event as the amount of reserve to which the appellant may be entitled under s. 85B(1)(*d*).

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But on this contention I am also of the opinion that the transactions with the finance company were not loans on the security of the conditional sale contracts but were outright sales to the finance company of the appellant's rights under them.

In discussing this distinction, Romer L. J. in *Re George Inglefield Limited*[1] said at p. 27:

> The only question that we have to determine is whether, looking at the matter as one of substance, and not of form, the discount company has financed the dealers in this case by means of a transaction of mortgage and charge, or by means of a transaction of sale; because, of course, financing can be done in either the one way or the other, and to point out that it is a transaction of financing throws no light upon the question that we have to determine.
>
> It appears to me that the matter admits of a very short answer, if one bears in mind the essential differences that exist between a transaction of sale and a transaction of mortgage or charge. In a transaction of sale the vendor is not entitled to get back the subject-matter of the sale by returning to the purchaser the money that has passed between them. In the case of a mortgage or charge the mortgagor is entitled, until he has been foreclosed, to get back the subject-matter of the mortgage or charge by returning to the mortgagee the money that has passed between them. The second essential difference is that if the mortgagee realizes the subject-matter of the mortgage for a sum more than sufficient to repay him, with interest and the costs, the money that has passed between him and the mortgagor he has to account to the mortgagor for the surplus. If the purchaser sells the subject-matter of the purchase, and realizes a profit, of course he has not got to account to the vendor for the profit. Thirdly, if the mortgagee realizes the mortgage property for a sum that is insufficient to repay him the money that he has paid to the mortgagor, together with interest and costs, then the mortgagee is entitled to recover from the mortgagor the balance of the money, either because there is a covenant by the mortgagor to repay the money advanced by the mortgagee, or because of the existence of the simple contract debt which is created by the mere fact of the advance having been made. If the purchaser were to resell the purchased property at a price which was insufficient to recoup him the money that he paid to the vendor, of course he would not be entitled to recover the balance from the vendor.
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> In this case the subject-matter of the mortgage or charge, or of the sale and purchase, whichever it be, is certain furniture subject to, and with the benefit of, the hiring agreements. If one considers the documents, which I do not intend to go through again, in relation to the three matters that I have mentioned, it will be found that in every one of those three respects the documents bear the attributes of a sale and purchase, and not the attributes of a mortgage or charge.

In the present case, it may first be noted that the form of assignment used included the word "sold". This I regard as some evidence that the transaction was in fact a sale

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though I think it was open to the appellant to show, if it could, that the nature of the transaction was not that of a sale notwithstanding the use of the word "sold". To this may be added the fact that the entries by which the appellant recorded the transaction in the customer's account also suggest that the transaction was a sale for the entries appear to me to indicate a disposal of the account rather than a loan on the security of it. If the transactions were loans there would ordinarily be no reason to credit the customer at that stage either with the immediate proceeds or with the sum held back. Against this may be set the evidence of Mr. Jensen, who described the transactions as loans or borrowings, but I doubt that Mr. Jensen, when making the arrangements, ever paused to consider whether the transactions would be loans or sales and, as previously mentioned, he regarded the memorandum from the Toronto office of the finance company to its branch offices as stating the terms of the arrangement which had been made, and this document leaves no doubt that the finance company regarded them as purchases. 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. If, indeed, the appellant had such a right, it would have been in a position to render the arrangements for holdbacks entirely ineffective by redeeming each contract as the time for completion of the payments approached. Moreover, in my view, the attention and service which the appellant and its collector gave to the collection of the payments are attributable to the appellant's desire to protect itself from loss on its guarantees, rather than indicative of ownership by the appellant of the accounts. I find nothing in the terms set out either in the assignment or the memorandum giving the appellant any right of redemption of the kind referred to by Romer L. J. in the passage above quoted. No doubt, certain equities in respect of the property assigned would arise in favour of the appellant upon the

appellant honouring its guarantee when called upon to do so, but in my opinion such equities are quite distinct from a right at any time to call for a return of property subject to a mortgage or charge upon payment of a loan. In my opinion, the appellant had no such right to repay the finance company and demand a return of the property assigned except upon being called upon to honour its guarantee. Accordingly, I find that the transactions were sales rather than loans.

It follows from this finding that, since the appellant was not the owner of the unpaid purchasers' accounts totalling $344,665.78, it is not entitled to a reserve under s. 85B(1)(*d*) in respect of any portion of that amount.

The appellant's second or alternative submission relates to the $23,926.65 held back by the finance company. This amount was included by the appellant in its income, but it had not been received and, under the terms of the arrangement with the finance company, it would not become receivable until some indefinite period after the several purchasers had completed the payments required by their contracts. This, in each case, would be at least two years after the making of the sale to the purchaser, and I think in the circumstances described it may also be taken that in each case the time when the sum would become receivable from the finance company would be at least two years after the date of the assignment.

Now under s. 85B(1)(*d*) what may be allowed as a reserve is not necessarily the whole of the amount which is receivable more than two years after the date of sale, for it may not be reasonable to regard all of the amount as profit from the sale; nor is the reserve to be allowed necessarily equal to the whole of the portion of the amount that can reasonably be regarded as profit from the sale. The reserve that may be deducted under s. 85B(1)(*d*) is *a reasonable amount in respect of that part of the amount so included in computing the income that can reasonably be regarded as a portion of the profit from the sale.*

The appellant submits that the whole of the $23,926.65 can reasonably be regarded as a portion of the profit from the sales to the purchasers of refrigerators and that the whole of this amount should be allowed as a reserve.

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In my opinion, it is open to question whether a reserve in respect of any portion of the $23,926.65 is strictly allowable under s. 85B(1)(*d*) since, in the view I have taken of the facts, the amount is payable by the finance company in each case as part of the consideration for the sale to it of the contract, rather than from the sale of the refrigerator, and there is no suggestion that any profit whatever accrued to the appellant from the sales of the contracts, the price at which they were assigned being merely equal to the unpaid portion of the selling price of the refrigerator. However, I do not think it is necessary to resolve this question for, even assuming that the reserve is in the present situation allowable in respect of the profit portion of the $23,926.65 on the basis of its being receivable in respect of the refrigerators and also assuming, as the appellant submits, that the whole of the $23,926.65 can reasonably be regarded and should be regarded as a portion of the profit from the refrigerator sales, there still remains the question: what is *a reasonable amount as a reserve in respect of that portion of the profit from* such sales? The Minister has allowed $10,395.56, and it was for the appellant to show, if it could, that the amount allowed should have been higher. There is evidence that the sums making up the $23,926.65 were not payable until a day more than two years after the sale. In addition, having regard to the guarantee arrangements, it is clear that all sums paid by the purchaser would be applied first in discharge of the other sums payable under the contract and nothing would be credited to the deferred account or paid to the appellant until all other sums payable by the purchaser under the contract had been paid. In effect, $344,665.78 had to be collected from the purchasers before the appellant would even become entitled to credit in the holdback acount for the $23,926.65. This feature of the situation suggests the need of a reserve in respect of the amounts making up the $23,926.65 but, on the other hand, the amounts payable by the purchasers were all secured on the refrigerators and presumably, as time went by and payments were made, the prospects of the amounts in question being paid by or recovered from the purchasers might be expected to improve rather than to deteriorate. In the meantime, the chances of recovery of these amounts were further protected

by provisions of the contract, making all payments immediately due in the event of default or breach by the purchaser or in the event of the finance company deeming itself insecure. The evidence does not show what proportion of the amounts making up the $23,926.65 was likely, in the experience of the appellant or its officers or of the finance company, to become irrecoverable or what amount of effort or expense might reasonably be expected to be required in later years in order to recover them. Nor is there evidence of the value on March 31, 1953 of the individual amounts making up the $23,926.65, or of the value on that date of the whole sum as an asset of the appellant, from which, in view of the fact that the whole amount has been included in revenue, an inference might be drawn as to what amount would be a reasonable reserve. In this situation, one might be tempted to speculate that the whole amount of the $23,926.65 would not be too much to allow as a reserve, but on the evidence as it stands I am of the opinion that no basis has been established for calculating the reserve at any higher figure than that which has been allowed, and that it has not been established that the amount allowed was not a reasonable reserve in the circumstances.

The appeal accordingly fails, and it will be dismissed with costs.

Judgment accordingly.